

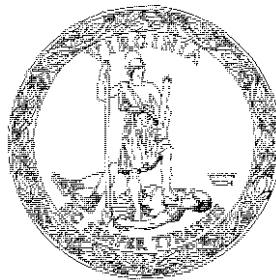
JOINT LEGISLATIVE  
AUDIT AND REVIEW  
COMMISSION

THE  
VIRGINIA  
GENERAL  
ASSEMBLY

FEDERAL FUNDS  
IN VIRGINIA

Special Report  
October 13, 1980

**REPORT OF THE**  
**JOINT LEGISLATIVE AUDIT AND REVIEW COMMISSION**  
**ON**  
**FEDERAL FUNDS IN VIRGINIA**  
**TO**  
**THE GOVERNOR**  
**AND**  
**THE GENERAL ASSEMBLY OF VIRGINIA**



**HOUSE DOCUMENT NO. 6**

**COMMONWEALTH OF VIRGINIA**  
**Richmond, Virginia**  
**1981**

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December 1, 1980

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The Honorable John N. Dalton, Governor  
The Honorable Members of the General Assembly  
State Capitol  
Richmond, Virginia

Ladies and Gentlemen:

I am pleased to transmit to you this final report from a study of federal funds conducted by the Joint Legislative Audit and Review Commission. The study was authorized by House Joint Resolution 237 of the 1979 Session.

The report and recommendations for legislative consideration were authorized for release at the October 13, 1980, meeting of the Commission.

Sincerely,

Richard M. Bagley  
Chairman

RMB:bj

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# Report Summary and Recommendations

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Federal funds provide approximately one-fourth of all State revenues. In FY 1979, more than 300 federal programs provided over \$1.7 billion to the State and its localities. Accompanying these funds are numerous federal requirements which influence State policies and procedures. Although the State may prefer to avoid some of the influences of these requirements, its options are limited by the penalties which may result from noncompliance.

This is the second report published under HJR 237 of the 1979 Session. An interim report was published as House Document 16 of the 1980 Session. The interim report provided information on the amount and distribution of federal funds in Virginia. It also raised issues regarding the accuracy of information which the General Assembly receives on federal funds during the appropriation process. Several recommendations of the interim report dealing with budgetary information and control have been acted on. In particular, legislative and executive attention has focused on improving the estimation of anticipated federal revenues.

Although steps have been taken to improve federal fund management, several areas require continuing legislative and executive attention. The following recommendations are suggested to strengthen the State's use of federal funds.

## **Influence of Federal Funds on Virginia**

Agency participation in federally-funded programs can require major policy, budgetary, and program commitments of the Commonwealth. For this reason, the General Assembly should be kept fully informed of significant policy and program impacts resulting from federally-mandated requirements. This can be accomplished by amending the 1980-82 Appropriations Act.

Section 4-3.05(a) directs the Governor to prepare a quarterly report summarizing nongeneral fund revenues in excess of appropriated amounts. The report is to summarize the approvals granted to agencies to spend above appropriated amounts, the reasons for the approvals, and implications.

*Recommendation (1). Section 4-3.05(a) of the Appropriations Act should be amended to require the Governor to identify for each approved request the anticipated budgetary, policy, and administrative impacts of significant program requirements which accompany the funding.*

Section 4-3.05(b) calls for the Governor to prepare for each agency a written reconciliation of the differences between revenues authorized for expenditure and estimates contained in the budget bill. The reconciliation is to emphasize:

The identification of programs that were initiated, expanded, or which underwent a significant change in anticipated levels of effort during the previous year as a result of the availability of additional funds.

The report of the Governor is to be furnished to the chairmen of the House Appropriations Committee and the Senate Finance Committee by December 1 of each year.

*Recommendation (2). The General Assembly should amend Section 4-3.05(b) of the Appropriations Act to require that the Governor include in his annual report a summary of significant federal requirements and their associated budgetary, policy, and administrative influence on State government. The report should also include a summary statement on the overall effect of cross-cutting requirements which have had significant budgetary, policy, or administrative influences on State government.*

As evidenced by the receipt of almost one-half billion dollars in federal funds in FY 1979, local dependence on federal funds is great. Participation in federally-funded programs provides valuable resources to all Virginia localities. However, the ability of Virginia localities to identify and seek federal funds varies significantly. Some localities have special staffs to identify and apply for federal funds. Others have minimal capabilities. Although the Department of Intergovernmental Affairs (DIA) has statutory responsibility to assist localities in seeking federal grants, this function has been given low priority.

*Recommendation (3). The Secretary of Administration and Finance should review the Department of Intergovernmental Affairs' present priorities and procedures with localities to ensure that its legislative mandate is satisfied and that all Virginia localities have adequate information and expertise to identify and solicit federal funds.*

Of the 125 State agencies that reported spending federal funds in FY 1979, 101 agencies provided matching funds. These agencies reported, on a JLARC survey, spending \$352.4 million to match federal funds. This represents a State expenditure of 30 cents for every federal dollar spent. The State's central accounting records, however, identified less than one-third of the State's match of federal funds, a substantial underrepresentation of the State's commitments to match federal funds.

*Recommendation (4). State funds spent to match federal funds should be consistently represented in the Commonwealth's Accounting and Reporting System (CARS). The Department of Accounts should require State agencies to use the capability of CARS to record match expenditures.*

## **Controls Over Federal Funds**

Federal funds are a valuable resource available to the Commonwealth for financing its programs and services. To ensure that federal funds are efficiently and effectively controlled and utilized, the following recommendations are made.

## Administration and Finance Directive 1-80

In issuing A&F Directive 1-80, the Secretary recognized the need to replace an ineffective grant-by-grant review of agency applications for federal funds. The new system emphasizes agency responsibility to seek and accept only funds consistent with legislative and executive mandates. It further limits agency acceptance of federal funds to 110 percent of their legislative appropriations, except in emergencies. This limitation should provide agencies with an incentive to accurately estimate anticipated federal funds in their budget submissions.

