

# **A REVIEW OF THE CAPITAL IMPROVEMENT PROJECT ALLOTMENT PROCESS AND THE MEMORANDUM OF UNDERSTANDING BETWEEN THE DEPARTMENT OF EDUCATION AND THE DEPARTMENT OF BUDGET AND FINANCE**

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## FOREWORD

This report was prepared in response to Act 123, Session Laws of Hawaii 2009, which directs the Bureau to review the memorandum of understanding between the Department of Education and the Department of Budget and Finance with regard to the capital improvement projects allotment process, with the goal of replicating the processes of the memorandum of understanding for use by other state agencies with many capital improvement projects that are predominantly funded by general obligation bonds.

This report sets forth the Bureau's findings, recommendations, and proposed legislation in accordance with the Bureau's review of the memorandum of understanding.

The Bureau wishes to acknowledge the cooperation and assistance of the several state agencies that were consulted during the preparation of this report. The Bureau consulted the Department of Education, the Department of Budget and Finance, the Office of the Attorney General, the Department of Accounting and General Services, the Department of Land and Natural Resources, and the University of Hawaii.

Ken H. Takayama  
Director

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## **FACT SHEET**

**Q. What is the capital improvement project allotment process?**

- A. The capital improvement project allotment process is initiated by the submission of the allotment request, and basically consists of the following four steps, which are as follows:
1. The expending department submits an allotment request to the Governor, through the Department of Budget and Finance, for the release of funds for a capital improvement project;
  2. The Department of Budget and Finance reviews the allotment request to ensure conformity with statewide planning goals, objectives, and priorities, and each expending department's CIP implementation plan, and makes a recommendation to the Governor to release funds;
  3. The Governor issues an allotment advice to the expending department, approving the allotment of a legislative appropriation for the capital improvement project;
  4. The expending department then proceeds to expend or encumber the funds allotted for the capital improvement project.

**Q. Is the capital improvement project allotment process established under statute?**

- A. No, the capital improvement project allotment process is established under executive memoranda issued by the Governor. The Legislature, by statute, authorized the Director of Finance to establish an allotment process for capital improvement projects that is separate from the quarterly allotment system that the Legislature established by statute for operating expenditures.

**Q. What is the document that expending departments use to list their capital improvement project priorities?**

- A. That document is the CIP implementation plan, which is submitted by each expending department to the Department of Budget and Finance generally by mid-August each fiscal year, and which the Director of Finance uses to review allotment requests. The implementation plan lists, in order of departmental priority, all authorized projects for which the expending department plans to request allotments in that fiscal year.

**Q. What are the statewide planning goals, objectives, and priorities, which the Director of Finance uses to review a department's allotment request?**

- A. They are the goals, objectives, and priorities found in the Hawaii State Planning Act.

**Q. What is the "Memorandum of Understanding Between the Department of Education and the Department of Budget and Finance for the Allotment of Capital Improvement Project Funds and Other Fiscal Matters"?**

- A. The Memorandum of Understanding is an agreement between the Department of Education and the Department of Budget and Finance that was entered into on June 28, 2006, and took effect from July 1, 2006. The terms of the agreement cover several types of fiscal matters, among them, the capital improvement project allotment process, deposits of funds into the State Educational Facilities Improvement Special Fund, debt service calculation, employee benefits calculation, funding of collective bargaining increases, federal funds, and other fiscal issues. The Memorandum of Understanding is automatically extended without further action by the departments each July 1, unless terminated in accordance with the terms of the Memorandum of Understanding. In the event of a conflict with any written budget execution memorandum or policy, the terms of the Memorandum of Understanding controls.

With regard to the capital improvement project allotment process, the Memorandum of Understanding sets out four major provisions, as follows:

- (1) The two departments agree to use the capital improvement projects priority list provided by the Department of Education as the basis for determining capital improvement project priorities for allotments for the year;
- (2) The Department of Budget and Finance provides the Department of Education with an estimate of the total amount of moneys to be available for the Department of Education's capital improvement projects for the year;
- (3) The departments discuss procedures and a schedule for the allotment of the Department of Education's capital improvement project moneys, and the departments respond to each other's requests in a reasonable time; and
- (4) If the Governor does not authorize allotment of moneys for a capital improvement project on the capital improvement priority list, the Department of Education may then submit additional allotment requests following the sequence in the capital improvement priority list.

**Q. What is the Department of Education's CIP Priority Matrix?**

- A. The CIP Priority Matrix is a planning related form that the Department of Education developed and uses to prioritize its capital improvement projects. The matrix is a rectangle divided into five rows of priority levels and four columns of alphabetized categories, for a total of twenty cells. The four categories are:

- A Health, Safety, Security, and Emergency
- B Classrooms
- C Support Facilities
- D State & District Facilities

The placement of a project into one of the twenty cells of the matrix determines its priority with relation to a project placed into another cell. The matrix governs the universe of all projects, so all projects will fall somewhere within the matrix. The order of priority within the matrix proceeds in a zigzag pattern, that is, from left to right, and top to bottom, as indicated by the ordinal numbers in the table below:

	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>
1	1st	2 <sup>nd</sup>	3 <sup>rd</sup>	4th
2	5th	6 <sup>th</sup>	7 <sup>th</sup>	8th
3	9th	10 <sup>th</sup>	11 <sup>th</sup>	12th
4	13th	14 <sup>th</sup>	15 <sup>th</sup>	16th
5	17th	18 <sup>th</sup>	19 <sup>th</sup>	20th

**Q. What is the Department of Education's assessment of its experience with the Memorandum of Understanding?**

A. The Department of Education is reportedly quite happy with the Memorandum of Understanding, based upon its experiences with the allotment process, both before and after use of the memorandum was instituted. The Department of Education indicated that the Memorandum of Understanding has increased the efficiency of the capital improvement project allotment process by providing predictability and increased certainty in the allotment process.

**Q. What is the position of the Department of Budget and Finance with respect to applying the processes of the Memorandum of Understanding, with regard to the capital improvement project allotment process, to other state agencies that have many capital improvement projects predominantly funded by general obligation bonds?**

A. The Department of Budget and Finance indicated it will give its best faith efforts to implement the processes of the Memorandum of Understanding for use by other state agencies immediately upon the effective date of any such legislation to adapt those processes. However, the Department of Budget and Finance views the Memorandum of Understanding as an administrative function and reports it will lose some of its administrative flexibility if the processes of the Memorandum of Understanding were legislatively mandated to apply to other state agencies.

**Q. In addition to the Department of Education, which state agencies have many capital improvement projects predominantly funded by general obligation bonds?**

A. The Department of Accounting and General Services, the Department of Land and Natural Resources, and the University of Hawaii.

**Q. What is the position of these state agencies with respect to applying the Memorandum of Understanding with regard to the capital improvement project allotment process?**

A. Their positions appear to range from opposition, to neutrality, to mild support, at best. They indicated that they do not find any fault with the present allotment process that requires a legislative remedy.

## Chapter 1

### INTRODUCTION

Act 123, Session Laws of Hawaii 2009, section 2(a), which sets out the main directive of the act, directs the Legislative Reference Bureau to:

...review the memorandum of understanding between the department of education and the department of budget and finance for the allotment of capital improvement projects, with the goal of replicating the processes of the memorandum of understanding for use by other state agencies with many capital improvement projects that are predominantly funded by general obligation bonds...

(See Appendix A.)

In other words, the ultimate directive of Act 123 appears to be adapting the Memorandum of Understanding into some form of legislation for the benefit of other state agencies.

The study is organized into five chapters, described as follows:

The first chapter is the introduction.

The second chapter is a background discussion of the capital improvement projects allotment process.

The third chapter is a discussion of the background and terms of the Memorandum of Understanding between the Department of Education and the Department of Budget and Finance. The chapter also indicates how the capital improvement projects allotment process is affected by the Memorandum of Understanding. The chapter specifically responds to section 2(b) of Act 123, which directs the Bureau to provide:

... an analysis of pertinent issues, including ... [t]he terms of understanding, ... [t]he period of agreement and other terms; and ... [a]ny other issues that may arise during the review.

The fourth chapter is a discussion of the issues involved in adapting the Memorandum of Understanding for use by other state agencies. The chapter specifically responds to section 2(a) of Act 123, which directs the Bureau to review:

- (1) Concerns or recommendations for changes that either the department of education or the department of budget and finance have regarding the terms of the current memorandum of understanding;

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- (2) Changes that would be required in adapting the memorandum of understanding procedures for use by other state agencies and the department of budget and finance, including statutory amendments; and
- (3) Recommendations and a proposed timetable for adoption of the processes of the memorandum of understanding for use by other state agencies and the department of budget and finance.

The fourth chapter also provides agency feedback from state agencies other than the Department of Education that have many capital improvement projects predominantly funded by general obligation bonds.

The fifth chapter contains our findings and recommendations.

## Chapter 2

### THE CAPITAL IMPROVEMENT PROJECT ALLOTMENT PROCESS

The allotment process for capital improvement projects is an administrative function that has its basis in the Hawaii State Constitution and the statutes, and is established in the executive memoranda. Specifically, the State Constitution empowers the Legislature to establish a means to control the rate of state expenditures. For operating expenditures, the Legislature has established a quarterly allotment system. But for capital improvement projects, the Legislature has authorized the Director of Finance to administratively establish a separate allotment process. The Director of Finance establishes that separate allotment process through the issuance of executive memoranda.

We explain in more detail below.

#### The 1950 Constitutional Convention

The first sentence of Article VII, section 5, of the State Constitution, on expenditure controls, proclaims as follows:

Provision for the control of the rate of expenditures of appropriated state moneys, and for the reduction of such expenditures under prescribed conditions, shall be made by law.

In other words, the State Constitution empowers the Legislature to establish a system of expenditure controls for appropriations. The constitutional provision was framed by the Constitutional Convention of 1950,<sup>1</sup> and is a part of the original State Constitution<sup>2</sup> that took effect immediately upon the admission of Hawaii into the Union as a state<sup>3</sup> through a presidential

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<sup>1</sup> Specifically, the provision was substantially drafted by the Committee of the Whole and refined into its present form by the Committee on Style. The provision as drafted by the Committee of the Whole read as follows:

SECTION 4. Expenditure of Money. The legislature shall provide means for the control of the rate of expenditures of appropriated State moneys, and for the reduction of such expenditures in such manner and under such conditions as it may prescribe.

Proceedings of the Constitutional Convention of Hawaii 1950, Volume I, Journal and Documents, 1960, Committee of the Whole Report No. 18, including Committee Proposal No. 10, RD 1; Standing Committee Report No. 122, including Committee Proposal No. 10, RD 2 (Committee on Style).

<sup>2</sup> The sentence was originally numbered Article VI, section 7, with the same title "Expenditure Controls." Proceedings of the Constitutional Convention of Hawaii 1950, Volume I, Journal and Documents, 1960, Appendices, State Constitution, p. 425.

<sup>3</sup> Proceedings of the Constitutional Convention of Hawaii 1950, Volume I, Journal and Documents, 1960, Appendices, State Constitution, p. 430: "This constitution shall take effect and be in full force immediately upon the admission of Hawaii into the Union as a State."

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proclamation issued on August 21, 1959.<sup>4</sup> The provision as it reads supersedes an earlier draft, under which the State Constitution would have empowered the Governor, rather than the Legislature to establish a system of expenditure controls for appropriations.<sup>5</sup>

With regard to appropriations for operating expenditures, the Constitutional Convention was evidently satisfied with the quarterly allotment system, which reportedly had been successfully used by the Territory of Hawaii for some time under statutory authority. The convention quoted an authority in the field of public administration who had stated that:

Allotments, that is, monthly or quarterly allocations, have been widely used as a method of controlling the rate of expenditure under appropriations for all operating purposes ....<sup>6</sup>

With regard to appropriations for capital improvement projects, the 1950 Constitutional Convention envisioned that the plan of proposals set forth in the capital improvement projects portion of the budget bill would be such that:

If successfully worked out, such a plan would result in a more equitable division of capital improvements among the several departments of the government and should very definitely provide for the most urgent projects to be constructed first.<sup>7</sup>

## **The 1959 Legislation**

The Legislature has carried out its constitutional power by establishing the allotment system, which is found in part II of chapter 37, Hawaii Revised Statutes. The Legislature enacted the original provisions of the allotment system in 1959,<sup>8</sup> based upon the suggestions of

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<sup>4</sup> Presidential Proclamation No. 3309, August 21, 1959, 24 F.R. 6868, 73 Stat. c74.

