

STATE OF NORTH CAROLINA

PERFORMANCE AUDIT

PROGRAM BUDGETING

OFFICE OF STATE BUDGET AND MANAGEMENT

JUNE 2011

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

PERFORMANCE AUDIT

PROGRAM BUDGETING

OFFICE OF STATE BUDGET AND MANAGEMENT

JUNE 2011



Beth A. Wood, CPA
State Auditor

STATE OF NORTH CAROLINA
Office of the State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet
<http://www.ncauditor.net>

June 23, 2011

The Honorable Beverly E. Perdue, Governor
Members of the North Carolina General Assembly
Mr. Andy Willis, State Budget Director, Office of State Budget and Management

Ladies and Gentlemen:

We are pleased to submit this performance audit titled *Program Budgeting, Office of State Budget and Management*. The audit objectives were to determine if (1) policies and procedures are in place to ensure that state agency performance information will be relevant and reliable, (2) state agencies have met initial Program Budgeting requirements, and (3) the Program Budgeting process is structured to achieve its objectives. Mr. Willis reviewed a draft copy of this report. His written comments are included in the appendix.

The Office of the State Auditor initiated this audit to improve the effectiveness of the State's system to measure performance of state government operations.

We wish to express our appreciation to the staff of the Office of State Budget and Management for the courtesy, cooperation, and assistance provided us during the audit.

Respectfully submitted,

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor

TABLE OF CONTENTS

	PAGE
SUMMARY	2
INTRODUCTION	
BACKGROUND.....	4
OBJECTIVES, SCOPE, AND METHODOLOGY	4
FINDINGS AND RECOMMENDATIONS.....	7
APPENDIX	
AUDITOR’S RESPONSE	15
DEPARTMENT RESPONSE	19
ORDERING INFORMATION	30

SUMMARY

Purpose

This audit report evaluates whether (1) policies and procedures are in place to ensure that state agency performance information will be relevant and reliable, (2) state agencies have met initial Program Budgeting¹ requirements, and (3) the Program Budgeting process is structured to achieve its objectives.

This audit makes recommendations so the Governor, Legislature, and Office of State Budget and Management (OSBM) can take appropriate corrective action.

Results

To link budgets to agency results and accomplishments, OSBM required state agencies to begin submitting performance measures during the 2007-09 biennial budget process. However, OSBM has not performed reviews to ensure that state agency performance measurement information is relevant and reliable. Specifically, OSBM has not performed reviews to ensure that (1) agency performance measures are linked to agency goals; (2) agency performance data is accurate, complete, and consistent; and (3) agencies have policies and procedures in place to ensure that performance data is accurate, complete, and consistent. Furthermore, three out of four Office of State Auditor (OSA) audits on “key agency indicators”² determined that the agency performance measures were not clearly linked to agency goals and were not collected, calculated, and reported under a system that ensured accurate, complete, and consistent performance measures. As a result, the Governor, Legislature, and public may not be able to rely on agency performance measures to evaluate agency performance and identify programs that need to be cut or enhanced.

As part of the Program Budgeting process, OSBM directed each state agency to develop an inventory of programs³ and required each cabinet agency⁴ to submit a strategic plan to explain how an agency’s mission and goals will be achieved. The program inventories and strategic plans are to be used in the budget process to analyze agency needs and make funding decisions. However, the information may not be reliable for analysis and decision-making because the list of programs is inaccurate and some cabinet agency strategic plans do not

¹ The OSBM website states, “OSBM emphasizes measurable results as an integral part of budgeting in order to encourage more efficient and effective management of state resources. Through program budgeting OSBM is creating a budget process that does the following: increases transparency, ensures accountability, promotes proactive management, and focuses on performance. Government leaders, elected officials, and citizens can more easily understand an agency’s goals and strategies, measure program results, evaluate past resource decisions, and make well-informed resource decisions for the future.”

² Key agency indicators are performance measures that identify and measure the key results necessary for an agency to achieve its goals. OSBM states that key agency indicators should “provide stakeholders, both internal and external to the agency, a clear message of what is important and how the agency is progressing toward achievement in the identified areas.”

³ A June 18, 2009, memo on “Program Inventory” from OSBM stated, “A program is a set of related services within an agency designed to achieve a measurable outcome for a designated group in support of the agency mission and goals.”

⁴ Cabinet agencies include the Departments of Administration, Commerce, Correction, Crime Control and Public Safety, Cultural Resources, Environment and Natural Resources, Health and Human Services, Juvenile Justice and Delinquency Prevention, Revenue, Transportation as well as the Office of Information Technology Services, Office of State Personnel, Employment Security Commission, and State Board of Education

PERFORMANCE AUDIT

include all of the required information. The lack of an accurate list of programs and properly completed strategic plans may prevent the Governor, Legislature, and OSBM from using the information to determine which programs are achieving their goals and objectives and which programs should be cut.

The current structure of the Program Budgeting process may not be sufficient to achieve the objectives of increasing transparency and ensuring accountability because the current structure (1) does not include the costs to perform the activity or provide the services, (2) does not require all state agencies to submit a strategic plan to explain how an agency's mission and goals will be achieved, and (3) does not include a state-level strategic plan to explain how the State's goals will be accomplished. The lack of service and activity cost data limits transparency and may prevent the Governor, Legislature, and public from obtaining the cost data needed to evaluate the efficiency of state government services and activities and assess the impact of proposed funding changes on those services and activities. Also, the lack of a state agency and state-level strategic plans limits accountability and may prevent the Governor, Legislature, and public from determining whether a state agency is sufficiently contributing to the accomplishment of statewide goals and objectives.

Recommendations

OSBM should conduct reviews to ensure (1) agency performance measures are linked to agency goals; (2) agency performance data is accurate, complete, and consistent; and (3) agencies have policies and procedures in place to ensure performance data is accurate, complete, and consistent.

OSBM should work with state agencies to ensure the list of programs is accurate and cabinet agency strategic plans include all required information.

The Legislature should consider directing the Office of the State Controller to work with OSBM to identify a method to include activity and service costs information in the North Carolina Accounting System (NCAS).

The Legislature should consider enacting legislation that requires all state agencies to create and submit a strategic plan to OSBM as part of the state budget process.

OSBM should work with the Governor's Office to develop a state-level strategic plan for North Carolina.

Agency's Response

The Agency's response is included in the appendix.

INTRODUCTION

BACKGROUND

The State Budget Act requires the Governor's biennial budget recommendations to include performance information for each state government program and for each proposed capital improvement.⁵ In response, the North Carolina Office of State Budget and Management (OSBM) introduced results-based budgeting as part of the development of the state budget for fiscal years 2007-2009.

The Governor's Executive Order No. 3, issued in January 2009, enhanced this effort by requiring the creation of a comprehensive performance and budgeting system. This system was required to determine the cost and benefits of state programs and to hold agencies accountable for results. To comply with this order, OSBM is expanding the existing results-based budgeting effort to fully integrate budget and performance in a process called "Program Budgeting."

