Office of the State Auditor
Performance Audit Division

State of Mississippi

From the Office of State Auditor

Phil Bryant

A Review of Performance-Based Budgeting in Mississippi

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STATE OF MISSISSIPPI

OFFICE OF THE STATE AUDITOR

PHIL BRYANT
AUDITOR

December 15, 2003

Honorable Amy Tuck
Lieutenant Governor
New Capitol
Jackson, MS

Dear Lieutenant Governor Tuck:

Per your request, the Performance Audit Division of the Office of the State Auditor (OSA) performed a review of Mississippi's current practice regarding the 1994 legislation mandating performance-based budgeting. OSA has completed this project and now submits this report for your review.

We trust that the information included in this report will be beneficial to you and other parties interested in this subject.

Sincerely,

Phil Bryant
State Auditor

Office of the State Auditor
Phil Bryant

A Review of Performance-Based Budgeting in Mississippi

Report Summary

At the request of the Lieutenant Governor, the Performance Audit division of the Office of the State Auditor (OSA) conducted a review of the philosophy of performance-based budgeting, as well as its functions in the Mississippi appropriations process.
Over the last ten years, many states across the country have transformed their appropriations process to a performance-based budgeting system. Similarly, during the 1994 legislative session the Mississippi Legislature updated Mississippi's budgeting law to mandate performance-based budgeting. Even though nine years have passed since the performance-based budgeting law was enacted, the law has yet to achieve its full potential. In light of this, as well as the recent economic downturn in Mississippi, the Lieutenant Governor is proposing a fresh review of performance-based budgeting and its benefits.

This review encompasses the definition and philosophy of performance-based budgeting in general, the current appropriations process in Mississippi, as well as the degree to which the 1994 legislation is having an impact on Mississippi's budgeting process. Further, other states that maintain successful and efficient performance-based budgeting systems were studied to determine the best practices for success. States reviewed include Texas, Florida, Virginia, and Louisiana. These states have all implemented performance-based budgeting systems that are generally accepted as standards in performance-based budgeting.

As a result of this review, the following recommendations are suggested:

Fully Implement the Law

The law passed in 1994 has never been fully implemented. This law maintains potential to achieve results if implementation is effected.

House and Senate Appropriations Committees Develop a Special Sub-Committee and Appoint a Chairman to Oversee Performance-Based Budgeting

The creation of a sub-committee from the House and Senate Appropriations Committees and an appointed chairman would the legislative oversight necessary to maintain a successful performance-based budgeting system

Amend Mississippi Code 27-103-129

This law should be updated to mandate an annual review of performance measures to ensure they remain consistent with agency and state goals and objectives.

Amend Mississippi Code 27-103-153

This law should be updated to insert the Joint Legislative Budget Committee into the process of setting performance targets. The Legislative Budget Office, in conjunction with the agency, should annually determine objective performance targets for each agency and the Joint Legislative Budget Committee, acting through the Legislative Budget Office, should recommend those targets to the Legislature.

Provide Focused Communication of the Law

Many important state employees are not aware of the true intentions of performance-based budgeting. Before results can be achieved, the significance and importance of performance-based budgeting must be communicated strenuously and regularly.

Agency Internal Auditor and the Legislative Budget Office Evaluate, Analyze, and Report Performance

House Bill 650, known as the Mississippi Internal Audit Act, was passed stating that each agency, subject to available funding, should employ an agency internal audit director. Each agency's internal auditor should evaluate their agency's performance results. These results should be analyzed by the internal auditor in close conjunction with the Legislative Budget Office.

Provide Necessary Training

Maintaining a successful performance-based budgeting system is a detailed long-term process. Additional training is necessary to equip the state agencies with the required knowledge to maintain a performance-based budgeting system.

Accountability for Results

In order for agencies to take performance-based budgeting seriously, accountability must be at the forefront. Agencies should be required to give the Legislature an explanation of performance that has failed to meet expectations.

Take Action Based on Performance Results

Rewards should be given for results that exceed expectations and penalties should be imposed for results that fail to meet expectations.

Implement Incentive Program

Mississippi Code 27-103-157 mandates that DFA establish an incentive program to reward agencies that develop cost savings measures. This program should be implemented and communicated as soon as funds are available.

Publish Results

Performance results should be published so that the public can see how agencies are performing. This allows taxpayers to see where their tax dollars are going.

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Introduction

Purpose

The Lieutenant Governor requested the Office of the State Auditor (OSA) to conduct a review of performance-based budgeting in Mississippi. The purpose of this review was to research the 1994 legislation and its role in Mississippi's budgeting process as well as perform a review of performance-based budgeting in surrounding states.

Scope

The scope of this review included research of the 1994 legislation, Mississippi's current budgeting process, and practices currently in place in other states.