While A&F Directive 1-80 is an improvement over former policies, it is inconsistent with existing language in the Appropriations Act.

Section 4-4.01. No donations, gifts, grants or contracts whether or not entailing commitments as to the expenditure, or subsequent request for appropriation or expenditure, from the general fund shall be solicited or accepted by or on behalf of any State agency without the prior written approval of the Governor; provided, however, that these requirements shall not apply to donations and gifts to the endowment funds of the institutions of higher education. The use of these funds for land, structures or equipment is subject to Sections 4-4.03, 4-7.01 and 4-9.05 of this act.

*Recommendation (5). The General Assembly should consider revising Appropriations Act language to reflect the decentralized procedures of A&F Directive 1-80. Such an amendment would reflect legislative endorsement of the policy.*

Sections 4-3.05 and 4-4.01 of the Appropriations Act do not represent the technical sequence of solicitation and acceptance of funds. The Act would be clearer if the normal sequence followed by agencies in soliciting and accepting funds were reflected by the language of the Act.

*Recommendation (6). The language of Sections 4-3.05 and 4-4.01 should be reordered to reflect the sequence of actions followed by agencies in soliciting and accepting funds.*

## Reimbursement Procedures

There are three basic mechanisms for receiving federal funds: cash advance, letter of credit, and reimbursement. Effective use of these mechanisms is necessary to support the State's investment program. JLARC identified an additional \$286,000 in investment revenue that could have been gained by better cash flow management practices by agencies. State funds are also used unnecessarily to finance federal programs when agencies do not apply for all allowable indirect costs.



*Recommendation (7). The Department of Planning and Budget should carefully monitor provisions of A&F Directive 1-80 which address the methods by which federal funds are received. Cash advances and letters of credit should be used whenever possible. When agencies are restricted by federal grantors to receiving funds by reimbursement, the Department of Planning and Budget should monitor such arrangements to ensure that agencies submit requests for reimbursement in a timely manner.*

*Recommendation (8). The Department of Planning and Budget should review subgrant financing arrangements used by State agencies to ensure that subgrantees are relieved, whenever feasible, of the need to provide advance financing for federal programs.*

*Recommendation (9). The Department of Intergovernmental Affairs should periodically evaluate agency indirect cost practices to ensure that full recovery is taking place. State agencies seeking federal funds for programs that will subsequently be carried out by a subgrantee should be encouraged to include the indirect costs of the subgrantee when possible.*

#### General Fund Loan Procedures

Procedures for making general fund loans to agencies for expenditures pending federal reimbursement need to be reviewed. JLARC identified loans totaling \$7 million for advance funding of programs that could have been avoided. Unnecessary loans to agencies increase the risk of overexpenditure and subsequent deficits and decrease incentives for sound cash flow management.

*Recommendation (10). General fund loan requests should be thoroughly analyzed by the Department of Planning and Budget to ensure that the need for advance financing by the State exists, that the amount of the loan is secured by an adequate repayment source, and that the amount is limited to that necessary to cover an anticipated reimbursement cycle. Loans which are required for the operation of particular grant programs should be based whenever possible on award notices. When a loan must be made based on anticipated funding, the difference between anticipated and actual awards should be reported and an adjustment made to the loan amount.*

#### Improved Budgeting Information

Essential to legislative oversight of federal funds is accurate budgetary information on the amounts and requirements of federal funding. Decisions by the Governor or his designee to increase agency budgets between legislative sessions must be based on accurate information. Required information on federal funds has not been provided to the General Assembly in all cases.

*Recommendation (11). The Department of Planning and Budget should require agencies to furnish information on actual awards of federal funds whenever the award differs from the anticipated amount. A report of these differences should be provided to the House Appropriations Committee and Senate Finance Committee as part of the quarterly reports required under the Appropriations Act.*

*Recommendation (12). The Department of Planning and Budget should continue to monitor federal budget reduction proposals and their potential impact on the programs of the Commonwealth and its localities. Findings should be reported to the House Appropriations and Senate Finance committees.*

*Recommendation (13). Agencies which receive federal funds as subgrantees or secondary recipients should be required to identify consistently in their budget exhibits the federal source of such subgrantee funding.*

*Recommendation (14). The Department of Planning and Budget should ensure that agencies comply with Section 2.1-398 of the Code of Virginia and provide identification of the authority for operation of a program.*

### Seeking Federal Funds

In general, agencies should use federal funds for carrying out programs which have received legislative endorsement through the appropriation process. In some cases, however, agencies fail to seek funding which is appropriate and could supplement or offset the use of other State resources.

*Recommendation (15). State agencies and departments should take steps to assess whether they are effectively identifying and utilizing federal resources available for programs that have been authorized by the General Assembly or Governor.*

## **Financial Administration of Research Grants**

The State needs to take several steps to extend the generally adequate financial administration of research grants and contracts to all State-supported universities. Adequate procedures are already in place in several institutions which can serve as models where needed.

Federal audit exceptions are an important indication of weaknesses in the financial administration of research grants and contracts. At present, the State lacks a clear policy that appropriate State officials be informed of audit exceptions. As a result, audit exceptions are sometimes not reported outside the university.

*Recommendation (16). The General Assembly should require that copies of all federal audits be forwarded to the Office of the Auditor of Public Accounts and the Department of Planning and Budget as soon as they are received by agencies of State government. In light of the magnitude of audit exceptions found at VCU and VIMS, the Auditor of Public Accounts should consider putting a high priority on grant and contract accounts while conducting State audits.*

Several weak practices in the financial administration of research grants and contracts were found to exist at Virginia Commonwealth University and at the Virginia Institute of Marine Science, now a school of the College of William and Mary. Although the institutions have identified and are addressing known management problems, several areas need continuing attention.