An effective performance and budgeting system can provide useful information for assessing whether the State is using its resources efficiently and effectively. The Governor, legislators, and the public can use performance information to help determine whether a state agency is improving its efficiency over time, compare the effectiveness of similar services among agencies, and make decisions regarding the most cost-effective use of available resources to accomplish statewide goals and objectives.

OBJECTIVES, SCOPE, AND METHODOLOGY

The audit objectives were to determine if (1) policies and procedures are in place to ensure that state agency performance information will be relevant and reliable, (2) state agencies have met initial Program Budgeting requirements, and (3) the Program Budgeting process is structured to achieve its objectives.

The Office of the State Auditor initiated this audit to improve the effectiveness of the state's system to measure performance of state government operations.

The audit scope included a review of requirements outlined in the Governor's Executive Order No. 3, strategic plans, and program inventories submitted to the Office of State Budget and Management (OSBM) by cabinet agencies. We conducted the fieldwork from February 2011 to March 2011.

To achieve the audit objectives we reviewed states laws and interviewed North Carolina Office of the State Budget and Management personnel. We obtained an understanding of the information system to process financial transactions, as well as the performance management and budgeting system currently under development. We also reviewed other government performance management and budget systems.

⁵ As specified in [North Carolina General Statute G.S. 143C-3-5](#).

PERFORMANCE AUDIT

Because of the test nature and other inherent limitations of an audit, together with limitations of any system of internal and management controls, this audit would not necessarily disclose all performance weaknesses or lack of compliance.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We conducted this audit under the authority vested in the State Auditor of North Carolina by *North Carolina General Statute 147.64*.

FINDINGS AND RECOMMENDATIONS

1. NO ASSURANCE PERFORMANCE DATA IS RELEVANT AND RELIABLE

To link budgets to agency results and accomplishments, the Office of State Budget and Management (OSBM) required state agencies to begin submitting performance measures during the 2007-09 biennial budget process. However, OSBM has not performed reviews to ensure that state agency performance measurement information is relevant and reliable. Specifically, OSBM has not performed reviews to ensure that (1) agency performance measures are linked to agency goals; (2) agency performance data is accurate, complete, and consistent; and (3) agencies have policies and procedures in place to ensure that performance data is accurate, complete, and consistent.

No Reviews to Ensure Agency Performance Measures are Linked to Agency Goals

OSBM has not performed reviews to ensure that state agency performance measures are linked to agency goals and provide a method for measuring agency goal achievement. Additionally, three out of four Office of State Auditor (OSA) audits on “key agency indicators”⁶ determined that the agency performance measures were not clearly linked to agency goals.

Performance measures that are clearly linked to agency goals can provide important information for evaluating agency performance, determining whether an agency is achieving its goals, and justifying state appropriations for an agency’s budget. OSBM “Planning Guidelines for North Carolina State Government” states:

“Performance measurement is a key element in achieving the actions that are outlined in an agency’s planning process. Identifying performance measures and establishing targets further refines the answer to the question, ‘Where do we want to be?’ Performance measures also provide the basis for continuous monitoring and evaluation of progress towards the agency’s goals and objectives.”

Due to the lack of reviews, the Governor, Legislature, and the public cannot be assured that state agency performance measures are clearly linked to agency goals. As a result, the Governor, Legislature, and public may not be able to rely on agency performance measures to evaluate agency performance and indentify programs that need to be cut or enhanced.

No Reviews to Ensure Performance Data Is Accurate, Complete, and Consistent

OSBM has not performed reviews to ensure that reported state agency performance data is accurate, complete, and consistent. Additionally, four out of four OSA audits on key agency indicators determined that agency performance data was incomplete because agencies did not report key agency indicators to OSBM for state fiscal years 2008-09 and

⁶ Key agency indicators are performance measures that identify and measure the key results necessary for an agency to achieve its goals. OSBM states that key agency indicators should “provide stakeholders, both internal and external to the agency, a clear message of what is important and how the agency is progressing toward achievement in the identified areas.”

FINDINGS AND RECOMMENDATIONS

2009-10. It was also noted that OSBM did not require state agencies to update key agency indicators for those years.

Performance data that is accurate, complete, and consistently calculated and presented from period-to-period can provide important information about whether an agency is operating efficiently and effectively. In fact, 2009-11 OSBM budget instructions state that good performance measures are consistent and verifiable (data is accurate, on file, and auditable).

Due to the lack of reviews, however, the Governor, Legislature, and the public cannot be assured that state agency performance data is accurate, complete, and consistent. As a result, the Governor, Legislature, agency management, and the public may not be able to rely on agency performance measures to evaluate agency performance.

No Reviews to Ensure Agency Policies and Procedures Are In Place

OSBM has not performed reviews to ensure state agencies have policies and procedures, or controls, in place to provide reasonable assurance that (1) source data for the performance measures is collected in a consistent manner, (2) errors are not introduced when performance data is processed, and (3) performance measures are reviewed for accuracy and consistency before they are reported. Additionally, three out of four Office of State Auditor (OSA) audits on key agency indicators determined that the agencies do not have adequate controls in place.

To prepare for the 2011-13 budget process, OSBM issued instructions in 2010 that required state agencies to “provide more descriptive information about measures, such as the purpose of the measure, desired trend, calculation methodology and source, and data limitations.” Documenting the source of performance data and the calculation methodology are controls that can help ensure performance information is accurate and consistent.

However, OSBM has not performed reviews to determine whether agencies followed the data collection and performance measurement procedures they submitted to OSBM. The Government Accountability Office (GAO) recommends that audits are performed to determine if controls are in place to provide reasonable assurance that “management information, such as performance measures, and public reports are complete, accurate, and consistent to support performance and decision making.”⁷

Due to the lack of reviews, OSBM cannot be assured that agency performance information was collected, calculated, and reported under a system that ensured accurate, complete, and consistent performance measures. As a result, the Governor, Legislature, and public may not be able to rely on agency performance measures to evaluate agency performance and identify programs that need to be cut or enhanced.

⁷ GAO, Government Auditing Standards, 2007

FINDINGS AND RECOMMENDATIONS

Recommendation: OSBM should conduct reviews to ensure (1) agency performance measures are linked to agency goals; (2) agency performance data is accurate, complete, and consistent; and (3) agencies have policies and procedures in place to ensure performance data is accurate, complete, and consistent.

2. STATE AGENCIES HAVE NOT MET TWO IMPORTANT REQUIREMENTS

As part of its effort to “more fully integrate budget and performance,” the Office of State Budget and Management (OSBM) directed each state agency to develop a list (or inventory) of programs and each cabinet agency⁸ to produce a strategic plan. The program inventories and strategic plans are to be used in the budget process to analyze agency needs and make funding decisions. However, the information may not be reliable for analysis and decision-making because the program inventories are inaccurate and some cabinet agency strategic plans do not include all of the required information.

