OPERATIONAL BUDGET REQUEST GUIDANCE FOR FYs 2007 AND 2008

Manage-to-Budget Process

The Agency's new Manage-to-Budget (MTB) process will decentralize more of the Agency's Operating Expense (OE) budget so that each operating unit (OU) controls, budgets and accounts for more of its own OE costs. MTB also will set ratio levels on program funds used for administrative or operational expenses. Operating units are defined as missions, independent offices, and bureaus.

Under MTB, managers may need to question whether the Agency should be performing certain activities that it has historically funded. Managers will need to evaluate funding decisions in an informed and strategic manner and make difficult choices based on cost/value assessments. The ultimate goal of MTB is to help managers be better able to use the Agency's resources most cost effectively to maximize the program resources reaching recipients. All operating units must still comply with Federal and Agency rules and regulations.

The Agency will evaluate MTB's effectiveness in two ways. With the use of expanded object class codes (EOCC) for OE and program funds, the Agency will be better able to monitor and analyze all funds used for operational expenses, from budgeting to obligations to expenditures. To monitor the MTB process and use of EOCCs, the Agency plans to conduct select compliance assessments, similar to audits, in the second half of FY 2007.

Budgeting Under MTB

Under MTB, all operating units that manage program funds must prepare comprehensive FYs 2007 and 2008 operational budgets that include program-funded operational expenses in addition to administrative expense accounts. In general, only OUs that implement and manage programs (i.e., pillar and regional bureaus and missions) should use program funds for operational expenses. OUs that do not manage program funds should prepare only an OE budget.

Operating units should review ADS Chapter 601, Funding Source Policy, and recent implementation guidance on that Chapter to ensure that their funding of operations complies with Agency policy. OUs that may currently program fund OE-mandated functions, as identified in ADS Chapter 601, must correct the funding source and identify the cost implications in their budget requests. Since the ultimate goal of MTB is to maximize the program resources reaching recipients, be conservative in interpreting ADS 601.

The Agency now will conduct a comprehensive review of all operational expenses to set budget allocations. Under this approach, **managers must justify all expenses**, as opposed to only explaining increases over the prior year's budget. An operating unit will have to show why its funding efficiently helps the Agency toward its goals. The Agency expects this approach will help managers to find more cost-effective ways to improve operations and result in more efficient allocation of resources. This approach also should improve cost containment, increase discipline in developing budgets, and eliminate the sense of entitlement to cost increases.

All operating units, including missions, must submit their budget requests to PPC at MTB@usaid.gov by August 11, 2006. Missions also should copy their bureaus. PPC will lead operational budget teams with members from the bureaus and HR in reviewing the requests and recommend allocations to the Administrator by September 1, 2006. PPC will provide OUs with their initial FYs 2007 and 2008 allocations by September 8, 2006. Operating units can request the Administrator reconsider their initial levels, including workforce level assumptions, by September 15, 2006. Final allocations will be set by October 1, 2006. OUs that submit late budget requests may be penalized.

Operational Cost Ratios

As part of the ongoing planning for the Agency-wide roll-out of the Manage-to-Budget initiative in FY 2007, PPC requested data on FY 2006 program-funded operational expenses from all operating units. PPC analyzed the data submitted to develop administrative cost ratios. The percentages identified below reflect the baseline analysis, represent an average across OUs, and include USDH salaries and benefits.

As a guideline, regional bureaus and missions can request no more than 6% of their annual program new obligation authority (NOA) for program-funded operational expenses. Their total operational costs (OE and program-funded) cannot exceed 12% of their annual NOA.

As a guideline, pillar bureaus can request no more than 14% of their annual program NOA for program-funded operational expenses. Their total operational costs (OE and program-funded) cannot exceed 17% of their annual NOA.

Although the operational cost ratios are set as a percentage of new obligation authority, operating units can use their annual OYB, which includes NOA, carryover, and recoveries, to fund their program-funded operational expenses. For example, if Mission X has an FY 2007 NOA of $30 million and FY 2007 OYB of $40 million, it can spend no more than $1.8 million (6% of $30 million) on program-funded operational expenses in FY 2007.

OUs that request budget levels exceeding these ratios must justify their needs.

Operational Budget Requests

In developing their operational budgets, OUs should assume their FY 2007 program levels equal the FY 2007 CBJ levels. For FY 2008 program levels, missions and Washington and overseas regional programs should consult with their regional bureaus for the latest program levels from the F country core teams. Pillar bureaus should use the latest FY 2008 program levels from F.

The operational budget request should contain four brief narrative justifications: (1) 10% reduction from the FY 2006 OE OYB for both FYs 2007 and 2008 (target levels); (2) requirements above the target for both FYs 2007 and 2008 (above-target levels); (3) program-funded operational expenses, if applicable, not exceeding the operational cost ratio for both FYs 2007 and 2008 (target) and requirements above the ratio for both FYs 2007 and 2008 (above-target levels); and (4) workforce.

Note to alternate service provider missions: The AR database table includes the Working Capital Fund as a separate account for identifying their budget requirements.

Operating Expenses

The OE budget requests must include all funding sources specifically designated for operational costs and included in the OE OYB. The OE OYB includes OE, trust funds, ESF funds used for East Timor, and Andean Counterdrug Initiative funds.