*Recommendation (17). VCU should continue to strengthen internal controls over grant and contract accounting, including the following:*

- a. All Financial Accounting System (FAS) accounts with negative balances should be identified and reconciled by the grant and contract office with the responsible academic department or faculty member. VCU should establish a policy that no expenditures should be made from any account with a negative balance without written authorization of the university controller.*
- b. VCU should develop a procedure whereby all FAS accounts which indicate that the grant or contract has terminated are protected from additional encumbrance and expenditure without the written authorization of the university controller.*

*Recommendation (18). VCU's administration should take steps to fully implement its effort reporting system as soon as an understanding is reached with federal authorities. This should include appropriate training sessions and aggressive supervisory post-audits to ensure compliance with reporting requirements.*

*Recommendation (19). VCU should develop an internal procedures manual for the grant and contract accounting section. Among the areas addressed should be procedures to prevent the submission of late fiscal reports to federal grantors.*

*Recommendation (20). The ongoing implementation of a financial accounting system at VIMS should be carefully monitored by the administration of the College of William and Mary.*

*Recommendation (21). VIMS should develop a standard grant and contract approval cover sheet to be maintained as part of each file. VIMS should also put a high priority on developing a procedures manual governing the administration of grants and contracts.*

## **New Sources of Information For Legislative Oversight of Federal Funds**

Lack of basic information on the amount, distribution, and impact of federal funds in Virginia was one of the principal reasons the General Assembly asked JLARC to study federal funds. The finding that one-fourth of all State revenue comes from federal funds justified the legislature's concern that more information was needed on this important revenue source. The continuing legislative need for current, accurate information on federal funds became evident during the course of the study.

To address this need, JLARC authorized its staff to apply to the National Conference of State Legislatures (NCSL) for technical assistance and funding to explore the feasibility of developing a computer program for legislative information on federal funds. NCSL awarded the Commission \$5,000 for this purpose.

The feasibility project is nearing completion, and programs on State agency and program expenditures of federal funds have been developed using data currently available in State computer systems. Other sources are continuing to be explored.

*Recommendation (22). The Department of Intergovernmental Affairs should continue to develop, with the Department of Management Analysis and Systems Development, user programs for the Federal Assistance Award Data System (FAADS).*

*Recommendation (23). Programs using CARS data on federal fund expenditures should continue to be generated as a means of providing comprehensive and timely information for legislative budget analysis.*

*Recommendation (24). The General Assembly should continue to have active communication, through JLARC, the House Appropriations Committee, and the Senate Finance Committee, with the Department of Intergovernmental Affairs and the Office of Management and Budget on FAADS and related projects.*

# I. Introduction

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In 1961, the Virginia Commission on Constitutional Government warned:

Grants-in-aid . . . are bringing within the orbit of federal supervision, if not control, many of the activities of administrative authorities and conditioning the prerogatives of governmental agencies at the state and local level.

The commission expressed concern that Virginia governments received \$125.7 million in federal grants during FY 1960--five times as much as was received in 1950. Today, there are more than 300 federal programs which provide over \$1.7 billion to the State and its localities. And the concerns raised in 1961 are still important to the Commonwealth in 1980. The provision of large amounts of intergovernmental aid and Virginia's dependence on this aid have given the federal government a powerful lever for influencing State and local programs.

The nature of federal influence is largely defined by the requirements attached to intergovernmental aid. The number of these requirements has grown substantially in recent years. Decision-makers and administrators alike are faced with a sometimes bewildering network of requirements which affect program delivery and administrative policies and procedures. Although these requirements produce influences the State may prefer to avoid, its options are limited by the substantial penalties which can result from noncompliance.

## Study Definition and Scope

This is the second report on federal funds prepared under House Joint Resolution 237. It focuses on federal influence over State and local programs and evaluates the procedures by which federal funds are sought, utilized, monitored, and controlled.

The General Assembly called for a study of federal funds because of concerns about the growing influence exerted by federal funds, and the corresponding potential loss of the legislative prerogative to appropriate funds. The specific charge for the study was outlined in HJR 237, adopted by the 1979 Session. The resolution specified seven areas of inquiry:

1. The dollar amounts of federal funds received by the Commonwealth and its localities.
2. The distribution of such funds among programs.
3. The dependence of the Commonwealth and its localities on federal funds for programs.

4. An analysis of the funds that Virginia would lose for failing to comply with the requirements of the federal programs which condition the grant.
5. The growth of federal funds and the resulting growth of federal influence on State and local policies and programs over the last ten years.
6. The substantive and procedural rights and duties available to, and incumbent upon, the Commonwealth in the event of federal action to withdraw federal funds or shift federal program costs to the agencies and institutions of State and local governments.
7. The methods and procedures by which federal funds are sought, utilized, monitored, and controlled.

An interim report on federal funds was published as House Document 16 of the 1980 Session of the General Assembly. The report described the intergovernmental aid system and provided information on the amount and distribution of federal funds in Virginia. It documented the extent to which State agencies underestimated anticipated federal fund revenues during preparation of the biennial budget. The report included recommendations relating to ways in which the legislative appropriations process could be strengthened and how budget information and control procedures could be improved.

#### Methods and Organization

A number of techniques were used to gather data on federal programs. Major data collection efforts included:

1. A survey to determine the extent of federal fund expenditures and the amount of State funds used to match federal funds.
2. A series of structured interviews with agency heads, program managers, and financial officers in 20 State agencies which received more than 90 percent of all federal funds.
3. A review and analysis of Department of Planning and Budget files regarding approvals to solicit and accept grant funds, and a review of documentation for loans made with federal funds as collateral.
4. A survey of attorneys in the Department of Law regarding federal fund disputes between State agencies and the federal government.
5. A review of project files and financial records relating to grants and contracts administered by six institutions of higher education.

This report is organized into five chapters. This chapter reviews various legislative and executive responses to the interim report. Chapter II highlights the ways in which federal influence affects State agencies and programs, and the consequences of that influence. Chapter III evaluates control over the receipt and expenditure of federal funds by State agencies. Chapter IV focuses on the management of federally-sponsored grant and contract research by universities and colleges. Finally, Chapter V discusses the development of new information programs intended to provide accurate and timely data on federal funds for the legislature.

### Legislative Action

During the 1980 Session, important actions were taken by the General Assembly in its approach to managing federal funds.

