

## **CHAPTER III BUDGET FORMULATION**

### **SECTION 1 Introduction**

#### **A. Purpose**

The purpose of this section is to outline the general information and policies applicable to budget formulation. An overview of policies, procedures and legislation relating to the Federal budgeting and financing process is covered in Chapter II of this Handbook.

#### **B. Definition of Budget Formulation**

Budget formulation consists of all steps, actions, and documentation in the budget process which are required or which properly should be taken in advance of the enactment by Congress of an appropriation bill.

Budget formulation implicitly includes program performance analysis that is conducted to determine where an activity stands at present, where is it going (i.e., what can we reasonably expect to happen regarding meeting stated goals and objectives) and what alternative approaches could be taken which could better achieve objectives. Within the Department of Commerce, major budget formulation activities are conducted three times a year: in the spring, operating units prepare and submit budget and planning requests to the Secretary; in the summer, the units prepare and submit budget and planning requests through the Secretary to OMB (based on the Secretary's allowances); and in the winter, the units prepare and submit the President's budget to Congress and the Annual Performance Plan through the Secretary, based on OMB's passback allowances.

The basic objectives of the formulation process are:

- to provide a satisfactory information basis for use by program managers, the Secretary, the President and Congress in making decisions about the allocation of the nation's resources toward fulfillment of the nation's goals and needs; and
- to ensure that each responsible party in the process has a satisfactory opportunity to analyze the information needed to make decisions.

Decision-makers at all levels must rely on staff for analysis and summary of the information developed in the budget formulation process. Therefore, budget formulation personnel should make every effort to provide staff with information equivalent to that needed by the decision-makers themselves. Justification documents summarize detailed information used in developing budget requests. Budget personnel should be able to furnish reviewers and decision-makers with detailed backup material when requested.

### **C. Framework of Budget Formulation**

The basic framework of budget formulation is established by law. The primary elements of this basic framework are:

- authorization bills, which may be submitted by the Administration or initiated by Congress;
- annual budget and planning requests which are submitted to OMB by Department heads;
- the President's annual budget, which is submitted to Congress by the first Monday in February;
- supplemental or deficiency requests, which may be submitted to the Congress by the President under certain conditions specified by law; and
- action by the Congress in considering and approving authorization and appropriation bills.

The operating units in the Department submit their budget proposals and performance plans to the Office of Budget by June 1<sup>st</sup> of each year. From June through August, Department-level staff review and evaluate requests and plans, provide decision-makers with information required to make budget and planning decisions, and assemble a Department budget request and performance plan which supports Departmental and Administration goals. This period includes briefings to the Secretary and Deputy Secretary in early August, followed by Secretarial decisions on priority budget increases to be sought from OMB. The Department's budget request and associated performance plan is due to OMB in September.

#### **1. Departmental Responsibilities and Requirements**

Departmental responsibilities regarding budget formulation are vested in the Secretary. The Secretary is legally responsible for the content of all budget requests made by the Department. Delegations of the Secretary's responsibilities have been made to:

- the General Counsel in the case of authorizing legislation; and
- the Chief Financial Officer/Assistant Secretary for Administration (hereafter, "Assistant Secretary") in the case of budget estimates and relationships with the appropriations committees. (The Office of Budget acts for the Assistant Secretary on non-policy aspects of such matters).

The Assistant Secretary's responsibilities include:

- maintaining a program structure which is linked to the Department's financial management system;
- identifying and studying program and budget problems needing resolution;
- reviewing budget proposals to assist the Secretary in making budgetary decisions;
- preparing and submitting approved budget and planning proposals to OMB;
- preparing for OMB review and hearings, and appeals of OMB decisions on the budget;
- preparing and submitting budgets, justifications, and performance plans to the Congress; and
- coordinating the Congressional hearings process.

## 2. OMB Requirements

OMB requirements regarding the annual budget and performance plan are covered in OMB Circular A-11 and in allowance and guidance letters issued from time to time. This Handbook supplements Circular A-11 and outlines Departmental responsibilities for meeting OMB requirements on preparing and submitting annual budgets and performance plans. Circular A-11 is reissued on an annual basis in the summer. The Department's September requests to OMB conforms to the guidelines included in the latest issue of Circular A-11.