<sup>5</sup> The version that the Committee of the Whole received from the Committee on Taxation and Finance empowered the Governor, rather than the Legislature, to provide the means to control expenditures. The provision as drafted by Committee on Taxation and Finance read as follows:

SECTION 7. Expenditure of Money. Whenever anticipated revenues fall below the revenue estimates upon which appropriations were based, or whenever the Governor is authorized by law to effect other economies, the Governor, to the extent proper to effect such economies, shall have authority to reduce expenditures of state monies below appropriations, and through allotments or otherwise, to control the rate at which such appropriations are expended during the fiscal period, provided, that the legislature, by resolution concurred in by a majority of the members of each House, may exempt specific appropriations for the legislative department from the exercise of this power by Governor.

Proceedings of the Constitutional Convention of Hawaii 1950, Volume I, Journal and Documents, 1960, Standing Committee Report No. 51, including Committee Proposal No. 10 (Committee on Taxation and Finance).

<sup>6</sup> Proceedings of the Constitutional Convention of Hawaii 1950, Volume I, Journal and Documents, 1960, Standing Committee Report No. 51 (Committee on Taxation and Finance), p. 195. The quote is attributed to A.E. Buck.

<sup>7</sup> Proceedings of the Constitutional Convention of Hawaii 1950, Volume I, Journal and Documents, 1960, Standing Committee Report No. 51, including Committee Proposal No. 10 (Committee on Taxation and Finance), p. 193.

<sup>8</sup> Act 12, Session Laws of Hawaii 1950 1<sup>st</sup> Special Session.

the Committee on Finance and Taxation of the 1950 Constitutional Convention.<sup>9</sup> The 1959 legislation still forms the basic framework of these statutory provisions today.

In establishing the allotment system, the Legislature intended that the total appropriations made by it, or the total of any budget approved by it, for any department or establishment, should be deemed to be the maximum amount authorized to meet the requirements of the department or establishment for the period of the appropriation.<sup>10</sup> Furthermore, the Legislature intended that the Governor and the Governor's Director of Finance should be granted such powers to effect savings "by careful supervision throughout each appropriation period with due regard to changing conditions; and by promoting more economic and efficient management of state departments and establishments."<sup>11</sup>

The allotment system applies to all appropriations made by the Legislature for all "departments and establishments."<sup>12</sup> It applies to appropriations to departments and establishments at both the state and county levels of government.<sup>13</sup> At the state level of government, the allotment system applies to the executive branch, but not to the legislative or judicial branches.<sup>14</sup>

Under the allotment system, each fiscal year is generally divided into four quarterly allotment periods, beginning respectively on the first days of July, October, January, and April.<sup>15</sup> A quarterly allotment of the legislative appropriation is made to a department after the department submits an estimate to the state Director of Finance of the amount required to carry on the work of the department during that quarter.<sup>16</sup> Allotments may be either modified<sup>17</sup> or reduced<sup>18</sup> by the Director of Finance. Where a quarterly allotment period is impracticable, the Director of Finance may prescribe a different allotment period, but a period nonetheless, suited to the circumstances, but not exceeding six months or extending beyond the end of the fiscal year.<sup>19</sup>

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<sup>9</sup> House Journal 1959 1<sup>st</sup> Special Session, House Standing Committee Report No. 99.

<sup>10</sup> Hawaii Revised Statutes section 37-31.

<sup>11</sup> *Id.*

<sup>12</sup> Hawaii Revised Statutes section 37-33.

<sup>13</sup> The general appropriation acts appropriate funds to the counties for both operating expenditures and capital improvement projects. *See, e.g.,* Act 213, Session Laws of Hawaii 2007. The executive memoranda provisions relating to allotment requests for capital improvement projects are addressed to both state and county agencies. *See, e.g.,* Executive Memorandum 97-07 (June 19, 1997).

<sup>14</sup> Hawaii Revised Statutes section 37-33.

<sup>15</sup> Hawaii Revised Statutes section 37-32.

<sup>16</sup> Hawaii Revised Statutes section 37-34.

<sup>17</sup> Hawaii Revised Statutes section 37-36.

<sup>18</sup> Hawaii Revised Statutes section 37-37.

<sup>19</sup> Hawaii Revised Statutes section 37-32.

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However, much of the allotment system applies only to operating costs, which are statutorily defined as the recurring costs of operating, supporting, and maintaining authorized programs, including the costs of salaries and wages, employee benefits, lease payments, supplies, materials, equipment, and motor vehicles.<sup>20</sup>

For capital improvement projects, on the other hand, section 37-33, Hawaii Revised Statutes, authorizes the state Director of Finance to establish a non-periodical allotment system that is separate from the periodical allotment system that is otherwise established under part II of chapter 37. Section 37-33 states in part that:

In the cases of capital improvements ... where periodical allotments are impracticable, the director of finance may dispense therewith [from most of the allotment system established in part II of chapter 37, except for section 37-43] and prescribe such regulations as will insure proper application and encumbering of funds.

Capital improvement project costs are indirectly defined by statute as the costs associated with capital investments, including the costs of acquisition and development of land, the design and construction of new facilities, and the making of renovations or additions to existing facilities.<sup>21</sup>

## **The Administration**

Pursuant to the Legislature's complete delegation of authority with regard to an allotment process for capital improvement projects, the state Director of Finance has dispensed with most of the allotment system legislatively established in part II of chapter 37 and has instead established an allotment process administratively. The "regulations prescribed" at the executive level pursuant to section 37-33 are not administrative rules directed at the public and adopted after notice and a public hearing. Rather, they are executive memoranda directed at the executive branch departments (and the counties) and issued by the Governor.

There are two sets of governing executive memoranda, and they apply to all means of financing for a capital improvement project.

The first is the single Executive Memorandum No. 97-07, which was issued by the Governor on June 19, 1997. It is addressed to all state and county governments and agencies expending capital improvement project funds and covers guidelines and instructions relating to procedures for requesting the implementation of capital improvement projects. Basically, the memorandum explains how to submit an allotment request. Specifically, it explains what forms to submit and what information to provide in those forms.

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<sup>20</sup> Definition of "operating costs," Hawaii Revised Statutes section 37-62.

<sup>21</sup> Definition of "capital investment costs," Hawaii Revised Statutes section 37-62, which indirectly defines "capital improvement costs" by first defining "capital investment costs" and then specifying that the "Capital investment costs for a program are the sum of the program's capital improvement project costs."

The second is the fiscal year budget execution policies and instructions, which are re-issued annually by the Governor, usually before the start of each fiscal year.<sup>22</sup> They are addressed to all department heads and apply to all legislative appropriations, regardless of the means of financing, authorized by the general appropriations act and supplemental appropriations act (in odd numbered fiscal years such as fiscal year 2009) and other specific legislative appropriations authorized for expenditure in the fiscal year in which the budget execution policies and instructions are issued. In other words, the budget execution policies and instructions cover operating expenditures as well as capital improvement projects. With regard to capital improvement projects, the budget execution policies and instructions contain instructions on submitting departmental capital improvement project implementation plans and further instructions on the capital improvement project allotment procedures.

The two sets of executive memoranda cross reference each other and are evidently intended to be used in conjunction with each other. On the one hand, Executive Memorandum 97-07 states that:

All user agencies responsible for capital improvements authorized by the Legislature must submit a CIP Implementation Plan for review. Instructions regarding this plan and information on planned expenditures will be issued under separate cover.<sup>23</sup>

On the other hand, the budget execution policies and instructions state that:

In general, departments are directed to consult guidelines and instructions in E.M. No. 97-07, "Procedures for Requesting the Implementation of Capital Improvement Projects," dated June 19, 1997. The following updated and/or amended guidelines shall also apply:<sup>24</sup>

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<sup>22</sup> We reviewed budget execution policies and instructions from previous years that are on the Department of Budget and Finance website. Specifically:

Executive Memorandum 08-03	FY 09 Budget Execution Policies and Instructions
Executive Memorandum 07-01	FY 08 Budget Execution Policies and Instructions
Executive Memorandum 06-04	FY 07 Budget Execution Policies and Instructions
Executive Memorandum 05-01	FY 06 Budget Execution Policies and Instructions
Executive Memorandum 04-02	FY 05 Budget Execution Policies and Instructions
Executive Memorandum 03-09	FY 04 Budget Execution Policies and Instructions

<sup>23</sup> Executive Memorandum 97-07, CIP Implementation Plan, p. 1.

<sup>24</sup> See e.g., Executive Memorandum 08-03, p. 19.

## **The Capital Improvement Project Allotment Process**

Based upon the budget execution policies and instructions and Executive Memorandum 97-07, the capital improvement project allotment process is initiated by the allotment request. The core steps of the capital improvement project allotment process may be outlined as follows:

1. As the need to implement arises, the expending department submits an allotment request to the Governor, through the Department of Budget and Finance, for the release of funds for a capital improvement project;<sup>25</sup>
2. The Department of Budget and Finance:
  - (a) Reviews the allotment request to "ensure conformity with statewide planning goals, objectives, and priorities, and each department's CIP implementation plan;"<sup>26</sup> and
  - (b) Makes a recommendation to the Governor to release funds;<sup>27</sup>
3. The Governor issues an "allotment advice" to the expending department, approving the allotment of a legislative appropriation for the capital improvement project;<sup>28</sup>
4. The expending department then proceeds to expend or encumber the funds allotted for the capital improvement project.<sup>29</sup>

## **Review Standards**

To reiterate, under step 2 of the allotment process, the Director of Finance reviews an allotment request to ensure conformity with statewide planning goals, objectives, and priorities, on the one hand, and each department's CIP implementation plan, on the other.<sup>30</sup>

First, the "statewide planning goals, objectives, and priorities" of Executive Memorandum 97-07<sup>31</sup> is evidently a reference to the "statewide planning goals and objectives and executive priorities" of section 37-43, Hawaii Revised Statutes, on the capital improvement project allotment process. The "statewide planning goals and objectives and executive priorities" of section 37-43 is, in turn, evidently a reference to certain part headings of the Hawaii State Planning Act, chapter 226, Hawaii Revised Statutes, specifically, part I, entitled "Overall Theme, Goals, Objectives and Policies" and part III, "Priority Guidelines."

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<sup>25</sup> Budget execution policies and instructions, CIP Expenditures, CIP Allotment Procedures.

<sup>26</sup> Executive Memorandum 97-07, Project Implementation Procedures, p. 2.

<sup>27</sup> Executive Memorandum 97-07, Appendix A, Allotment Advice (A-15).

<sup>28</sup> Executive Memorandum 97-07, Project Implementation Procedures, p. 1-2; Appendix A, Allotment Advice (A-15).

<sup>29</sup> Executive Memorandum 97-07, pp. 1-2.

<sup>30</sup> Executive Memorandum 97-07, Project Implementation Procedures, p. 2.

<sup>31</sup> Executive Memorandum 97-07, Project Implementation Procedures, p. 2.

Second, the "CIP implementation plan" is a document submitted by each expending department to the Department of Budget and Finance generally by mid-August each fiscal year. A form for the CIP implementation plan (Form C) is provided as an attachment in the budget execution policies and instructions. The implementation plan lists, in order of departmental priority, all authorized projects for which the expending department plans to request allotments in that fiscal year. For each capital improvement project, the implementation plan lists the following basic information about the project:

- (1) Departmental priority;
- (2) Authorizing act and year of act;
- (3) Project title and brief project description;
- (4) Whether project is an executive project or a project added by the Legislature;
- (5) The means of financing;
- (6) Appropriation amount;
- (7) Prior allotments;
- (8) Planned allotments for the first half of the fiscal year;
- (9) Planned allotments for the second half of the fiscal year; and
- (10) Comments.

Furthermore, the budget execution policies and instructions require that all allotment requests must be consistent with the departmental implementation and appropriate financial plans.<sup>32</sup>

## Next Chapter

The foregoing discussion generally applies to all expending departments of the executive branch of state government. However, for the Department of Education, the allotment process is also affected by a 2006 memorandum of understanding between the Department of Education and the Department of Budget and Finance. In other words, the capital improvement project allotment process for the Department of Education is governed by Executive Memorandum 97-07, the fiscal year budget execution policies and instructions, and the Memorandum of Understanding.

The Memorandum of Understanding is discussed in the next chapter.

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<sup>32</sup> Budget execution policies and instructions, CIP Expenditures, Implementation Plans, Form C.