Method

In conducting the review, the OSA performed the following procedures:

- Reviewed applicable statutes
- Reviewed current budgeting process in Mississippi
- Researched performance-based budgeting
- Studied performance-based budgeting as it is conducted in other states
- Interviewed representatives from agencies within Mississippi, as well as from other states

Background

Legislative Authority

There are multiple sections in Mississippi that address and mandate performance-based budgeting. The most pertinent sections are listed below:

27-103-113 – Budget preparation

> "*It shall be the duty of the Legislative Budget Office to prepare an overall balanced budget of the entire expenses and income of the state for each fiscal year….. Beginning with the 1996 fiscal year, such budget shall be prepared in a format which will include performance measurement data associated with the various programs operated by each agency.*"

27-103-115 – Recommendations and studies as to state agencies

> *"It shall be the further duty of the legislative budget office to make continuous and careful study of all state agencies, and it may make recommendations to the state Legislature for abolition or consolidation or creation of state agencies."*

27-103-129 – Budget requests

> *"Beginning with the 1996 fiscal year, the budget requests shall include a definition of the mission of the agency, a description of the duties and responsibilities of the agency, financial data relative to the various programs operated by the agency and performance measures associated with each program of the agency. The performance measures to be contained within the agency budget request shall be developed by cooperative efforts of the Legislative Budget Office, the Department of Finance and Administration and the agency itself and shall be approved jointly by the Legislative Budget Office and the Department of Finance and Administration prior to inclusion within the agency budget request. Beginning with the 1996 fiscal year, the budget requests shall also include in an addendum format a five-year strategic plan for the agency which shall include, but not be limited to, the following items of information: (a) a comprehensive mission statement, (b) performance effectiveness objectives for each program of the agency for each of the five (5) years covered by the plan, (c) a description of significant external factors which may affect the projected levels of performance, (d) a description of the agency's internal management system utilized to evaluate its performance achievements in relationship to the targeted performance levels, (e) an evaluation by the agency of the agency's performance achievements in relationship to the*

targeted performance levels for the two (2) preceding fiscal years for which accounting records have been finalized."

<u>27-103-139 – Submission of budget; employment of budget officer</u>

"Beginning with the 1996 fiscal year, the budget submitted shall be prepared in a format which will include performance measurement data associated with the various programs operated by each agency."

<u>27-103-153 – Appropriation bills; performance targets</u>

"Beginning with the 1996 fiscal year, the appropriation bills enacted to provide funding for each state agency or institution shall include performance targets for each performance measure established for each program within each such agency. Said performance targets shall be established annually by the Legislature and shall be based upon the funding level authorized for each agency within its appropriation bill."

<u>27-103-155 – Evaluation of performance accomplishments</u>

"Beginning with the 1995 fiscal year, the Legislature shall make available funds for the employment of such persons as may be required to conduct an evaluation of the actual performance accomplishments of each agency and its programs in comparison to the targeted performance levels established within the appropriation bill for each agency and its programs. The results of such evaluations shall be prepared in such form and in such detail as may be required by the Joint Legislative Budget Committee. Beginning with the 1996 fiscal year, the Legislative Budget Office and the Department of Finance and Administration shall review the five-year strategic plans submitted by each agency as an addendum to its budget request and shall make copies of said plans available to the Legislature for review and consideration."

<u>27-103-157 – Innovation incentive program; awards</u>

"The Department of Finance and Administration is hereby authorized and directed to establish an innovation incentive program whereby agencies which develop and implement innovative cost saving measures can receive both public commendation and monetary reward in recognition of their efforts. The Department of Finance and Administration shall develop policies and procedures as may be required in order to properly administer said program and such policies and procedures shall include the development of evaluation criteria by which the cost saving results of the various innovations can be calculated and compared against the innovations of other agencies. The Department of Finance and

Administration shall make all agencies aware of the innovation incentive program and shall encourage the participation of agencies in the program.

The Department of Finance and Administration shall submit its recommendations for innovation incentive awards to the Legislature for consideration on or before January 1 of each year. The recommendations of the Department of Finance and Administration shall include the following items of information: (a) proposed recipients of awards, (b) the proposed amount of the monetary award, and (c) the proposed manner in which the monetary award should be made available to the recipient. The Legislature may hold hearings in regard to the innovations recommended for consideration by the Department of Finance and Administration and may, in its discretion, appropriate funds to reward agencies for innovations."

27-103-209 – Reports on state budget system, privatization of government programs and services and financial statements and fiscal control systems.

"The Joint Legislative Budget Committee shall study and review the state budgeting system and make comparisons with and evaluations of other budgeting systems in use in other states.

The Joint Legislative Budget Committee shall file a report of its findings together with any recommendations with the Clerk of the House of Representatives and the Secretary of the Senate not later than December 15, 1992. The Joint Legislative Budget Committee shall utilize staff of the Legislative Budget Office, University Research Center, State Tax Commission and other agencies as necessary.

The Joint Legislative Committee on Performance Evaluation and Expenditure Review shall prepare a report on privatization of government programs and services. The study shall analyze all areas of state government with the objective of identifying programs and services that can be performed by the private sector with lower cost or increased efficiency. Areas of privatization shall include, but not be limited to, contracting-out, competitive bidding and sale of assets. In determining and comparing the costs of performance between the private and public sectors, the actual costs incurred in engaging in the activity shall include the cost and value of labor, real estate, equipment, overhead and other direct expenses. Cost-benefit analysis of current and proposed regulations shall be included. Generally accepted accounting principles shall be followed. Input shall be solicited from representatives of the private sector. Recommendations shall be provided to the Legislature and the Governor by December 15, 1992.

The Joint Legislative Committee on Performance Evaluation and Expenditure Review shall review the adequacy of financial statements of state government and fiscal control systems including legal authority and methodology of the agencies that prepare public financial statements and exercise control over state expenditures. The review shall focus on the SAAS accounting system and its *development, implementation and benefits. A report by the committee on its findings shall be provided to the Legislature and the Governor by December 15, 1992."*

Performance-Based Budgeting

Performance-based budgeting involves integrating performance measures and performance targets into the annual budget process. Performance-based budgeting focuses heavily on the projected and achieved results of an agency's expenditures. This concept provides for the objective evaluation of an agency's performance in relation to their budget allocation. Performance-based budgeting also adds a substantial measure of accountability to the budget process by directly linking performance to funding. It allows good performers to be recognized and rewarded, and poor performers to be identified.

