# BUDGET AND PERFORMANCE INTEGRATION

# 1. BUDGET AND PERFORMANCE INTEGRATION

A year and a half ago, the Administration began an effort to improve budgeting and management to achieve better results—and to do so consistently. It was called the President's Management Agenda. One of the major problems identified was lack of budget and performance integration (see box). For seven years, agencies had developed Strategic Plans and Annual Plans under the Government Performance and Results Act (GPRA). But these plans were not integrated into the budget, and the budget drives policy making, allocates resources, and provides incentives to program managers. The budget showed dollars requested, but not the cost of producing an output or achieving a goal. As a result, the plans were not linked to reality and driven by the cycle of budget preparation and execution. Also as a result, budget dollars could not be allocated systematically to achieve the best outcomes per dollar spent.

**At the Start: Budget and Performance Were Not Integrated**

- Past and planned results were not shown with budget requests, let alone linked in a cost-and-results relationship.
- Program managers responsible for achieving results often did not control the resources they use or have flexibility to use them efficiently.
- Performance and cost data were recorded in separate systems and not integrated to provide timely, analytical feedback to decision-makers and managers.
- Americans could not readily assess program results, and could not compare performance and cost across programs.

The Administration is using complementary approaches to strengthen the link between budget dollars and results achieved.

***Using Performance Information to Make Budget Decisions.*** One of these approaches focuses on the use of performance information to make budget decisions. Starting with the Budget for 2003, the Administration collected and used all of the performance information available in making budget decisions; this increased demand for performance information. For this Budget, the Administration created a new Program Assessment Rating Tool (PART), which was applied to individual programs comprising about 20 percent of agency budgets. The PART questionnaire asked about the program's purpose, performance measures, alignment with budget, and results, as well as its planning and management practices. The PART summarizes but does not create information. To the extent that it is influential in making budget decisions, however, it creates demand from policy makers, program managers, and program advocates for the kind of information used to make the rating. The Administration plans to improve the PART this year and apply it to more programs.

***Linking Performance and Cost in a Performance Budget.*** The other approach will create a framework of information and incentives covering all programs in the agency and across government. Agencies have been asked for a revised strategic plan (draft due in March 2003) that would be a template for their 2005 budget. This places the plan in a realistic context, requiring the agencies to focus their goals and set priorities. The plan is to analyze how all of the programs that influence each goal exert their influence—and how well they do it. Performance measures must include the outcomes desired (measuring progress in carrying out the program's purpose) and outputs produced (the tools used). To the extent possible, the full annual budgetary cost of resources to produce these outputs are to be requested in separately identified lines in the budget along with measures of what is produced—ready for monitoring and analysis of the effect of resources on performance. (This link between cost and production is routine in business, but rare in government.) Performance results, cost, and evaluations would provide feedback for a cycle of using linked performance and cost data year-round to improve budgeting and management.

**An Assessement of Progress**

This is an ambitious list. Yet precisely these objectives are behind the Standards for Success by which the Budget and Performance Integration Initiative is rated on the President's Management Agenda scorecard. In the summer of 2001, the standards were created, reviewed by outside experts, and approved by the President's Management Council—the Chief Operating Officers of the major agencies. The "Scorecard Standards for Success" are reprinted at the end of the chapter "Progress on the President's Management Agenda" in the new *Performance and Management Assessments* volume of this Budget.

The Budget and Performance Integration Initiative is one of the most challenging of the items on the President's Management Agenda. While no green status scores have been achieved yet, gains in a half-dozen departments and independent agencies testify to fundamental improvement in their ability to relate resource requests to results produced. Nine agencies out of 24 have reached yellow status for this Initiative, and several others have made notable strides toward linking budget dollars with improvements for citizens.

OMB Director Daniels testified in September 2002, "I see this as a common sense idea upon which people of different philosophies should agree. For those who think that government does too much, costs too much, and is too big, basing funding on results makes sense. But those who believe government should be more active, should have greater influence on people's lives, also should want resources invested in programs that produce results."

The remainder of this chapter has three sections. The first section describes the approach of increasing the use of performance measures to make budgetary and management decisions. The second describes the substantial progress made in the past year in building an information and incentive framework to support continuing improvement in results. The third describes the ways in which the other four Management Agenda initiatives interrelate with the Integration Initiative.

***Budgeting and Managing for Results.*** Eager to make government work better, last year the Administration used all of the performance information it could gather in making decisions for the 2003 Budget. It also began a transition to place the burden of proof on agencies and advocates to supply evidence of program effectiveness instead of assuming effectiveness in the absence of evidence to the contrary.

For the 2004 budget, emphasis broadened to creating better ratings of program effectiveness and using them to make budget, policy, and management decisions. To make ratings more systematic, OMB developed a Program Assessment Rating Tool (PART), a diagnostic questionnaire that was used to rate programs that comprised about 20 percent of each agency's total budget. Common performance measures were developed in several program areas and used for cross-cutting comparisons. The first section of this chapter analyzes this effort to use ratings to budget and manage for results.

***Foundation for Results.*** To create a foundation for continual improvement in government effectiveness, agencies increased collaboration among planning, budget, financial, and program staff. Some agencies began to give program managers control over resources, while making them accountable for achieving results. Agencies are revising Strategic Plans to be delivered to OMB in March. They are refining goals, improving outcome measures, and relating programs to outcomes.

These forthcoming plans, according to OMB guidance, are to be considered the template for an integrated "performance budget" for 2005. The annual performance plan and the budget justification will become an integrated document organized by strategic plan goals. For each goal, the plan analyzes the relationships from goal to outcomes to programmatic effects on outcomes to resource requests.

Half of the agencies took steps toward creating an integrated performance budget this year—ahead of schedule—showing programs in relation to the strategic goals they are intended to achieve. These early performance budget justifications reveal efforts to link full cost to program activities, and to explain how program activities work together to achieve the agency's goals.

To encourage efficient use of resources, the budget needs a uniform measure of the full annual cost of the resources used that will be charged to each program and activity. As it has before, the Administration will propose to reflect program costs more accurately by moving toward charging program costs to the appropriate programs, including the accruing costs of retirement and retiree health care benefits. The Administration has also developed proposals to charge for support services, capital assets, and hazardous substance cleanup where these resources are used. These proposals do not change total budget outlays, budget concepts, or public-private cost comparisons. However, they would provide a better assessment of program costs.

