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The Effectiveness of Line-Item Budgeting: A Study of Marina Coast Water District

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The Effectiveness of Line-Item Budgeting:
A Study of Marina Coast Water District

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Abstract

This study discusses the effectiveness of continued usage of the line-item budget process at the Marina Coast Water District in Marina, California. Using interviews of management, staff and public officials of the District, findings will indicate whether an alternative budget process such as multi-year, program or performance based budgeting systems would result in a more effective tool for its users or if preference is for the continued use of the traditional line-item budget. A survey of what type of budget process is used by other water and wastewater districts of the Monterey Bay was performed, and an extensive literature review was been done to discuss alternatives to the line-item budget that the District currently produces and utilizes.

Introduction

Throughout the past eighteen months during the 2008 presidential campaigns, America has heard through television and read in newspapers and on the internet about the state of our nation's economy, that our country is in fiscal crisis. Homeowners are losing their homes in record numbers which in turn means less property tax revenue for local governments. Gas prices have soared driving up the cost of basic necessities of food and clothing all while forcing a halt to new business activity. Government at every level, federal, state, local, and all of the public sector are being asked to do more with less, to provide services with the least amount of resources as possible.

The budget of any government or public sector organization is used to inform the public of its plan to use its resources to provide the services they were formed to perform. In local government and special districts such as the Marina Coast Water District (MCWD) in Marina, California, there are normally two types of budgets, the Operating Budget which consists of items of daily operations that are depleted at the end of the fiscal year and the Capital Budget which consists of long-range, high cost items such as buildings, infrastructure additions or improvements and spans over several fiscal years.

The purpose of this study is to determine whether or not the current line-item budget system used by Marina Coast Water District (MCWD) is effective as a management tool for the users of its budget. Furthermore, the study will strictly address the operating budget of MCWD.

Agency Background

Marina County Water District located in Marina, California was formed in 1966 to build and operate a municipal-owned water district whose service area coincided with existing Marina Fire District. The District's current source of water comes from three deep wells in the nine hundred foot aquifer. In 1970, the district built a sewage treatment plant and disposal system in response to the community's growing sanitation needs. In 1993, Marina County Water District became a member of the joint powers agency, Monterey Regional Water Pollution Control Agency (MRWPCA) which enabled their wastewater to be treated at the regional plant owned by MRWPCA. While the District ceased in treating wastewater, it continues to operate and maintain the sewer collection system. In 1994, the District changed its name to Marina Coast Water District (MCWD) to avoid confusion about being part of the Monterey County government (MCWD Homepage, Retrieved August 15, 2008).

MCWD is governed by a five-member Board of Directors with a staff of thirty. Its mission is "Providing high quality water, wastewater and recycled water service to the District's expanding communities through management, conservation, and development of future resources at reasonable costs." The District's vision is as follows: "The Marina Coast Water District will be the leading public supplier of integrated water and wastewater services in the Monterey Bay Region" (MCWD Homepage, Retrieved August 15, 2008).

Budget Approaches and Types

According to Riley and Colby (1991, p. 23-26), one approach to building a budget is taking a rational approach by basing the budget on tasks the organization intends to perform. It begins by addressing the organization's mission statement and then breaking that down into specific goals. The goals are broken down further into major and short-term objectives. Once the objectives are established, units of service or outputs are determined to accomplish the objectives. Finally, resources or inputs are specified to achieve the level of service. Lee, Johnson and Joyce (2008, p. 154) refer to this process as using strategic planning in performance based budgeting.

The incremental approach to budgeting is based on the last year's budget plus an incremental increase. It is a macro approach which looks at the budget from the top down and takes less time but is also less thorough (Fincke, 2008). Increments are made up of different components (inflation-price, population-quantity, level of service, and productivity.)

Zero based budgeting approach is based on the question, "What if a program was eliminated?" It is a micro approach that looks at the budget from the bottom and takes more time but is also more thorough. Rather than assuming that a base exists, one had to assume that the program could be discontinued (Fincke, 2008).