Although there are many components of performance-based budgeting, two of the most important are performance measures and performance targets. Performance measures are generally defined as a quantifiable, enduring measure of outcomes, outputs efficiency, or cost-effectiveness. Performance measures are typically related to an agency's mission and programs and do not measure one-time or short-term activities. Performance measures are relatively static, but should be reviewed often to ensure they remain in line with overall goals and objectives.

Performance targets are generally defined as a level of performance that a service or program is projected to accomplish in a particular year, consistent with objectives. Performance targets are specific goals or objectives associated with performance measures. Targets serve as a quantifiable standard of achievement. For example, the Department of Public Safety might set a performance target of 0.8 fatal accidents per million vehicle miles in the year 2003. Performance targets are more dynamic than performance measures and should be set annually by the agency in conjunction with objective outside representatives. These targets should also be evaluated, analyzed, and reported each year by an objective party.

The philosophy behind performance-based budgeting is very much unlike traditional government budgeting practices. Historically, government budgeting has focused on directing spending through appropriations for line items such as salaries, operating expenses, and capital improvements. The traditional method of budgeting uses incremental funding alterations to satisfy current needs. Opponents of this approach have widely criticized that line-item budgeting tends to continue programs without examining their effectiveness and does not maximize the use of scarce public resources. One of the primary differences of performance-based budgeting is that it provides agencies with more flexibility in expending their resources, but also maintains a greater level of accountability for those resources.

Although performance-based budgeting programs vary with regard to structure, there are several components generally accepted as necessary for a successful performance-based budgeting process.

- **Planning:** Involves detailed planning of targeted results expected to be achieved with appropriations. Projected performance objectives are clearly outlined and documented in order to provide a platform against which actual results may be measured.

- **Measurement and Reporting:** Comprised of routine (generally quarterly or semi-annually) data gathering used to compare actual performance results to expected performance results. These reports are compiled by the individual agency in conjunction with an objective representative of the Legislature.

- **Evaluation:** Includes a comprehensive review of the previous fiscal year's results in comparison to the documented projected results.

- **Budgeting:** The process of integrating the previous fiscal year's performance results into the upcoming fiscal year's budget allocation. Included in this process are rewards for success and penalties for failure.

The benefits of performance-based budgeting are well-documented and far-reaching. Performance-based budgeting highlights agencies that are successful as well as those agencies that are not performing. This allows budget dollars to be allocated more knowledgeably and efficiently. Minimally, agencies are held accountable for performing short of their specified measures and are required to offer explanation. Maximally, agencies or programs that are not performing are identified and allocated reduced funds, recommended as candidates for consolidation with other agencies or programs, or abolished.

Performance-Based Budgeting In Other States

In the last decade, many states have recognized the need for some form of a performance-based budgeting program. Increasingly, leadership in state governments is emphasizing the need for systematic evaluation of results of state expenditures. Former Indianapolis Mayor Stephen Goldsmith stated that "government should be measured the same way every other enterprise is measured – by results. If people aren't getting a dollar's worth of service for every dollar they pay in taxes, then government isn't helping them – it is ripping them off." Holding state government accountable for its expenditures is becoming a prevalent theme across the country.

Of the four states that were reviewed (Texas, Florida, Virginia, Louisiana), each state maintains a successful performance-based budgeting system. The programs that have been implemented in these states differ somewhat in their philosophies, but each program is well-planned and diligently implemented. The common ground that these states have with regard to performance-based budgeting is that law was passed and action was taken to implement the law.

All four states have stated that their performance-based budgeting systems have been widely successful. These systems have added a level of accountability to their governments that was not previously present. Each state reports that agencies now have more clearly defined goals and visions, and have in turn become more efficient. The government can now more credibly inform the public of how tax dollars are being spent.

A detailed review of each of the four states reviewed can be found in appendix A, B, C, and D at the conclusion of this report.

Performance-Based Budgeting in Mississippi

In determining the extent to which the performance-based budgeting laws were being implemented and achieving results, several state agencies were interviewed. Agencies that were interviewed include the following:

- *Attorney General's Office*
- *State Personnel Board*
- *Legislative Budget Office*
- *Department of Health*
- *Office of the State Auditor*

The general purpose of these interviews was to determine the importance of performance measures and performance targets in the budgeting process of an individual state agency. These interviews were used as a sample or snapshot of the budgeting process in Mississippi and may or may not be representative of every aspect of every agency's budgeting process. This kind of information is vital in evaluating the effectiveness of state law that mandates the inclusion of performance measures and targets in the budget process. Among the specific issues addressed in these interviews were:

- *The budget compilation process*
- *Requirement of performance measures and targets*
- *Examples of performance measures and targets*
- *Determining performance measures and targets*
- *Evaluating performance measures and targets*
- *Repercussions or rewards*

These interviews proved very beneficial in further understanding the degree to which performance measures and targets are a part of the state budgeting process. After speaking with representatives from these agencies, it is apparent that the role of performance measures and targets in an agency's budgeting process is peripheral at best. Although performance measures and targets are required in each agency's annual budget submission, there is not much attention given to them. The manner in which each state agency derives its budget differs from agency to agency, but performance measures and targets do not appear to play a prevalent role.