Program Inventory Is Not Accurate

State agencies have not submitted an accurate inventory of programs to OSBM. During interviews, OSBM personnel stated that the program inventories were not valid. Additionally, 495 out of 1,646 programs (30%) submitted to OSBM by state agencies did not identify expenditures associated with employee salaries or contracted services. The lack of employee salary and contracted services expenditures indicates that the listed “programs” may not have people who are performing services and activities as required to meet the definition of a valid program.⁹

According to OSBM 2011-13 budget instructions, a comprehensive program inventory is necessary to “more fully integrate budget and performance” and to “more closely align those programs with the traditional budget/fund/cost center structure.” OSBM budget instructions state:

“Funds and cost centers will be mapped to the agreed upon programs and subprograms to establish a program structure ‘view’ of the budget. The program structure will be used in the future for analyzing budget requests based on program need and impact, tracking planning and performance information, and conducting reviews of programs.”

As a result, the Governor, Legislature, and public may not be able to rely on agency performance measures to evaluate agency performance and identify programs that need to be cut or enhanced. Additionally, state agencies will be required to develop performance measures and targets for their programs. However, performance measures

⁸ Cabinet agencies include the Departments of Administration, Commerce, Correction, Crime Control and Public Safety, Cultural Resources, Environment and Natural Resources, Health and Human Services, Juvenile Justice and Delinquency Prevention, Revenue, Transportation as well as the Office of Information Technology Services, Office of State Personnel, Employment Security Commission, and State Board of Education

⁹ A June 18, 2009, memo on “Program Inventory” from OSBM stated, “A program is a set of related services within an agency designed to achieve a measurable outcome for a designated group in support of the agency mission and goals.”

FINDINGS AND RECOMMENDATIONS

and targets for invalid programs will not provide useful information for operational or policy decision-makers and the public.

Strategic Plans Do Not Include All Required Information

Cabinet state agencies have not submitted strategic plans to the Office of State Budget and Management (OSBM) that meet the requirements outlined in the OSBM “Planning Guidelines for North Carolina State Government.” Out of 14 strategic plans that OSBM received from cabinet state agencies:

- Five (36%) did not include performance targets for each identified strategic goal;
- Five (36%) did not include performance timeframes for each identified strategic goal.
- Four (29%) did not clearly reflect the associated Governor’s priority for each strategic goal; and
- Two (14%) did not include baseline data for core management functions such as human resources; information technology; and budget and financial management.

According to OSBM guidelines, agency strategic plans are important because the “information developed through the strategic planning process will be the source for agency level performance management information presented in the Governor’s Recommended Budget.” Furthermore, the OSBM guidelines state:

“In preparation for development of the 2011-13 biennial budget, state agencies will work with the Office of State Budget and Management (OSBM) to develop a strategic plan in order to evaluate agency-specific operations, identify areas where progress is most essential, and create and execute a plan for the future.”

The lack of properly completed strategic plans may prevent OSBM from obtaining the information necessary to evaluate agency operations and “transition toward a budget process that focuses on results.” Additionally, the Governor, Legislature, and public may not be able to rely on agency performance measures to evaluate agency performance and identify programs that need to be cut or enhanced.

Recommendations: OSBM should work with state agencies to ensure that the list of programs is accurate and cabinet agency strategic plans include all required information.

FINDINGS AND RECOMMENDATIONS

3. CURRENT STRUCTURE NOT SUFFICIENT TO ACHIEVE OBJECTIVES

The current structure of the Program Budgeting process may not be sufficient to achieve the objectives of increasing transparency and ensuring accountability because the current structure (1) does not include activity or service cost data, (2) does not require all state agencies to submit a strategic plan, and (3) does not include a state-level strategic plan.

No Activity or Service Cost Data

The objective of increased transparency may not be achieved under the current Program Budgeting process because it does not include cost data necessary to inform the public and decision-makers about the unit cost of state government activities and services.

A program is a “set of related services within an agency designed to achieve a measurable outcome for a designated group in support of the agency mission and goals.”¹⁰ Services may be “thought of as an agency’s lines of business, business processes, set of activities, or generic work processes.”¹¹

Complete transparency requires that the public and decision-makers are able to easily determine how much a government service or activity costs and what is achieved with the money. Furthermore, the Government Finance Officer Association (GFOA) recommends that “governments calculate the full cost of the different services they provide.”¹² The GFOA also notes, “Cost data can be extremely useful in identifying situations where a government should explore alternative delivery options.”

Activity and service unit cost data is not available because of the way that the North Carolina Accounting System (NCAS) is currently used to account for and manage financial transactions. NCAS uses a 12 digit account structure to account for state government financial transactions. The first four digits are used to identify the budget fund and the remaining eight digits are used by state agencies at their discretion. Agencies often use the last eight digits to allocate expenses by organizational unit instead of by service or activity. Office of State Budget and Management (OSBM) personnel assert that service and activity costs cannot be captured by only using the first four digits of the account (budget fund code). Consequently, OSBM does not require agencies to identify NCAS expenditure information for activities and services.

The lack of service and activity cost data limits transparency. The Governor, Legislature, and public may not have the cost data needed to evaluate the efficiency of state government services and activities. Additionally, the Governor, Legislature, and public may not have the information needed to assess the impact of proposed funding changes on services and activities.

¹⁰ June 18, 2009 OSBM memo on “Program Inventory”

¹¹ OSBM, Results Based Budgeting: Preparing for the 2009-11 Biennium

¹² GFOA, Measuring the Cost of Government Services, 2002

FINDINGS AND RECOMMENDATIONS

No Statewide Requirement for Agency Strategic Plans

The objective of increased accountability may not be achieved under the current Program Budgeting process because it does not require all state agencies to prepare a strategic plan that outlines what the agency is going to achieve and how it is going to achieve it. Although all state agencies are required to complete some elements of strategic planning, only cabinet agencies are currently required to create and submit a strategic plan to OSBM.

Accountability requires that the public and decision-makers are able to determine what a government agency plans to achieve and then determine whether the agency accomplished its plans. The Office of State Personnel states, “Strategic planning creates an accountability framework that makes clear to the citizens what the agency is doing. Later, the agency comes back to report on what it has accomplished.”¹³ Furthermore, the GFOA recommends that “all governmental entities use some form of strategic planning to provide a long-term perspective for service delivery and budgeting, thus establishing logical links between authorized spending and broad organizational goals.”¹⁴

Not every state agency prepares a strategic plan because there is no law that compels agencies to create a plan. OSBM requires cabinet agencies to create and submit a strategic plan because the Governor’s Executive Order No. 3 requires a plan. However, Executive Order No. 3 is not binding on non cabinet agencies. Consequently, OSBM does not require all state agencies to prepare and submit a strategic plan.