## Chapter 3

### THE MEMORANDUM OF UNDERSTANDING

This chapter discusses the Memorandum of Understanding. In part, it discusses the terms of understanding of the Memorandum of Understanding, as directed under Act 123, which specifies as follows:

- (b) The review shall include an analysis of pertinent issues, including:
  - (1) The terms of understanding, in particular the:
    - (A) Capital improvement projects allotment process;
    - (B) Procedures for deposits of funds;
    - (C) Debt service calculations;
    - (D) Federal funds; and
    - (E) Other fiscal issues;
  - (2) The period of agreement and other terms; and
  - (3) Any other issues that may arise during the review.<sup>1</sup>

#### Background of the Memorandum of Understanding

The Memorandum of Understanding is a byproduct of the interagency working group that was established under the "Reinventing Education Act of 2004," Act 51, Session Laws of Hawaii 2004, to develop comprehensive plans for transferring certain rights, powers, functions, duties, and resources of various executive departments to the Department of Education.<sup>2</sup> In particular,

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<sup>1</sup> Act 123, Session Laws of Hawaii 2009, section 2(b) (1) to (3).

<sup>2</sup> According to its findings and purpose section, Act 51 consisted of a coordinated package of initiatives aimed at implementing comprehensive education reform in Hawaii's public schools. Its main elements included:

- (1) Establishing a weighted student formula;
- (2) Providing additional information technology;
- (3) Empowering principals through a Hawaii principals academy and other means;
- (4) Strengthening community involvement through school community councils and parent-community networking centers;
- (5) Providing more mathematics textbooks;
- (6) Lowering class size in kindergarten, grade one, and grade two;
- (7) Providing full-time, year-round, high school student activity coordinators;
- (8) Providing support for students who need additional help to succeed in school;
- (9) Establishing a national board certification incentive program for teachers;
- (10) Enhancing teacher education;
- (11) Reducing the bureaucracy that hampers the effectiveness of the department of education;
- (12) Improving the educational accountability system; and
- (13) Requiring the board of education members to hold community meetings in their districts.

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among the rights, powers, functions, duties, and resources of the Department of Budget and Finance to be transferred were those relating to the capital improvement project allotment process. The interagency working group was convened by the Department of Education, and its members included the Superintendent of Education and the Director of Finance.<sup>3</sup>

Between 2004 and 2007, the interagency group submitted four annual reports to the Legislature regarding the transfer of functions from various departments to the Department of Education. The reports are dated December 2004, December 2005, December 2006, and August 2007. The two middle reports, dated December 2005 and December 2006, provide the most background information on the Memorandum of Understanding.

In its December 2005 report, the interagency working group reported that the Department of Education and the Department of Budget and Finance had agreed that the capital improvement project allotment process *should not be transferred* from the Department of Budget and Finance to the Department of Education. The departments instead preferred to enter into a memorandum of understanding, to be completed by June 30, 2006, that would describe the allotment request process.<sup>4</sup>

In its December 2006 report, the interagency working group subsequently reported that the Department of Education and the Department of Budget and Finance had used the 2006 fiscal year to "practice" implementing, on a trial basis, the provisions and procedures proposed to be included in the Memorandum of Understanding. This "dry run" supported the departments' belief that the Memorandum of Understanding would provide significant improvements and efficiencies. The departments accordingly entered into the Memorandum of Understanding on June 28, 2006.<sup>5</sup>

The departments' rationales against a transfer of the capital improvement project allotment process from the Department of Budget and Finance ("B&F") to the Department of Education and in favor of a Memorandum of Understanding that describes the capital improvement project allotment process were stated as follows:

1. Section 5 of Article VII of the State Constitution, Expenditure Controls, provides that the control of the rate of expenditures of appropriated state moneys, and for the reduction of such expenditures under prescribed conditions, shall be made by law.
2. Section 37-43, Hawaii Revised Statutes ("HRS"), provides that B&F shall carry out the capital improvement project allotment process. The capital improvement project allotment process consists of the review, prioritization, and evaluation of capital improvement projects to insure consistency with executive priorities.

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<sup>3</sup> Act 51, Session Laws of Hawaii 2004, section 42.

<sup>4</sup> Interagency Working Group: Transfer of Functions from Various Departments to the Department of Education: Report to the Legislature in Response to Section 42 of Act 51, Session Laws of Hawaii 2004, December 2005, p. 17.

<sup>5</sup> Interagency Working Group: Transfer of Functions from Various Departments to the Department of Education: Report to the Legislature in Response to Section 42 of Act 51, Session Laws of Hawaii 2004, December 2006, p. 17.

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3. Section 103-7, HRS, provides that all capital improvement projects require authorization by the Legislature and the Governor.
4. The DOE recognizes the Governor's fiscal responsibility for the entire State and that the Board of Education does not have a revenue source to support either cash expenditures or the authorization of general obligation bonds to finance capital improvement projects.
5. The DOE desires that the allotment process and those factors influencing the allotment process such as debt service to be transparent, understandable, and explainable to the Board of Education and the public. The DOE is also desirous of predictability and timeliness in the allotment process so that the DOE can manage an effective and efficient construction and repair and maintenance program.
6. The DOE and B&F agree that the allotment process function should not be transferred from B&F to the DOE. Further, the DOE and B&F have signed an MOU that among other things sets forth the CIP allotment request process.<sup>6</sup>

In its final report in August 2007, the interagency working group reported that the improved allotment process allowed the Department of Education to more effectively plan and schedule its capital improvement projects.<sup>7</sup>

A timeline of events stemming from the "Reinventing Education Act of 2004," Act 51, Session Laws of Hawaii 2004, relating to the transfer of capital improvement project functions and duties from the Department of Accounting and General Services and the Department of Budget and Finance to the Department of Education may be found at Appendix B.

### **Description of the Memorandum of Understanding**

The Memorandum of Understanding is an agreement between the Department of Education and the Department of Budget and Finance. It was entered into on June 28, 2006, and is formally entitled "Memorandum of Understanding between the Department of Education and the Department of Budget and Finance for the Allotment of Capital Improvement Project Funds and Other Fiscal Matters." (See Appendix C.) The Memorandum of Understanding is unique to the two departments. In other words, no other state agency has a similar written agreement with the Department of Budget and Finance.<sup>8</sup>

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<sup>6</sup> Interagency Working Group: Transfer of Functions from Various Departments to the Department of Education: A Report to the Legislature in Response to Section 42 of Act 51, Session Laws of Hawaii 2004, December 2006, pp. 17-18.

<sup>7</sup> Interagency Working Group: Transfer of Functions from Various Departments to the Department of Education: Final Summary Report to the Legislature in Response to Section 42 of Act 51, Session Laws of Hawaii 2004, August 2007, p. 2.

<sup>8</sup> Telephone interview with the Administrator, Budget, Program Planning and Management Division, Department of Budget and Finance.

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The title of the memorandum clearly indicates that the memorandum is not solely about the capital improvement project allotment process. It partially addresses the "allotment of capital improvement project funds." But it also addresses "other fiscal matters" as well.

The Memorandum of Understanding is divided into three main Roman numbered sections, preceded by an unnumbered preamble, as follows:

- Preamble
- I. Purpose;
- II. Terms of Understanding; and
- III. Period of Agreement and Other Terms.

The provisions are discussed below, with reference to their section, subsection, or further division, as designated in the Memorandum of Understanding.

### **The Preamble**

The preamble specifies the parties to the Memorandum of Understanding, specifically, the Department of Education and the Department of Budget and Finance, and the date that the memorandum was entered into, specifically, June 28, 2006. The preamble also summarizes the purpose of Act 51, Session Laws of Hawaii 2004, with regard to the transfer of functions from the Department of Budget and Finance to the Department of Education. Finally, the preamble sets out the two departments' mutual response to Act 51 that those functions should remain with the Department of Budget and Finance and that processes can be best improved through a mutual agreement between the two departments.

### **Section I. The Purpose**

Section I of the Memorandum of Understanding on "Purpose" sets out the purpose of the Memorandum of Understanding, which is:

...to establish procedures that will improve the flow of information and operations between the parties governing fiscal operations....Both parties are committed to improving transparency, understanding and knowledge between the parties for the fiscal functions.

### **Section II. The Terms of Understanding**

Section II of the Memorandum of Understanding on "Terms of Understanding" is divided into seven subsections, alphabetized as follows:

- A. Capital Improvement Project Allotment Process;
- B. Deposits of Funds into the State Educational Facilities Improvement Special Fund;
- C. Debt Service Calculations;
- D. Employee Benefits Calculation;
- E. Funding of Collective Bargaining Increases;
- F. Federal Funds; and
- G. Other Fiscal Issues.

By their titles, only one subsection of the terms of understanding appears to deal directly with the capital improvement project allotment process, and that subsection is section II.A., entitled the "CIP Allotment Process." The titles of the other subsections indicate that they deal with other matters that do not directly relate to the capital improvement project allotment process. In other words, they evidently deal with the "other fiscal matters" alluded to in the title of the Memorandum of Understanding.

### **Section II.A. Capital Improvement Project Allotment Process**

*Section II.A.* of the Memorandum of Understanding on the "CIP Allotment Process" is the core of the Memorandum of Understanding. It is divided into five numbered paragraphs.

*Section II.A.1.* specifies that the two departments agree to use the Board of Education's capital improvement project priority list as the basis for determining capital improvement project priorities for allotments. According to the Department of Education, section II.A.1. is one of the major provisions of the Memorandum of Understanding.<sup>9</sup>

*Section II.A.1.a.* specifies that the Department of Education shall establish its priority list of CIP projects for each fiscal year, as approved by the Board of Education. The CIP priority list shall then be submitted to the Department of Budget and Finance ten days prior to the meeting that is specified in section II.A.3.

**Note:** The Department of Education establishes its priority list based upon where projects fall within its CIP Priority Matrix, which is a planning related form developed by the Department of Education. (See Appendix D.)

The matrix is a rectangle divided into five rows of priority levels and four columns of categories, for a total of twenty cells. Under the column for a single category, level 1 is the highest level of priority and level 5 is the lowest level of priority. The alphabetized categories are as follows:

- A Health, Safety, Security, and Emergency;
- B Classrooms;

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<sup>9</sup> Department of Education written responses to questions submitted by the Bureau.

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- C Support Facilities; and
- D State and District Facilities.

The placement of a project into one of the twenty cells of the matrix determines its priority with relation to a project placed into another cell. The matrix governs the universe of all projects, so all projects will fall somewhere within the matrix. The order of priority within the matrix proceeds in a zigzag pattern, that is, from left to right, and top to bottom. In other words, the priority sequence follows a priority level through four categories and wraps around to the next priority level. Projects within a higher level of priority will be considered before projects within a lower level. Projects within priority level 1 will be considered before projects in priority level 2. Within each priority level, projects will be considered in alphabetical progression, so that projects in category A will be considered before projects in category B.<sup>10</sup> Accordingly, the highest priority projects fall into level 1, category A, which is a cell defined as meaning: "Serious threat to life and property; severe health problems. Emergency needs requiring immediate response. Requirements or citations from regulatory agencies for immediate action. Replace building destroyed by fire or other unforeseen causes (supplement insurance funds)."<sup>11</sup> The lowest priority projects fall into level 5, category D. (This cell has no description.)

In summary, the twenty cells are aligned in the following priority from highest to lowest priority:

	A	B	C	D
1	1st	2nd	3 <sup>rd</sup>	4th
2	5th	6th	7 <sup>th</sup>	8th
3	9th	10th	11 <sup>th</sup>	12th
4	13th	14th	15 <sup>th</sup>	16th
5	17th	18th	19 <sup>th</sup>	20th

*Section II.A.1.b.* provides flexibility in implementing projects from the CIP priority list. First, the Department of Education, in its sole discretion, can elect not to implement a project on the CIP priority list. Second, the Department of Education may also request that a project be allotted out of sequence from the CIP priority list to address health, safety, and welfare concerns. Third, if in any case an allotment request for a project on the CIP priority list is not authorized by the Governor, the Department of Education may substitute the request with additional allotment requests following the sequence in the CIP priority list. According to the Department of Education, this right of the Department of Education to submit substitute requests is one of the major provisions of the Memorandum of Understanding.<sup>12</sup>

<sup>10</sup> Telephone interview with the Facilities Development Branch, Department of Education.

<sup>11</sup> CIP Priority Matrix - Department of Education.

<sup>12</sup> Department of Education written responses to questions submitted by the Bureau.