***A Complementary Management Agenda.*** Budget and Performance Integration is one of five interrelated initiatives in *The President's Management Agenda*. The others are Strategic Management of Human Capital, Competitive Sourcing, Expanded Electronic Government, and Improved Financial Performance. They are all interrelated .They all give program managers the ability to deliver services more effectively. The third section of this chapter shows some of their progress toward making federal programs more effective.

## BUDGETING AND MANAGING FOR RESULTS

Testifying before Congress in May 2001, the Director of OMB signaled his intention to focus on performance. “Our main focus. . . .will be working toward full integration of budget and performance information, and using performance data to help make program and budget decisions.”

***Budgeting for Results, 2003.*** OMB staff and agencies followed up, collecting evidence on which programs were improving desired outcomes. Budget decisions were influenced by performance information. For each agency, the Budget included a table listing selected programs with an assessment of the program’s effectiveness and a brief explanation of the assessment.

The results of this performance-oriented process of policy development and budget allocation were analyzed a year ago in Chapter 1 of *Analytical Perspectives*. Five analytical categories were discussed. First were programs that had been identified in the review process as effective—yielding real benefits for Americans. Many of them received increased funding, including the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC); the Bureau of Economic Analysis, which produces gross domestic product (GDP) statistics; Health Centers; drug treatment; the Job Corps; and the National Science Foundation.

In the second category, the review process compared programs for similar purposes and identified some as comparatively more effective. Funding was shifted toward these programs. In the third category, performance measures were used to set targets for better results, with or without more funding. A fourth use of performance measures was to provide incentives to states and other recipients who achieved the most with federal grants, or to charge costs so management decisions would balance cost against results. And fifth, performance measures were used to drive improvements in efficiency in programs and support services.

Like the scorecard system, the immediate use of existing performance measures to make budget decisions was a motivational success. Agencies saw that having good performance measures and being able to demonstrate effectiveness, or at least improvement, in performance was going to make a real difference in their budgets. Performance became a factor to address in agency budget development.

***Budgeting with the PART, 2004.*** Shortly after the 2003 Budget was published, OMB set out to strengthen the process for assessing the effectiveness of programs by making it more rigorous, systematic, and transparent. OMB staff developed a questionnaire, the PART, designed to provide a consistent tool for rating programs. Questions are designed to be answered “yes” or “no”, and require a brief narrative, including evidence to support the answer. In scoring, half of the grade depends on program results.

The story of the development and application of the PART can be found in “A Tool to Evaluate Federal Programs,” in the new *Performance and Management Assessments* volume of this Budget. It includes a one-page summary of the PART for each rated program, scorecards showing the status and progress of each of the five Management Agenda Initiatives for each agency, and a chapter “Progress on the President’s Management Agenda.” Upon publication of the 2004 Budget, all of the completed PARTs will be posted on the OMB website, www.OMB.gov.

The PART was not designed to obviate the need for the many other judgments that must go into budget decision making, such as setting priorities. While a high PART score, good performance measures, and documented influence on outcomes give programs an advantage in budget decisions, as shown by the examples below, they are demonstrably not the only factors considered.

The PART was applied to 234 programs of different types, sizes, and expected levels of effectiveness. Of the programs rated, 6 percent were found effective; 24 percent moderately effective; 15 percent adequate; and 5 percent ineffective. The remaining 50 percent of programs were given a new rating, developed in December after discussion with the President’s Management Council, called “results not demonstrated.” This rating was applied to programs for which adequate long-term and short-term performance measures have not been established, or where there is no data to indicate how the program is performing under the measures that have been established. It was applied regardless of the program’s numerical score.

**Availability and Use of Performance Information**

*". . . .there are important questions to be asked regarding the availability and use of performance information at each stage of the traditional budget process—i.e., budget preparation, budget approval, budget implementation or execution, as well as audit and evaluation. . . .a limited scope of inquiry risks missing important opportunities for applying and capturing the benefits from performance-informed budgeting."*

*Performance Information and Budgeting*
*In Historical and Comparative Perspective*
*Rita M. Hilton and Philip G. Joyce*

***Effective Programs.*** In the 2004 Budget, the PART-rated programs in the topmost "effective" category all received budget increases, or were held level.

- As they were last year, the Bureau of Economic Analysis (the producer of GDP statistics), and the Health Centers were in this top category. Their budget increases were significant. Health Centers, moreover, had low cost per patient and the next to highest number of patient visits per worker in the common measures assessment. Two programs rated effective last year, the WIC nutrition program for women, infants, and children, and the Job Corps, were not included in the PART evaluation this year. Both got funding increases.
- Newly rated effective programs that got budget increases above 6 percent included the Energy Conservation Improvement program in the Department of Defense (funding was doubled), the International Nuclear Materials Protection and Cooperation program in the Department of Energy, the National Weather Service in the Department of Commerce, and NASA's Mars Exploration program.
- Other programs deemed effective included coin production at the United States Mint, bank regulation by the Office of the Comptroller of the Currency, thrift regulation by the Office of Thrift Supervision, the Advanced Simulation and Computing program in the Department of Energy, basic research in the Department of Defense and the Medicare Integrity program at the Department of Health and Human Services.
- There were 56 programs in the moderately effective category. Budget outcomes were more varied, but on balance were favorable. Three out of five got increased funding; about one in five, a reduction.

***Ineffective and Results-Not-Demonstrated Programs.*** The PART assessments were often particularly valuable when programs were deemed ineffective or simply without demonstrable results. Some of these programs have been funded for many years without regard to whether they achieved program goals. PART reviews have led to reform proposals in the Departments of Education and Labor.

- The PART rated the Vocational Education State Grant program ineffective. In high schools, national evaluations and annual performance data show that vocational education has little or no benefit for student academic performance, job skills, or postsecondary degrees. In community colleges, there is no accountability for how the funds are used and no meaningful connection to student outcomes. The reform proposal in this Budget will give States and school districts the flexibility to design high quality programs, provided they meet strict accountability standards for student performance. They may also use this funding for Elementary and Secondary Education Title I programs. Postsecondary school funding will be distributed competitively to community and technical colleges and will be based on a rigorous assessment that student outcomes are being achieved.
- Overlapping programs at the Department of Labor would be similarly reformed: the Workforce Investment Act adult program, the dislocated worker program, and the Employment Service state grants would be folded into a single block grant that would allow the States and the Secretary to target resources where most needed. Underexpended resources will be shifted to where they will do more good. Overlap with Department of Education programs will be minimized by using the Department of Labor's youth formula resources for out-of-school youth and non-school programs.