When preparing the annual budget, local governments typically utilize one of three types of budgets. The first type is the line-item budget which allocates resources to specific objects of cost. The categories of cost objects are personal services which include salaries and benefits, operating expenses which include such items as office supplies and utility costs, and capital outlay such as furniture, office equipment, and vehicles (Riley and Colby, 1991, p. 3.) The detailed format of a line-item budget acts as a good mechanism for controlling costs and resource allocation. This type of budget fits into the rational

model of budgeting in that once resources are established; they are then assigned to specific line items. This essentially lists the inputs required to accomplish the objectives. Line-item budgets are easy to prepare but because of the specific structure, they lack flexibility and offer no information about the activities and functions of the organization (Riley and Colby, 1991, p. 3, 13.)

The second type is the program budget which allocates resources to major program activities rather than to specific line items. The program budget acts as a planning tool on determining how a program or activity will be accomplished. The program budget has more flexibility than the line-item budget model because it simply states the costs in total per program and allows for program areas to cross organizational lines. Furthermore, the program budget fits into the rational input-output model in that it defines the quality and quantity of services to be provided (Riley and Colby, 1991, p. 25.)

The third type is the performance budget which, like the program budget, states the total cost for each activity performed but also states the cost per unit of service for each activity. This method uses performance measures and statistics to determine how much will be allocated to the program and activity. Performance budgeting is used as a

managerial tool which seeks to improve the internal management of the program's efficiency as well as its effectiveness. According to the Government Finance Officers Association (GFOA, 2007), in performance based budgeting (PBB), also referred to as budgeting for results and outcomes, there is a wide variation on how performance data is used during the budgeting process from using performance data to justify departmental requests to budgeting by the results to be achieved.

Furthermore, GFOA supports the National Advisory Council on State and Local Budgeting (NACSLB) and has published recommended practices that capture the four essential principles of effective budgeting set forth by the NACSLB. The specific principles include: (1) set broad goals to guide decisions, (2) develop strategies and financial policies, (3) design a budget supportive of strategies and goals and (4) focus on the necessity of continually evaluating a government's success at achieving the goals that it has set for itself (GFOA, 2007).

Marina Coast Water District (MCWD) uses a line-item budget and presents the line items of the four different cost centers separately and in total. MCWD also provides line-item detail for each department, again broken down by cost center and totaled. The \$17.7 million budget consists

of \$8.1 million operating budget and \$9.6 million capital budget (MCWD 2008-09 Budget, Retrieved August 13, 2008). While individual budget justification is given to each line item within the budget as an appendix of the budget, the departments give no description of the duties and services it provides for and on behalf of the District nor gives specifics such as targets for said services on what the department plans to accomplish with their budgeted resources (Finance Director (FD), MCWD, personal communication, August 12, 2008).

According to the Finance Director (personal communication, August 12, 2008), MCWD uses an incremental approach to budgeting for expenditures and the budget preparation takes approximately six months. The District performs a rate study and analysis every five years and proposes a two year rate schedule in their budget.

Literature Review

An extensive literature review was performed on sources related to budgeting and different budget types. Very few articles were found on line-item budgeting as opposed to the many articles obtained regarding performance based budgeting. The following is a summary of literature reviewed in relation to this study.

"A Study of a Program Budget for a Small City" by Charles Lawrence (1972), is an early view of program budgeting. Lawrence discusses that under traditional practices of line-item budgeting, a government is considered successful if they end the period with the least amount of unspent funds since the funds were mandated (taxes) by law for citizens to pay.

Lawrence proposes a supplementary program budget "to perhaps evoke greater understanding and support from the citizenry." He acknowledges that there are obstacles to such reporting because it takes more time and human resources to accomplish this additional reporting which is difficult for small governments such as Marina Coast Water District but that it supports the proposition of keeping the contributors to a fund informed about how their funds are used in the clearest manner possible.

"A Budget for All Seasons: Why the Traditional Budget Lasts", by Aaron Wildavsky (1978), focuses on the reasons why traditional line-item budgeting is still widely used among governments. Wildavsky asserts that because traditional line-item budgeting is annual, incremental, and conducted on a cash basis; calculations are easier because they are based on history.