*Section II.A.2.* of the Memorandum of Understanding specifies that based on the priority list, the Department of Education will submit a "written annual allotment and expenditure plan request" to the Department of Budget and Finance regarding the Department of Education capital improvement projects for the fiscal year ten days prior to the meeting described in section II.A.3. According to the Department of Education, the "annual allotment and expenditure plan" identifies the monthly batches of allotment requests. It shows which projects will be submitted for allotment approval in a given month.<sup>13</sup>

The "written annual allotment and expenditure plan request" appears to incorporate by reference a statutory provision in the allotment system under part II of chapter 37, Hawaii Revised Statutes, pertaining exclusively to the Department of Education. Specifically, section 37-34.5, Hawaii Revised Statutes, requires the Department of Education to submit an "annual allotment and expenditure plan" to the Governor for each fiscal year. The section was added to the allotment system in 1993<sup>14</sup> in order to establish separate allotment procedures for the Department of Education as a necessary component of school/community-based management.<sup>15</sup> In other words, section II.A.2. of the Memorandum of Understanding appears to implement section 37-34.5, Hawaii Revised Statutes, relating solely to the Department of Education.

*Section II.A.3.* is divided into two alphabetized paragraphs relating to the two topics to be discussed by the two departments not less than fifteen days prior to the beginning of each fiscal year. According to the Department of Education, section II.A.3.a. and b. are two of the major provisions of the Memorandum of Understanding.<sup>16</sup>

*Section II.A.3.a.* specifies that one topic is the total amount of moneys estimated to be available for the Department of Education capital improvement projects from all sources, including but not limited to, general funds, special funds, general obligation bond funds, and state educational facilities improvement special fund moneys.

**Note:** Pursuant to section II.A.3.a., the Department of Budget and Finance provides the Department of Education with an estimate of the total amount of allotment funds to be made available in a fiscal year to the Department of Education. The other departments are not provided with such an estimate. Having such an estimate at the start of a fiscal year may hold potential planning benefits for a department.

*Section II.A.3.b.* specifies that the other topic is the procedures and schedule for the allotment of the Department of Education capital improvement project moneys.

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<sup>13</sup> Department of Education written responses to questions submitted by the Bureau.

<sup>14</sup> Act 364, Session Laws of Hawaii 1993.

<sup>15</sup> Senate Journal 1993, Senate Standing Committee Report No. 1346.

<sup>16</sup> Department of Education written responses to questions submitted by the Bureau.

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**Note:** As implemented by the parties, the allotment schedule under section II.A.3.b. is a monthly schedule. The Department of Education submits allotment requests in monthly batches to the Department of Budget and Finance up to the allotment limit established by the Department of Budget and Finance.<sup>17</sup>

The submission of allotment requests in monthly batches apparently brings about more predictability in the flow of allotment requests and allotment approvals, resulting in greater efficiency.<sup>18</sup>

*Section II.A.4.* specifies that the departments may meet subsequently to address adjustments to the total amount of moneys estimated to be available for the Department of Education's capital improvement projects due to: changes in the financial condition of the State; modifications of procedures and the schedule for the allotment of the Department of Education's capital improvement project moneys; and other issues and concerns related to capital improvement project allotments.

Finally, *section II.A.5.* specifies that, when notified by the Department of Budget and Finance of changes in economic conditions that will impact the availability of the Department of Education capital improvement project moneys, the Department of Education must submit an update of its allotment and expenditure plan for its capital improvement projects based upon the changed economic conditions and the amended amount of the Department of Education capital improvement project moneys.

## **Section II.B. Deposits of Funds into State Educational Facilities Improvement (SEFI)**

*Section II.B.* of the Memorandum of Understanding on deposits of funds into the state educational facilities improvement special fund is divided into five numbered paragraphs.

**Note:** In its December 2005 report, the interagency working group noted that the state educational facilities improvement special fund is established under section 36-32, Hawaii Revised Statutes, and is funded, under section 237-31, Hawaii Revised Statutes, through a portion of general excise tax revenues and general obligation bonds. The working group noted that the position of the Department of Budget and Finance (B&F) regarding the special fund was that it believed the fund should be repealed because the fund had been funded entirely by general obligation bonds. Consequently, B&F viewed capital improvement projects funded by the special fund as essentially being funded by general obligation bonds, rather than by special funds. On the other hand, the working group noted that the position of the Department of Education (DOE) regarding the special

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<sup>17</sup> Department of Education written responses to questions submitted by the Bureau.

<sup>18</sup> Written responses of the Department of Education to questions submitted by the Bureau.

fund was that it desired to maintain the fund. The working group finally noted that the two departments had agreed to revisit the issue in the future.<sup>19</sup>

Section II.B of the Memorandum of Understanding establishes a schedule for the transfer of general obligation bond funds into the state educational facilities improvement special fund. However, the mere establishment of the schedule does not appear to reflect any change in the position of B&F that regardless of the transfer of general obligation bond funds into the state educational facilities improvement special fund, the source of funding for capital improvement projects funded by the special fund is, in actuality, general obligation bonds. Furthermore, the issue of whether a capital improvement project is funded by a special fund or by general obligation bond funds does not affect the applicability of the Memorandum of Understanding to the capital improvement project, since section II.A.3.a. of the memorandum indicates that the memorandum applies to capital improvement projects from *all sources of funding*, "including, but not limited to, general funds, special funds, general obligation bond funds, and State Educational Facilities Improvement ("SEFI") Special Fund moneys." Finally, the issue of whether a capital improvement project is funded by a special fund or general obligation bond funds does not affect the applicability of the DOE's CIP Priority Matrix to the project, because, as specified earlier in the note to the discussion on section II.A.1.a. of the Memorandum of Understanding, the CIP Priority Matrix applies to *all projects*.

*Section II.B.1.* specifies that at the start of each fiscal year, the Department of Education will provide the Department of Budget and Finance with a projection of its monthly expenditures from the state educational facilities improvement special fund for the upcoming fiscal year.

*Section II.B.2.* specifies that the Department of Education will submit to the Department of Budget and Finance on a monthly basis, or as necessary, a request to transfer general obligation bond capital improvement project funds into the state educational facilities improvement special fund.

*Section II.B.3.* specifies that the Department of Budget and Finance will review the monthly request submitted under section II.B.2. and, if deemed appropriate, submit a journal voucher to transfer the requested amount into the state educational facilities improvement special fund.

*Section II.B.4.* specifies that the Department of Budget and Finance and the Department of Education agree that a reasonable contingency balance in the state educational facilities improvement special fund is appropriate in the event that actual expenditures exceed the estimated amounts, and they will meet to establish an appropriate contingency level.

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<sup>19</sup> Interagency Working Group: Transfer of Functions from Various Departments to the Department of Education: Report to the Legislature in Response to Section 42 of Act 51, Session Laws of Hawaii 2004, December 2005, p. 18.

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*Section II.B.5.* specifies that in the event of a shortfall in the state educational facilities improvement special fund, the Department of Education may request a supplemental transfer of funds into the state educational facilities improvement special fund in addition to the monthly request submitted under section II.B.2.

**Section II.C. Debt Service Calculation**

*Section II.C.* on debt service calculation specifies that, on an annual basis and as may be requested by the Department of Education, the Department of Budget and Finance will provide and explain the amount of debt service costs allocated to the Department of Education.

**Section II.D. Employee Benefits Calculation**

*Section II.D.* on employee benefits calculation specifies that, with the assistance of the Department of Budget and Finance, the Department of Education will learn to calculate its share of employee benefit contributions due for pension accumulation, health benefits, Social Security, and Medicare costs.

**Section II.E. Funding of Collective Bargaining Increases**

*Section II.E.* on the funding of collective bargaining increases specifies that for collective bargaining appropriation bills affecting employees of the Department of Education, the Department of Budget and Finance will separately display the salary and benefit appropriations, and furthermore, with the assistance of the Department of Budget and Finance, the Department of Education will learn how to and practice calculating the applicable costs for its employees relating to collective bargaining.

**Section II.F. Federal Funds**

*Section II.F.* on federal funds specifies that the Department of Education will request an increase in its federal funds expenditure ceiling for federal funds only when the expenditure of such federal funds will cause the Department of Education to exceed its total federal funds expenditure ceiling.

## **Section II.G. Other Fiscal Issues**

*Section II.G.* on other fiscal issues specifies that prior to the beginning of each fiscal year, the Department of Education and the Department of Budget and Finance will meet to identify fiscal issues that either party would like to discuss during that fiscal year.

## **Section III. Period of Agreement and Other Terms**

*Section III.* of the Memorandum of Understanding on the "Period of Agreement and Other Terms" is divided into four alphabetized subsections.

*Section III.A.* specifies that the Memorandum of Understanding shall be effective from July 1, 2006, and shall be automatically extended without further action by the departments each July 1, unless terminated in accordance with the terms of the Memorandum of Understanding.

*Section III.B.* specifies that either department may terminate the Memorandum of Understanding at any time for any reason with at least sixty days written notice of termination; provided that the departments have mutually agreed to a replacement process for the allotment of capital improvement project moneys.

*Section III.C.* specifies that any changes or modifications to the Memorandum of Understanding must be by written agreement of the departments.

*Section III.D.* specifies that in the event of a conflict with any written budget execution memorandum or policy, the terms of the Memorandum of Understanding will control.

## **The Capital Improvement Project Allotment Process**

As between the Department of Budget and Finance and the Department of Education, the Memorandum of Understanding adds a few steps to the capital improvement project allotment process that is otherwise established pursuant to the budget execution policies and instructions and Executive Memorandum 97-07. According to the Department of Budget and Finance, some of these steps affect only the framework or approach to the allotment process, rather than the allotment process itself, which consists of the submission of the allotment request, the review of that request, and the approval of that request.<sup>20</sup> However, for purposes of simplicity, we shall treat steps affecting the framework or approach as steps affecting the allotment process.

Thus, for the Department of Education, the steps of the capital improvement project allotment process consists of those steps outlined in the previous chapter in the section entitled

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<sup>20</sup> Meeting with the Department of Budget and Finance Administrator of the Budget, Program Planning and Management Division and staff, September 11, 2009.

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"*The Capital Improvement Project Allotment Process*," plus the steps added to that allotment process by the memorandum of understanding. See the previous chapter for comparison. Below, the underscored steps represent steps added by the memorandum; the steps that are not underscored represent the steps in the allotment process that was outlined in the previous chapter:

1. By early June of each fiscal year, the Department of Education submits the Board of Education's CIP Priority List of capital improvement projects<sup>21</sup> and a written annual allotment and expenditure plan request<sup>22</sup> to the Department of Budget and Finance;
2. By the middle of June, the Department of Budget and Finance and the Department of Education meet to discuss the total amount of moneys estimated to be available in the upcoming fiscal year for the Department of Education's capital improvement projects from all sources, as well as procedures and schedule for the allotment of Department of Education capital improvement project moneys;<sup>23</sup>
3. As the need to implement arises, the Department of Education submits an allotment request to the Governor, through the Department of Budget and Finance, for the release of funds for a capital improvement project.<sup>24</sup>
4. The Department of Budget and Finance:
  - (a) Reviews the allotment request to "ensure conformity with statewide planning goals, objectives, and priorities, and [the Department of Education's] CIP implementation plan;"<sup>25</sup>
  - (b) Uses the Board of Education's CIP Priority List as the basis for determining capital improvement project priorities for allotments to the Department of Education;<sup>26</sup>
  - (c) Agrees to respond to the allotment request in a reasonable time;<sup>27</sup> and
  - (d) Makes a recommendation to the Governor to release funds;<sup>28</sup>

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<sup>21</sup> Memorandum of Understanding Between the Department of Education and the Department of Budget and Finance for the Allotment of Capital Improvement Project Funds and Other Fiscal Matters, June 28, 2006, II.A.1.a., p.2.

<sup>22</sup> Memorandum of Understanding Between the Department of Education and the Department of Budget and Finance for the Allotment of Capital Improvement Project Funds and Other Fiscal Matters, June 28, 2006, II.A.2., p.2.

<sup>23</sup> Memorandum of Understanding Between the Department of Education and the Department of Budget and Finance for the Allotment of Capital Improvement Project Funds and Other Fiscal Matters, June 28, 2006, II.A.3., p.2.

<sup>24</sup> Budget execution policies and instructions, CIP Expenditures, CIP Allotment Procedures.

<sup>25</sup> Executive Memorandum 97-07, Project Implementation Procedures, p. 2.

<sup>26</sup> Memorandum of Understanding Between the Department of Education and the Department of Budget and Finance for the Allotment of Capital Improvement Project Funds and Other Fiscal Matters, June 28, 2006, II.A.1., p.1.