In developing their budgets, managers should assume ICASS costs will increase by 7% from FY 2006 and by 7% from FY 2007. Managers should adjust these assumptions for special circumstance (e.g., moves into new embassy compounds). Managers also should assume NEPs/IDIs in training positions will receive up to $150,000 for support costs from a centrally budgeted account (i.e., exclude the support costs from the request). Managers should describe other assumptions (e.g., number of educational allowances, etc.) used in developing the budget.

<u>(1) Target Request (10% Reduction)</u>

All operating units must submit a narrative justification for an FY 2007 and FY 2008 OE budget 10% below the FY 2006 OYB. The justification should discuss how the OE request factors shifting program priorities, efforts to improve efficiency, proposed realignments in resources, and captured savings (e.g., lease savings resulting from co-locations).

It also should discuss the negative implications of a reduced budget, including the:

- impact of anticipated growth in program levels or responsibility
- curtailment of current operations required to cover increased fixed costs, such as inflation in personnel costs, rent increases, etc.
- Agency's increased operational vulnerability

<u>(2) Above-Target Request</u>

Since a reduced OE budget may not meet an Operating unit's needs, OUs may request FY 2007 and FY 2008 levels above their target levels. The narrative justification should describe and quantify the request in terms of:

- Maintenance of current operations
- Changes to/expansion of programs managed
- Staff/items/activities previously program-funded
- Other (trust fund situations, co-locations, regionalization, mission opening/closing, etc.)

(3) Program-funded Operational Expenses

Operating units must report their program-funded operational expenses by EOCC in the AR database, as they currently report for OE. The narrative justification should identify and describe the same factors considered in the OE request(s), as described above. It also should describe and quantify the use of program funds to support program-funded personnel and operating unit operations or oversight. This information is critical to determining Agency total administrative costs and how to fund them.

Operational costs encompass activities performed for USAID's benefit and not the direct benefit of host countries. Please refer to MTB Guidance for Missions (Attachment A) and Additional MTB Guidance for Missions (Attachment B) for information on identifying operational costs.

Note to Washington Offices: Disregard the initial guidance received on identifying operational costs within awards and follow the guidance referenced above. As the referenced guidance explains, OUs must identify the separate operational components of awards. For example, if 20 percent of an award is operational, report 20% of the entire amount as operational.

Assume the following cost-recovery charges for program-funded personnel:

	FY 2007	FY 2008
IT – Overseas	$5,800	$6,100
IT - Washington	$8,800	$9,200
IT – Washington OFDA	$6,300	$6,600
Space –Washington	$10,000	$10,500

(4) Workforce

Through MTB, managers will need to focus on position management -- how they have or will structure their organizations and positions to ensure they optimize economy, productivity, and organizational effectiveness. Managers should consider and address the following criteria when requesting their workforce levels (end-of-year on-board levels):

- All work performed is essential.
- The organizational structure reasonably balances efficiency and effectiveness.
- The organizational structure is sound from a human resources management viewpoint.
- The organizational structure enhances communication, decision-making, and responsiveness.
- Positions and organizational structure are sound from a motivational viewpoint.

The Agency is moving towards a centralized Workforce Planning Model for analyzing the entire workforce. Using information from the Model and overall program requests, budget review teams, comprised of PPC, HR, and the bureaus, will evaluate staffing requests.

The workforce justification narrative should describe how OUs consider program priorities, cost, and security to organize and rightsize their workforce. It also should describe the different general functions of program-funded staff (i.e., USPSCs, FSN, PASA) and discuss how they are aligned with OE-funded staff for overall program management. OUs with specific staffing problems should describe and justify requests for increased staffing. Since PPC and HR will consider these requests in the context of HR's overall Agency workforce planning, discussion of any underlying assumptions is necessary to refine the models used.

Budget Submission

PPC will use the AR database to collect, analyze, and aggregate budget requests**.** Operating units must enter their information into the AR database by August 11, 2006. Enter the target OE, target program-funded operational expenses, and corresponding workforce levels in the target columns. Enter the above-target OE, above-target program-funded operational expenses, and corresponding workforce levels in the request columns.

AR Database – Administrative Expenses Table

OUs must enter their requests for OE and program-funded operational expenses in the new Administrative Expenses table in the AR database. The Administrative Expenses table reflects the new EOCCs and allows data to be collected by account (i.e., OE, Trust Funds, DA, CSH, ESF, etc.). Do not enter estimates for USDH salaries and benefits, as PPC will provide these.

AR Database – New Workforce Table

Operating units must enter their workforce requests in a new workforce table in the AR database. In addition to the workforce information normally collected, the new workforce table will collect: 1) grade level for each position and 2) funding account for each position (for split-funded positions, report the majority account). Identify positions by account so that, in aggregate, the staffing matches total funding. For example, if four positions are split-funded between DA and ESF, identify two positions as DA and two as ESF.

The new workforce table adds institutional support contractor as an employment type. Institutional support contractors provide services that support Agency operations (as described in Attachment B). The services are defined by the provision of labor hours by specifically assigned individuals. Indicators that individuals are institutional support contractor staff include: 1) they work in USAID space, or in contractor space specifically designated for USAID operations; and/or 2) they rely on regular access to the USAID network.

Narrative Justification

Operating units must prepare their narrative justifications using the attached template (Attachment C). Submit narrative justifications to PPC at MTB@usaid.gov by August 11, 2006. For ease in tracking, please write the Budget Request OU name on the e-mail heading (i.e., Budget Request – Peru).

Contact Information

If you have any questions on the budget guidance and AR database, please contact Diana Fernandez/PPC or Theresa Stoll/PPC.