He further contends that line-item budgets are still prevalent because they fulfill the earliest purposes of budgeting which is to have control over public funds and accountability to the public. The author addressed other forms of budgeting such as multi-year budgeting, Performance-based budgeting, and Zero based budgeting and explained that while these modern forms of budgeting may be more effective instruments of economic management and planning, the traditional line-item budget endures because it is easier, simpler, more controllable, and more flexible. While this article was written thirty years ago, Wildvasky's reasons may still hold true today thirty years later.

"Managing with Limited Resources: Strategies, Constraints, and Techniques: A Report on the Third Annual Conference of the Section on Budgeting and Financial Management" by L.R. Jones (1992), is a summary of topics covered at the conference including the crisis in budgeting and the challenges to government finance and budgeting. One of the speakers, Alan Schick, said that the federal budget crisis of a projected 852 billion dollars is a result of a couple of things: (1) the lack of discipline in the budgetary process caused by a government divided by political partisanship; and (2) the effectiveness of

special interest groups which results in little or no program cuts.

Other speakers such as John Peterson from the Government Finance Officers Association further explained that the federal crisis tickles down to the state and local government and affects all of the public sector primarily because all sectors have fiscal dependency on the "feds".

"Conditions to implement Outcome-Oriented Performance Budgeting: Some Empirical Evidence" by XiaoHu Wang (1999), is a study that discusses conditions for effectively implementing outcome-oriented performance budgeting. Wang discusses the theory behind performance budgeting, offers a definition of performance budgeting, and finally offers five conditions to implement for successful performance budgeting. These conditions consist of (1) public officials need to identify their motives for using performance measurement and performance budgeting which include external demands for service quality and accountability and internal demands for efficiency and effectiveness; (2) accept the fact that performance budgeting is an evolutionary process because as performance management and reporting increases, the chance of success for the performance budgeting increases; (3) it is important to solve the input-output-outcome puzzle since

the outcome-oriented performance budgeting system links budget inputs and outcomes, and converts them to outcomes of public service which can be difficult because these outcomes may be influenced by socioeconomic factors beyond management control and change over time; (4) although a performance budget system should include different types of measures, outcome measures must play the dominant role because they are the indication that policy maker requirements of service quality; and (5) performance budgeting systems require the inclusion of citizen evaluation and feedback which seems obvious since the citizens are the receivers of the services provided and contributors of the resources used to provide the services.

"Performance Budgeting in Federal, State, and Local Government" by William C. Rivenbark and Janet M. Kelly (2004) is part of four-part performance management series that addresses the current status of performance budgeting at the various levels of government. Rivenbark and Kelly indicate that the roots of performance budgeting began in the 1940's with the Hoover Commission. They offer a definition of performance budgeting as

"A budget preparation and adoption process that emphasizes performance management, allowing allocation decisions to be made in part on the efficiency and effectiveness of service delivery."

Rivenbark and Kelly provide a discussion on the status of performance budgeting at the local level and revealed that the commitment to performance budgeting is more administratively driven as opposed to being mandated by the governing bodies. They further explained that while the success and effectiveness of performance budgeting lies in the tracking of outcome measures of performance, many small governments still tend to report on output measures because they are the least expensive to collect and the easiest to create and track over time.

The authors conclude that compared to Federal and State governments, the outlook on performance budgeting at the local level lacks promise. Not only is it expensive to implement but it (1) does not take the politics out of budgeting, (2) reduce influence of interest groups, (3) cannot refocus citizen priorities, (4) cannot solve a fiscal crisis, and (5) cannot prevent poor managerial decisions.

However, Rivenbark and Kelly offer the following reasons why managers should use performance budgeting to enhance operational accountability: (1) it can align service priorities and service spending, (2) it can add an information dimension to budget deliberations, (3) it can

motivate program managers and employees by recording their progress toward service delivery goals, and finally (4) performance budgeting can help demonstrate to citizens that their public service providers are interested in improving service quality.