It is stated in the law that the Legislature should play a prominent role in the annual establishment of each agency's performance targets (27-103-153). The role of making recommendations to the Legislature for an agency's annual targets would likely be fulfilled by the Joint Legislative Budget Committee, acting through the Legislative Budget Office. Although the Legislature's duty in determining performance targets is clearly stated in this law, it is evident from our discussions with various state agencies that the Legislature and the Joint Legislative Budget Committee participate in only a limited manner in the annual determination of performance targets. Targets are established by the individual agency with little input from the Legislature or the Joint Legislative Budget Committee.

In addition to establishing performance targets, the Legislature also has the responsibility of providing funding to employ staff to evaluate the performance targets at the close of each fiscal year (27-103-155). Our interviews with state agencies did not yield any information that suggests funding has been provided for post-year evaluation. According to those interviewed, performance targets are not measured by any objective party to determine success or failure in meeting stated targets. Further, since targets are not evaluated or reviewed, repercussions or rewards are not currently implemented to agencies that fail to achieve or agencies that achieve or exceed expectations.

Findings and Recommendations

Findings

Once it is determined that Mississippi law mandates performance-based budgeting and it is also determined that performance-based budgeting is not fully occurring, it is important to then determine how the process can be enhanced to achieve the beneficial results envisioned in the original law. According to Mississippi Code 27-103-153, "Said performance targets shall be established annually by the Legislature and shall be based upon the funding level authorized for each agency within its appropriation bill." This indicates that the process of establishing performance targets should be jointly undertaken by the Legislature and the agency. This law also leads to the conclusion that the process of establishing and reevaluating performance targets would be undertaken each year during the budget compilation process by the Legislature, and the agency.

As stated above, it was determined during interviews with various state agencies that the Legislature does not participate in this process to the degree envisioned in this section of law. While all agencies include performance measures and targets in their budgets, the targets appear to be established independently by the agency with relatively little direct input from the Legislature on an annual basis. This lack of objectivity in the target setting process can result in targets that have the potential to be somewhat shallow in nature. Further, targets that are set by the agency alone are inherently flawed because they are established with only the agency's goals in mind and do not have the input of the Legislature, the Legislative Budget Office or DFA, who would likely have a more comprehensive perspective of overall state goals.

In addition to the performance target-setting phase of performance-based budgeting, the law also specifically addresses the evaluation phase of performance budgeting. "The Legislature shall make available funds for the employment of such persons as may be required to conduct an evaluation of the actual performance accomplishments of each agency and its programs in comparison to the targeted performance levels established within the appropriation bill for each agency and its programs. The results of such evaluations shall be prepared in such form and in such detail as may be required by the Joint Legislative Budget Committee" (27-103-155). This law explicitly states that there should be an objective evaluation phase at the end of the fiscal year. Although additional funds may not be available to employ someone specifically for performance evaluation, the role could possibly be fulfilled by the Legislative Budget Office, DFA, OSA, and each agency's internal auditor.

According to information obtained during interviews with various state agencies, there is no post-year evaluation conducted by an objective party of actual performance results compared to stated targets. The lack of objective evaluation greatly reduces the credibility of performance targets in the budget submission because there is an absence of accountability on the back end of the process.

Recommendations

During the course of the review of Mississippi's performance-based budgeting practices, as well as the review of performance-based budgeting programs across the country, it has become apparent that further action is required in order for Mississippi's performance-based budgeting system to be effective. The following recommendations are based on knowledge gained as a result of a thorough review of the philosophy of performance-based budgeting as well as successful systems in place across the country.

I. Fully Implement the Law

Although Mississippi passed legislation in 1994 that mandated performance-based budgeting, this law has never been fully implemented. In order for Mississippi to see results from the 1994 law, the statutory requirements stated in the law should be revisited and fully put into practice. Simply maintaining performance measures and targets in each agency's appropriations bill is not sufficient to achieve the results the law intended. The law currently in place maintains the potential to be extremely effective if implemented in its entirety; however, implementing only portions of the law will not yield results consistent with those originally envisioned.

II. House and Senate Appropriations Committees Develop a Special Sub-Committee and Appoint a Chairman to Oversee Performance-Based Budgeting

Legislative oversight will be a key component in the success of performance-based budgeting. One way to achieve legislative oversight is to develop a sub committee from the House and Senate Appropriations Committees as well as appoint a sub-committee chairman. This committee's primary responsibility would be to work with the Legislative Budget Office to implement and monitor the progress of the performance-based budgeting system. This committee would provide progress reports to the Appropriations Committees and assist in making funding decisions based on performance.

III. Amend Mississippi Code Section 27-103-129

This section of law mandated that performance measures be developed for each agency and included in their 1996 budget requests. These measures were developed through a cooperative effort from the Legislative Budget Office, DFA, and each agency. During the time since 1996 these measures have not been revisited on a regular and systematic basis by the Legislative Budget Office, DFA, and the agency cooperatively. Although performance measures should remain relatively static in order to ensure the platform for measurement remains constant, these measures should be reviewed in detail each year by the Legislative Budget Office, DFA, and the agency to determine if the measures remain consistent with overall agency and state goals. It is the recommendation of this report that Mississippi Code section 27-103-129 be amended to mandate an annual evaluation of performance measures by the Legislative Budget Office, DFA, and the agency cooperatively.

IV. Amend Mississippi Code Section 27-103-153

In this section of law the annual establishment of performance targets is mandated. It is stated in the law that the Legislature is responsible for annually establishing these targets. Although the Legislature should remain responsible for establishing these targets, the targets would likely be more effective if the Legislative Budget Office were involved in the process. The Legislative Budget Office maintains a more comprehensive knowledge of the process of setting effective targets as well as knowledge of the agency's performance measures and overall goals. Mississippi Code 27-103-153 should be amended to state that the Legislative Budget Office, in conjunction with the agency, should annually determine objective performance targets for each agency and that the Joint Legislative Budget Committee, acting through the Legislative Budget Office, should recommend those targets to the Legislature.