OMB requirements regarding supplemental, deficiency, and revised estimates are also covered in Circular A-11 and in policy letters issued on an as needed basis. This Handbook also provides instructions for preparing such estimates.

## 3. Congressional Requirements

Although Congress makes exceptions from time to time, it has established two basic requirements regarding consideration of budgets:

- a formal request must be transmitted by the President; and
- authorizing legislation must exist.

Agencies are legally prohibited from transmitting budget estimates or requests for appropriations directly to the Congress unless Congress has specifically requested them to do so. Requests not supported by authorizing legislation are subject to a point of order on the floor of the House of Representatives. If a point of order is raised, unanimous consent is required in order to consider an appropriation for a non-authorized program. Appropriations committees are sometimes reluctant to report favorably on items which lack authorization.

Specific requirements for budget justifications are left largely up to each appropriations subcommittee. All subcommittees require certain Departmental summary material, formal printed justifications for each appropriation, and formal hearings. Usually the summary material and the hearings follow a consistent format within a subcommittee, but the format and content of justifications may vary considerably from agency to agency. Details of requirements are worked out with subcommittee staff and agency budget officers. Section 4 of this chapter of the Handbook outlines procedures and prescribes Departmental responsibilities for preparing and submitting justifications to Congress. Chapter IV Section 2 describes requirements for the appropriations hearing process.

## **D. Standards of Department of Commerce Budget Formulation**

### 1. General Concept of Formulation

The development of the Department's budget request begins with the most recent President budget's request, referred to as the 20BY budget, that has been submitted to the Hill. To the 20BY amount, adjustments-to-base are added to arrive at a base or current services level that would continue operations at the 20BY level, adjusted for inflationary and other uncontrollable cost changes. Program changes are added to the base level to arrive at a total budget request.

### 2. Program Budgeting

The Department's budgets are formulated on a program basis: the estimates are organized and presented in a structure which places emphasis on and describes the objectives, outputs and work to be accomplished with the proposed resources.

Program budgeting within the Department allows for organizations responsible for administering the budget to be identified in the budget itself. Further, it is Department policy that:

- where more than one primary operating unit participates in an activity, each unit will be identified in the program's structure as a subactivity; and
- line items may not cut across primary operating units and must be directly identified within each unit. Thus the major organizational elements of the Department can be identified in the budget justifications.

Generally, budgets are formulated by each primary operating unit on all levels of the program classification structure (activity, subactivity and line item) and identified as such in budget justifications.

Organizational units below the line item level need not be presented in formal budget estimates. However, each operating unit should develop its program budget data by object classification of expenditure so that it can demonstrate the basis for arriving at the estimate if called upon to do so.

In addition to the structural aspects, program budgeting requires that supporting data and justifications are presented in such a way that cost-utility analyses and alternative courses of action may be conducted.

### 3. Planning

For the Secretarial and OMB requests, Departmental requirements for projections of budget authority and outlays for each activity are for four years beyond the budget year and are prescribed in the sections of this chapter relating to preparation of Secretarial, OMB and Congressional submissions.

The Government Performance and Results Act requires that all Federal agencies publish annual program performance reports and annual performance plans. These requirements are outlined in OMB Circular A-11. This handbook provides detailed guidance on what bureaus must provide for the Office of Budget to assemble a Department-wide performance plan or report.

### 3. Capital Asset Planning, Budgeting and Acquisition

A “Capital Asset Plan” (Exhibit 300) is required for each bureau submitting a request for a major capital asset. Specifically, this exhibit should be prepared for new and on-going projects that have total (full-funding) non-recurring costs over \$30 million, or have been identified in the Department’s Budget Guidance letter as a major capital asset. These Exhibits are required regardless of the financing mechanism (lease, purchase, construction) used to acquire the major asset.

Major capital projects include land, structures, equipment and intellectual property such as software. Your acquisition plans should support the mission statements, long-term goals and objectives and annual performance plans developed under the Government and Performance and Results Act. OMB’s Circular A-11 Section 300 and OMB’s Capital Programming Guide (available on-line) are good resource for defining what constitutes a capital project and guidance on planning, budgeting, procuring and managing such a project.