In "Aligning Priorities in Local Budgeting Process" Aimee Franklin and Carol Ebdon (2004) compare the perspectives of three different groups of stakeholders: elected officials, administrators, and citizens. The authors found that the elected officials and administrators saw the role of the group of citizens is to provide information and act as a sounding board for community sentiment.

They further discovered that the perceptions of elected officials and administrators depended on the level of trust and confidence of each other. Administrators perceptions of public officials were determined on whether they viewed the official as one with an agenda for his/her constituency or if the official had the government as a whole as primary importance and officials perceptions of administrators relied heavily on whether the administrators show strong leadership, and budget according to officials priorities.

Franklin and Ebdon concluded that whatever the perceptions of each group, citizen participation in the budget process is ultimately dependent on the strong sense of civic duty and a willingness to commit their time to the process of the participants. Currently, Marina Coast Water District has little input on the budget from its citizens other than the few who appear at Board meetings objecting to water and sewer rates.

In "Models of Performance-Measurement Use in Local Governments: Understanding Budgeting, Communication, and Lasting Effects" by Julia Melkers and Katherine Willoughby (2005), it was discovered that that local administrators and budgeters viewed the use of performance measurement positively. The authors found that while respondents of their research did not view performance measurement as vital for decision making in regards to budget, they believed that performance measures enhanced program management.

Methodology

I received a phone call from a friend and former co-worker who had just taken a new position at the Marina Coast Water District (MCWD) in Marina, California. She had been given an assignment and needed to figure out what

budget resources she had available for the project. My friend's complaint was that there were so many line items and so many of the same lines within different cost centers that she couldn't figure out where she should charge the costs to which line items and how much was available for the particular project.

I met her for coffee to go over the budget document with her and figure out what she had to work with which sparked me to question the traditional line-item budget of Marina Coast Water District over other forms of budgets such as multi-year budgets, program budgets and performance based budgets.

Research Questions

- Is the traditional line-item budget of Marina Coast Water District an effective management tool for the District's Board, management, and staff?

Sub-questions

- Who is involved in the budget process?
- Do the users of the budget use it as a management tool?
- What do the users/preparers like and dislike about the current traditional line-item budget of the District?

- What are the possible alternative types of budgets that can be utilized by Marina Coast Water District?

Basic Assumptions

- The Marina Coast Water District's line-item budget is not an effective management tool.
- Users of the Marina Coast Water District's budget want to change from the traditional line-item format to an alternative budget system.

Operational Definitions

1. Effectiveness - For the purposes of this study, effectiveness shall be defined as the ease of use and understanding of those who use the MCWD budget.
2. Line-Item Budget - A budget in which monies are allocated to specific items or objects of cost.
3. Program Budget - A budget where allocations are made to major program areas or activities rather than to specific line items.
4. Performance based Budget - A budget that allocates money to various programs within an organization but also details the level of service on which the budget is predicated.

Review of Literature

My research methodology initially focused on a review of relevant literature on the traditional line-item budget

process and its alternatives. I found no articles on the traditional line-item budget written after 1978. In contrast, I found multiple articles on program and performance based budgeting. In fact, many recommended practices written by the Government Finance Officers Association are on budgeting for outcomes and performance based budgeting.

Interviews/Survey

Interviews were conducted with MCWD staff, management and Board to determine the perceptions of those who use the budget and its effectiveness as a management tool. The respondents were asked of their involvement in the budget process and how they felt about their agency's budget. The respondents were also asked what they thought were the pluses and minuses of the agency budget. Respondents were then asked what participation they had in the execution phase of the budget process.

Key informant interviews were also conducted with the District General Manager, Management Services Administrator, and the Director of Finance to gain insight on the actual process and to obtain a background of the District. I agreed not to include a survey of MCWD customers in my research. Both the Finance Director and General Manager believed that due to lack of customer

presence during rate and budget study sessions, which are public meetings, the budget format of the District was a non-issue. Furthermore, both were apprehensive with raising a non-issue to customers which could possibly elevate it to an area of concern among the ratepayers.