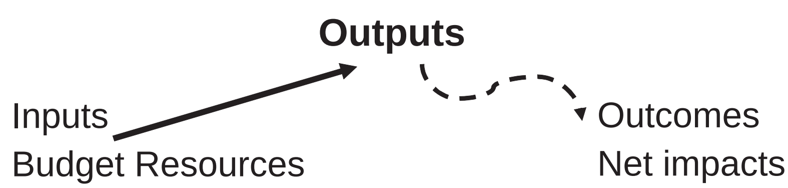
***Use to Improve Management.*** The PART improved program management this year. As OMB and agencies began answering questions together, different views about the program's purpose sometimes emerged; these were sometimes clarified in the ensuing discussion or even reconciled. There were discussions about program planning, analyzing how the program could best influence its desired outcome, and what initiatives might be taken to remove obstacles. Ideas for improving management were considered. Indeed, some agencies and programs applied the PART themselves for this purpose.

In a wider context, many of the PART summaries—for effective as well as ineffective programs—included recommendations for program improvement. These recommendations, accessible on OMB's website, will encourage program improvements throughout the agencies next year.

***Expanding Use of These Tools.*** The Administration plans to improve these tools and expand their use. Given the fact that use of the PARTs for budget decisions creates a demand for information to respond to these questions—and given the parallels between these questions and the GPRA planning and budget integration tasks described in the next section—there may be useful additional information to be gained if some of the PART questions addressed these tasks more precisely.

- Given the high proportion of programs without good performance measures, it is vital to communicate the importance of including outcome measures in the Strategic Plan that show how the program is making a difference for Americans. Since programs influence outcomes, but do not control them, and often influence them only after a lag, it is also important to measure intermediate outcomes or characteristics of outputs that monitor the route by which the program affects the desired outcome. And finally, in order to match resources with the tools that programs use to influence these outcomes, it is important to include output measures. As shown in Chart 1.1, outputs and outcomes are complements, not alternatives; outputs are needed in the equation to relate resources to outcomes.
- One PART question asks: "Is the program budget aligned with the program goals in such a way that the impact of funding, policy, or legislative changes on performance is readily known." That question can be read in different ways, and could usefully be subdivided so that one question can specifically relate to the database changes the agencies need to link cost and performance.

**Chart 1-1. Budget for Outputs Justified by Their Influence on Outcomes**




- Budget "obligations by program activity" can be aligned with an output or cluster of related outputs intended to influence a single outcome, so that cost can be "matched" with outputs produced.
- Outcomes, which have an unstable relationship with cost, can be explained using these outputs and their characteristics, other federal outputs, external factors, and time lags in analytical equations.

## FOUNDATION FOR RESULTS

It is a major undertaking to institutionalize a reform as profound as infusing a performance orientation into federal budgeting and management.

Integration starts with increasing collaboration among planning, budget, financial, and program staffs. Program managers must be given authority—program management authority, budget authority for full cost, and staff supervision—and then held accountable for results. The agency's Strategic Plan should capture the overarching purposes of the agency in a limited number of strategic goals. It should have outcomes that measure progress toward the goals and should explain how each program contributes toward the desired outcomes. Activities that contribute to the same outcome should coordinate and monitor progress. The agency should develop a "performance budget," organized like its Strategic Plan, that matches resources with outputs and justifies resources requested by their effectiveness at influencing the desired outcomes. In the past year, most agencies have made progress in implementing some of these changes, and each of them has been implemented by some agencies.

***Collaboration.*** Breaking down the "stovepipes" that separate planning, budgeting, financial management, and evaluation is essential to integration. A plan is only realistic if it drives a budget request; a budget request is not meaningful unless justified by a plan. Budgets are more meaningful when they tell the cost of producing an output or achieving a performance goal. Budgeting and accounting form a continuum, with the budget reporting proposals and the accounting reporting what happened. Moreover, the next year's plan and budget should build on the past record of cost and performance.

Wherever progress is reported in this section of the chapter, its foundation is greater collaboration among such staff units, and between them and the operating programs.

- For example, in the Department of Justice, planning, budget, and financial management teams at all departmental levels worked together. They identified major program activities ("decision units"), and requested budget authority to reflect the full cost of outputs produced by each of the decision units.
- The Department of State, which is just beginning to use its new Strategic Plan to manage for results, has merged its budget staff and planning staff into an office called Resource Management to link budget and performance on a daily basis.
- And the Department of Transportation, where the budget submission was formatted as a performance budget, pulled it all together with help from the planning and budget staffs under the leadership of the Chief Financial Officer.

***Strengthening Programs.*** A program manager who is authorized to manage the program, controls budget authority that covers the full cost of resources used, and has authority over program staff can focus his attention on getting results. With this combination of authority and some flexibility, a program manager has the tools necessary to be accountable for results, efficiently producing effective outputs.

The other four Management Agenda initiatives all help to strengthen programs. Aligning staff with programs, and giving managers more flexibility to hire staff and reward good work, are key goals of the Strategic Management of Human Capital Initiative. Giving program managers flexibility in buying support goods and services is a key goal of the Competitive Sourcing Initiative. Increasing program effectiveness by electronic delivery of services is a goal of the Electronic Government Initiative. Providing programs with timely financial information and more accurate financial management are key goals of the initiative to Improve Financial Performance. Together, these changes focus programs on good management, make them increasingly effective, and attract civil servants to opportunities to do worthwhile work under conditions that permit doing it well.

What the integration initiative contributes to this process may seem technical, but it is actually just common sense budgeting. It seeks to align budget accounts with programs, and to align sub-accounts with an output or cluster of related outputs. In each of these accounts or sub-accounts, budget authority would be requested to cover the full cost of the resources used. This would link budgetary cost with outputs, which is the first step in routine comparison of costs and benefits.

- The ***Department of Veterans Affairs (VA)*** has completely restructured its budget so that accounts are aligned with their programs. The 2004 budget justification shows how the old account structure transforms into the new; it also shows how each account in the new structure contributes to the Department's strategic goals and objectives. VA consulted with its Congressional Committees on these changes and has included the changes in the 2004 budget database. The new structure, VA believes, will improve delivery of services to veterans.
- The ***Department of Justice*** worked at a finer level of detail. Within each account, they aligned "obligations by program activity," in effect, sub-accounts, with one or more related outputs. They show the outputs, the full cost of producing them, and the outcomes they are designed to influence. These changes also are in the 2004 budget database. Chart 1–2 provides an example of the new account and program activity structure in the United States Marshals Service.