#### Full Funding and Useful Segments

Exhibit 300 should show the full funding amount for each project with each project broken out by useful segments. Structure your exhibit to address costs of these assets either by planning segments (i.e., Planning, Full Acquisition, Maintenance) or by useful end items (i.e. building 1, building 2...). The full funding policy requires that each useful segment of a capital project be fully funded with regular annual appropriations or advance appropriations. A useful end item is defined as a project output that justifies the project’s costs. For example, one complete satellite with sensors is a useful end item.

Advance procurement of up to 20% of full funding has been permitted by Congress. This 20% can be spread over one or two years. Incremental funding is only permitted for certain research and development projects or where specific authority is provided by Congress.

### Information Technology Capital Requirements

Under the Information Technology Management and Reform Act (a.k.a. Clinger-Cohen) information technology projects are required to meet rigorous guidelines for planning, procurement, management and justification. The Office of the Chief Information Officer (OCIO) is the lead organization for providing guidance on information technology reporting requirements. The CIO chairs the Commerce Information Technology Review Board (CITRB) which has a mandate to evaluate all proposed (large) information technology initiatives. Major new IT initiatives will not be eligible for funding consideration until they have been evaluated by the CITRB.

To ensure integration with the budget process, the Director of Budget serves on the CITRB. In addition, the appropriate Office of Budget analyst will be present at ITRB sessions involving their accounts. For the Secretarial and OMB Budget submissions, the Office of Budget requires Exhibit 300 only for major capital projects and will provide specific guidance to the bureaus as to which ones. The OCIO, however, may require Exhibit 300 at a more detailed level to meet their reporting and review requirements.

### Exhibit 300

Exhibit 300s should be updated and resubmitted as appropriate for each phase of the budget submission process. Care should be taken to adjust budget amounts as well as related milestone and performance goals to reflect the adjusted level of budgetary resources.

1. For purposes of submitting bureau budgets to the Office of Budget, an Exhibit 300 is needed for each new acquisitions with a total (full funding) cost of more than \$30 million, or for a capital project that has been previously identified as such by the Department's CFO and the Office of Budget. Structure your exhibit to be responsive to Raines Rules (detailed below) and address costs of these assets in useful segments. Baseline cost, schedule and performance goals, which are documented in Exhibit 300 are the basis for reporting to Congress on variances of 10% or more (in cost, schedule or performance) as required by the Federal Acquisition Streamlining Act of 1994.
2. The information reported on Exhibit 300 for financial and information system projects is aggregated in Exhibit 52 for financial systems and on Exhibit 53 for all information systems. These exhibits are submitted by the bureaus to the Department. The Department-wide aggregated versions of Exhibit 52 and Exhibit 53 are submitted to OMB in September.

### **E. Criteria for a Good Budget Justification**

A good justification concisely and specifically provides a summary of all relevant information regarding the budget and planning proposal. Program managers must be able to, upon request, provide detailed information supporting the summary information contained in the justification. The appropriate format and content for a justification varies depending on the nature of the budget proposal, its urgency and need, and the stage in the budget process. A good justification minimizes technical jargon not readily used by budget examiners or other policy makers outside of the specific technical community.

The criteria stated below cover factors of conciseness, specificity and relevancy, and provide guidelines for dealing with such factors as alternatives and intangibles. These criteria are consistent with those outlined in OMB Circular A-11.

### 1. Conciseness and Specificity

For a justification to meet standards of conciseness and specificity, it must:

- be written in language that can be clearly understood by reviewers, not all of whom may be familiar with the program's technical content;
- be consistently organized with respect to its program and budget elements, financial tables and supporting data; and
- be prepared with regard to the needs, desires and time constraints of reviewers.

### 2. Relevancy

For a justification to meet standards of relevancy, it must:

- describe the magnitude of the need for the proposal, including the economic, social, programmatic, and environmental characteristics of the problem;
- describe the current situation, what public and private actions are now being conducted to meet the need, and the reasons why additional Federal funding and action is required;
- reference adequately existing and proposed statutory authority relating to the problem;
- state the specific objectives of the proposal, quantified wherever practicable, in terms of the performance level in the budget year and future years;
- discuss outyear resources, expected benefits, and program performance;
- describe how the proposal was developed, including how resource estimates, outputs, unit costs and productivity were calculated;

- relate the proposal to other programs already in existence or proposed and how programs will be coordinated; and
- identify all constraints and issues which may arise in connection with the review and approval of the proposal, including political considerations, availability of resources, and other organizational, institutional, and procedural factors.