A brief phone survey of other local water and wastewater collection service providers was conducted to obtain what type of budgeting system they used.

Researcher Qualifications

Additional perspectives were gleaned from my experience as an accountant with over twenty years in the public sector and whose last eight years being spent as Accounting Supervisor for a wastewater agency whose service area includes the service area of Marina Coast Water District.

Results and Findings

The answer to the primary research question of this study, "Is the traditional line-item budget of Marina Coast Water District an effective management tool for the District's Board, management, and staff?" is a resounding, "YES."

Summary of Personal Interviews/Survey

Personal interviews were conducted with various staff, managers, and Board members using the same set of questions. The respondents include a Board member (BM), the General Manager (GM), the Management Services Administrator (MSA), the Maintenance and Operations Manager (MOM), the Finance Director (FD), the Executive Assistant/Clerk of the Board (EA), and the Accounting Technician (AT). The following is a brief summary of answers of the respondents to some of the interview questions:

Question 1 - What is your level of participation in the budget process?

Board Member	Review proposed budget and offer suggestions at the Board's budget workshop and ultimately approve.
General Manager	Review every stage of budget from rate analysis to presentation to the Board.
Management Services Administrator	Had no participation due to being a new employee. Plans to provide staffing level, salary and benefit information for future budgets.
Maintenance & Operations Manager	Provide input of department needs, meet with FD every other month to review needs for budget adjustments and transfers.
Finance Director	Involved at every stage.
Executive Assistant/Clerk of the Board	None.
Accounting Technician	Provide calculations to FD as requested and perform all data entry, printing, duplicating and distribution.

Question 3 - What do you see as pluses and minuses of the District's budget?

	+	-
Board Member	Likes presentation and format of the budget and believes it to be a reasonable and conservative budget.	
General Manager	Likes that historical information is included.	Lacks variance percentages.
Management Services Administrator		Too detailed; too many line items; not broken down by department.
Maintenance & Operations Manager	Most items are relatively fixed. Only have to estimate and anticipate repair costs.	A bit complicated.
Finance Director	Likes that it is a detailed format so that Board knows what exactly is going on and involved in budget. Also likes that it is easy to execute and implement.	Very time consuming - 6 months start to finish; need to present and get approval from Fort Ord Reuse Authority (FORA) as well as own Board.
Executive Assistant/Clerk of the Board		
Accounting Technician	Ease to execute because of the many detailed line items.	Some spreadsheets within the document can become difficult to read because too many columns are used.

Question 5 - What improvements would you suggest to make the budget a more effective tool?

Board Member	Would like to see multi-year budgeting incorporated into the budget process and would like to have better estimates at the beginning of the budget process.
General Manager	Would like to see a more condensed format and variance percentages included in the budget.
Management Services Administrator	Would like to have included in budget document a summary of costs by program or function.
Maintenance & Operations Manager	Would like to have the process streamlined on how the budget is formulated and prepared and to have it less detailed.
Finance Director	Would like to have only have Board approve budget instead of Board and FORA, would like to see the line items summarized further, and would like to shorten the process.
Executive Assistant/Clerk of the Board	No.
Accounting Technician	No.

Question 6 - Are you aware of alternatives to the District's current budget system?

Board Member	Yes; familiar with program budgeting and performance based budgeting concepts but has never seen them actually utilized.
General Manager	Yes; would like to see some performance measures and outcomes included in the budget.
Management Services Administrator	Yes; previous place of employment had been considering performance based budgeting.
Maintenance & Operations Manager	No.
Finance Director	Yes but instead of changing budget process would like to mail out a condensed report

	on performance measures.
Executive Assistant/Clerk of the Board	No.
Accounting Technician	No.

As can be seen by the answers, all but one manager had positive comments about the current line-item budget. The Executive Assistant was the only staff interviewed that had no involvement in the budget process. All minus answers as well as suggestions for improvement were not to change from the line-item format but to improve or enhance it.