V. Provide Focused Communication of the Law

Before any performance-based budgeting system can be successfully implemented, all involved parties and organizations need to be aware of the law that mandates it. It is likely that in many agencies, the budget coordinator may be the only member of the agency that is aware that performance measures and targets are required. Although agencies were notified of the new legislation when it was passed in 1994 and program performance measurement information is included in the annual budget instructions, an increased level of communication is necessary. Given change in agency heads and turnover at the director and staff levels, the mandate and importance of performance-based budgeting should be communicated annually. All members of each agency should be aware of the need to perform or be held accountable. Following each election cycle, a newly elected Governor, Lieutenant Governor, or member of the Legislature should be made aware of the law, as well as the reasoning and intent of the law. In addition, the law should be communicated to the public so they are made aware that those that receive public funds are made accountable for those funds.

VI. Agency Internal Auditor and the Legislative Budget Office Evaluate, Analyze, and Report Performance

According to Mississippi Code 27-103-155, appropriations should be made available to hire staff to conduct the evaluation and reporting of performance measures. "The Legislature shall make available funds for the employment of such persons as may be required to conduct an evaluation of the actual performance accomplishments of each agency and its programs in comparison to the targeted performance levels established within the appropriation bill for each agency and its programs. The results of such evaluations shall be prepared in such form and in such detail as may be required by the Joint Legislative Budget Committee." While performance results are recorded in the statewide accounting system and are reported in the Legislative Budget Report published by the Joint Legislative Budget Committee, the review and analysis of performance data remains peripheral, and therefore, unlikely to achieve the results envisioned in the original law.

During the 2003 Legislative Session, House Bill 650 known as the Mississippi Internal Audit Act was passed stating that "each university, community college, and state agency shall, subject to specific appropriation of available funding, employ an agency internal audit director who shall be appointed by the university president or chancellor, the community college president, elected official or executive director or his counterpart of a state agency without a governing board or commission." Given the unlikelihood of additional funds being allocated to employ additional staff to evaluate performance, it is recommended that the agency's internal auditor perform the duty of evaluating and reporting actual performance in comparison to performance targets. The results of this evaluation should be analyzed by the agency's internal auditor in close coordination with the Legislative Budget Office and the Office of Budget and Fund Management. The internal auditor and the Legislative Budget Office should attempt to understand the factors causing the agency to fall short of targets, meet targets, or exceed targets. This type of detailed analysis of performance data will aid the Legislative Budget Office in assisting the Joint Legislative Budget Committee in their recommendation for performance targets the following year.

VII. Provide Necessary Training

Maintaining a performance-based budgeting system is a detailed process that requires knowledge and understanding as to the intent of the system. It is imperative that agencies understand how to: 1) develop objective performance measures and targets that are realistic, yet challenging to the agency, 2) create performance measures and targets that not only make the agency more efficient, but have overall state goals in mind, 3) evaluate performance measures to determine success or failure, and 4) develop reports outlining actual performance in relation to measures. In order to equip the agencies with this type of knowledge, additional training is required.

VIII. Accountability for Results

The primary factor in agencies taking a performance-based budgeting system seriously is accountability. If the theme of accountability is not at the forefront of performance-based budgeting, then it will never achieve maximum results. Agencies currently provide an accounting of their performance at the end of the first allotment period and at the end of each fiscal year. If performance is below expectations, agencies should be required to provide an explanation for not achieving their results.

IX. Take Action Based on Performance Results

Once an agency's results are evaluated, reported, and the agency has had the opportunity to offer explanations for performance, consequences or rewards should be put into place. If an agency exceeds performance measures, they should be rewarded for their performance with additional appropriations the following year, or increased flexibility with their budget. Contrarily, if an agency performs below expectation with no relevant explanation, there should be penalties imposed.

X. Implement Incentive Program

According to Mississippi Code 27-103-157, the DFA is charged with establishing and directing an innovation and incentive program. The purpose of this program is to reward agencies which "develop and implement innovative cost saving measures." This program would encourage agencies to research and develop methods to conserve state funds. The DFA should implement and communicate this program to agencies and, as soon as funds are available, incentives should be made available to agencies that meet criteria for rewards.

XI. Publish Results

During the review of other states that have implemented successful performance-based budgeting systems it is apparent that one of the keys to success is informing the public of how agencies are performing. This provides extra incentive to agencies to perform up to expectation. This also allows the public to see where their tax dollars are going. This is an important part of establishing accountability, credibility, and overall success in the performance-budgeting process.

Appendix A: A Review of Performance-Based Budgeting in Texas

Although Texas has used performance measures as an element of budgeting since 1974, it was not until 1991 when the Lieutenant Governor submitted the “Budget Reform Proposal” that Texas became serious about performance budgeting. The performance-based budgeting system currently in place in Texas is called the “Strategic Planning and Performance Budgeting System” (SPPB). This system is described as a “mission and goal-driven, results-oriented system that combines strategic planning and performance budgeting in Texas into the State’s appropriations process”. The primary purpose of the system is to allow state funding decisions to be made based on whether state agencies are accomplishing expected results.

As the first step in developing the performance-based budgeting system, the Legislative Budget Board (LBB) developed specific objectives that the SPPB should be designed to achieve.