### 3. Alternatives

Budget planners are expected to thoroughly analyze the impact of alternative objectives and programs through program performance studies, cost-benefit analyses, cost-effectiveness, systems analyses, operations research and the like. The Department's long-range goals and objectives should be the yardstick by which alternatives are compared.

The number of alternatives given serious consideration diminishes as proposals move forward in the budget formulation process. Program managers may well want a detailed review of all alternatives presented for their consideration. Secretarial officers frequently require that major alternative proposals be submitted with the pros and cons of various options analyzed.

For OMB review, agencies are expected to have made a decision as to the best course of action conforming to the President's policies and budget targets; however, alternatives are sometimes submitted by the Department.

Alternative budget proposals are generally not presented to Congress unless specifically requested by the Congress. This policy eliminates confusion as to what is being requested by the agency. However, it must be kept in mind that a major purpose of the Congressional review is to judge each proposal in relation to other public needs and alternatives. Therefore, the subcommittee can be expected to consider alternatives. In anticipation of that interest, justifications may include a discussion of alternatives considered and rejected by the bureau. The thrust of the justification must be on presenting the reasons why the President's budget proposal was chosen and why it should be approved, rather than simply on presenting alternatives for consideration. If the issues are not fully covered in the justification, witnesses should be prepared to demonstrate that other feasible alternative courses of action and their consequences have been considered, including the effects of no action.

### 4. Managerial Review

There are many points during the budget process where managerial participation is instrumental in creating a relevant and effective budget request; e.g., interpreting or elaborating early guidance, discussing possible changes or alternatives to be considered, communicating priorities that should govern the structuring of justifications. Managers at the operating unit level are expected to perform this managerial review during the formulation of the budget and planning requests made to the Department.

## 5. Intangible Factors

A good justification convinces the reviewer that in addition to providing all relevant information regarding the need for the proposal, the agency has the ability to produce the projected results in a timely manner. Part of the information needed to justify a proposal may be a demonstration of the competence and reliability of program managers, and the track record of the organizations involved.

## F. Amendments and Supplementals

Information and policies regarding amendments to the budget and supplemental budget proposals are covered in detail in OMB Circular A-11 and in Section 5 of this chapter of the Handbook. The standards and criteria for formulation and justification of budgets outlined above apply equally to amendments and supplementals. However, it is OMB policy (and also a matter expected by the Appropriations Committees) that the regular annual estimates will anticipate all requirements in the budget year for continuing activities and those for which authorizing legislation will be sought by the Administration. Therefore, supplemental estimates or upward amendment of regular estimates are to be considered later only if due to: (a) circumstances not known at the time the budget was submitted; or (b) Congressional action not requested by the Administration. Justification for amendments and supplementals should explain:

- why the change was omitted from the regular estimates; and
- why it is considered essential that the proposal be acted on as an amendment or supplemental instead of waiting for the next regular budget request.

It is sometimes preferable to both the President and Congress to defer proposals which can be anticipated, but about which there are outstanding questions regarding the possibility of change in authorization, funding requirements, or the time period in which funds will be needed. If possible supplemental needs are known, they should be brought to OMB's attention when Departmental requests are submitted in September. The annual budget often mentions specific possibilities for later transmission. If not mentioned in the budget, agencies should not advise the Congress of such possibilities without OMB clearance. The only exception to this rule is if a witness is specifically asked about potential supplemental requirements in a hearing. Then, a witness may appropriately mention the fact that a supplemental is being considered, but should not state the amount which may be needed unless the information is explicitly requested. See also Chapter II, Section 4 of this Handbook, "Policies Governing the Release of Budgetary Information".

## G. Nature of the Commitments Made in Budget Formulation

Commitments are made at each step of the budget formulation process and involve legal, policy and administrative considerations. Legal considerations are expressed in authorization and appropriation acts, and are subject to interpretation by the Comptroller General. Legal

constraints are usually stated in very general terms as to program and budget content, and may identify no more than the agency, the purpose and the dollar total. Therefore, there may be broad discretion in the budget, both in the formal justifications and testimony of witnesses at hearings. It is a basic principle of Federal budgeting that the agency commits to do exactly what is proposed, assuming the proposal is approved as submitted. However, this is subject to qualifications stated in justifications or testimony.