The lack of strategic plans limits accountability because the Governor, Legislature, and public may not have the information necessary to effectively evaluate operational results for the entire state. Although cabinet agencies are required to have a strategic plan, non cabinet state entities such as the Department of Public Instruction, University System, and Community College System are not required to submit strategic plans. By only requiring plans from cabinet agencies, state agencies associated with about two-thirds of the State’s operating expenses may not be held adequately accountable for results.

No State-Level Strategic Plan

The objective of increased accountability may also fail to be achieved under the current Program Budgeting process because there is no state-level strategic plan that identifies goals and objectives for each major state function. A state-level strategic plan would identify state priorities and allow each state agency to align its programs to help accomplish statewide goals and objectives.

Although no state-level strategic plan currently exists, OSBM indicates on its website that it will develop one. The website lists one of the responsibilities of the OSBM Strategic Management Section as:

¹³ OSP website, <http://www.performancesolutions.nc.gov/strategicPlanning/index.aspx>

¹⁴ GFOA, Recommended Budget Practice on the Establishment of Strategic Plans, 2005

FINDINGS AND RECOMMENDATIONS

“Statewide Strategic Plan - Work with the Governor’s office to communicate statewide goals and priorities that agency plans should support. Develop a plan to implement the Governor’s Agenda with a process to monitor its progress.”

However, the current lack of a state-level strategic plan may limit accountability because the Governor, Legislature, and public may not have the information necessary to determine whether a state agency is contributing to the accomplishment of statewide goals and objectives. Strategic goals and objectives identify the desired long-term outcomes that often require contributions from programs and services administered by several agencies. Documentation of statewide goals and objectives in a state-level strategic plan will help ensure that the public and Legislature can evaluate the contribution of each state agency in accomplishing statewide goals and objectives. In addition, documentation of a state-level strategic plan would enable the Governor and Legislature to determine proper funding levels for each statewide goal and objective.

Recommendations: The Legislature should consider directing the Office of the State Controller to work with OSBM to identify a method to include activity and service costs information in NCAS.

The Legislature should consider enacting legislation that requires all state agencies to create and submit a strategic plan to OSBM as part of the state budget process.

OSBM should work with the Governor’s Office to develop a state-level strategic plan for North Carolina.

FINDINGS AND RECOMMENDATIONS

ISSUE FOR FURTHER CONSIDERATION

The Legislature should consider establishing a board dedicated to performance management and reporting. The Office of State Budget and Management (OSBM) is currently responsible for the development and implementation of the State's performance management and budgeting system but may not have sufficient authority to effectively manage the system.

In addition, research indicates legislative involvement in the development and implementation of a performance management and budget system is important to the ultimate success of the system. Legislative involvement in the selection of agency strategic performance measures helps ensure measures are relevant to their concerns and will be used in its decision-making.

Agency personnel and legislators may have different ideas about what is important about an agency's work. Operational performance indicators are likely to focus on management factors – full time employees, caseloads, staff productivity, and reports processed. When these types of management indicators appear in reports to legislators, they may have the unintended consequence of shifting legislative attention to executive branch responsibilities and away from policy results.

OSBM may not have the requisite authority to administer a performance management and budgeting system that includes all of the activities and services performed by North Carolina state government. Several options exist, which would help ensure the success of an expanded performance management and budgeting system.

One alternative is establishment of a separate entity to advise the Governor and the Legislature on the implementation of the State's performance management and budgeting system. Responsibilities may include:

- Development of the state-level strategic plan;
- Development of policy statements and recommendations for proposed legislation;
- Collection and dissemination of performance results to the Legislature and the public;
- Perform reviews of agency strategic plans.

At a minimum, the performance board should include key stakeholder representatives to include the Legislature, Governor, Council of State entities, Administrative Office of the Courts, community colleges and universities, as well as members of the public.

[This Page Left Blank Intentionally]

APPENDIX

Auditor's Response

We are required to provide additional explanation when an agency's response could potentially cloud an issue, mislead the reader, or inappropriately minimize the importance of our findings.

Generally Accepted Government Auditing Standards state,

When the audited entity's comments are inconsistent or in conflict with the findings, conclusions, or recommendations in the draft report, or when planned corrective actions do not adequately address the auditor's recommendations, the auditors should evaluate the validity of the audited entity's comments. If the auditors disagree with the comments, they should explain in the report their reasons for disagreement.

To ensure the availability of complete and accurate information and in accordance with Generally Accepted Government Auditing Standards, we offer the following clarifications:

To audit finding 1, *No Assurance Performance Data is Relevant and Reliable*, the Office of State Budget and Management (OSBM) responded:

- "It is not entirely clear in the report what would constitute a satisfactory "review."
- "Your report...implies that **formal audits** (emphasis added) of the measures and agency controls must also be conducted before information can be useful to decision makers."
- "...the expectation that every measure collected would be **formally audited** (emphasis added) before it is reported is problematic because it ignores the best practice of a cost and risk based approach to validating information. Without such an approach the budget development process would grind to a halt."
- "This data is no different than any other information OSBM collects...none of which goes through the type of **formal audit** (emphasis added) process suggested by this report."
- "OSBM does not believe the staff time and cost required for undertaking such a **detailed audit** (emphasis added) would add sufficient value to the process to be warranted..."
- "It is anticipated that the Office of State Auditor and the Program Evaluation Division will also be validating measures as they review programs, providing further checks on agencies and incentives to maintain data quality and controls. We believe these steps are a sufficient, cost-effective means for ensuring reliability of reported measures."
- "The report seems to imply that no information is better than information that has not been **thoroughly audited** (emphasis added)."
- "In the real world, decision makers...frequently rely on information from agencies or other sources that has not been through a **formal audit** (emphasis added)."

APPENDIX

A “review” in no way implies a formal audit. A satisfactory review would include cost/effective methods determined by OSBM that result in accurate performance information, which can be reliably used by the Governor, Legislature, and the public. A review of this type is not an **audit** but instead an integral part of good business practices to ensure performance information can be reliably used in decision-making. Legislators have indicated to the State Auditor the difficulty during the most recent Legislative session in determining appropriate budget cuts without reliable agency performance information.

Executive Order #3 directed establishment of a comprehensive performance and budgeting system that incorporates a review and accountability program. We recommend OSBM consult with the Office of the State Comptroller to determine appropriate methods which ensure, in a cost/effective manner, decision-makers are provided reliable performance data. “Validating measures,” after publication of performance information as anticipated by OSBM, by the Office of the State Auditor and the Division of Program Evaluation does not relieve OSBM of their statutory responsibility to ensure performance information is accurate when made available to the Governor, Legislature and general public. .

To audit finding 2, *State Agencies Have Not Met Two Important Requirements*, OSBM responded: “We respectfully take issue with the assertion that agencies have not submitted an accurate inventory of program.” However, OSBM recognizes in its response that the program inventory is not accurate. OSBM states, “Additionally, because agencies were required to account for every budgeted fund in their program crosswalk, there are items that do not meet the definition of a program.” OSBM further stated in its response: “Any undertaking of this magnitude will be less than perfect on the first iteration and **will contain errors and inconsistencies that will require cleanup** (emphasis added).”