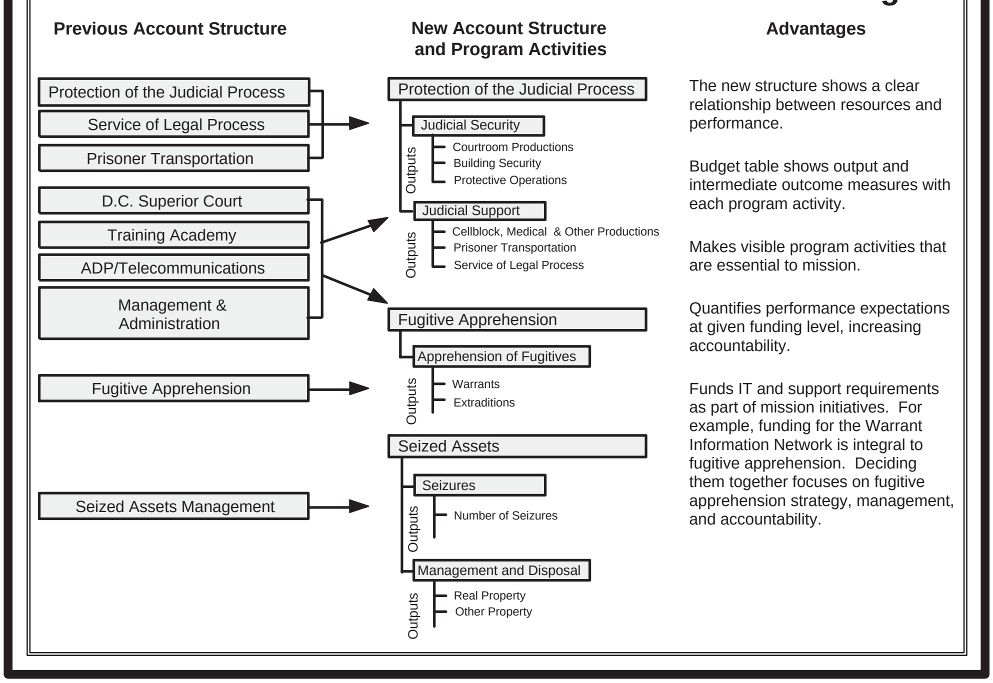


Chart 1-2. United States Marshals Service Restructuring

- The ***National Aeronautics and Space Administration (NASA)*** modified its account and program activity structure to show the full cost of its programs. NASA's budget development was a paper-less electronic process, and it is carried down to the project level at which NASA will manage.

***Harnessing Programs to Strategic Goals.*** For the past seven years, GPRA has required agencies to produce a Strategic Plan every three years, explaining the agency's mission and its strategic goals, and discussing how these goals will be achieved over the long term. Plans are generally grounded in the major laws that the agency implements. In crafting a plan, the agency is required to consult with the Congress, with other agencies, and OMB, and to conduct outreach to the public. The plans should be analytical—explaining how agency programs will help reach their goals, and what external factors may affect success.

Draft revised Strategic Plans are due to OMB in March 2003, and most agencies are far along in preparing their revisions. OMB Circular A-11 instructions for preparation are unchanged, but for one significant addition: these plans are intended to provide the template for a fully integrated performance budget for 2005. Instead of separate instructions for a performance plan and a budget justification, the instructions will require an integrated performance budget.

This change brings a dose of reality to strategic plans. Do the agency's programs really achieve their goals? Are they designed and coordinated for that purpose? Is there a place for everything, and if not, what should be done about it? Is it possible, in sum, to present each goal, the outcomes that assess progress toward the goal outcome, and what the agency does to influence each outcome? As agencies acquire an overview of themselves, they are increasingly focusing their goals, improving their strategies for achieving goals, and shifting the balance and coordination of their program portfolio to get better results. This transformation is particularly impressive in agencies that are large, diverse, and decentralized.

- The ***Department of Health and Human Services*** is developing a "One HHS" plan with goals which stretch across the Department and are designed to improve public health for everyone. Its goals include promoting healthy behavior and other preventive steps, strengthening the public health system to respond to bioterrorism, enhancing the capacity and productivity of health research, improving the quality of health care services, and increasing access. Considerable thought has gone into selecting these goals, the strategies to achieve them, and the right combination of program activities to get the most public benefit for the cost.
- The ***Department of the Interior*** is also crafting a Strategic Plan to integrate its decentralized activities. The four major sectors of its plan are resource protection, resource use, recreation, and

serving communities. This framework is useful in searching for the right balance among these categories, and also in comparisons to identify the most cost effective way of achieving goals within each. Programs in many bureaus are participating in achieving Departmental goals.

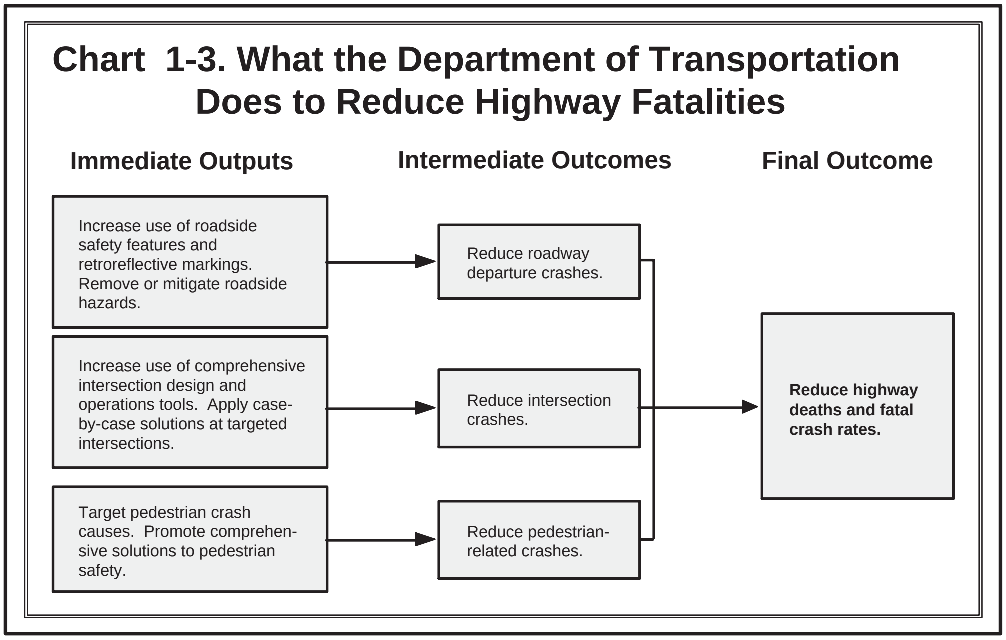
- Sorting through programs to determine the best strategy is no easy job. The ***Department of Housing and Urban Development (HUD)*** has already done a good job of figuring out what combination of services and housing is needed to prevent and reduce chronic homelessness. HUD has just begun to think about extending the same strategic approach to some other major policy goals.