Congress establishes the basic nature of the legal commitments involved by enactment of authorization and appropriation bills. Authorization acts may provide for programs which are entirely non-discretionary (certain elements of the Social Security system), for programs which are entirely discretionary (most elements of the Department's programs), or for programs which have both non- discretionary and discretionary elements (the patent system and periodic censuses which must be provided for under the Constitution). However, authorization acts may have a large element of discretion in the size and content of the program. Authorization acts usually set limits on amounts that may be spent for particular purposes, but leave to the terms of appropriation acts, Executive Branch policy and administrative discretion, how much, if any, will be spent. On the other hand, appropriation acts often contain limitations not in the budget proposal.

Congress expects the budget to be executed as justified, except for changes it makes in appropriation acts and Committee reports, changes in requirements, or other developments after final Congressional action, which can be satisfactorily explained to them in reprogramming requests. (See also Chapter V, Section 7 regarding reprogramming requirements).

Congress is technically not committed by anything except formal floor action; however, Committee Reports, expressions of intent and clarifications made or accepted by Committee chairmen in floor debate, and formal letters from Committee chairmen, are considered as Congressional expectations of commitments to be honored. The Department submits formal responses to each directive contained in the current year appropriation documents as soon as possible after the budget year request is submitted. Chapter V, Section 9 of this Handbook provides guidance on preparing responses to Congressional directives. Expressions by individual members of Congress at hearings, in floor debate, or in correspondence are considered as their individual expressions and not those of the Congress. However, such expressions should be given due consideration in budget formulation consistent with Administration policy and formal expressions on the part of Congress.

#### 1. The Executive Office of the President

The President establishes the basis for budget formulation commitments on the part of the Executive Branch in the State of the Union Message, formal budget documents, Executive Orders and Proclamations and other documents, including legislative proposals, supplementals and amendments to the budget. Program and budget plans, estimates and justifications and all commitments, testimony and other presentations on the budget must conform to these documents and statements until they are formally revoked or amended.

OMB budget decisions are communicated in a "passback" which includes the rationale for the decisions and an indication of what latitude exists for further distribution of the allowances. Acceptance of the allowance without qualification implies a commitment by the Department to accept the rationale and the latitude for distribution of allowances as communicated. It is incumbent on program and budget officials to take steps to assure that the rationale for the allowances is fully understood, and are either acceptable to the Department or are made part of the appeal before the allowances are accepted.

OMB monitors budget commitments by:

- reviewing proposed agency positions in appealing or concurring in Congressional modifications to the budget;
- reviewing agency financial plans in support of apportionment requests;
- reviewing reports of agency program and financial performance; and
- conducting studies and inquiries.

## 2. The Department

It is the Department's policy that:

- all representations in the budget transmittals by the President, the estimates, justifications, and performance plans submitted by the Department, and testimony of Departmental witnesses shall be faithfully adhered to; and
- all expressions of Congressional intent stated in Committee reports or in discussion on the floor of the Congress regarding the objects or purposes for which funds are appropriated shall be adhered to unless otherwise directed by OMB and/or the Secretary. (Refer to Chapter V Section 9 for guidance on preparing responses to Congressional Directives).

Program managers monitor budget commitments on behalf of the Secretary. The Secretary has legal responsibility for budget matters of the Department. However, program managers and agency heads have specific responsibilities for and work jointly with Departmental staff officials in developing and monitoring the commitments on the part of the Department. These are communicated by:

- policies and guidelines from the Secretary prior to preparing requests to the Department;
- major program and budget studies;
- Secretarial allowance documents;

- budget transmittals and summary and highlight statements; and
- testimonies at hearings.

Program managers and heads of operating units participate in developing the materials listed above. The Assistant Secretary for Administration and the Director of Budget have responsibility for assuring that the Secretary's policies, guidelines and decisions are promptly and accurately communicated within the Department, and that final documents and testimony accurately reflect the Department's and the Administration's position.

The Office of Budget also monitors budget commitments on behalf of the Department through:

- reviewing justifications, supporting data, financial plans and reports, reprogramming proposals, and performance plans for conformance to Departmental policy;
- providing advice to Departmental and operating unit officials; and
- providing liaison with OMB and Appropriations Committee staff on questions, interpretations and resolution of problems.