1. **Focus the appropriations process on outcomes:** The appropriations process should emphasize what state agencies and institutions accomplish instead of just what they do.

2. **Strengthen monitoring of budgets and performance:** The Governor and Legislature should receive periodic reports and assessments of agency performance.

3. **Establish standardized unit-cost measures:** Most agency strategies have at least one unit-cost measure, and these should be clearly identified.

4. **Simplify the budget process:** The number of performance measures should be reduced to include only measures that are relevant and measurable.

5. **Provide rewards and penalties for success and failure:** Performance rewards should be established for state agencies that meet specified performance criteria. Additionally, House and Senate appropriations committees request that agencies with performance difficulties testify about causes and recommended solutions.

6. **Have the State Auditor’s Office (SAO) certify the accuracy of performance measurement data:** The SAO should provide an independent assurance of measurement data accuracy. The LBB should respond to the SAO’s audit by requiring plans for corrective action when necessary.

In addition to establishing objectives of the system, a second critical component of Texas’s SPPB system is performance measures. Characteristics of performance measures included in the SPPB system are:

- Performance measures are a part of each agency's strategic plan; they indicate how progress toward agency goals and objectives will be measured.

- Performance measures are used by decision-makers in allocating resources and determining appropriation levels.

- Performance measures are intended to help focus agency efforts on achieving priority goals and objectives.

- Performance measures are monitoring tools to help guide government and make it accountable to the taxpayer.

The Texas SPPB system is made up of three interrelated phases. Included in these phases are strategic planning, budget development, and performance monitoring. These phases serve as a step by step guide for the ongoing SPPB process.

Phase I: Strategic Planning

The primary purpose of this phase is to establish a forum for the agencies to submit long term plans. Each agency is required to develop five-year strategic plans that include goals, objectives, and performance measures. These plans are then submitted to the LBB and the Governor's Office of Budget and Planning (GOBP) for approval. In addition, if agencies wish to make adjustments or changes to their strategic plans or performance measures, these changes have to be approved by the LBB and GOPB. The LBB and GOPB review requested changes and either accepts them or proposes alternatives and negotiates with agencies regarding the changes.

Phase II: Performance Budget Development

During this phase, the LBB and GOPB jointly develop instructions for agencies on preparing their appropriation requests. Once instructions are issued, agencies begin the process of developing their appropriation requests. Each agency's appropriation request includes "requested dollars and descriptions of the goals, objectives, and strategies to be addressed by this funding". Also required in the agency's budget submission is performance information for all performance measures in their requests. The LBB then submits a draft appropriations bill identifying key performance measures with corresponding performance targets.

Phase III: Performance Monitoring

This phase is designed primarily to track and evaluate progress during the fiscal year. Each agency is responsible for submitting quarterly reports to the LBB and GOPB outlining their actual performance as well as explanation of variance. The LBB and GOPB monitor agency expenditures and performance data in relation to appropriation levels and report results to the Legislature. To ensure data integrity in the performance reporting process, the SAO audits performance measures to determine the accuracy of reported information. In addition to verifying the accuracy of reported data, the audit is intended to determine how agencies use performance information to achieve expected results. The results of the audit are submitted to the Legislature and Legislative committees initiate hearings to inquire about variations of performance or expenditures.

Appendix B: A Review of Performance-Based Budgeting in Florida

In 1994, the Florida Legislature passed the Government Performance and Accountability Act which initiated performance-based program budgeting (PB²) in Florida. When the act was passed it was determined that PB² would be phased in over a seven-year period, with a designated number of agencies participating each year. Agencies are required to provide specific information regarding their agency's goals, missions, and performance measures. "Each agency must provide the Executive Office of the Governor with a list of programs, performance measures for each program, baseline data showing its past and current performance, and proposed standards for performance on each measure for the coming year." These standards are evaluated by the Governor and the Legislature and approval, modification, or rejection decisions are made. Once these decisions are made, the performance data is included in the appropriations bill. During the following year's appropriations process, the Legislature "examines actual performance of programs in comparison to their standards and may provide incentives or disincentives based on performance".

As with many other states as well as the Federal Government, Florida identified specific goals for which PB² should aspire to achieve. The following are documented goals Florida intends the PB² system to accomplish:

1. Agencies should develop performance measures that demonstrate benefits of their services.

2. Agencies should be accountable for meeting specified performance measures.

3. Legislature should consider agency performance during budget process.

4. Legislature should reward and sanction agencies based on their performance.

After goals of the system were clearly defined, Florida determined the steps to be included in the PB² system. As with most performance-based budgeting systems, Florida has its own philosophy with regard to the specific structure and steps involved in implementing the system. Florida's PB² system consists of six interrelated steps.

Step I: Identify Programs and Goals

- Who are the agencies customers?

- What does the agency do?

- What purposes does it serve?

- What would happen if government did not perform this agency's functions?

Step II: Identify Performance Measures

- Meet with stakeholders and staff to go through program logic and develop measures.

- Include an external facilitator to ensure balance.

- Limit the number of measures for each agency to ensure measures are well-defined and measurable.

- Keep additional “smaller” measures for internal management purposes.

Step III: Develop Performance Standards

- Standards should be ambitious but attainable.

- Standards may be based on past experience or the performance of other, similar entities.

Step IV: Assessing the Validity and Reliability of Performance Data

- Validity
    - Completeness
    - Balance

- Reliability
    - Accuracy

Step V: Use Performance Data to Improve Government

- Highlight areas in which performance falls below expectations for management review.