*Appropriations Act Requirements.* The interim report recommended that the General Assembly consider language changes in the Appropriations Act to insist that it be kept fully informed about the flow and use of federal funds in the Commonwealth. Specifically, the General Assembly was urged to:

- Require the inclusion in agency budget estimates of all federal revenues which could be reasonably anticipated.
- Require a written reconciliation of the difference between federal funds that were originally appropriated, and those actually received.

The legislature's long-standing intent that agencies include all reasonable estimates of nongeneral revenues in their budgets was mandated with the adoption of new language.

. . . It shall be incumbent on each State agency to ensure that every reasonable estimate of receipts from donations, gifts or other nongeneral fund revenues are included in their budget estimates. (Section 4-3.05a.)

The legislature also amended the Appropriations Act to require a written reconciliation between agency estimates and actual receipts of nongeneral fund revenues.

Annually, the Governor shall prepare for each agency a written reconciliation of the difference between revenues authorized for expenditure under this section and estimates contained in the budget bill. The reconciliation should emphasize the identification of programs that were initiated, expanded, or which underwent a significant change in anticipated levels of effort during the previous year as a result of the availability of additional funds. The report shall

be furnished to the Chairman of the House Appropriations Committee and the Chairman of the Senate Finance Committee not later than December 1, of each year. (Section 4-3.05b.)

As a result of increased legislative, as well as executive, attention to the appropriation of federal and other nongeneral funds, the 1980-82 budget more accurately reflected the projected base of State spending. Appropriations identified as from a federal trust in the 1980-82 budget increased by almost \$400 million over the 1978-80 amounts. This occurred despite the loss of \$92 million in general revenue sharing funds and other cutbacks in intergovernmental aid. Significantly, \$29 million of the increase came in the form of amendments requested during the 1980 budget session. These appropriations clearly reflected legislative insistence on full identification of anticipated federal funding.

*Legislative Hearing on Local Impact.* The impact and influence of federal aid provided to Virginia's cities and counties were assessed through a special legislative hearing. A legislative subcommittee was appointed from the Commission to address three important questions:

1. What is the overall impact of intergovernmental aid on localities?
2. What is the potential impact of proposed federal fund cutbacks on localities?
3. What are possible local and State responses to potential cutbacks?

Representatives of 21 local jurisdictions and municipal organizations testified before the subcommittee on May 30, 1980. Testimony covered the scope and nature of federal funding influence on local governments and highlighted the damaging effects of proposed cutbacks in the level of federal aid. Most Virginia localities were shown to depend on federal funds for between 15 and 20 percent of their operating budgets, and other federal grants supported such needed capital improvements as parks, wastewater treatment plants, and public buildings.

Localities and organizations with representatives who spoke before the subcommittee, and excerpts from testimony, are shown in Figure 1. A copy of statements made at the hearing is available on request from the Commission.

The public hearing also highlighted the difficulty in doing a comparative review of federal funds received by localities. The best available information indicates that Virginia cities and counties received \$454 million in federal funds during FY 1979. However, reporting inconsistencies make it almost certain that this understates the actual amount received from all federal sources. The Auditor of Public Accounts, the State official responsible for collecting comparative cost data on local governments, has recently issued standardized reporting guidelines which should improve the usefulness of local cost reports.



Figure 1

JLARC SUBCOMMITTEE HEARING ON FEDERAL FUNDS  
May 30, 1980

SELECTED LOCAL COMMENTS

Fairfax County	<i>"If none of these federal funds were available, the county real estate tax rate would have to be increased by approximately nine cents . . . the average homeowner in Fairfax County would pay \$69 more in real estate taxes to recoup these funds."</i>
Charlotte County	<i>"The loss of all these (federal) programs would double our tax rate if the Board of Supervisors chose to fund our request--but we are not a wealthy community and the school programs would be lost because our citizens simply cannot afford the burden of a 100 percent tax increase."</i>
Alleghany County	<i>". . . Alleghany County has become dependent on revenue sharing to a point where any cuts in this program would place an unbearable burden on our taxpayers."</i>
Henrico County	<i>"There still sometimes is a void in getting accurate financial information regarding potential policies and procedures of federal funding."</i>

LOCAL JURISDICTIONS AND ORGANIZATIONS REPRESENTED

<u>Cities</u>	<u>Towns</u>	<u>Planning District Commissions</u>
Hopewell Portsmouth Richmond Virginia Beach	Blacksburg West Point	Central Shenandoah Richmond Regional Thomas Jefferson
<u>Counties</u>	<u>School Boards</u>	<u>Associations</u>
Alleghany Charlotte Dinwiddie Fairfax Hanover Henrico Prince William	Charlotte Portsmouth	Virginia Association of Counties Virginia Association of Planning District Commissions Virginia Municipal League

A final point made during the hearing concerned the adequacy of State support in providing information and assistance to localities regarding federal funding programs. Three State agencies--the Local Government Advisory Council, the Virginia Liaison Office, and the Department of Intergovernmental Affairs--have statutory mandates to provide information to localities to help identify and obtain federal grants. The Department of Intergovernmental Affairs (DIA) is responsible for staffing the information and assistance efforts.

DIA representatives have concluded that local governments have sufficient information and expertise to identify and solicit grants on their own. As a result, the department does not place a high priority on this function. The testimony of local officials suggested that a significant number of localities may need additional assistance. The Secretary of Administration and Finance and DIA need to review priorities and procedures to ensure that the department's legislative mandate is satisfied.

#### Executive Action

During the fall of 1979, and subsequent to the issuing of recommendations contained in the interim report, the executive branch agencies developed and initiated new procedures to control the receipt and expenditure of federal funds.

*Improved Budget Information.* The interim report recommended that the Governor's budget proposal identify all federal revenues anticipated by agencies. Comingling of funds, where necessary to conform to Department of Accounts fund structure, should be explained with appropriate footnotes and supporting detail.