To audit finding 3, *Current Structure Not Sufficient to Achieve Objectives, No Activity or Service Cost Data*, OSBM responded:

- “The implication of the report is that the effort is a failure unless it can deliver every thing at once. This is an unrealistic expectation for implementation of any initiative. In addition, it endangers the overall objective by overwhelming with marginally important requirements.”
- “The emphasis is on program performance and ultimate outcomes, as opposed to inputs and processes.”¹⁵
- “Cost data at the activity level can provide useful supplemental information for monitoring and evaluating programs, but not be the primary level of focus for OSBM analysts.”
- “When inundated with too much data, decision-makers may disregard it if they cannot quickly and easily hone in on the information they need.”
- “...formally tracking expenditures in a very detailed manner can lead to micro-management of activities...”

¹⁵ *Budget Analyst Training Program*, National Association of State Budget Offices (NASBO)

APPENDIX

- “...tracking of cost data at the activity/service level should be limited to expenditures and are for informational purposes, not for budgetary control.

Our report does not imply that the performance measurement and budgeting system is a failure if all aspects are not provided at once. The Office of the State Auditor recognizes OSBM’s efforts are ongoing and states on page 2 of this report that the Governor issued Executive Order No. 3 in January 2009, and “To comply with this order, OSBM is **expanding** (emphasis added) the existing results-based budgeting effort to fully integrate budget and performance in a process called “Program Budgeting.”

The OSBM response minimizes the importance of activity or service cost data and its importance to budgetary control at the program level. Examples of service cost data include: cost to inspect elevators by the Department of Labor and cost to inspect gasoline pumps by the Department of Agriculture and Consumer Services. We believe OSBM’s position on activity or service cost data contradicts the best practices as referenced in this report on page 10.

The Governor, Legislators, and the citizens of North Carolina should consider the clarification provided above when evaluating the Office of State Budget and Management’s response to the audit findings.

[This Page Left Blank Intentionally]

APPENDIX



STATE OF NORTH CAROLINA OFFICE OF STATE BUDGET AND MANAGEMENT

BEVERLY EAVES PERDUE
GOVERNOR

ANDY WILLIS
STATE BUDGET DIRECTOR

June 15, 2011

The Honorable Beth A. Wood, State Auditor
N.C. Office of the State Auditor
20601 Mail Service Center
Raleigh, NC 27699-0601

Dear State Auditor Wood:

OSBM appreciates your decision to evaluate the budgeting and performance initiatives currently under development by our office. Our goal is to incorporate strategic planning and performance information into the budget decision-making and management process in order to provide more effective and efficient services to the people of North Carolina. There is growing demand in North Carolina and across the country for government to focus more on results and outcomes and to operate in a more transparent manner. These are driving principles behind our efforts. We hope that this report will bring positive attention to the value of this initiative and assist us in furthering our efforts.

Before responding to the specific findings and recommendations in the report, we believe it is necessary to provide a more thorough accounting of OSBM's budget and performance initiatives over the last few years. The lessons learned from the steps taken over the last few years have shaped efforts currently underway, and it is important to understand this background when evaluating our current plans and to understand why certain decisions were made.

Background on Strategic Planning and Program Budgeting Initiatives

Results Based Budgeting (RBB)

Planning requirements were statutorily eliminated in 2001 and many positions were eliminated. After a number of years without any requirements for strategic planning and performance in the budget process, OSBM introduced its Results Based Budgeting (RBB) initiative for the FY 2007-09 biennium. RBB was a first step to reintroduce the concepts of strategic planning and performance measurement. There was no mandate requiring the information other than the requirement in the State Budget Act to provide "performance information for each state government program and for each proposed capital improvement." Many agencies lacked staff with knowledge and experience in strategic planning and performance management, and there was a great deal of skepticism and fear given the failure of past efforts.

To avoid pitfalls of the past, OSBM adopted a few basic guidelines:

- Implementation should be iterative and continually evolving and maturing;
- Information should be tied to the budget in a clear way; and
- Requirements should be implemented uniformly for all agencies at the same time.

For the first cycle of RBB, agencies were required to provide mission and goals for their organization, and service statements (including budget and FTE estimates) and performance measures for each of their

funds. These same requirements continued in FY2009-11 with the addition of agency level performance measures and an emphasis on improving the quality of information collected previously.

After the FY 2009-11 cycle, OSBM identified a number of issues and limitations with the RBB effort, such as:

- Information was often outdated and of limited value. For example,
 - Mission and goal statements were often outdated because most agencies did not initiate a renewed strategic planning effort to review and update the information.
 - Goals were generally broad and unspecific and no targets were required for performance measures, so it was difficult to use information to make any assessment about performance.
 - Agencies often reported available data for performance measures (usually input and output measures) rather than information that might actually be useful for assessing performance and outcomes.
- Budget and FTE estimates for services were not always reliable and had limited value in decision making processes. For example,
 - Estimates were manually reported by the agencies through a labor intensive process and could not always be validated.
 - Estimates also did not provide detail on source of funds (e.g. state appropriation, federal receipts, fees, etc.).
 - Estimates only provided prior year actual data and not proposed budget, so amounts reported were not necessarily reflective of what would be dedicated to those services in the recommended budget.
- Funds often were created for accounting or budgetary reasons and were frequently not aligned with the programs and functions currently managed by the agency. For example,
 - Some programs cut across multiple funds, usually divided by source of funds (e.g. state versus federal) or recipient of the fund (e.g. aid to counties versus agency).
 - Larger funds contained multiple programs, often based on how funds were disbursed (aid to counties) as opposed to commonalities in the programs.
- The fact that the fund structure was not aligned with programs created limitations for analysis and reporting. For example,
 - Decision-makers and the public could not easily find commonly recognized programs in one place in the budget document.
 - Service statements and measures were often repeated across funds.
 - It was difficult to establish meaningful performance measures at the fund level.
 - Level of detail in the service analysis varied by agency depending on the fund structure and agencies usage of reliability cost centers (RCCs) to track spending within the fund.

When Governor Perdue took office, one of her first actions was to issue a series of executive orders related to state government performance, including Executive Order 3, On-Site and State-Stat

Performance Management and Accountability. This EO required the following from executive branch agencies:

- Strategic plans that included: the mission of the department; the goals of the department; the strategies for achieving department goals; measures that demonstrate how well the goals are being achieved; and a description of the department strategic planning process.
- Performance tracking of management functions, including: financial management; procurement; information technology; capital planning; human resources; customer service; and strategic planning, performance management and budgeting.
- Program performance, which included a requirement for annual and long-term goals with measurable outcomes and the use of objective performance information to assist with budget decisions.

Additionally, the Governor initiated an effort to review all programs in state government, and requested a series of information on programs from all agencies (including Council of State) in preparation for the 2010 legislative session.