- Use performance to give employees recognition.

- Compare performance in different geographical areas.

- Find out factors responsible for differences in cost or performance.

- Discontinue processes that do not contribute to results.

Step VI: Link Performance to Policy and Budgeting Decisions and Requests

- What does each key activity cost?

- How specifically would increases or decreases in your budget affect your performance?

- Would it be cost-effective to privatize this service?

Appendix C: A Review of Performance-Based Budgeting in Virginia

The performance-based budgeting system currently in place in Virginia was adopted in 1995. The intent of the adoption of this system was to "integrate planning and performance concepts with budget development". Virginia made it top priority to design a system that would enable them to set priorities and allocate limited resources based on those priorities. "Performance budgeting" in Virginia is specifically defined as a blend of strategic planning, performance measurement, and budgeting techniques. As with most states that implement performance-based budgeting, Virginia developed clearly defined steps that make up their system. Below are the four steps included in Virginia's performance-based budgeting system:

Step I: Strategic Planning

Strategic planning in Virginia is intended to help agencies "understand its present situation, examine how current and future trends may affect it, and decide how to best manage anticipated challenges". Strategic planning forces agencies to annually revisit their goals, purpose, and mission statement. This type of planning creates a common understanding about the purpose and direction of the agency. Strategic planning also creates an atmosphere of forward thinking. Forward thinking allows agencies to respond more rapidly to ever-changing related circumstances. Virginia's strategic planning process can be illustrated by the following four questions:

- **Where are we now:** This question prompts agencies to conduct a detailed assessment of their current situation. Recent accomplishments, organizational mandates, initiatives and goals, and customer needs are all considered during this phase.

- **Where do we want to go:** Critical issues are examined and agencies determine more efficient ways in which the issues could be addressed.

- **How will we get there:** Among other things, an action plan is developed during this stage. This action plan is used as a roadmap to implement the details of the strategic plan.

- **How do we measure our progress:** In order to determine success or failure, a well-planned accountability system must be in place.

Step II: Performance Measurement

Performance measurement in Virginia is defined as "the systematic collection and reporting of information that track resources used, work produced, and intended results achieved". Performance measurement adds a distinct measure of accountability to the budgeting process. Although Virginia has always maintained a comprehensive set of financial rules and regulations to govern public agencies, they recently came to the conclusion that financial measures are no longer sufficient to accurately judge performance. "To fully gauge performance, measures about the products or services, which public money supports, must complement existing financial indicators."

Although many other states passed legislation that inserted performance measures into their budgeting process immediately, Virginia decided to insert performance measures on a more gradual basis. In 1991 the Department of Planning and Budget (DPB) issued a report recommending a pilot program be implemented to test performance measures. This program was implemented and state law was passed in 1994 that required performance measures to be included in the budget process. Beginning in 1996, agencies were required to develop and submit three to five performance measures with their budget proposals. Measures collected in 1996 were then included in the 1997 budget document.

With the foreknowledge that performance measurement systems would differ from agency to agency depending on the nature of service, Virginia determined a list of characteristics that would be common in any agency's performance measurement system. Characteristics of effective performance measures in Virginia are as follows:

- Is built into the strategic planning process
- Focuses on outcomes or results, not processes
- Uses a few balanced, key indicators to measure performance
- Generates data consistently over time
- Includes both internal and external comparisons
- Reports regularly and publicly
- Informs both policy and program decisions
- Promotes swift feedback to managers and front-line employees who can use the information to improve operations

These established characteristics of effective performance measures steer agencies to develop performance measures that are in line with the overall goals and objectives of the state as a whole. Performance measurement is a vital part of Virginia's performance-based budgeting program and allows accurate and credible performance evaluation.

Step III: Performance Evaluation

The third step in Virginia's performance-based budgeting system is performance evaluation. The purpose of this phase is to analyze the performance of each agency with regard to their previously determined performance measures. Virginia specifically defines performance evaluation as "systematic collection, analysis, and reporting of information to determine an agency or program's performance and reasons for achieving that level of performance." In order to provide uniformity for each agency or program's evaluation, Virginia has outlined typical steps of the evaluation process.

1. **Project Definition:** This phase of the evaluation process is concerned with determining which programs will be evaluated and the strategy to be used to evaluate them. A resource assessment is also conducted to determine the number of staff members required to complete the evaluation.

2. **Project Scoping and Planning:** During this phase of the evaluation, the parameters of the evaluation are determined. The type of analysis that will be performed and background information is gathered. Step by step plans are made as to how the evaluation will be conducted and initial contact is made with the representatives of the agency or program being evaluated.

3. **Conducting the Study:** This phase consists of collecting and analyzing data relevant to the evaluation. The study is conducted in coordination with the previously determined scope.

4. **Completing the Study:** The final stage of the evaluation process is simply summarizing the data in a written report format. This report is a manageable length so its content can be easily absorbed.

Step IV: Performance Budgeting

Performance budgeting is the "systematic incorporation of performance information (planning, performance measurement, and program evaluation) into the budget decision making process". The two primary uses of performance budgeting in Virginia are as an advocate for policy and programs and to allocate resources to maximize efficiency and effectiveness. However, in order for these results to be realized the following steps are required to develop a successful performance budgeting phase.

1. **Get Organized:** This is the process of identifying resources available for performance budgeting as well as identifying eligible participants.

2. **Determine Key Policy and Program Priorities:** This phase is primarily concerned with clarifying and documenting policy and priorities. Additionally, performance information is collected to support stated policies and priorities.