The Department of Planning and Budget has already taken action by encouraging agencies to provide full information on anticipated federal funding in their budget submissions. This action resulted in a fuller representation of anticipated federal funding in the 1980-82 budget. In addition, revisions of agency revenue estimates provided to the legislature during the 1980 Session resulted in an additional \$29 million in federal revenues being added as amendments to the 1980-1982 Appropriations Act. Many of these revisions were in direct response to legislative questions regarding the accuracy and completeness of agency revenue estimates.

*Administration and Finance Directive 1-80.* One of the interim recommendations also urged the Department of Planning and Budget to clarify its policies governing the Form 16 "notification of intent" process.

In May 1980, the Secretary of Administration and Finance issued A&F Directive 1-80 which completely revised the basis for agency solicitation and acceptance of nongeneral fund revenue. The policy directive had been under development since September 1979, and became effective on July 1, 1980. The new system replaced an application by application, notice, review, and approval procedure, with blanket authority to solicit

and accept grants according to approved agency mission. The directive established policy guidelines and requires quarterly agency reporting of new revenue. Prohibitions are included in the directive against soliciting seed money grants for which the State must eventually assume costs and against grants which increase manpower beyond authorized levels. Agencies are also encouraged to maximize cash flow by using letters of credit and by timely claims for reimbursement.

Under the new system, the review and approval of individual grant solicitations will no longer be done centrally. Instead, agencies have been given authority to solicit, without prior approval, any funds that have been appropriated by the General Assembly. This delegation of authority represents the administration's feeling that agencies should be able to determine whether a federal program is consistent with their approved legislative missions. It also reflects the fact that, under the old system, few applications were ever disapproved by DPB. Acceptance of federal funding for new programs must receive the prior approval of the Governor.

It is significant that the directive limits an agency's receipt of federal funds to 110 percent of its legislative appropriation, except for emergencies. This should provide the necessary incentive for agencies to accurately estimate all anticipated federal income.

### Conclusion

Many steps have been taken to improve federal fund management. Nevertheless, several areas require continuing legislative and executive attention.

- Constant attention needs to be given to the influence which accompanies federal funds. The State needs to exercise every option possible to avoid undesirable consequences.
- Agencies need to be carefully monitored to ensure they make best use of advance funding and letters of credit. JLARC identified \$286,000 in potentially lost investment revenue resulting from poor agency cash flow management.
- Policies regarding general fund loans, made in anticipation of federal funding, need review.
- Gaps in the accuracy and completeness of reporting federal funds need to be closed.
- Accounting procedures used at Virginia Commonwealth University and the Virginia Institute of Marine Science of the College of William and Mary to account for and control federally-sponsored grant and contract research funds need improving.

Finally, accurate information on federal funds is needed by the legislature to use in its decision-making activities related to the

appropriations process. The interim report recommended that the State continue its participation in the Federal Assistance Information Test and examine ways to link various federal and State account records. This effort has begun. Legislative and executive agencies have worked together to develop a new report. The status of that effort is reported in Chapter V.

## **II. Influence of Federal Funds**

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Federal funds substantially influence budgets, policies, and administration of programs they aid. This influence is most often effected through the use of requirements attached to aid programs. There are two types of requirements. Program-specific requirements relate to individual programs. Cross-cutting requirements relate to all federal programs. Together, these requirements have substantial impact and influence on the State.

### Program-Specific Requirements

Program-specific requirements limit the use that recipients can make of funds and the way in which the program can be administered. Often detailed and numerous, program-specific requirements originate in the program's authorizing legislation and are frequently expanded by federal agency interpretations.

For example, provisions of the Older Americans Act, which provides funds to Virginia's Office on Aging, demonstrate the scope of program-specific requirements. These requirements include:

- State match requirement--at least 25 percent of administrative costs must be borne by the state and local agencies.
- Specific organizational requirement--a sole state agency must be designated to administer the program.
- Staffing requirement--persons over 60 will receive preference for staff positions.
- Planning requirements--three-year state and area plans must be developed and annually updated.
- Specified priorities are established--50 percent of funds must be spent in three priority areas: access to services, in-house services, and legal services.
- Service delivery requirements--no direct services can be provided by state or area agencies if an alternate provider is available.
- Special needs requirements--special menus necessitated by health or religious requirements or ethnic backgrounds should be provided where appropriate and feasible.
- Special program requirements--an ombudsman program for long-term facility residents must be established, for example.

### Cross-Cutting Requirements

Cross-cutting requirements, in contrast, do not originate with any particular program and do not reflect unique program needs. Instead, they are specifically designed to gain the cooperation of recipients in attaining broad federal objectives--whether related to program goals or not. Thus, while grantees may be concerned with a focused goal, such as providing services to the handicapped, they frequently must also assist in attaining federal goals.

There are currently 59 cross-cutting requirements, according to the U. S. Office of Management and Budget, up from one such requirement in 1934. Most of these requirements have been added during the past decade and seek to affect the socio-economic policies of recipients in areas such as protection of the environment, non-discrimination, and labor standards. Others prescribe administrative and fiscal practices which must be followed.

Due to the lack of a clear relationship to the program's objectives, recipients sometimes consider cross-cutting requirements more objectionable than program-specific requirements. Nonetheless, to receive federal assistance in accomplishing a particular goal, recipients must commit themselves to the goals represented by cross-cutting requirements.

### Cost of Implementing Requirements

While the goals of federal requirements may be admirable, they can result in added costs to the State. The number of federal programs and the complexity of their interactions make it impossible to determine an overall cost of compliance. However, the following example illustrates that the increased costs resulting from federal requirements are not only high, but can appear to be both arbitrary and unnecessary.