***Using Performance to Manage.*** In agencies where developing good performance measures is particularly difficult, the Departments of Defense and State have developed Strategic Plans, chosen performance measures, and are beginning to use them to coordinate and monitor progress.

- The ***Department of Defense (DoD)*** has crafted a balanced scorecard to assess four risks and identify the right balance in responding to them in order to minimize overall risk. The risks are: force management risk, operational risk, future challenges risk, and institutional risk. In each area, five to eight measures have been chosen which will be calculated and monitored by each DoD component, and reported to the Secretary at least quarterly. They are collectively called "the Secretary's instrument panel," which acknowledges that he is using them to steer. But primary responsibility for performance tracking, linkage of plans, outputs, and resources, and scorecards have been "cascaded" down to all DoD components. Specific performance metrics are also being reported by the military services and defense agencies. The Secretary's greatly revised Annual Defense Report and Congressional Justifications are incorporating all of these metrics and linkages.
- The ***Department of State and USAID*** are merging their 2003 Strategic Plans into one consolidated document that will link all foreign operation and international affairs programs. The new Strategic Plan framework has four high-level strategic objectives and a reduction from 20 to 12 strategic goals for better focus and clarity. Each of the Department's missions around the globe, and each regional or functional office in the Department, was asked to select five priority performance goals and describe specific outcomes they would achieve in support of each. Coordinating these outcomes with other program managers working toward the same goal throughout the Department, at overseas missions, and at the interagency level creates a virtual team and an implicit strategy for moving toward that goal. The restructuring of the Department's 2004 Performance Plan better conveys the linkages among policy priorities, budget decisions, and program outcomes. Efforts are also underway to automate the Mission and Bureau Performance Plan processes to streamline performance information with direct linkage to resources.

***Creating a Performance Budget.*** Perhaps the best way to sum up the accomplishments of the past year is to look at the first attempts to create an integrated performance budget. The art of creating an integrated performance budget is not yet fully developed or uniformly applied. But the structure of a performance budget—explaining goals, how they will be achieved, and what resources are required—encourages an analytical justification which answers key questions in an organized format.

- The ***Department of Labor*** started from a good Strategic Plan with many useful performance measures, created collaborative teams, and plunged into the task of creating a performance budget for the whole department. It was based on a uniform format, and included tables showing full cost and how much was funded by accounts other than the main program account.
- The ***Department of Transportation (DOT)*** also started from a good Strategic Plan, and decided early to capitalize on that plan by presenting an integrated performance budget. Tables were structured by strategic goal, performance goal, and account. The highway safety goal, for example, commits to reducing highway fatality rates from 1.7 per hundred million vehicle miles in 1996 to 1.0 million by 2008. It analyzes the causes of fatalities and explains precisely what contributions it plans from 16 programs to help reduce them. One-third of all fatalities result from vehicles leaving the road and hitting something or overturning. Solutions range from road engineering to rumble strips and reflective markers. Heavy trucks are a disproportionate cause of fatalities; in response, road inspections will be increased and commercial driver education improved. The entire section on highway safety leaves the reader with a solid sense that DoT has a thoughtful plan for reducing fatalities. Chart 1–3 was included in DoT's thorough analysis of the causes of traffic fatalities.




***An Integrated Database.*** OMB has begun a multi-year effort systematically to collect and publish integrated budget and performance information. When the project is complete, information will be routinely available to Congress and the public on how much agencies are spending on outputs and other performance goals.

As agencies improve budget alignment and request resources where they are used, OMB, Treasury and the agencies may find new ways to simplify the collection of data linking performance with cost. This would move the government toward an integrated 21st century information system. This collaboration includes finding an Architecture—a blueprint for developing a strategic information database—that is effective in advancing Budget and Performance Integration and all of the other Management Agenda initiatives.

## Charging Full Annual Budgetary Cost

To make good budgetary choices, decision makers require not only measures of benefits, but a matching, uniform measure of full annual budgetary cost. In preparing their 2004 budgets, several agencies moved in that direction.

- NASA has traced all of its costs to the program activities for which they are used, even allocating overhead. For each program activity, they propose to request budget authority for all associated costs. The Department of Justice has done that too, and the Department of Veterans Affairs has done it at the more aggregated program level while tracking appropriations within the program total. These agencies are giving programs flexibility to get the best inputs and incentives to achieve results. They are also providing better information to decision makers.
- The Department of Labor, the Small Business Administration, and other agencies have calculated the costs that would be associated with their activities and show them in text tables in their budget justification. Labor shows how much is financed in the program's account and how much is financed elsewhere. These agencies are providing decision makers with better information.

The first set of agencies has voluntarily agreed to charge salaries and expenses, the full cost of support goods and services, and an allocation for overhead to programs, and the second set of agencies to *show* those costs. But in neither case will the agency charge or show costs that are not charged to the agency. Legislation is needed for that purpose.

In October 2001, the Administration transmitted to the Congress legislation to charge the employer's share of the full accruing cost of retirement benefits to federal employers as they are earned. "Budgeting and Managing for Results: Full Funding of Retiree Costs Act of 2001" would charge to salary and expense accounts in all federal agencies the employer's share of the accruing cost of pensions, retired pay, and retiree health care. Existing liabilities of the retirement funds for these benefits would be amortized by mandatory payments from the general fund, and the benefit payments would continue to be mandatory.

Agencies have made full accrual payments to the Federal Employee Retirement System (FERS) and the Military Retirement System (MRS) since the mid-1980s. The Civil Service Retirement System and associated Foreign Service and Central Intelligence Agency systems, which are for employees hired earlier, are only partly funded. At the time the legislation was transmitted, Congress had recently enacted a law to shift health care for Medicare-eligible military retirees to an accrual basis. Retired pay for the three small uniformed services (the Coast Guard, Public Health Service, and National Oceanic and Atmospheric Administration Commissioned Officers), and retiree health care for civilians and for military retirees who are not Medicare-eligible, is not accrued at all.