3. **Quantify the Performance Gap:** Information is collected and analyzed in order to identify the difference between the actual and desired level of performance.

4. **Determine Resource Needs:** Once the performance gap is recognized, the resources required to achieve desired results are identified and gathered.

5. **Identify the Performance Gaps to Close:** This phase is concerned with determining which gaps to close based on policy and priorities.

6. **Adequately Fund Priorities –** Providing agencies or programs with funding necessary to close performance gaps.

7. **Track Priorities:** Performance measures are clearly documented to track the progress in closing the performance gaps.

Appendix D: A Review of Performance-Based Budgeting in Louisiana

Ten years ago, Louisiana began to transition its budget approach from a line item (salaries, operating expenses, etc.) appropriation process to a program-driven process. This initial transition served as a pre-cursor to Act 1465 of 1997 which established a system of performance-based budgeting in Louisiana. This act was passed in part because both citizens and legislators alike "perceived that state government was inefficient and unresponsive". There was also a lack of confidence among legislators that spending priorities established during the adoption of the state budget were being implemented by the agencies during the year. The implementation of performance-based budgeting has inserted a level of accountability in the budgeting process that was previously lacking. Louisiana decided to implement their performance-based budgeting system over a three year period. The following outlines details of action items for each year:

- **Year 1**: Included program descriptions in the Appropriation Bill

- **Year 2**: Key performance indicators included in the Appropriations Bill with semi-annual reporting; Enacted performance-based budgeting legislation; Refinement and revision of performance data through development of agency strategic plans

- **Year 3**: Key objectives included in the Appropriation Bill with full quarterly reporting requirements in place

- **Year 4**: Provisions for rewards and penalties became effective July 1, 1999

As with most states that have a performance-based budgeting system in place, Louisiana developed specific steps to be included in their system. The three steps included in Louisiana's process are defining outcomes, measuring and reporting performance, and evaluating performance and using results.

Step I: Defining Outcomes

Louisiana surmised that in order to measure performance, there needs to be something in which to measure performance against. In order to measure progress toward a given outcome, it is imperative that the expected outcome is clearly defined. The specific manner in which Louisiana defines outcomes is via outcome statements and operation plans.

- *Outcome Statements* – Outcome statements, which consist of goals and objectives, are outlined during policy planning, strategic planning, and operational planning processes. Goals are defined as the "general end purposes (or results) toward which effort is directed." Objectives are "specific and measurable targets for accomplishment." Goals set the direction in which an organization is moving in order to reach a particular destination while objectives identify milestones along the way toward accomplishing goals. Goals and objectives are established with the organization's vision, mission, and philosophy in mind as well as the organization's current and projected internal and external status.

- *Operations Plans* – Operation plans are directly linked to and guided by strategic plans. Operation plans "not only set annual objectives but propose performance standards for the performance indicators related to those objectives." Louisiana defines performance standards as "the expected level of performance (value) associated with a particular performance indicator for a particular fiscal year and funding level."

Step II: *Measuring and Reporting Performance*

Once outcomes are defined, the next step in Louisiana's performance-based budgeting system is measuring and reporting results. This step is based on the premise that "in order to succeed, you have to know how well you are doing". Performance measurement is concerned with comparing actual results with expected results. This allows managers and legislators to evaluate progress toward stated goals. The Louisiana Government Performance and Accountability Act mandated that agencies report quarterly on their performance in relation to their stated goals. This type of reporting creates a level of accountability that is not otherwise present.

In developing a manner in which to measure and report performance, Louisiana has identified three stages necessary to effectively measure and report performance.

1. **Identify and select performance indicators:** Performance indicators are defined as "the tools used to measure the performance, progress, and accomplishments of policies, plans, and programs". Examples of performance indicators include: input, output, outcome, efficiency, and quality.

2. **Organize to gather appropriate information:** This stage consists of a thorough evaluation of data collected, the systems used to collect the data, and the sufficiency of the data. Depending on the results of this evaluation, changes in the way data are collected or new database development may be implanted.

3. **Monitoring and tracking performance:** This stage is simply monitoring and tracking performance so that managers will know what to continue doing if results are in line with plan, or what should be changed in order to achieve better results. This stage is the primary vehicle in inserting accountability into the process.

Step III: Evaluating Performance and Using Results

This phase is concerned with "assessing performance and using the results of that evaluation to improve management and budget decision making, justify continuation of services, and provide performance-based rewards and penalties". Specific performance evaluation methods included in this phase are:

- **Performance Progress Report Review:** This review is conducted by the Legislative Auditor and is to ensure that data included in each agency's progress report is accurate.

- **Annual Agency In-house Performance Review and Evaluation:** An annual audit conducted by each agency at the end of the fiscal year to evaluate performance.

- **Program Evaluation:** The systematic examination of a specific program or activity to provide information on the full range of its short-term effects.

- **Performance Audit:** An evaluation of the efficiency and effectiveness with which an organization is carrying out its mission and achieving its goals and objectives.

- **Sunset Review:** Allows the legislature an opportunity and mechanism to evaluate the operations of state statutory entities to determine whether the merits of an entity's activities support its continuation.

Once evaluations are completed, the legislature may use the results to authorize rewards or impose penalties. For example, if an agency's year-end review yields findings that the agency exceeded its performance standards by five percent or more, the legislature may authorize a reward for that agency through the adoption of a committee resolution. Alternatively, if the year-end review determines that an agency has failed to achieve its performance standards by more than five percent, the legislature may impose a penalty on the agency through adoption of a committee resolution.