*The Davis-Bacon Act requires that workers in federally-assisted construction projects be paid the prevailing wage rate for construction work classifications in the area.*

*In 1978, the Department of Highways and Transportation (DHT) entered into a dispute with the U. S. Department of Labor over the classification of some work on the I-66 project in Northern Virginia. As part of the State's commitment to the Metro subway system, the State agreed to construct a tunnel for Metro in the I-66 median. DHT had constructed similar structures for other highway projects elsewhere.*

*When DHT requested approval for "highway" wage rates for the entire project, it was told that the work for Metro must be done under the more expensive "heavy construction" wage rates, even though the*

*skills necessary to do the work were the same as the highway work, and similar work had been done by DHT in other projects under highway rates.*

*Application of the prevailing heavy wage rate to the project meant an increase in hourly wages ranging from 121 percent to 310 percent.*

*DHT appealed the decision and lost. It redesigned the project to exclude the tunnel work in the median, which it designed and contracted separately. The cost to Virginia in increased construction costs due to delays and the payment of higher rates for a portion of the project was estimated by DHT to be between \$4 and \$5 million.*

Even when State and federal policies are consistent, the federal government may impose its requirements on the State in the interest of nationwide uniformity. In the case below, a State program was preempted by a similar federal act.

*In 1970 the General Assembly passed a law which required that buildings built or altered with public funds must be made barrier free to the handicapped. Three years later, the U. S. Environmental Barriers Removal Act was passed. The federal law requires that recipients of funds through designated programs must make their programs accessible to the handicapped.*

*The federal law established a compliance date of June 3, 1980, although no construction standards were ever adopted. The State did not meet the compliance deadline, and could be subject to sanctions even though its commitment to the goal of barrier removal was reflected in the 1970 law, and by the appropriation of approximately \$5 million in both the 1978-1980 and 1980-1982 bienniums to carry out this goal.*

The deadline in the above case will likely be extended because no state in the nation is in compliance.

A significant aspect of federal requirements is that many of them apply to large and small grants alike. In the example below, federal fund requirements and conditions must be met by recipients, even though some of the grants affected are for very small amounts of money.

*Any State agency or locality applying for a subgrant of the \$12 million received by the Division of Justice and Crime Prevention under its grant from the Law Enforcement Assistance Administration (LEAA) must comply with three lists of federal requirements.*

# Cross-Cutting Federal Requirements

## Prohibition of Discrimination

- †1964 — due to race, color, or national origin  
(Civil Rights Act of 1964, Title VI)
- †1965 — due to race, color, religion, sex, and national origin in construction employment  
(Executive Order 11246, September 24, 1965, Part III)
- †1968 — against the handicapped in access to public facilities  
(Architectural Barriers Act of 1968)
- †1968 — due to race, color, religion, sex, and national origin in housing  
(Civil Rights Act of 1968, Title VIII)
- †1970 — against alcohol abusers by hospitals  
(Comprehensive Alcohol Abuse and Alcoholism Prevention, Treatment, and Rehabilitation Act of 1970)
- †1972 — against drug abusers by hospitals  
(Drug Abuse Office and Treatment Act of 1972)
- †1972 — due to sex in education programs  
(Education Act Amendments of 1972, Title IX)
- †1973 — against the handicapped  
(Rehabilitation Act of 1973, Section 504)
- †1975 — due to age  
(Age Discrimination Act of 1975)

## Protection of the Environment

- †1934 — mountain fish and wildlife resources  
(Fish and Wildlife Coordination Act of 1934)
- †1966 — protect historical resources  
(National Historical Preservation Act of 1966, Section 106)
- †1968 — protect wild and scenic rivers  
(Wild and Scenic Rivers Act of 1968)
- †1968 — protect from loss due to floods  
(National Flood Plain Insurance Act of 1968)
- †1969 — eliminate damage to the environment  
(National Environmental Policy Act of 1969)
- †1970 — clean up the air  
(Clean Air Act Amendments of 1970, Section 306)
- †1971 — protect and enhance cultural environment  
(Executive Order 11593, May 31, 1971)
- †1972 — protect and enhance coastal resources  
(Coastal Zone Management Act of 1972, Section 307(e), (d))
- †1972 — clean up waterways  
(Federal Water Pollution Control Act Amendments of 1972, Section 508)

- †1973 — protect endangered species  
(Endangered Species Act of 1973)
- †1974 — protect drinking water sources  
(Public Health Service Act, Title XIV)
- †1974 — protect historic and cultural properties  
(Procedures for the Protection of Historic and Cultural Properties)
- †1974 — preserve archeological remains in construction  
(Archeological and Historic Preservation Act of 1974)
- †1977 — protect flood plains  
(Executive Order 11988, May 24, 1977)
- †1977 — protect wetlands  
(Executive Order 11990, May 24, 1977)
- †1977 — coordinate state/federal efforts to clean up the air  
(Clean Air Act Amendments of 1977, Title I)

## Protection and Advancement of the Economy

- †1954 — protect U. S. shipping  
(Cargo Preference Act)
- †1974 — protect U. S. air transport  
(U. S. Flag Air Carriers, International Air Transportation Fair Competitive Procedures Act of 1974)
- †1977 — encourage employment of resources in labor surplus areas  
(Placement and Procurement and Facilities in Labor Surplus Areas)

## Health, Welfare and Safety

- †1966 — provide for human treatment of research animals  
(Animal Welfare Act of 1966)
- †1971 — prohibit use of lead paint  
(Lead-Based Paint Poisoning Prohibition)
- †1974 — protect human research subjects  
(National Research Act, Section 474)

## Minority Participation

- †1975 — give preference to Indians in assistance that benefits Indians  
(Indian Self-Determination and Education Assistance, Section 7)
- †1979 — encourage women's business enterprise  
(Executive Order 12138, May 18, 1979)

## Labor Standards

- †1931 — pay construction workers prevailing wages  
(Davis-Bacon Act)
- †1934 — prohibit illegal deductions or kickbacks from wages earned in construction  
(Anti-Kickback Copeland Act)

- †1962 — prohibit sweat shops and pay overtime  
(Contract Work Hours and Safety Standards Act)

## Public Employee Standards

- †1940 — ensure political independence of U. S. financed activities  
(The Hatch Act)
- †1970 — support professionalized public personnel systems  
(Intergovernmental Personnel Act of 1970)