The Administration will work with the Congress to enact legislation that charges federal employers their full share of the accruing cost of all retiree benefits as those benefits are earned, and to amortize the unfunded liabilities of the retirement funds by payments from the general fund. The legislation would not change total budget outlays or the deficit; the benefits are already required by law. The amounts involved are shown as memorandum items in the Budget Appendix.

The General Accounting Office (GAO) supported these concepts in a report on *Accrual Budgeting: Experiences of Other Nations and Implications for the United States* (February, 2000). The Congressional Budget Office (CBO) reviewed them in *The President's Proposal to Accrue Retirement Costs for Federal Employees* (June, 2002). The Comptroller General, Association of Government Accountants, and the American Institute of Certified Public Accountants supported the proposal.

### Charging Full Annual Budgetary Cost—Continued

Charging appropriately for retiree benefits would go a long way to permitting agencies to charge programs uniformly for the full annual budgetary cost of the resources they use. Legislation to cover two other types of cost would be needed to complete the job.

- Some agencies, notably the Departments of Energy and Defense, acquire assets that generate hazardous substances which the agency is required by law to clean up at the end of the asset's operating life. Currently, these costs are paid long after the asset is acquired and after its period of use as well. Good budgeting requires that the estimated cost be considered when the asset is acquired and when it is used.
- From the standpoint of showing the cost of usage, capital assets are also problematic. From a program's perspective, the cost may be: 1) zero if they are financed centrally, 2) the program's share of the acquisition cost if it is allocated among programs, 3) the rental value if office space is rented from GSA, or 4) a substantial bite out of their budget for an occasional capital acquisition. One way to show a uniform annual cost for the use of capital without changing the Constitutional requirement to get an appropriation up front would be to create agency Capital Acquisition Funds (CAF). Following good budget practice, the CAF would request budget authority (BA) up front to acquire assets, and outlays would be recorded in the budget when payment was made. The BA would be in the form of authority to borrow from Treasury. The CAF would then borrow for the period of the asset's useful life, charge programs each year in proportion to asset use, and make the mortgage payments to Treasury.

Discussions along these lines have been held with GAO, CBO, and others with encouraging interest. Draft legislation has been developed, discussed with agencies, and improved. As agencies make progress in developing performance budgets and improving the alignment of budget accounts and sub-accounts with program outputs, the advantage of having a fully uniform budgetary measure of the annual cost of running programs and producing outputs becomes greater. Such a measure would permit continual comparison of cost with benefits among similar programs and over time. These changes, like the ones for retiree costs, can be made without changing the basic budget concepts of BA, obligations, and outlays or the deficit or surplus of the budget as a whole.

## A COMPLEMENTARY MANAGEMENT AGENDA

Each of the other Management Agenda initiatives makes programs more efficient and effective. Each encourages more cross-cutting collaboration to coordinate programs so that they influence outcomes effectively. Collectively, all the initiatives highlight the importance of top management policy development and oversight. This final section of the chapter discusses the complementarities of these initiatives with Budget and Performance Integration. It also notes particular examples of progress agencies have made in the past year.

Chart 1–4 provides a perspective on the relationships of the other Initiatives and the Integration Initiative. Budgetary and human resources would be aligned with programs and reported by financial management; all elements focus on getting and rewarding results.

**Chart 1-4. The Management Agenda**

- Getting results: effective delivery of services should be the focus of all government decisions.

Budgeting ⟶ align structure, allocate for results

Managing is in the spotlight.

Staffing ⟶ align structure, reward performance
Acquisition ⟶ performance-based, competitive
IT ⟶ deliver integrated services and data

Reporting ⟶ align results, make them transparent

- Program managers would be accountable for efficiently producing effective outputs.

**Strategic Management of Human Capital**

A large proportion of the federal workforce will become eligible to retire by 2005—40 percent of all workers, and 71 percent of senior executives. A key factor in attracting new entrants into federal service is shaping their jobs so that they carry out clear and worthwhile missions—and do so under conditions which give them a chance to be effective. Surveys show that many young people are avoiding federal service because they believe they are more likely to be able to "make a difference" in the non-profit or private sectors.

For agencies to meet policy goals and objectives, both human and budgetary resources need to be aligned with programs and activities that produce results. Managers should be given the authority they need to get the job done, including more flexibility to hire and manage personnel. Reducing layers of review and program overlap is equally important to improve performance and results. Both the Integration and Human Capital Initiatives support linking rewards to individual and group success in reaching performance goals. Changes like these raise the prospect that civil servants will feel they can be effective.

***Progress So Far.*** Perhaps the greatest change the Human Capital Initiative has made so far is to develop in agencies the understanding that human capital management is a tool to propel mission accomplishment. People are assets for the organization; they become more valuable with investment in their special skills and knowledge. At the same time, organizations need to think strategically about the abilities they will need to meet future challenges. The Office of Personnel Management (OPM) has been helping agencies to elevate the level of analysis that supports this approach. Agencies have collected data to assess what skills will be needed in future years, analyze what the gaps are, identify where leadership succession needs urgent attention, and set priorities for training and development programs.

Few agencies have moved into the implementation stage of better managing their human capital, which explains why most are still red in status. But this year, they will begin implementing their new human capital plans. To help, OPM is restructuring itself to be more responsive to agency needs, and is working closely with OMB and Executive Branch agencies. It offers policy guidance and links to exemplary products on its website.

The Administration is continually evaluating each agency's progress and the hiring, classification, pay, performance management, and other human capital tools that are available to help agencies become as productive as possible. Several personnel reforms, including authorities to streamline and speed up the hiring process, were enacted as part of the Homeland Security Act of 2002.

Rewarding top performers and those with critical skills is preferable to the traditional practice of evenly spreading raises across the federal workforce regardless of performance or contribution. For 2004, the Administration proposes to allow managers to increase pay beyond annual raises for high-performing employees. A new $500 million fund will be established in OPM and allocated among agencies based on plans submitted to and approved by OPM. The Administration also proposes to eliminate the current pay structure for senior managers and increase their pay ceiling. Under this proposal, each agency will adjust pay for its senior managers on the basis of individual performance, which will help address the current lack of meaningful senior manager appraisal systems.