<sup>27</sup> Memorandum of Understanding Between the Department of Education and the Department of Budget and Finance for the Allotment of Capital Improvement Project Funds and Other Fiscal Matters, June 28, 2006, II.A.3.b., p.2.

<sup>28</sup> Executive Memorandum 97-07, Appendix A, Allotment Advice (A-15).

5. The Governor issues an allotment advice to the Department of Education, approving the allotment of a legislative appropriation for the capital improvement project;<sup>29</sup>
6. The Department of Education then proceeds to expend or encumber the funds allotted for the capital improvement project;<sup>30</sup>
7. If the Governor does not authorize the allotment of moneys for a capital improvement project on the CIP Priority List, the Department of Education may then submit another allotment request in its place, following the sequence in the CIP Priority List.<sup>31</sup>

## Summary

In summary, the Memorandum of Understanding is an agreement between the Department of Education and the Department of Budget and Finance, entered into on June 28, 2006. It is entitled "Memorandum of Understanding between the Department of Education and the Department of Budget and Finance for the Allotment of Capital Improvement Project Funds and Other Fiscal Matters." According to the Department of Education, the Memorandum of Understanding contains four major provisions that relate to the capital improvement project allotment process, and they are as follows:

- (1) The two departments agree to use the capital improvement projects priority list provided by the Department of Education as the basis for determining capital improvement project priorities for allotments for the year (*section II.A.1.*);
- (2) The Department of Budget and Finance provides the Department of Education with an estimate of the total amount of moneys to be available for the Department of Education's capital improvement projects for the year (*section II.A.3.a.*);
- (3) The departments discuss procedures and a schedule for the allotment of the Department of Education's capital improvement project moneys, and the departments respond to each other's requests in a reasonable time (*section II.A.3.b.*); and
- (4) If the Governor does not authorize allotment of moneys for a capital improvement project on the capital improvement priority list, the Department of Education may then submit additional allotment requests, following the sequence established in the capital improvement priority list (*section II.A.1.b.*).<sup>32</sup>

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<sup>29</sup> Executive Memorandum 97-07, Project Implementation Procedures, p. 1-2; Appendix A, Allotment Advice (A-15).

<sup>30</sup> Executive Memorandum 97-07, pp. 1-2.

<sup>31</sup> Memorandum of Understanding Between the Department of Education and the Department of Budget and Finance for the Allotment of Capital Improvement Project Funds and Other Fiscal Matters, June 28, 2006, II.A.1.b., p. 2.

<sup>32</sup> Written responses of the Department of Education to questions submitted by the Bureau.

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The Department of Education establishes its priority list based upon its CIP Priority Matrix, which is a planning related form that is not a part of the Memorandum of Understanding. Based upon the matrix, capital improvement projects that receive the highest priority are those that fall into the following category: "Serious threat to life and property; severe health problems. Emergency needs requiring immediate response. Requirements or citations from regulatory agencies for immediate action. Replace building destroyed by fire or other unforeseen causes (supplement insurance funds)."

## Chapter 4

### **ADAPTING THE MEMORANDUM OF UNDERSTANDING FOR USE BY OTHER STATE AGENCIES**

Act 123 directs the Bureau to specifically review, identify, or develop the following matters in connection with the Bureau's review of the Memorandum of Understanding:

- (1) Concerns or recommendations for changes that either the department of education or the department of budget and finance have regarding the terms of the current memorandum of understanding;
- (2) Changes that would be required in adapting the memorandum of understanding procedures for use by other state agencies and the department of budget and finance, including statutory amendments; and
- (3) Recommendations and a proposed timetable for adoption of the processes of the memorandum of understanding for use by other state agencies and the department of budget and finance...<sup>1</sup>

for the ultimate purpose of:

...replicating the processes of the memorandum of understanding for use by other state agencies with many capital improvement projects that are predominantly funded by general obligation bonds.<sup>2</sup>

These three matters are discussed in turn below, followed by a discussion of agency feedback from the other state agencies likely to be affected by a replication of the processes of the Memorandum of Understanding.

#### **Concerns or Recommendations for Changes that Either the Department of Education or the Department of Budget and Finance have Regarding the Terms of the Current Memorandum of Understanding**

We find that neither department had any concerns or recommendations for changes regarding the terms of the Memorandum of Understanding.

First of all, in their testimonies on Act 123 (S.B. No. 389 S.D. 1, H.D. 1), before the House Committee on Finance, the Department of Education stated that they "do not at this time see a need for revisions to the MOU," while the Department of Budget and Finance stated that the memorandum "has proved satisfactory to both the Departments of Education and Budget and Finance."

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<sup>1</sup> Act 123, Session Laws of Hawaii 2009, section 2(a) (1) to (3).

<sup>2</sup> Act 123, Session Laws of Hawaii 2009, section 2(a).

Secondly, in their responses to questions posed to them by the Bureau, both departments reaffirmed that they had no recommendations for changes to any of the terms of the Memorandum of Understanding.

In fact, the Department of Education is reportedly quite happy with the Memorandum of Understanding, in view of its experiences with the allotment process before as compared to after use of the Memorandum of Understanding was instituted. The Department of Education is pleased with the Memorandum of Understanding because it has increased the efficiency of the capital improvement project allotment process.

Prior to the Memorandum of Understanding, the Department of Education reported that it would submit allotment requests for all appropriated projects. However, the Department of Education would not know which ones would be approved, or when. The uncertainty made it difficult for the schools to know when or if moneys for their projects would be forthcoming.

After entering into the Memorandum of Understanding, the flow of allotment requests and allotment approvals has become much more predictable. The Department of Education generally knows when the allotment requests will be submitted and can expect, for the most part, that the requests will be approved. The Memorandum of Understanding does not change the department's priorities. However, it provides the department with greater predictability as to which of those priorities can be allotted and thus results in greater efficiency.<sup>3</sup>

### **Changes that Would be Required in Adapting the Memorandum of Understanding Procedures for Use by Other State Agencies and the Department of Budget and Finance, Including Statutory Amendments**

We understand this directive to refer to the changes that would be required in "adapting the memorandum of understanding procedures for use by other state agencies and the department of budget and finance" in cases where the other state agencies have *many capital improvement projects that are predominantly funded by general obligation bonds*, since the express goal of Act 123 is "replicating the processes of the memorandum of understanding for use by other state agencies with many capital improvement projects that are predominantly funded by general obligation bonds." We recognize that Act 123 is not necessarily intended to limit the authority of the Department of Budget and Finance to enter into any type of memoranda of understanding with a state agency that *does not* "have many capital improvement projects that are predominantly funded by general obligation bonds."

We also note at the outset that an adaptation of the procedures and processes of the Memorandum of Understanding for use by other state agencies can be initiated through any number of legislative approaches, including but not limited to the following:

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<sup>3</sup> Written responses of the Department of Education to questions submitted by the Bureau.

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- (1) Passing a *resolution* that requests the Director of Finance to enter into similar agreements with the other agencies;
- (2) Passing a *law* that *authorizes* the Director of Finance to enter into similar agreements with the other agencies;
- (3) Passing an *law* that *requires* or *mandates* the Director of Finance to enter into similar agreements with the other agencies; or
- (4) Passing a *law* that *statutorily codifies the language* of the Memorandum of Understanding.

Adapting the "memorandum of understanding procedures" ultimately involves the drafting of either of two types of documents. The first is a form document for similar memoranda of understanding to be entered into between the Department of Budget and Finance and the other state agencies. The second is a statute modeled upon the language of the Memorandum of Understanding, which imposes the procedures of the Memorandum of Understanding upon the Department of Budget and Finance and the other state agencies. Our discussion below accommodates the drafting of either type of document, either a form document for similar memoranda of understanding or a statute.

We have determined that the changes that might be required in adapting the Memorandum of Understanding for use by other state agencies are the following:

- (1) Modifying the language of the Memorandum of Understanding so that the processes apply to expending agencies of the executive branch with many capital improvement projects that are predominantly funded by general obligation bonds, but not including the Department of Education:

***Reasoning***

There are two primary reasons for not including the Department of Education in any adoption of the Memorandum of Understanding for use by other agencies. First, the Memorandum of Understanding currently specifically applies only to the Department of Education. This Memorandum of Understanding was adopted specifically as an alternative to legislation that would have transferred considerably more power to the Department of Education over fiscal matters. (See discussion in chapter 3 at notes 36 to 39.) There is no reason to change this existing Memorandum of Understanding; rather the adaptation of the Memorandum of Understanding should exclude the Department of Education so as not to interfere with or disrupt the current process that seems to be working quite well.

Further, since the intent of adopting the Memorandum of Understanding appears to be to allow its use by other state agencies for capital improvement projects funded by general obligation bonds, the Department of Education should be

excluded from any adaptation because the present Memorandum between the Department of Budget and Finance and the Department of Education is broader in that it covers *all means of financing*, not just general obligation bonds.

- (2) Modifying the language of the Memorandum of Understanding so that the processes apply only to capital improvement projects that are predominantly funded by general obligation bonds:

***Reasoning***

As noted above, the Memorandum of Understanding, pursuant to section II.A.3.a., specifically applies to capital improvement projects funded by all means of financing, including but not limited to general funds, special funds, general obligation bond funds, and the state educational facilities improvement special fund under section 36-32, Hawaii Revised Statutes.

The intended goal of Act 123 appears to be a replication of the Memorandum of Understanding be replicated for use by other state agencies for those capital improvement projects that are predominantly funded by general obligation bonds. We acknowledge, however, that while Act 123 expressly limits the "goal of replicating the process" to "*other state agencies with many capital improvement projects that are predominantly funded by general obligation bonds*," the language of the Act does not further specifically limit the *use* of the adopted Memorandum of Understanding *only* to those capital improvement projects that happen to be predominantly funded by general obligation bonds. Thus, it is conceivable that the intent of the Act is to adopt the Memorandum of Understanding for use by agencies for *all* of their capital improvement projects, agencies, regardless of the means of financing, as long as those agencies, in fact, have "many capital improvement projects that are predominantly funded by general obligation bonds." Nevertheless, we do not believe this is the intent.

- (3) Eliminating aspects of the Memorandum of Understanding that do not relate to the capital improvement project allotment process:

***Reasoning***

The title of the Memorandum of Understanding relates to the "allotment of capital improvement project funds and other fiscal matters." In adapting the memorandum for use by other state agencies for the purpose of the capital improvement project allotment process, those "other fiscal matters" need not be adapted. Under section II on the terms of understanding, these "other fiscal matters" are found in section II.B to section II.G, relating to deposits of funds into the State Educational Facilities Improvement special fund, debt service

calculation, employee benefits calculation, funding of collective bargaining increases, federal funds, and other fiscal issues.

### **Recommendations and a Proposed Timetable for Adoption of the Processes of the Memorandum of Understanding for Use by Other State Agencies and the Department of Budget and Finance**

In response to questions posed to the Department of Budget and Finance by the Bureau, the Department of Budget and Finance reported that they would give their best faith efforts to implement the processes of the Memorandum of Understanding for use by other state agencies immediately upon the effective date of any such legislation to adapt those processes.

However, the Department of Budget and Finance views the Memorandum of Understanding as an administrative function. The department will lose some administrative flexibility if the processes of the Memorandum of Understanding were to be *legislatively mandated* to apply to other state agencies. The Department of Budget and Finance indicated it would prefer to retain its administrative flexibility to enter or not to enter into a similar arrangement with the other state agencies, without legislative intervention, because the state agencies are different and must be handled differently.<sup>4</sup>

Specifically, the ways that state agencies and their respective capital improvement projects differ include but are not limited to the following:

- (1) The number of projects requested by each agency in a fiscal year;
- (2) The size and cost of a project;
- (3) The manageability of a project;
- (4) Whether the project can be divided into increments;
- (5) The length of time needed to complete a project;
- (6) Whether an appropriation covers the total cost of a project or only a portion of the project (i.e., the design phase only);
- (7) The origin of a project (i.e., whether the project was initiated by the executive branch or the legislative branch);
- (8) Whether a legislatively initiated project is a grant to a private third party through a contract with the agency;
- (9) The agency's staff resources and expertise in handling projects; and
- (10) The agency's use of a formalized priority setting system (i.e., a set of criteria for requesting and implementing projects), as opposed to the use of an ad hoc method of setting project priorities.<sup>5</sup>

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<sup>4</sup> September 11, 2009 meeting with the Administrator and staff of the Budget, Program Planning and Management Division, Department of Budget and Finance.