OSBM determined that the existing RBB initiative did not provide sufficient information to meet the Governor's new requirements and began an effort to evolve and expand upon the work done under RBB. The two primary areas of focus, and the most relevant to this audit, were strategic planning and program budgeting.

Strategic Planning

Under Executive Order 3, all Cabinet agencies were required to have updated strategic plans that contained:

- the mission of the department;
- the goals of the department;
- the strategies for achieving department goals;
- measures that demonstrate how well the goals are being achieved; and
- a description of the department strategic planning process.

OSBM released strategic planning guidelines in March 2010, and required agencies to submit their updated strategic plans by October 29, 2010. The guidelines were not requirements per se, but guidelines based on best practices in strategic planning. The guidelines also advised non-Cabinet agencies that while they were not subject to EO 3, they would be expected to submit strategic planning elements (mission, goals, and agency indicators) in the future through the budget process as they did under RBB.

OSBM, in conjunction with the Governor's Policy Office, reviewed agency plans for compliance with EO 3 and provided feedback in January-February 2011. Agencies were asked to make any necessary revisions and finalize plans by February 15, 2011.

Program Budgeting

In response to the Governor's requirements and lessons learned from RBB, OSBM began an effort to transition towards a program budgeting process – connecting programs to budget and performance in a way that facilitates the continual evaluation of programs. This transition was coupled with OSBM's efforts to replace its budget systems.

As a first step, and in preparation for the new budget system, OSBM started the process of defining agency programs and better aligning agency budgets with those programs. This is an ongoing process, and, to date, OSBM has not published a finalized program inventory or established an automated process or schedule for collecting and maintaining performance measures or other data on programs. This information will be required of agencies once the new Integrated Budget Information System (IBIS) is implemented in order to inform budget decisions and future program evaluations.

OSBM has taken the following steps in implementing this process:

June 2009 – Memo issued to agencies announcing the effort to restructure budgets around programs. Agencies were required to develop an initial program inventory by August 2009. After receiving OSBM input, agencies were to revise the inventory and provide additional data on each program by October 2009.

October 2009 – the Governor advised agencies that she would be conducting a review of all programs and directed OSBM to collect budget and performance information on every program. OSBM developed a template for agencies to complete on each program to collect budget, performance and other information. Information was reported manually for this initial process, and quality and completeness varied by agency.

November 2009-January 2010 – OSBM met with the Governor on programs and used information gathered from the agencies for an initial review and to assist with development of the 2010-11 budget.

February-March 2010 – In preparation for implementation of IBIS, OSBM met with agencies to revisit their program inventory and identify any budget restructuring that would be required to automate collection of budget data in the new system.

June 2010 – OSBM issued a memo requiring agencies to submit program crosswalks to establish a budgetary relationship with every item listed on the program inventory by June 25. The memo also provided instructions and deadlines for completing any necessary budget restructuring. Crosswalks were provided to the budget system vendor to establish the program structure in IBIS.

July-August 2010 – Using the template developed in October 2009 as a basis, OSBM developed a revised program information form that consisted of three sections: 1.) program overview information (description, point of contact, customers); 2.) program performance information (goals and measures); 3.) additional program details (series of questions on various program attributes, such as authorizing legislation, type of program, matching requirements, recent policy changes, results of external reviews, etc. This form will be automated through the IBIS system. [Note: a version of the form was deployed during this past budget cycle with a requirement to complete section 1 for every program. Due to problems with IBIS implementation, collection and review of the required information was delayed.]

October 2010-January 2011 – agency crosswalks were used to create a program view of the budget in IBIS. Agencies were required to submit section 1 of the program form in IBIS for each of their programs (see note above regarding completion of this effort). Given timing and the expectation that further refinements to the program inventory would be needed, no performance data or other information was required for this phase but will be required in the future.

February 2011-present –Upon review of the initial draft of the program budget presentation, OSBM determined that further refinements were needed to ensure the list of programs was valid and to improve consistency across agencies. Additionally, because agency crosswalks included all budgeted funds, non-programmatic items, such as accounting funds, reserves and transfers, trust funds, and administrative functions, are intermingled in the inventory. OSBM is currently identifying those items that should be excluded from program reporting requirements. Given these outstanding issues and delays in the IBIS

project, OSBM has not yet published a program budget report and no official version of the program inventory has been publicly released.

Next Steps – OSBM plans to complete its revisions to the program inventory and publish a list of programs with descriptions and budget information by this summer. The IBIS project plan is currently being revised, but it is anticipated that the program form will be redesigned and automated in the next year. Once more clarity is available on the ability to collect program data in IBIS, OSBM will also establish a process and schedule for conducting routine program reviews.

Response to Findings and Recommendations

1). No Assurance Performance Data is Relevant and Reliable

This finding is based on the assertion that OSBM did not conduct reviews to the satisfaction of the auditors to ensure:

- Agency performance measures are linked to agency goals;
- Performance data is accurate, complete, and consistent;
- Agency policies and procedures are in place.

It is not entirely clear in the report what would constitute a satisfactory “review.” The report does not consider analysts’ current review of data or the planned program review process sufficient, so OSBM assumes the auditor is envisioning an extensive, formal audit process to evaluate agency internal controls and validate every measure on a regular basis.

OSBM disagrees with this finding and believes that sufficient standards and requirements are in place or planned. Given the relative immaturity of these efforts, it is not the best use of limited staff resources to focus on auditing existing measures when significant work still needs to be done in other areas, such as implementation of the IBIS system to support data collection, capacity building within agencies to develop better measures for tracking program and agency performance, and establishing processes within OSBM to more fully incorporate program performance reviews into the decision making process.

As discussed in the background section of this response, OSBM first collected performance measures for each budget fund in FY 2007-09 for RBB. For the first iteration of RBB, the measures were simply intended to provide performance information on the activities supported by that specific fund and were not associated with agency goals. Measures were collected and published for informational purposes, but were not used for any formal review process. Like most information submitted by agencies to OSBM, analysts reviewed the measures prior to publication to identify potential errors and provide suggestions to agencies for improving the measures.

In FY 2009-11, OSBM introduced an additional requirement for key agency indicators in FY 2009-11. The purpose was to collect a smaller number of higher level outcome measures, while still allowing agencies to report all of the fund-level measures they deemed useful. OSBM did review measures and provided feedback to agencies on measures that did not meet guidelines provided in the budget instructions. However, this was the first time the information was required, and most agencies were not tracking these types of measures. Because data was primarily being reported for informational purposes, OSBM published the best available information with the expectation of working with agencies in the future to improve the measures.

For 2011-13, OSBM discontinued collection of fund-level measures when the decision was made to establish a program budgeting process. Going forward, performance measures will instead be collected by program once the program inventory and crosswalk are finalized, and the capability to collect data in

IBIS is in place. Some previously reported measures may be continued if the funds generally aligned with programs, but many of the measures are likely to change so there is limited value in auditing previously collected measures.