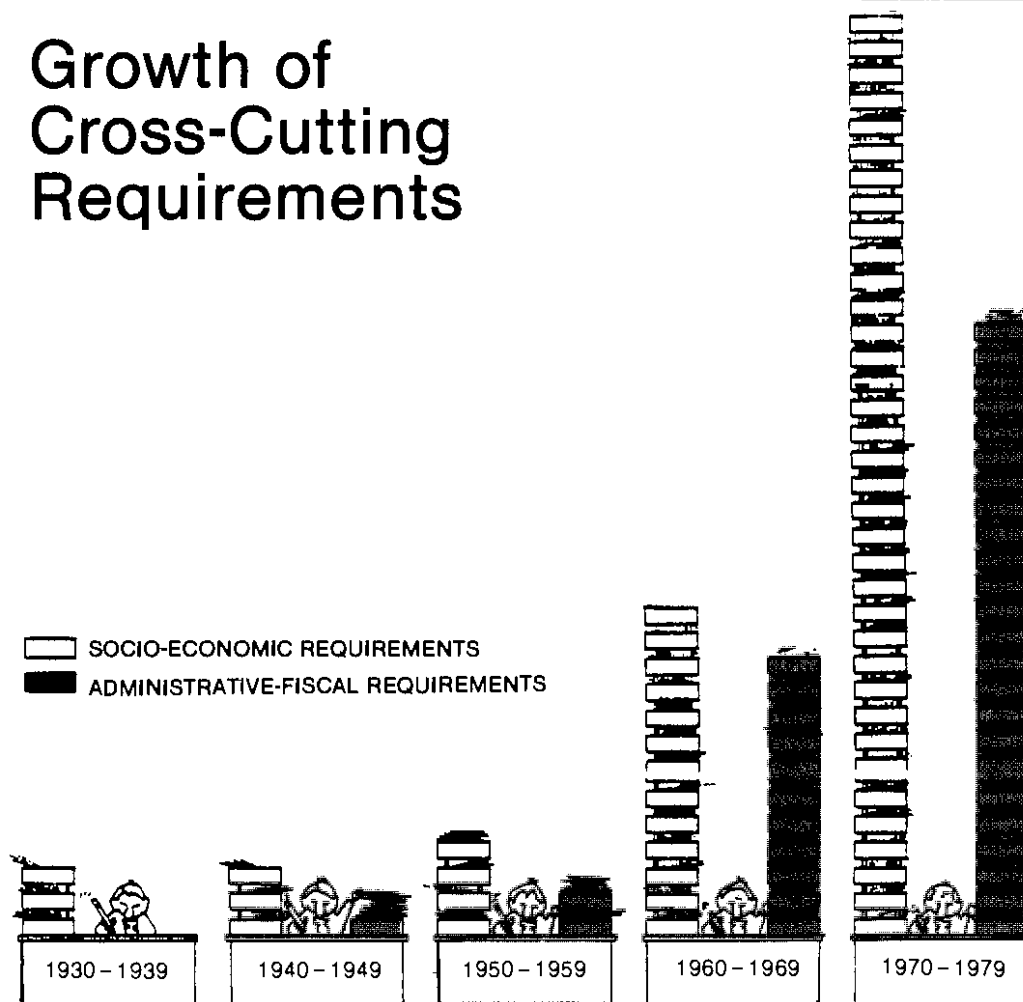
## General

- †1947 — coordinate payout of federal funds to reduce interest costs to government  
(Treasury Circular 1075: Regulation Governing the Withdrawal of Cash from Treasury for Advance Payments Under Federal Grant and Other Programs)
- †1962 — minimize public reporting burden  
(OMB Circular A-40: Management of Federal Reporting Requirements)
- †1966 — provide standards for collection of U. S. claims  
(Claims Collection Act of 1966)
- †1970 — provide equitable, uniform treatment to persons displaced by federally-assisted projects  
(FMC 74-8: Guidelines for Agency Implementation of the Uniform Relocation Assistance and Real Property Acquisition Policies of 1970)
- †1973 — inform states concerning grant awards to states and localities  
(Treasury Circular 1082: Notification to States of Grant-in-Aid Information)
- †1974 — combine federal and state resources in support of projects  
(OMB Circular A-111: Jointly Funded Assistance to State and Local Governments and Nonprofit Organizations, Policies and Procedures)
- †1976 — coordinate federal and federally-assisted programs and projects  
(OMB Circular A-95: Evaluation, Review and Coordination of Federally-Assisted Programs and Projects)
- †1977 — rationalize federal assistance relationships and processes  
(Federal Grant and Cooperative Agreement Act of 1977)
- †1978 — improve rulemaking procedures  
(Executive Order 12044, March 23, 1978, Improving Government Regulations)
- †1978 — provide uniform standards for federal statistical surveys  
(Department of Commerce, Directives for the Conduct of Federal Statistical Activities)



# Growth of Cross-Cutting Requirements

 SOCIO-ECONOMIC REQUIREMENTS  
 ADMINISTRATIVE-FISCAL REQUIREMENTS



## Non-Profit Organizations and Institutions

- 1973 — encourage cost-sharing on federally-funded research projects (FMC 73-3: Cost Sharing on Federal Research)
- 1973 — provide for single agency determination of allowable costs and single audit (FMC 73-6: Coordinating Indirect Cost Rates and Audit on Educational Institutions)
- 1973 — ensure greater consistency of agency policies and procedures with respect to the administration of research grants/contracts by educational institutions (FMC 73-7: Administration of College and University Research Grants)
- 1976 — establish standards for obtaining consistency and uniformity in administration of grants to nonprofits (OMB Circular A-110: Grants and

Agreements with Institutions of Higher Education, Hospitals and Other Nonprofit Organizations—Uniform Administrative Requirements)

- 1979 — apply generally accepted accounting principles to determine costs of research and development performed by educational institutions (OMB Circular A-21: Cost Principles for Educational Institutions)

## State and Local Governments

- 1968 — achieve a more coordinated and effective intergovernmental flow of information while eliminating duplication (OMB Circular A-90: Cooperating with State and Local Governments to Coordinate and Improve Information Systems)
- 1973 — improve audit practices, improve coordination of audit efforts, and emphasize need for early audits of new programs

(OMB Circular A-73: Audit of Federal Operations and Programs)

- 1974 — establish uniform principles for determining allowable program costs (FMC 74-4: Cost Principles Applicable to Grants and Contracts with State and Local Governments)
- 1977 — establish standards for obtaining consistency and uniformity in administration of grants (OMB Circular A-102: Uniform Administrative Requirements for Grants-in-Aid to State and Local Governments, Revised)

## Access To Information

- 1965 — make information about assisted activities readily available to the public (Freedom of Information Act)
- 1974 — restrict the disclosure of personal information by federal agencies and grantees (Privacy Act of 1974)

Source: JLARC representation of OMB data.