<sup>5</sup> September 11, 2009 and December 8, 2009 meetings with the Administrator and staff of the Budget, Program Planning and Management Division, Department of Budget and Finance.

### **The Other State Agencies with Many Capital Improvement Projects that are Predominantly Funded by General Obligation Bonds**

Finally, we also sought feedback from the "other state agencies with many capital improvement projects that are predominantly funded by general obligation bonds."

According to the Department of Budget and Finance, these other state agencies with many capital improvement projects that are predominantly funded by general obligation bonds are the Department of Accounting and General Services, the Department of Land and Natural Resources, and the University of Hawaii.<sup>6</sup>

We asked these three state agencies for their feedback on the benefits of having the following two provisions from the Memorandum of Understanding apply to them:

- (1) At the beginning of each fiscal year, the agency and the Department of Budget and Finance agree to use the capital improvement projects priority list provided by the agency as the basis for determining capital improvement project priorities for allotments for that year (section II.A.1.); and
- (2) At the beginning of each fiscal year, the Department of Budget and Finance provides the agency with an estimate of the total amount of moneys to be made available for the agency's capital improvement projects for the year (section II.A.3.a.).

Our general impression of the responses of these three agencies is that their positions on having the processes of the Memorandum of Understanding extended to them range from opposition by the Department of Accounting and General Services, to neutrality by the Department of Land and Natural Resources, and to mild support, at best, by the University of Hawaii.

Basically, none of the three agencies finds any fault with the present capital improvement project allotment process (as applied to themselves) for which a legislative remedy is required.

Both the Department of Land and Natural Resources and the University of Hawaii report that allotment decisions regarding capital improvement projects predominantly funded by general obligation bonds are generally based upon the respective department's priority list. Both also report that the current capital improvement project allotment process generally allows them to plan, schedule, and implement in an effective and efficient manner those capital improvement projects that are predominantly funded by general obligation bonds.

The Department of Land and Natural Resources reports that it is uncertain about the amount of benefit to be realized if the terms of the Memorandum of Understanding were to be

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<sup>6</sup> Telephone interview with the Administrator of the Budget, Program Planning and Management Division, Department of Budget and Finance.

made applicable to them; however, they do not believe those terms would adversely affect the current processes or procedures.

The University of Hawaii, on the other hand, reports that if it were informed of the total amount of general obligation bond funds to be made available in each year, it would be better able to plan, schedule, and implement their capital improvement projects.

The Department of Accounting and General Services expressed its clear opposition to any legislative modification of the allotment process, as follows:

...DAGS has found the annual Governor's budget execution policies to be effective. They are adapted from time to time to effectively address changing conditions. DAGS believes the best way to optimize allotment of GOB appropriations is through carefully developed annual Governor's budget execution policies. Legislation in this matter will not be optimum for DAGS and will not be responsive to changing conditions.

## **External Review**

As part of its external review process, the Bureau provided a working draft of this chapter to the state agencies that the Bureau regards as the primary stakeholders in the outcome of the matters reviewed under this report, specifically, the Department of Budget and Finance, the Department of Accounting and General Services, the Department of Land and Natural Resources, and the University of Hawaii. The Bureau asked these agencies to review the Bureau's interpretation of their responses to the questionnaire that the Bureau had previously submitted to them.

All four agencies replied that they either concurred with our interpretation of their responses or had no response to give. The University of Hawaii stated that "[t]he University of Hawai'i concurs with your interpretation of our response dated July 31, 2009."<sup>7</sup> The Department of Accounting and General Services stated that "[y]our interpretation of DAGS' administrative position is correct."<sup>8</sup> The Department of Budget and Finance indicated that they had no response to the external review letter that the Bureau had sent to them.<sup>9</sup> Finally, the Department of Land and Natural Resources indicated they concurred with the Bureau's discussion and interpretation of their responses to the Bureau's earlier questionnaire.<sup>10</sup>

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<sup>7</sup> December 4, 2009 letter from the Associate Vice President for Capital Improvements, Office of Capital Improvements, University of Hawaii System to the Legislative Reference Bureau.

<sup>8</sup> December 15, 2009 letter from the Comptroller, Department of Accounting and General Services to the Legislative Reference Bureau.

<sup>9</sup> December 22, 2009 phone call from the Department of Budget and Finance to the Legislative Reference Bureau.

<sup>10</sup> December 23, 2009 phone call from the Legislative Reference Bureau to the Engineering Division, Department of Land and Natural Resources.

## **Summary**

First, neither the Department of Education nor the Department of Budget and Finance have any concerns or recommendations for changes regarding the terms of the current Memorandum of Understanding. In fact, the Department of Education is reportedly quite happy with the Memorandum of Understanding, in view of its experiences with the allotment process before as compared to after use of the Memorandum of Understanding was instituted. The Department of Education reports that the Memorandum of Understanding has increased the efficiency of the capital improvement project allotment process by introducing predictability and increasing certainty in the allotment process.

Second, the changes that would be required in adapting the Memorandum of Understanding procedures for use by other state agencies and the Department of Budget and Finance, including any necessary statutory amendments would be as follows:

- (1) Modifying the language of the Memorandum of Understanding so that the processes apply to those expending agencies of the executive branch, other than the Department of Education, with many capital improvement projects that are predominantly funded by general obligation bonds;
- (2) Modifying the language of the Memorandum of Understanding so that the processes apply only to those capital improvement projects that are predominantly funded by general obligation bonds (if this is the intent); and
- (3) Eliminating aspects of the Memorandum of Understanding that do not relate to the capital improvement project allotment process.

Third, with regard to recommendations and a proposed timetable for adoption of the processes of the Memorandum of Understanding for use by other state agencies and the Department of Budget and Finance, the Department of Budget and Finance reports that they would give their best faith efforts to implement the processes of the Memorandum of Understanding for use by other state agencies immediately upon the effective date of any such legislation to adapt those processes. However, the Department of Budget and Finance views the Memorandum of Understanding as an administrative function and believes it will sustain a loss of administrative flexibility if the processes of the Memorandum of Understanding were to be legislatively mandated to apply to other state agencies.

Finally, besides the Department of Education, the other state agencies with many capital improvement projects that are predominantly funded by general obligation bonds are the Department of Accounting and General Services, the Department of Land and Natural Resources, and the University of Hawaii. None of the three agencies report finding any fault with the present capital improvement project allotment process, as established under the executive memoranda, for which a legislative remedy is required. Their positions on having the processes of the Memorandum of Understanding extended to them appear to range from opposition, to neutrality, and to mild support, at best.

## Chapter 5

### FINDINGS AND RECOMMENDATIONS

#### Findings

The Bureau finds as follows:

1. The State Constitution empowers the Legislature to establish the means to control the rate of state expenditures. In turn, the Legislature established a quarterly allotment system for operating expenditures, but authorized the Director of Finance to administratively establish a separate allotment process for capital improvement projects. In response, the Director of Finance has established a separate allotment process for capital improvement projects, through the issuance of executive memoranda.
2. As established under the executive memoranda, the capital improvement project allotment process is triggered by an allotment request. For an allotment request that is approved, the core steps of the capital improvement project allotment process may be outlined as follows:
  - (1) As the need to implement arises, the expending department submits an allotment request to the Governor, through the Department of Budget and Finance, for the release of funds for a capital improvement project;
  - (2) The Department of Budget and Finance reviews the allotment request to ensure conformity with statewide planning goals, objectives, and priorities, and each expending department's CIP implementation plan and makes a recommendation to the Governor to release funds;
  - (3) The Governor issues an "allotment advice" to the expending department, approving the allotment of a legislative appropriation for the capital improvement project;
  - (4) The expending department then proceeds to expend or encumber the funds allotted for the capital improvement project.
3. For the Department of Education, the allotment process as prescribed by the executive memoranda is also affected by a 2006 Memorandum of Understanding between the Department of Education and the Department of Budget and Finance. This Memorandum of Understanding is a written agreement that is unique to the Department of Education and the Department of Budget and Finance. The other expending state agencies do not have such a similar written agreement with the Department of Budget and Finance.
4. The "Memorandum of Understanding between the Department of Education and the Department of Budget and Finance for the Allotment of Capital Improvement Project Funds and Other Fiscal Matters," is a byproduct of the interagency working group that was established under the "Reinventing Education Act of 2004," Act 51,

Session Laws of Hawaii 2004, to develop comprehensive plans for transferring certain rights, powers, functions, duties, and resources of various executive departments to the Department of Education.

5. The Memorandum of Understanding was developed as an alternative to legislation that would have transferred considerably more power to the Department of Education over fiscal matters.
6. The Memorandum of Understanding contains terms of understanding involving the capital improvement project allotment process. According to the Department of Education, the four major provisions of the terms of understanding involving the capital improvement project allotment process are as follows:
  - (1) The Department of Education and the Department of Budget and Finance agree to use the capital improvement projects priority list provided by the Department of Education as the basis for determining capital improvement project priorities for allotments for the year;
  - (2) The Department of Budget and Finance provides the Department of Education with an estimate of the total amount of moneys to be available for the Department of Education's capital improvement projects for the year;
  - (3) The departments discuss procedures and a schedule for the allotment of the Department of Education's capital improvement project moneys, and the departments respond to each other's requests in a reasonable time; and
  - (4) If the Governor does not authorize allotment of moneys for a capital improvement project on the capital improvement priority list, the Department of Education may then submit additional allotment requests, following the sequence in the capital improvement priority list.
7. Neither the Department of Education nor the Department of Budget and Finance have any concerns about or recommendations for changes regarding the terms of the Memorandum of Understanding.
8. In fact, the Department of Education is reportedly quite happy with the Memorandum of Understanding, based upon its experiences with the allotment process both before and after use of the memorandum was instituted. The Department of Education indicated that the Memorandum of Understanding has increased the efficiency of the capital improvement project allotment process by providing predictability and increased certainty in the allotment process.
9. The changes that might be required in adapting the Memorandum of Understanding for use by other state agencies with many capital improvement projects that are predominantly funded by general obligation bonds are the following:
  - (1) Modifying the language of the Memorandum of Understanding (as applied to those other agencies) so that the processes apply to expending agencies of the executive branch, other than the Department of Education, with many capital improvement projects that are predominantly funded by general obligation bonds (again, if this is indeed the intent);

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- (2) Modifying the language of the Memorandum of Understanding so that the processes apply only to those capital improvement projects that are predominantly funded by general obligation bonds; and
  - (3) Eliminating aspects of the Memorandum of Understanding that do not relate to the capital improvement project allotment process.
10. The Department of Budget and Finance is willing to give its best faith efforts to implement the processes of the Memorandum of Understanding for use by the other state agencies immediately upon the effective date of any such legislation to adapt those processes.
  11. However, the Department of Budget and Finance views the Memorandum of Understanding as an administrative function and reports that it will lose some administrative flexibility if the processes of the Memorandum of Understanding were legislatively mandated to apply to other state agencies. The department would like to retain its administrative flexibility to enter or not to enter into similar arrangements with other state agencies because it believes that the state agencies are different and must be handled differently.
  12. Besides the Department of Education, the other state agencies "with many capital improvement projects predominantly funded by general obligation bonds" are the Department of Accounting and General Services, the Department of Land and Natural Resources, and the University of Hawaii.
  13. The positions of these other state agencies appear to range from opposition, to neutrality, to mild support, at best, for having the processes of the Memorandum of Understanding applied to them. They generally do not appear to find any fault with the present allotment process that requires a legislative remedy.

## **Recommendations**

Based upon the responses of the various affected agencies, it does not appear that extending the processes of the Memorandum of Understanding to the other state agencies with many capital improvement projects that are predominantly funded by general obligation bonds is necessary or will significantly improve the capital improvement project allotment process.

However, the Bureau has nonetheless prepared two versions of proposed legislation, attached as Appendices E and F, in the event the Legislature wishes to replicate the processes of the Memorandum of Understanding.

In Appendix E, the proposed legislation authorizes the Director of Finance to enter into similar memoranda of understanding with expending state agencies other than the Department of Education.

In Appendix F, the proposed legislation statutorily codifies the provisions of the Memorandum of Understanding and requires the Director of Finance and expending state agencies, other than the Department of Education, to follow those provisions.

# Appendix A

## ACT 123

S.B. NO. 389

A Bill for an Act Relating to Capital Improvement Projects.