***Examples of Success.*** While few agencies are implementing strategies to address all six standards for success in human capital management, there are numerous examples of impressive change.

- The Social Security Administration (SSA) is an example of effective leadership planning and knowledge management. SSA uses succession planning, hiring and retention flexibility, aggressive developmental programs, and cost/benefit analysis of training. It anticipates vacancies, targets critical positions to designate "understudies," and is managing the retirement wave with early-out flexibility.
- The Department of Veterans Affairs provided automated data tools to help managers and staff with workforce planning. It assesses organizational and geographic needs in relation to goals, documents barriers to its efforts, and seeks ways around them.
- The Department of Labor worked with consultants to identify competencies for mission-critical occupations and devised strategies to address its competency gaps.
- The Departments of Energy, Health and Human Services, and Labor have linked performance expectations for their executives to agency strategic goals and objectives. These new Senior Executive Service appraisal systems are designed to distinguish and reward top performers.
- The Department of Transportation adopted an effective human capital strategy for staffing the new Transportation Security Administration (TSA). It hired tens of thousands of federal screening employees, and at the same time embraced its authority to conduct screening pilot projects at five airports utilizing contract screeners. TSA decided for the long term to harness the law enforcement resources of state and local governments to staff airport checkpoints, rather than hiring 3,000 of its own officers. Finally, TSA aggressively outsourced most administrative activities.

The Human Capital Initiative has become a powerful agent for change in the past year. It has the attention and support of agency heads, and agencies are making headway toward meeting the initiative's standards for success.

## Competitive Sourcing

The Competitive Sourcing and Integration Initiatives share the goal of giving program managers more flexibility—in this case, by increasing the ease with which they can acquire the support goods and services needed to accomplish their mission. The previous cumbersome and limited process for acquiring support is being replaced by one which makes competition recurrent, simplifies the competitive process, and permits the use of a "best value" cost and technical trade-off in selecting the winning source.

These changes are intended to bring innovation and efficiency into public services, to build an environment in which agencies explore new options, and to encourage learning from commercial practices. They are expected to improve contract administration information systems and increase the use of electronic commerce.

OMB is revising its old, burdensome Circular No. A-76, "Performance of Commercial Activities," drawing on testimony from numerous congressional hearings, participation on the Commercial Activities Panel, chaired by Comptroller General Walker, and responses to OMB's *Federal Register* request (67 FR 69769) for agency and public comments. The revision seeks to encourage federal managers and employees performing commercial activities to compete ( often for the first time—to demonstrate their professional capabilities in much the same way as their commercial private sector counterparts do on a recurring basis. Both public-private and private-private competitions for commercial work will be based on the principles of the Federal Acquisition Regulation (FAR).

***Principles of Competition.*** The proposed revisions to Circular A-76 are designed to facilitate broader and more strategic use of competitive sourcing as a management tool for improving agency performance. The major proposed revisions include:

1. Requiring agencies to presume that all activities are commercial in nature unless an activity is justified as inherently governmental. To reinforce this presumption, agencies are required to submit annual inventories of their inherently governmental positions, using a more concise definition of "inherently governmental."

2. Eliminating the "grandfather clause" that currently permits public reimbursable service providers working under commercial inter-service support agreements (ISSAs) in existence prior to March 1996 to perform work indefinitely without being subject to competition. Agencies relying on public reimbursable providers will be required to develop plans for competing work done by these commercial ISSAs.

3. Establishing standards for conducting competitions. Public-private competitions take too long—longer on average than private-private competitions. The revised Circular establishes time limits and requires agencies to report when these are exceeded. Agencies, for example, will be permitted the same time-frames to develop an in-house offer as the agency is prepared to give to private sector offerors.

4. Requiring that agencies generally comply with the Federal Acquisition Regulation (FAR) in conducting competitions. The general principles of the FAR are well established and enjoy widespread familiarity within the procurement community. Greater application of FAR-type principles and practices throughout the Circular is intended to bring public-private competitions closer to mainstream source selection and reduce confusion that may currently make it more difficult for parties to compete.

5. Accountability for in-house performance after a contract is awarded is now required that is similar to what is expected of private sector contractors. Agencies relying on an in-house provider or a public reimbursable provider will be required to document changes to the solicitation, track actual costs, and terminate for failure to perform.

***Alternative Approaches.*** The new focal point will be on "standard competitions," or direct conversions when appropriate. Recognizing that agency needs cannot be met through a "one-size-fits all" approach, the Circular's guidance is broader and more accommodating than the procedures developed over the years for conducting cost comparisons. For example, when conducting a standard competition, agencies will have three options for considering non-cost factors.

- An agency may conduct a source selection where the decision is based on the low cost of offers that have been determined to be technically acceptable.
- Alternatively, the agency may conduct a "phased evaluation process." During the first phase, technical factors are considered, and offerors may propose performance standards different from those specified in the solicitation. If the agency determines that the proposed alternative performance standards are appropriate and are within the agency's current budget, the agency could issue a formal amendment to the solicitation and allow revised submissions. The technically qualified offerors and the in-house offeror would then compete based on price against the revised performance standard.
- Finally, if non-cost factors are likely to play a more dominant role, agencies may conduct an "integrated evaluation process" with cost-technical tradeoffs similar to those authorized by FAR Part 15. Private sector offers, public reimbursable providers, and in-house providers may submit higher performance standards than the solicitation. If the in-house offer is not among the most highly rated proposals, it could be eliminated from the competitive range. The Circular recognizes that this integrated evaluation technique may not be appropriate for all needs and should be tested before wider application is authorized.

## Expanding Electronic Government

Expanding Electronic Government focuses directly on improving the government's effectiveness. It helps programs work together to improve outcomes, such as better educational achievement and better health care. It coordinates services to citizens, businesses, and government by common internet sites. And it has a yet undeveloped potential to improve not just the use of information technology, but the overall organization and effectiveness of federal programs. This Initiative strongly supports the work of the Budget and Performance Integration Initiative.

***Improving Program Outcomes.*** Two of the E-government initiatives under way are directly related to agency efforts to use performance information to improve budget and management decisions.

- A Performance-Based Data Management Initiative is under way to streamline the collection of performance data so that it will provide accurate and timely information to help inform state, local, and federal management of education programs.
- The Department of Veterans Affairs and the Department of Defense are working jointly to improve services to veterans. DoD's eligibility and enrollment system will be the base for veterans' enrollment, providing seamless services as veterans leave the military. The two Departments are working together on computerized patient records, which will improve the quality of patient care, since many veterans and their families use both systems.