OSBM also did not publish key agency indicators in 2011-13 because most Cabinet agencies were in the process of adopting new measures as part of the strategic planning process required by Executive Order 3. Per OSBM guidelines, strategic plans were to include measures with targets to support each agency goal and objective. Historical data had not been collected for many of these measures, so in many cases there was no data to report or review.

Going forward, OSBM will require agencies to report information about each measure, such as data source, methodology, purpose, etc. OSBM will also be establishing a formal process for reviewing programs, and every program review will include evaluation and validation of the program's measures. Your report acknowledges that this documentation was already our current plan and will help ensure performance information is accurate. However, it implies that formal audits of the measures and agency controls must also be conducted before information can be useful to decision makers.

In our view, the expectation that every measure collected would be formally audited before it is reported is problematic because it ignores the best practice of a cost and risk based approach to validating information. Without such an approach the budget development process would grind to a halt. This is so for several reasons.

- OSBM's purpose for collecting performance measures is primarily to support program reviews to inform recommendations for budget and policy changes. The vast majority of issues with the data would be picked up in these reviews.
- This data is no different than any other information OSBM collects from agencies and provides to the public or decision-makers, none of which goes through the type of formal audit process suggested by this report.
- OSBM does not believe the staff time and cost required for undertaking such a detailed audit would add sufficient value to the process to be warranted; there are thousands of measures. OSBM has established requirements to document information about each measure that would enable OSBM or any external reviewer to validate the measure before use. OSBM will also be reviewing measures as it reviews programs. It is anticipated that the Office of State Auditor and the Program Evaluation Division will also be validating measures as they review programs, providing further checks on agencies and incentives to maintain data quality and controls. We believe these steps are a sufficient, cost-effective means for ensuring reliability of reported measures.
- The report seems to imply that no information is better than information that has not been thoroughly audited. In the real world, decision makers often have limited time and resources and have to use the best available data to inform decisions. They frequently rely on information from agencies or other sources that has not been through a formal audit. OSBM believes the information still has value and that continual use and scrutiny will also drive accuracy and consistency.

2.) State Agencies Have Not Met Two Important Requirements

This finding is based on the report's assertion that the program inventory is not accurate and that strategic plans do not include all required information. Each of these is discussed in more detail below.

Program Inventory is Not Accurate

OSBM agrees that the program inventory has a number of issues that need to be addressed and has been working on those problems over the last few months. For this reason, OSBM has not yet published an

official version of the program inventory, and the auditors from your office were advised that the program inventory and crosswalk documents that were provided were not final.

We respectfully take issue with the assertion that agencies have not submitted an accurate inventory of programs. Defining a program can be fairly subjective and reasonable people can disagree about what should be contained in a list of programs. There has been a great deal of back and forth between OSBM and the agencies to reach agreement on the inventory. Identifying a program is one thing, but being able to clearly delineate it in the budget and accounting structure can sometimes be a challenge. The effort was fairly complex, requiring many hours of negotiation, restructuring of budgets, and complicated mapping of thousands of cost centers. Any undertaking of this magnitude will be less than perfect on the first iteration and will contain errors and inconsistencies that will require cleanup.

Additionally, because agencies were required to account for every budgeted fund in their program crosswalk, there are items that do not meet the definition of a program, but that cannot be accurately allocated to any particular program (e.g. reserves and transfers, accounting funds, administrative overhead, special revenues, etc.). Some of these items are easily identifiable by their name, but others are not as obvious. Many of these items account for the invalid programs cited in the report. As part of OSBM's process for finalizing the inventory, these items are being identified for exemption from program reporting and will simply be tracked to ensure the whole budget is accounted for on the bottom line.

Strategic Plans Do Not Include All Required Information

The report states that Cabinet agencies did not submit strategic plans containing all required information. The requirements referred to in the report are outlined in the OSBM "Planning Guidelines for North Carolina State Government." OSBM would like to clarify that this document contained *guidelines* based on best practices; they were not requirements. The only mandated requirements for strategic planning are the elements identified in Executive Order 3. The guidelines specifically state, "Strategic plans should contain, at a minimum, a mission statement, agency goals, management goals, objectives, and performance measures."

OSBM agrees that a quality plan should include all of the elements outlined in the guidelines, and agencies were given feedback encouraging them to incorporate these items. However, in approving plans, reviews focused on whether agencies had met the requirements of Executive Order 3. Additionally, for many agencies, this was the first time they had completed a strategic plan in over ten years. Plans are to be reviewed and updated annually, and we expect the quality of plans to improve as agencies rebuild capacity and expertise for strategic planning and performance management.

3.) Current Structure Not Sufficient to Achieve Objectives

The report states that the program budgeting process may not be sufficient to achieve the objectives of increasing transparency and ensuring accountability because it:

- Does not include activity or service cost data,
- Does not require all state agencies to submit a strategic plan, and
- Does not include a state-level strategic plan.

While OSBM agrees that these additional requirements could add some value to the overall process, we disagree with the finding that the current structure is not sufficient to achieve objectives. As stated previously, implementation of a budget and performance system is an iterative process that will

continually evolve and expand. OSBM believes the actions taken to date and planned for the near future are important and manageable steps for increasing transparency and ensuring accountability. The process can always be improved and expanded, but that does not mean the interim steps fail to move the state towards achieving these objectives. The implication of the report is that the effort is a failure unless it can deliver everything at once. This is an unrealistic expectation for implementation of any initiative. In addition, it endangers the overall objective by overwhelming it with marginally important requirements. OSBM's responses to the specific recommendations for this finding are as follows.

No Activity or Service Cost Data

The National Association of State Budget Offices publishes a manual titled *Budget Analyst Training Program*. It describes Program Budgeting on page 14 as follows:

The concept itself is quite simple to understand. A governmental unit first defines its functions or programs. Once programs are defined, the organization must apply three factors to the program: the goal, the objectives, and the strategies or performance measures to be used to determine whether the objective or goal is met. The major benefit of this process is that it forces an agency or department to focus on what it does and why, as opposed to how it does it. **The emphasis is on program performance and ultimate outcomes, as opposed to inputs and processes.** The process of program budgeting enables citizens served by the agency to understand in service and functional terms what the agency does and how its performance can be measured.

OSBM agrees that it would be ideal to have easy access to cost data at lower levels of detail. But doing so would not be a fundamental objective of Program Budgeting. In addition, capturing this data right now is not feasible for a number of reasons.