*Be It Enacted by the Legislature of the State of Hawaii:*

SECTION 1. The legislature finds that an efficient and fiscally responsible process for the allotment of capital improvement project funds is even more critical during periods of economic instability, such as Hawaii is now experiencing. Capital improvement projects provide needed infrastructure, directly benefiting the residents of the state and contributing to an improved economy through jobs, purchases of goods and services, and other "trickle down" effects of the moneys expended.

The legislature further finds that the allotment process for state capital improvement projects is governed by part II, of chapter 37, Hawaii Revised Statutes. Currently, the department of education and the department of budget and finance follow the allotment requirements through a memorandum of understanding to establish procedures to improve the flow of information and operations between the departments governing fiscal operations. Through the memorandum of understanding, both parties are committed to improving transparency, understanding, and knowledge between the departments for fiscal operations.

The purpose of this Act is to direct the legislative reference bureau to review the memorandum of understanding between the department of education and the department of budget and finance for the allotment of capital improvement projects, with the goal of replicating the processes of the memorandum of understanding for use by other state agencies with many capital improvement projects that are predominantly funded by general obligation bonds.

SECTION 2. (a) The legislative reference bureau shall review the memorandum of understanding between the department of education and the department of budget and finance for the allotment of capital improvement projects, with the goal of replicating the processes of the memorandum of understanding for use by other state agencies with many capital improvement projects that are predominantly funded by general obligation bonds, including:

- (1) Concerns or recommendations for changes that either the department of education or the department of budget and finance have regarding the terms of the current memorandum of understanding;
  - (2) Changes that would be required in adapting the memorandum of understanding procedures for use by other state agencies and the department of budget and finance, including statutory amendments; and
  - (3) Recommendations and a proposed timetable for adoption of the processes of the memorandum of understanding for use by other state agencies and the department of budget and finance.
- (b) The review shall include an analysis of pertinent issues, including:
- (1) The terms of understanding, in particular the:
    - (A) Capital improvement projects allotment process;
    - (B) Procedures for deposits of funds;
    - (C) Debt service calculations;
    - (D) Federal funds; and
    - (E) Other fiscal issues;
  - (2) The period of agreement and other terms; and
  - (3) Any other issues that may arise during the review.

(c) The legislative reference bureau shall consult with, at a minimum, the department of budget and finance, the department of education, and other government agencies as deemed appropriate by the legislative reference bureau and legislators.

(d) The legislative reference bureau shall submit a report of its findings, recommendations, and any proposed legislation to the legislature no later than twenty days prior to the convening of the regular session of 2010.

SECTION 3. This Act shall take effect upon its approval.

(Approved June 16, 2009.)

## Appendix B

### TIMELINE OF EVENTS STEMMING FROM ACT 51, SESSION LAWS OF HAWAII 2004, RELATING TO THE TRANSFER OF CAPITAL IMPROVEMENT PROJECT FUNCTIONS AND DUTIES FROM THE DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES AND THE DEPARTMENT OF BUDGET AND FINANCE TO THE DEPARTMENT OF EDUCATION

Date	Event
5/3/04	Act 51, SLH 2004, takes effect.
	Through section 46, Act 51 transfers from DAGS to DOE effective 7/1/05 "[a]ll the rights, powers, functions, duties, and resources...relating to capital improvement programs..."
	Through section 47, Act 51 transfers from B&F to DOE effective 7/1/06 "[a]ll the rights, powers, functions, duties, and resources...relating to the...[f]unding of collective bargaining agreement increases; and...[s]ecuring, administering, use, and expending of federal funds and other aid, including their custodial supervision..."
	Through section 42, Act 51 requires DOE to convene "an interagency working group to develop comprehensive plans for transferring certain rights, powers, functions, duties, and resources...from the departments of accounting and general services, budget and finance...to the department of education. Rights, powers, functions, duties, and resources...to be transferred shall include but not be limited to...(1) The expending of capital improvement funds for construction of new school facilities and resources, for repairs and maintenance services;...(4) The capital improvement project allotment process...", requires the working group to "submit its comprehensive plans, including proposed legislation, to implement the transfer of rights, powers, functions, duties, and resources...relating to the...[d]epartment of accounting and general services..." to the legislature prior to the regular session of 2005 and the "[d]epartment of budget and finance..." to the legislature prior to the regular session of 2006.
	Through section 43, Act 51 terminates the interagency working group on 6/30/07.
12/04	The interagency working group reports to the 2005 regular session of the legislature, recommending that DAGS functions and resources as detailed in section 46, Act 51, relating to the repair and maintenance and capital improvement projects, will transfer to the DOE on 7/1/05.
7/1/05	Act 189, SLH 2005, takes effect, transferring the state educational facilities improvement special fund from DAGS to DOE.
12/05	The interagency working group reports to the 2006 regular session of the legislature, recommending the amending of sections 47 and 48 to repeal the transfer of functions from B&F to DOE. The report also notes that B&F and DOE will prepare and complete by 6/30/06 an MOU regarding the allotment request process.
6/28/06	The MOU between DOE and B&F takes effect, relating to the allotment of capital improvement project funds and other fiscal matters.

Date	Event
6/29/06	Act 225, SLH 2006, takes effect, amending section 47 of Act 51 by delaying from 7/1/06 to 7/1/07 the transfer date of the rights, powers, functions, duties and resources from B&F to DOE relating to the funding of collective bargaining agreement increases and the securing, administering use, and expending of federal funds and other aid.
12/06	The interagency working group reports to the 2007 regular session of the legislature, noting that B&F and DOE actually practiced the allotment processes agreed upon during the 2006 fiscal year and that the MOU was signed on 6/28/06, and recommends repealing the transfer of functions from B&F to DOE.
6/29/07	Act 99, SLH 2007, takes effect, amending section 47 of Act 51 by repealing the transfer of rights, powers, functions, duties and resources from B&F to DOE relating to the funding of collective bargaining agreement increases and the securing, administering use, and expending of federal funds and other aid.
8/07	The interagency working group completes its final summary report, noting that Act 99, SLH 2007 repealed the transfer of functions from B&F to DOE.

## Appendix C

**MEMORANDUM OF UNDERSTANDING  
BETWEEN  
THE DEPARTMENT OF EDUCATION  
AND  
THE DEPARTMENT OF BUDGET AND FINANCE  
FOR THE ALLOTMENT OF CAPITAL IMPROVEMENT PROJECT FUNDS  
AND OTHER FISCAL MATTERS**

This Memorandum of Understanding (MOU) is entered into on this 28th day of June, 2006, between the DEPARTMENT OF EDUCATION, hereinafter referred to as "DOE," and the DEPARTMENT OF BUDGET AND FINANCE, hereinafter referred to as "B&F,"

WHEREAS, Act 51, Session Laws of Hawaii (SLH) 2004, provided that all the rights, powers, functions, duties, and resources of the B&F relating to the funding of collective bargaining agreement increases; and securing, administering, use, and expending of federal funds and other aid, including their custodial supervision, be transferred to the DOE effective July 1, 2006; and

WHEREAS, the DOE and B&F have agreed that these functions should remain with B&F and that the processes for these and other fiscal functions can best be improved through the mutual agreements as set forth in this MOU.

### AGREEMENT

NOW, THEREFORE, the parties hereby agree to the following:

#### **I. PURPOSE**

The purpose of this Memorandum of Understanding ("MOU") is to establish procedures that will improve the flow of information and operations between the parties governing fiscal operations.

Both parties are committed to improving transparency, understanding and knowledge between the parties for the fiscal functions.

#### **II. TERMS OF UNDERSTANDING**

##### **A. CIP Allotment Process**

1. B&F and the DOE agree to use the Board of Education ("BOE") CIP Priority List as the basis for determining CIP priorities for allotments.

- a. The DOE shall establish its priority list of CIP projects for each fiscal year, as approved by the BOE. The CIP Priority List shall be submitted to B&F ten (10) days prior to the meeting specified in 3. below.
  - b. The parties agree that the DOE, in its sole discretion, can elect not to implement a project on the CIP Priority List. In addition, the parties agree that the DOE may request that a project be allotted out of sequence from the CIP Priority List to address health, safety, and welfare concerns. Further, the parties recognize that the Governor has the sole discretion to authorize release of funding for a project. If the Governor does not authorize allotment of moneys for a CIP project on the CIP Priority List, the DOE may then submit additional allotment requests following the sequence in the CIP Priority List.
2. Based on this priority list, the DOE shall submit a written annual allotment and expenditure plan request to B&F regarding the DOE CIP projects for the fiscal year ten (10) days prior to the meeting specified in 3. below.
3. Not less than fifteen (15) days prior to the beginning of each fiscal year, B&F and the DOE shall meet to discuss the following:
  - a. The total amount of moneys estimated to be available for the DOE CIP projects from all sources, including, but not limited to, general funds, special funds, general obligation bond funds, and State Educational Facilities Improvement ("SEFI") Special Fund moneys (collectively, the "DOE CIP Moneys").
  - b. Procedures and schedule for the allotment of the DOE CIP Moneys. Both parties agree to respond to the requests from the other in a reasonable time.
4. The parties may meet subsequently, as may be necessary, to address:
  - a. Adjustments to the total amount of moneys estimated to be available for the DOE CIP projects due to changes in the financial condition of the State.
  - b. Modification of procedures and schedule for the allotment of the DOE CIP Moneys.
  - c. Other issues and concerns related to CIP allotments.
5. The DOE can rely on the B&F estimates of DOE CIP Moneys available in preparing its CIP allotment requests unless informed by B&F that the probable receipts from taxes or any other sources of funding that are the

source of the DOE CIP Moneys will be less than anticipated, and that consequently the amounts available for the remainder of the term of the appropriations for the DOE CIP projects will be less than the amounts originally estimated. B&F shall inform the DOE regarding any changes in economic conditions that will impact the availability of the DOE CIP Moneys. DOE will submit an update of its allotment and expenditure plan for its CIP projects based on changing economic conditions and the amended amount of DOE CIP Moneys.

B. Deposits of Funds into SEFI

1. Annually -- Not less than fifteen (15) days prior to the start of each fiscal year, DOE shall provide B&F with a projection of its monthly SEFI expenditures for the upcoming fiscal year.
2. Monthly -- In the format attached as Exhibit 1, DOE shall submit to B&F on a monthly basis, or as necessary, a request to transfer general obligation bond CIP funds into the SEFI account. In submitting the monthly request, DOE shall take into account:
  - a. the prior amount of actual funds transferred into and expended from, the SEFI account;
  - b. the actual ending balance of the SEFI account at the end of the prior month; and
  - c. updated expenditure projections for the month in which funds are being requested. As such, the actual amount of funds requested on a monthly basis may differ from the annual monthly projections submitted prior to the beginning of the fiscal year.
3. B&F shall review the monthly request and, if deemed appropriate, submit a journal voucher to transfer the requested amount into the SEFI account within five (5) business days of the receipt of the request.
4. B&F and DOE agree that a reasonable contingency balance in the SEFI account is appropriate in the event actual expenditures exceed the estimated amounts. B&F and DOE shall meet to establish an appropriate contingency level, which in part shall take into account the projected monthly expenditures.
5. In the event of a shortfall in the SEFI account balance, the DOE may request a supplemental transfer of funds into the SEFI account in addition to the monthly request.

C. Debt Service Calculation

On an annual basis, and as may be requested by the DOE, B&F shall provide and explain the amount of debt service costs allocated to the DOE at mutually agreed upon times.

D. Employee Benefits Calculation

With the assistance of B&F, the DOE will learn how to and practice calculating for its employees the employer's share of contributions due for pension accumulation, health benefits, Social Security, and Medicare costs at mutually agreed upon times.

E. Funding of Collective Bargaining Increases

For collective bargaining appropriation bills affecting DOE employees, B&F will separately display the salary and benefit appropriations. With the assistance of B&F, the DOE will learn how to and practice calculating the applicable costs for its employees relating to collective bargaining at mutually agreed upon times.

F. Federal Funds

The DOE shall request an increase in its federal funds expenditure ceiling for federal funds only when the expenditure of such federal funds would cause the DOE to exceed its total federal funds expenditure ceiling.

G. Other Fiscal Issues

Prior to the beginning of each fiscal year the DOE and B&F will meet to identify fiscal issues that either party would like to discuss during that fiscal year.