***Coordinating Service Delivery.*** The most visible and effective of the E-government initiatives deliver services via the internet directly to citizens, businesses, or government. Agencies that provide similar services must work together to deliver them in seamless, coordinated, electronic form. Information about the service and often the service itself can be delivered this way in minutes or hours instead of weeks or months.

- *FirstGov.gov* is the American citizens' gateway to the federal government. Last year, it was completely redesigned to provide government services within "three clicks." The Office of Citizen Services was created to facilitate one-stop shopping for citizens who do business electronically with the government. This strategy has increased the number of site visitors by 50 percent. Last summer, FirstGov.gov was named by Yahoo "One of the Top 50 Most Incredibly Useful Web Sites."
- *GovBenefits.gov* provides one-stop access to information and services of almost 200 government programs representing more than $1 trillion in annual benefits. GovBenefits.gov receives over 500,000 visitors per month and appears on USA Today's list of "Hot Sites."
- *IRS Free Filing* is a new point of access to free online tax preparation and electronic filing services provided by Industry Partners to reduce taxpayer burden and costs. As of January 2003, this service is available to a substantial majority of taxpayers at www.firstgov.gov or www.irs.gov.
- *Recreation.gov* provides online access to America's National Parks and public recreation areas. The

site links to 1900 federal, state, and local parks and recreation centers; it has over 750,000 site visitors per month.

Similarly, federal internet sites deliver effective services to businesses, governments, and federal agencies.

- Businesses are helped by E-government projects that make it easier to comment on proposed regulations, identify the regulations that affect them, and find opportunities to sell to the government and expand their international trade.
- State and local governments use E-Grants.gov to apply for federal grant programs. A single electronic application will allow grant applicants to enter identifying information once; using a single identifier for each grantee allows the government to track and oversee grantees.
- Federal agencies are supported by many E-government projects. Common sites have been created for hiring, security clearance, training, and employee payroll. Other sites help with acquisitions, travel, and intra-governmental payments.

***Sharpening the Focus of What Government Does.*** The Expanding Electronic Government Initiative seeks to rationalize the use of information technology across the federal government. Its initial focus was on reducing overlap and redundancy in IT investments. To assess commonalities across government—and to categorize the data in IT systems in useful ways—the Federal Enterprise Architecture team developed a Business Reference Model that identifies different lines of business. It was used to question possible redundancies in the funding requests for new and expanded IT investment submitted for the 2004 Budget.

Additional uses for the Federal Enterprise Architecture are under consideration, including recording the outcomes that agencies are attempting to influence and the outputs they produce. The value of a common Architecture across the federal government that could support all of the Management Agenda has become increasingly clear. To make a lasting E-Government transformation, it would be useful to integrate with categories that have been developed with the Congress for budget justification and execution and that are already in agency IT systems, providing considerable historical data for analysis and comparison.

As agencies revise their Strategic Plans to create performance budgets, they are focusing goals, measuring outcomes, and coordinating programs to achieve them. Goals in different agencies overlap; the same process of increasing focus and coordination is needed across agencies. By recording the new agency goals and measures in relation to each other, a modern Architecture could evolve. E-government projects would help them to come together to achieve their common goals, rationalizing not only the use of IT but the strategies for achieving outcomes. The same evolving Architecture could also be the key to a 21st century integrated budget, performance, and accounting system providing rapid analytical feedback for government decision making.

## Improving Financial Management

The Improved Financial Performance initiative complements the Budget and Performance Integration Initiative because successful financial performance ensures that accurate and timely financial information is available to measure past activities, affect current operations, and better predict the outcome of planned activities. In fact, to meet the standards for success fully under the Improved Financial Performance Initiative—to get a "green" score—requires that agency financial and performance systems be integrated. Integration makes the true cost of programs more transparent.

***More Integrated Financial and Performance Information.*** A major step toward integration of financial and performance information was taken this year. For 2002, agencies must submit combined *Performance and Accountability Reports* that contain the audited financial statements and performance results for the same period. More importantly, the due date for this report moves from February 27, as was the case in 2001, to November 15 in 2004. In short, performance results and audited financial information for 2004 will be available 45 days after the close of the fiscal year, and in time to inform the 2006 budget process.

OMB also requires agencies to produce comparative and quarterly reports. To meet these more frequent and accelerated due dates, agencies must reinvent their business processes, develop estimating techniques and methods, and improve their underlying systems. In addition to meeting these reporting requirements, these new systems must be sufficiently robust to provide budget, financial, and performance information to support day-to-day operations and decision-making.

***Better Cost Measurement.*** A number of agencies such as the Environmental Protection Agency are beginning to implement full cost accounting systems. Cost accounting helped the Department of Veterans Affairs, the Department of Justice, and the National Aeronautics and Space Administration to calculate budget requests for each of their programs and activities as they restructured their budget accounts and "program activity" lines in this budget (discussed earlier in this chapter). As more agencies align their budgets with strategic plans, the demand for sound cost information will escalate because it is essential for measuring program performance and improving program effectiveness.

***Using Performance Information.*** One example of managing integrated financial and performance information is in an area of particular vulnerability, erroneous payments. Federal agencies make hundreds of billions of dollars of benefit payments each year. Today, the 57 Federal programs responsible for distributing more than $1.2 trillion each year in benefit payments must submit with their budgets an estimate of their erroneous payments and goals for reducing them. These agencies will also report on their expected performance against these goals.

Results are already apparent. The National Food Stamp erroneous payment rate fell from 8.9 percent in 2000 to 8.6 percent in 2001, its lowest ever, and the Department of Agriculture is aggressively enforcing its quality control program in states with high error rates. Also, for the first time ever, California and Michigan, with Food Stamp payment error rates of 17.4 percent and 12.5 percent respectively, are being assessed cash sanctions called for under the law. And Medicare reported a continued decrease in its erroneous payment rate from 6.8 percent in 2000 to 6.3 percent in 2001.

## Conclusion

A year and a half ago, the Administration embarked on a Management Agenda intended to make government results-oriented. At that time, there was little assessment of the effectiveness of existing programs. Performance information was not consistently at hand when budget decisions were made. Costs and results were not linked; budget requests were not organized to fund a plan to achieve specific results. A great deal has been accomplished since then to increase the influence of performance information on budgeting and management. However, the Management Agenda has only been partly fulfilled. More still needs to be done to make government routinely effective.