### 3. Operating Units

In addition to participating in developing Departmental commitments in the justifications, performance plans, and hearings, the heads of operating units have direct responsibility for the execution of commitments. It is incumbent on them to ensure that:

- policies and guidelines are communicated to their subordinates; and
- budget transmittals, performance plans, highlight documents, and justifications clearly reflect the intent of operating unit management.

Program managers and operating level budget staff are usually responsible for conducting the studies and developing proposals which form the basic commitments underlying the budget formulation process. In some instances, the entire process depends on their first-hand knowledge and professional competence regarding what can be accomplished at various resource levels. Further, program managers have the ultimate responsibility for carrying out the commitments made. It is incumbent on these officials, therefore, to:

- study thoroughly and competently all reasonable alternatives for meeting program needs; and
- present accurately and fully to the head of the operating unit the results of their studies, particularly as to the impact of alternative courses of action.

## **H. Information Support**

An immense amount of information is required to develop and review the budget for the Department's programs. Although it may not be possible for any single official to read and keep fresh recollection of all required data, officials justifying budgets are expected to know or have readily at hand information on:

- content of budget schedules and justifications;
- history of prior budget proposals in the program area;
- authorization acts and their legislative background;
- background data on the program need or problem, including the history and status of efforts to find solutions;
- details on related Federal programs currently authorized, including their budgets and status; and
- special studies and investigations recently completed or underway in the program area.

### **1. Legal Requirements Regarding Contents of Budgets**

Title 31, U.S.C., Section 1105 (reprinted at Chapter II, Section 1.B.2.) prescribes the standardized set of data required to be submitted by the President in the budget request. Each budget must include the following:

- information on activities and functions of the Government;
- when practicable, information on costs and achievements of Government programs;
- a reconciliation of the summary information on expenditures with proposed appropriations;
- estimated expenditures and proposed appropriations for the budget year (BY) through BY+4;
- estimated receipts for BY through BY+4;
- appropriations, expenditures and receipts for the prior year (PY) and current year (CY);
- balanced statements of the condition of the Treasury at the end of the PY, CY and BY;

- tables explaining, for each legislative proposal establishing or expanding a Government activity or function, the BY through BY+4 appropriation and expenditure effects; and
- miscellaneous provisions regarding uncontrollable expenditures, variations in receipts, etc.

Title 31, U.S.C., Section 1106 (Chapter II, Section 1.B.3.) prescribes informational requirements for a supplemental summary of budget estimates submitted by the President to Congress before July 16th. The supplementary summary is commonly referred to as the "Mid-Session Review". It must include:

- substantial changes in or reappraisals of estimates of expenditures and receipts;
- substantial obligations imposed on the budget after its submission;
- current information on receipts, expenditures, appropriations and the condition of the Treasury;
- additional fiscal information the President decides is advisable;
- information on expenditures for authorized and mandatory programs through BY+4; and
- information on estimated expenditures of carryover balances from the BY.

The General Accounting Office (GAO) is also required to review and analyze Federal programs and activities and provide assistance to Congressional committees in connection with proposed legislation and their review of Federal programs and activities.

Agency records must be available for examination by OMB and GAO or by appropriations committee investigators for purposes of examining estimates, or other authorized purposes.

## 2. Operating Unit Programs

Each operating unit is required to maintain additional program and financial management data not routinely provided to the Department, but expected to be available for special analyses, or as backup information in the justification and review of budgets. Such data should include:

- program, budget and accounting data at the program, project and activity level;
- object class detail at the program, project and activity level;
- worksheets and working papers in support of the budget, containing such information as the details on how its estimates were computed, workload data, cost/benefit analyses, processing methods and the like; and

- program and budget studies which were developed internally to the operating unit.

Operating units are also expected to maintain the kinds of additional program, operating and financial data needed for effective internal management. Such information is often required in order to respond to inquiries on how monies already appropriated are being used, and to demonstrate the effectiveness of current fund management. Such information would include, but not be limited to:

- identification, location and costs of major facilities and installations;
- description of internal organization and processing structure;
- recent experience and status of output and performance with respect to quality, time schedules, backlogs and the like; and
- detailed knowledge of inquiries and investigations, public issues and criticisms, and other such matters including impending problems and issues about which an effective program manager might expect to be concerned.