**III. PERIOD OF AGREEMENT AND OTHER TERMS**

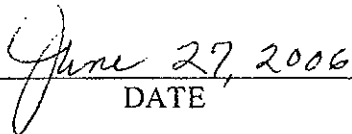
- A. This MOU shall be effective from July 1, 2006, and shall be automatically extended without further action by the DOE or B&F each July 1, unless terminated in accordance with the terms of this MOU.
- B. Either party may terminate this MOU at any time for any reason at least sixty (60) days' written notice of such termination; provided that the termination of this MOU shall not be effective until B&F and the DOE have mutually agreed to a replacement process for the allotment of CIP moneys.
- C. Any changes or modifications to this MOU shall be by mutual written agreement of the parties.

- D. In the event of a conflict with any written budget execution memorandum or policy, the terms of this MOU shall be controlling.

IN WITNESS WHEREOF, the parties hereto, by their authorized representative, have executed this MEMORANDUM of UNDERSTANDING on the day and year first written above.

Department of Education

  
PATRICIA HAMAMOTO  
Superintendent

  
DATE

Department of Budget and Finance

  
GEORGINA K. KAWAMURA  
Director

  
DATE

Department of Education  
Office of Business Services, Accountability Branch  
State Educational Facilities Improvement Special Fund (SEFISF)

Request for Funds  
Fiscal Year Ending June 30, \_\_\_\_\_

	Receipts / (Expend.)	Balance
Beginning Balance July 1, _____:		\$ _____
FY Cumulative Receipts to Date (a): _____	\$ _____	
FY Cumulative Expenditures to Date (b): _____	(\$ _____)	
Current Balance a/o _____:		\$ _____
<b>Amount of This Request:</b> _____	\$ _____	
Estimated Expend. for Month Ending _____:	(\$ _____)	
Estimated Balance for Month Ending _____:		\$ _____

	Actual Transfers to SEFI	Actual Expenditures (per FAMIS)	Remarks
July _____	\$ _____	\$ _____	
Aug _____	\$ _____	\$ _____	
Sep _____	\$ _____	\$ _____	
Oct _____	\$ _____	\$ _____	
Nov _____	\$ _____	\$ _____	
Dec _____	\$ _____	\$ _____	
Jan _____	\$ _____	\$ _____	
Feb _____	\$ _____	\$ _____	
Mar _____	\$ _____	\$ _____	
Apr _____	\$ _____	\$ _____	
May _____	\$ _____	\$ _____	
Jun _____	\$ _____	\$ _____	
<b>Total (a) \$</b>		<b>(b) \$</b>	

## Appendix D

CIP Priority Matrix - Department of Education

Rev. 7/12/06

	Category A Health, Safety, Security, and Emergency	Category B Classrooms	Category C Support Facilities	Category D State & District Facilities
1	Serious threat to life and property; severe health problems. Emergency needs requiring immediate response. Requirements or citations from regulatory agencies for immediate action.  Replace building destroyed by fire or other unforeseen causes (supplement insurance funds).	Construct classrooms in new or existing schools to accommodate large enrollment increase—need within 3 years (required support facilities may be included in increment). Replace classrooms deteriorated beyond repair and maintenance. Land acquisition required for growth. Construct classrooms necessary to fully complete a new school as designed. Construct classrooms in new or existing schools where 50% or more of the total cost will come from private funding, provided the matrix designation would have been 4B or higher without consideration of the private funding.	Construct P.E. locker/showers, playfield, playcourts (minimal requirements for school), parking stalls, if none available Provide temporary administration building, library, serving kitchen, dining room. Replace P.E. locker/shower deteriorated beyond repair and maintenance. Provide permanent dining room for enrollment exceeding 400 students. Telecommunication, electrical, and program bell improvements. Construct support facilities necessary to fully complete a new school as designed. Construct support facilities where 50% or more of the total cost will come from private funding, provided the matrix designation would have been 3C or higher without consideration of the private funding.	
2	Less serious health or safety problems. Compliance with federal, state and county laws and ordinances. Must be done within a reasonable time.	Renovate or construct special classrooms at secondary schools - below 70% of standard and lacking proper equipment. Renovate or construct classrooms for multiple disabled or mentally retarded (below 70% of standard). Air conditioning for computer labs - all grade levels. Renovate classrooms to meet current needs, if the classrooms were originally designed for an educational program that is no longer appropriate.	Construct or replace library, administration building - enrollment exceeding 600 students within 2 years (below 70% of standard). High school athletic fields (baseball, football, track) for practice purposes. Elementary playcourts - no playcourts on campus or adjoining park. Gymnasiums - high school (none available). Dining rooms - permanent facilities for schools exceeding 400 students.	Major cost benefit savings to state or district programs.
3	Moderate health, safety, or security problems - no critical time frame. May be programmed - no danger to life or property.	Renovate or construct regular classrooms below 70% of standard. Renovate or construct special classrooms below 70% of standard or lacking properly built-in equipment (grades 7-12). Replacement of portable classrooms exceeding 10% of design enrollment.	Replace P.E. locker/showers over 40 years old and less than 70% of standard. Construct or replace library, administration building, kitchen-dining room - less than 70% of standard. Covered playcourts - exceeds 100 inches mean annual rainfall. Improvements - Includes grace period for PCNC and A+ program. Athletic locker/showers; athletic trainer's room. Additional parking stalls to meet standard.	
4	Secondary health, safety, or security problems.	Construct special classrooms required for schools with enrollment less than 400 students in secondary grades. Renovate classrooms not covered in Parts 1, 2, or 3. Replace classrooms not covered by above - no condition to age but substandard.	Construct kitchen-dining room, library, administration building - not covered in Parts 1, 2, or 3. Replace library, cafeteria, administration - not covered in Parts 1, 2, or 3. Covered playcourts - not covered above. Bleachers, lights, track for competition. Swimming pools. Other improvements - directly benefiting students. Rifle range.	Improvements to state or district programs.
5	Occasional and secondary health, safety, or security problems.	Construct classrooms in new or existing schools to accommodate enrollment increase - need 4 years and beyond.	Replace or construct other nonclassroom facilities. Other improvements - no direct benefit to students. Student centers.	

THE SENATE  
TWENTY-FIFTH LEGISLATURE, 2010  
STATE OF HAWAII

S.B. NO.

---

## A BILL FOR AN ACT

RELATING TO THE CAPITAL IMPROVEMENT PROJECTS ALLOTMENT PROCESS.

**BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:**

1       SECTION 1. The purpose of this Act is to adapt the capital  
2       improvement projects allotment process set out in the memorandum  
3       of understanding between the department of education and the  
4       department of budget and finance, dated June 28, 2006, for use  
5       by other state agencies with many capital improvement projects  
6       that are predominantly funded by general obligation bonds.

7       SECTION 2. Section 37-33, Hawaii Revised Statutes, is  
8       amended to read as follows:

9       "§37-33   Funds to which allotment system applies. Sections  
10       37-31 to 37-42 relating to the allotment system shall apply to  
11       all appropriations (including standing, continuing, or annual  
12       appropriations and special funds) for all departments and  
13       establishments, but shall not apply to refund accounts nor to  
14       appropriations for the courts or the legislature nor to payment  
15       of unemployment compensation benefits. In the cases of capital  
16       improvements and in other cases where periodical allotments are  
17       impracticable, the director of finance may dispense therewith

## S.B. NO.

1 and prescribe such regulations as will insure proper application  
2 and encumbering of funds. For capital improvement projects  
3 funded predominantly by general obligation bonds, where the  
4 department or establishment is a state agency other than the  
5 department of education, with many capital improvement projects  
6 that are predominantly funded by general obligation bonds, the  
7 director of finance is authorized to enter into a memorandum of  
8 understanding with such department or establishment that  
9 conforms to the extent practicable to those terms of the  
10 memorandum of understanding entered into on June 28, 2006,  
11 between the department of education and the department of budget  
12 and finance that relate to the capital improvement project  
13 allotment process. Subject to section 37-40, emergency or  
14 contingent funds, revolving funds, and trust funds, shall be  
15 subject to such regulations as the director may prescribe for  
16 controlling the expenditures and encumbering the funds."

17 SECTION 3. Statutory material to be repealed is bracketed  
18 and stricken. New statutory material is underscored.

19 SECTION 4. This Act shall take effect on July 1, 2010.

20 INTRODUCED BY: \_\_\_\_\_

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## A BILL FOR AN ACT

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**BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:**

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2 improvement projects allotment process set out in the memorandum  
3 of understanding between the department of education and the  
4 department of budget and finance, dated June 28, 2006, for use  
5 by other state agencies with many capital improvement projects  
6 that are predominantly funded by general obligation bonds.

7       SECTION 2. Chapter 37, Hawaii Revised Statutes, is amended  
8 by adding a new section to part II to be appropriately  
9 designated and to read as follows:

10       "§37-     Capital improvement projects allotment process;  
11 general obligation bond funds. (a) Prior to each fiscal year,  
12 the director of finance shall determine which departments or  
13 establishments have many capital improvement projects that are  
14 authorized to be funded predominantly by general obligation  
15 bonds in the coming fiscal year and shall request each of those  
16 departments or establishments to submit a priority list of such  
17 capital improvement projects authorized to be funded

## S.B. NO.

1 predominantly by general obligation bonds. The director of  
2 finance shall also request each of those departments or  
3 establishments to submit a written annual allotment and  
4 expenditure plan regarding those capital improvement projects  
5 that are authorized to be funded predominantly by general  
6 obligation bonds in the coming fiscal year.

7 (b) The director of finance shall notify each of the  
8 departments or establishments submitting a priority list and  
9 written annual allotment and expenditure plan under subsection  
10 (a) of the total amount of general obligation bond funds  
11 estimated to be available for the capital improvement projects  
12 of that department or establishment that are authorized to be  
13 funded predominantly by general obligation bonds. The director  
14 of finance may subsequently adjust the total amount of general  
15 obligation bond funds estimated to be available for the capital  
16 improvement projects of that department or establishment that  
17 are authorized to be funded predominantly by general obligation  
18 bonds; provided that the director of finance provides adequate  
19 notice to the affected department or establishment and the  
20 adjustment is due to changes in the financial condition of the  
21 State.

## S.B. NO.

1        (c) The director of finance shall use the capital  
2 improvement projects priority list as the basis for determining  
3 priorities for allotments to that department or establishment  
4 for capital improvement projects that are authorized to be  
5 funded predominantly by general obligation bonds; provided that  
6 each department or establishment, in its sole discretion, may  
7 elect not to implement a project on its capital improvements  
8 projects priority list or may request that a project be allotted  
9 out of sequence from the capital improvement projects priority  
10 list to address health, safety, and welfare concerns; provided  
11 further that if the governor does not authorize the allotment of  
12 moneys for a capital improvement project on the capital  
13 improvement projects priority list of a department or  
14 establishment, the department or establishment may then submit  
15 additional allotment requests, following the sequence in the  
16 capital improvement projects priority list.

17        (d) The director of finance shall establish procedures and  
18 schedules for the allotment of capital improvement projects  
19 funded predominantly by general obligation bonds for the  
20 departments and establishments that submit a priority list under  
21 subsection (a). The director of finance may also modify those

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1 procedures and schedules, upon adequate notice to those  
2 departments or establishments.

3 (e) The director of finance shall respond to allotment  
4 requests from departments or establishments within a reasonable  
5 period of time not to exceed one month; provided that those  
6 allotment requests are based upon the priority lists.

7 (f) Allotments for capital improvement projects that are  
8 not subject to this section shall be subject to the allotment  
9 process referenced in section 37-33.

10 (g) This section shall not apply to the department of  
11 education."

12 SECTION 3. Section 37-33, Hawaii Revised Statutes, is  
13 amended to read as follows:

14 "**§37-33 Funds to which allotment system applies.** Sections  
15 37-31 to 37-42 relating to the allotment system shall apply to  
16 all appropriations (including standing, continuing, or annual  
17 appropriations and special funds) for all departments and  
18 establishments, but shall not apply to refund accounts nor to  
19 appropriations for the courts or the legislature nor to payment  
20 of unemployment compensation benefits. In the cases of capital  
21 improvements and in other cases where periodical allotments are  
22 impracticable, the director of finance may dispense therewith

# S.B. NO.

1 and prescribe such regulations as will [~~insure~~] ensure proper  
2 application and encumbering of funds[-], subject to section  
3 37-\_\_. Subject to section 37-40, emergency or contingent funds,  
4 revolving funds, and trust funds, shall be subject to such  
5 regulations as the director may prescribe for controlling the  
6 expenditures and encumbering the funds."

7 SECTION 4. Statutory material to be repealed is bracketed  
8 and stricken. New statutory material is underscored.

9 SECTION 5. This Act shall take effect on July 1, 2010.

10

INTRODUCED BY: \_\_\_\_\_