- As previously described, establishing the program inventory has been a significant undertaking with many complexities and challenges. Attempting to collect data at even lower levels of detail at the same time would have made the effort even more complicated. OSBM chose to focus on establishing a reliable program structure first, and evaluate needs for lower levels of detail at a later date.
- OSBM attempted to track service level budget data through RBB, but as described previously and for the accounting limitations described in the report, this data could only be collected manually. Collecting the information was labor intensive and could not be reasonably updated on a regular basis, so only prior year actuals were collected each biennium. It was also difficult to validate the budget data to ensure reliability.
- OSBM chose to implement program budgeting, not activity based costing. Program budgeting focuses on planning, managing and tracking accountability at the program level. In return for greater accountability for results, agencies should have more flexibility for managing program budgets. One goal of the program budgeting effort was to focus OSBM analysts on broader oversight and analysis of program results and less on day-to-day transactions. Cost data at the activity level can provide useful supplemental information for monitoring and evaluating programs, but should not be the primary level of focus for OSBM analysts.
- More data is not always better. When inundated with too much data, decision-makers may disregard it if they cannot quickly and easily hone in on the information they need. Too much detail can also cause people to lose sight of the bigger picture and focus on narrow issues that may have little impact on the results and outcomes that the public actually cares about.
- While agencies should be accountable for knowing how their program dollars are used, formally tracking expenditures in a very detailed manner can lead to micro-management of activities for which agencies should have some flexibility to manage in order to achieve program results. It should be

clear that any tracking of cost data at the activity/service level should be limited to expenditures and are for informational purposes, not for budgetary control.

- Even if expenditures can be tracked in NCAS, the data is only as good as the agency's ability to accurately account for costs by activity or service. This can be difficult when people and resources contribute to multiple activities. In these cases, an estimated percentage allocation may be the most reasonable way to determine costs, and this could potentially be accomplished in the new IBIS system without major changes to agencies' accounting structures.

The Office of State Controller can provide a better assessment on the feasibility of capturing this information in NCAS. Given OSBM's prior conversations with OSC and obstacles faced just to map programs, it seems unlikely that this recommendation could be implemented without significant cost and effort. It is more realistic to wait and address this issue when the state decides to replace NCAS.

No Statewide Requirement for Agency Strategic Plans

OSBM agrees with this recommendation. While OSBM has required non-Cabinet agencies to submit some strategic planning elements in the past as part of the budget development process, the information provided has been of inconsistent quality and is often not the result of a robust strategic planning process as now required of Cabinet agencies through Executive Order 3. A legislative directive focused toward non-Cabinet agencies would address this issue.

No State-Level Strategic Plan

OSBM agrees that a state-level strategic plan would be valuable for identifying state priorities and tracking progress towards crosscutting objectives and outcomes. However, to successfully implement a strategic plan, there need to be clear lines of accountability for the objectives outlined in the plan. Given the structure of North Carolina's Executive Branch and the number of agencies not controlled centrally, OSBM questions whether this activity would be worthwhile. OSBM would be an appropriate body for collecting and reporting data on statewide goals and measures, and IBIS will have the capability to collect and manage this type of data. However, the General Assembly eliminated the planning arm of OSBM a number of years ago. To implement this recommendation additional staff would be needed and significant cost would be incurred.

Issue for Further Consideration

As suggested in our response to the recommendation for a State-level strategic plan, there may be some value in having an advisory body, with representation from the executive branch (both Cabinet and Council of State) and the legislature, to take responsibility for statewide policy issues related to budget and performance, such as establishing the state's strategic plan and setting statewide goals and measures. However, we caution against having such an entity take on too much of the day to day operational responsibilities associated with a budget and performance system.

In order to ensure continuity and stability of the budget and performance system, OSBM believes there is value in establishing many of the functions at an oversight agency with professional staff that does not change from one administration to the next. Some examples of these functions include: implementing and maintaining systems to collect, analyze and report budget and performance information; establishing reporting requirements; providing instructions, guidance and assistance to agencies; and evaluating programs and performance results and making recommendations based on findings. OSBM is one of the few agencies in the executive branch that has the appropriate skill set and resources to take on these responsibilities.

Also, to ensure the success and usefulness of this effort, it is imperative that program and performance initiatives are clearly tied to the development and management of the budget. In North Carolina and in other states, when performance initiatives are not related to the budget, they have generally failed to have

an impact. In our research, even in states where these functions have managed to persist separate from the budget office, the findings and results are rarely used in the budget decision-making process. As the agency responsible for oversight and management of the state budget, OSBM is the most logical choice for implementing the operational aspects of any budget and performance initiative. Of course, we also look to our counterparts at the Office of the State Auditor, the Program Evaluation Division, and the Fiscal Research Division, to also evaluate the information and use it to advise decision-makers throughout state government to make more informed budget and management decisions.

Conclusions


With regard to the first set of findings and recommendations in the report concerning the lack of assurance that performance data is relevant and reliable. OSBM believes that the currently planned requirements and procedures will provide a sufficient, cost-effective means for ensuring reliability of reported data. Given the relative immaturity of these efforts, we believe that it is not the best use of limited staff resources to focus on auditing existing measures when significant work still needs to be done in other areas.

OSBM partially concurs with the second set of findings and recommendations regarding failure of agencies to meet requirements for program inventories and strategic plans. We agree that the program inventory has a number of issues that need to be addressed, and, as we advised the auditors, the inventory is not final and OSBM has not published an official version. We would like to clarify the fact that many of the outstanding issues are not due to any failure by the agencies to comply with requirements. As explained in more detail above, the effort has been a significant undertaking with many complexities and challenges. Any undertaking of this magnitude will be less than perfect on the first iteration and will contain errors and inconsistencies that will require continued work. For strategic plans, again, we need to make clear that the requirements cited in the report are from OSBM's guidelines, which were guidelines based on best practice, not requirements. While we agree that agencies should follow the guidelines, the only mandated requirements are those outlined in Executive Order 3.

OSBM partially concurs with the third set of findings and recommendations regarding the sufficiency of the current structure for achieving objectives. We believe the actions taken to date, and those planned for the near future, will enable us to make significant progress towards meeting our objectives. This initiative is expected to evolve and grow over time and the recommendations in this section of the report are reasonable future steps to consider. We agree that activity/service level data could be useful, but there are numerous reasons, as outlined above, why this information will not be a core objective and is not practical to collect. OSBM also agrees with the recommendation for a statewide requirement for agency strategic plans and for the development of a state-level strategic plan. However, we question the utility of a state-level strategic plan given the decentralized organization of state government.

OSBM appreciates the opportunity to review and respond to this audit and look forward to working with the Office of the State Auditor in the future as we continue to implement our budget and performance initiative. If you have any questions or concerns about our efforts and this response, please do not hesitate to contact me at 919-807-4717.

Sincerely,



Andy Willis
State Budget Director

[This Page Left Blank Intentionally]

ORDERING INFORMATION

Audit reports issued by the Office of the State Auditor can be obtained from the web site at www.ncauditor.net. Also, parties may register on the web site to receive automatic email notification whenever reports of interest are issued. Otherwise, copies of audit reports may be obtained by contacting the:

Office of the State Auditor
State of North Carolina
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Telephone: 919/807-7500

Facsimile: 919/807-7647