Four neighboring water and wastewater districts were surveyed by phone to find out what type of budgeting system they used. All four districts utilize the traditional line-item budget. Two of the four districts included some sort of program information and/or performance outcomes and all four agencies included the line-item break down within each department.

Name	Budgeting System	Program/Performance Information
Carmel Area Wastewater District	Line-Item	None
Castroville Water District	Line-Item	None
Pajaro Valley Water Management Agency	Line-Item	Program
Monterey Regional Water Pollution Control Agency	Line-Item	Program

Alternative budgeting systems for MCWD

The literature review revealed that performance based budgeting is the most effective alternative over line-item budgeting. In order for MCWD to move from a line-item budget to a performance based budget, the District may use the recommended steps of transition from GFOA (GFOA, 2007) which are:

- (1) Determine how much money is available.
- (2) Prioritize results or outcomes that matter most to citizens or customers of government.
- (3) Allocate resources among high priority results fair and objectively.
- (4) Conduct analysis to determine what strategies, programs, and activities will best achieve the desired outcomes.
- (5) Budget available dollars to the most significant programs and activities in order to maximize the benefit of available resources.
- (6) Set measures of annual progress, monitor, and feedback loop. The measures should spell out the expected results and outcomes and how they will be measured.

- (7) Check what actually happened which involves performance measures to compare actual versus budgeted results.
- (8) Communicate performance results to internal and external stakeholders in an understandable format.

Conclusion

"If it ain't broke, don't fix it!" The personal interviews of various users of the Marina Coast Water District's Budget and a survey of water and wastewater districts in the area clearly reveal line-item budgeting is an effective management tool for districts such as MCWD. Even though recommended practices of the Government Finance Association are dominated by performance based budgeting directives, line-item budgeting still is the dominant system of budgeting for these districts today.

Recommendation

While the results and findings of this study indicate that line-item budgets such as Marina Coast Water District's are still effective for its users, it seems that all budget formats should be included in an organization's budget. The reader/user of the budget should not only know what types of expenses the organization intends to allocate

their resources towards but also what programs will be utilizing the resources.

Furthermore, it would also be valuable for the reader/user to know the unit and total cost of the product/service of the program that will be providing by utilizing the resources. Lastly, by communicating its efficiency and effectiveness through using performance measures in the budget, organizations such as the Marina Coast Water District can inform, not only those who use the budget but also the ratepayers, that it is fulfilling its mission of "Providing high quality water, wastewater and recycled water service to the District's expanding communities through management, conservation, and development of future resources at reasonable costs."

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My name is Kelly Cadiente. I am a graduate student at Golden Gate University. I am doing research on Line-Item budgeting and implementation at MCWD.

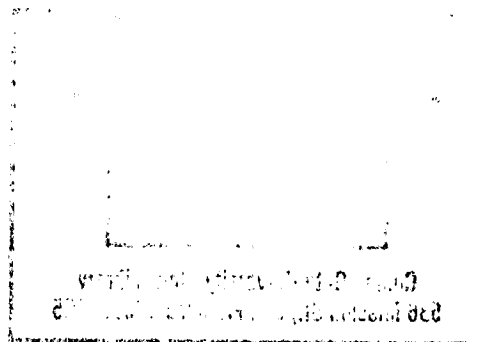
My interviews will be confidential, and I will not be mentioning any names in the report. Thank You.

1. What is your level of participation in the budget process?
2. What are your feelings about the District's budget?
3. What do see as the pluses and minuses?
4. What action steps do you take in the implementation phase of the budget process?
5. What improvements would you suggest to make the budget process a more effective tool?
6. Are you aware of alternatives to your current budgeting system?

My name is Kelly Cadiente. I am a graduate student at Golden Gate University. I am doing research on Line-Item budgeting.

My survey will be anonymous and confidential, and I will not be mentioning any names in the report. Thank You.

1. Is your budget a line-item, program, or performance based budget?
2. If you use line-item budgeting, what if any program and/or performance information do you include in your budget?



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