*Twenty-seven requirements relate to Justice System Improvement Act funds, 16 requirements are under the Juvenile Justice and Delinquency Protection Act, and 34 requirements apply generally to the programs. Examples of these requirements include:*

- Proposed actions must not jeopardize the continued existence of endangered species.*
- Federal funds must not be used to supplant State and local funds.*
- Subgrants and contracts will not be made with parties convicted of offenses under the Clean Air Act and the Water Pollution Control Act.*
- Any computer application will be written in ANS COBOL or ANS FORTRAN.*
- LEAA will be notified if any rivers specified in the Wild and Scenic Rivers Act will be affected.*

While the restrictiveness of federal requirements varies, most programs are subject to requirements similar in scope to those mentioned in the example. The choice is to accept the conditions under which the funds are offered, or to not participate in the program and lose the benefits. Given the State's dependence on federal funds and the benefits of the programs, the choice to turn down funds is usually unattractive.

Such requirements are "the cost of doing business" with the federal government. The requirements are not accidental or purposeless, though they may seem so to the program administrator who sees little relationship between juvenile justice and clean rivers. Rather, federal requirements are what they are designed to be--powerful levers of influence intended to promote broad social, economic, and administrative goals.

## **Types of Federal Influence**

Just as federal requirements are often broader than the programs they accompany, federal influence manifests itself over a broad range of State governmental activities. Federal influence is pervasive, affecting not only programs, but also the institutions and agencies of State government which manage the programs. To provide a framework for understanding the nature of influence, JLARC has categorized federal influence into three types: budget influence, policy and program influence, and administrative influence.

### **Budget Influence**

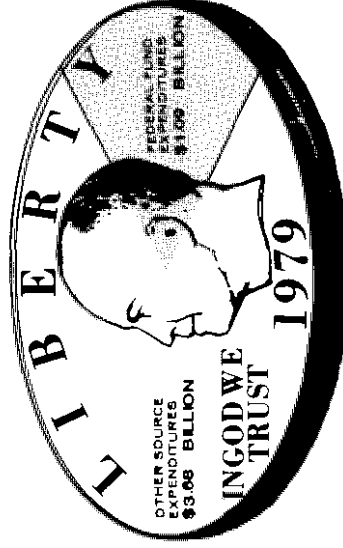
Intergovernmental aid influences the State budget in four major ways. The most obvious way is by financing almost one-fourth of all State expenditures in FY 1979 (Figure 2). One hundred and twenty-five

FIGURE 2

# FEDERAL FUND EXPENDITURES BY STATE AGENCIES (FY 1979)

Agency	Federal Fund Expenditures	Percent of Total Expenditures
State Highway Commission	\$ 244,600,183	20.2%
State Board of Health	204,341,583	48.5
Department of Welfare	173,269,819	62.7
State Department of Education	164,250,164	52.9
Department of Corrections	123,159,096	56.5
Department of Equal Opportunity Services		64.6
Woodrow Wilson Rehabilitation Center	59,324.8	68.1
University of Virginia	30,580,134*	88.1
State Department of Social Services		23.0
Hospital Division	25,762,940	1.5
Clinch Valley College	1,048,273	13.6
School of General Studies	368,893	1.2
Academic	158,956	14.4
Virginia Commonwealth University		18.1
Academic	167,48,184	8.2
MCV Hospital Division	51,185	1
Virginia Polytechnic Institute & State University	10,778,276	35.1
Extension Division	1,786,568	8.8
Academic Division	721,651	9.0
Office of Aging		96.3
Virginia Community College System		8.0
York College	1,031,539	8.3
York College	1,023,398	2.9
Northern Virginia Community College	982,506	2.9
Wytheville Community College	470,458	73.8
Virginia Western Community College	370,598	18.5
Rappahannock Community College	583,588	23.5
Southwest Virginia Community College	561,280	13.3
University of Lynchburg	431,304	28.9
University of Lynchburg	417,785	26.8
Virginia Highlands Community College	393,617	7.8
Central Virginia Community College	303,815	8.7
Thomas Nelson Community College	299,981	10.2
Southwest Virginia Community College	265,888	13.0
Patch Henry Community College	233,655	11.9
Paul O. Camp Community College	219,282	12.8
Midway Community College	211,652	19.0
Eastern Shore Community College	211,038	5.1
Daniels Community College	165,289	2.4
Blue Ridge Community College	50,358	3.3
State Board of Community College Systems	14,087	7.6
State Corporation Commission	9,787,318	37.8
Division of Justice & Crime Prevention	8,660,814	89.4
Central Office		88.5
Criminal Justice Services Commission	8,857,394	88.0
College of William & Mary		59.9
The College	5,366,572	3.2
Virginia Polytechnic Institute & State University	1,036,449	2
Richmond State College	401,808	21.1
Virginia State University	6,806,557	24.8
Department of Mental Health & Mental Retardation	8,238,688	13.8
State Division of Mental Health & Mental Retardation		1.1
Lynchburg Training School & Hospital	4,938,140	4.5
Southwestern Virginia Training Center	370,233	4.5
Southwestern Virginia Training Center	244,772	2.3
Eastern State Hospital	232,036	2.3
Southwestern Virginia Training Center	66,428	1.0
DeLameter Center for Human Development	61,543	3.6
Central State Hospital	61,972	1.4
Western State Hospital	29,392	1
Southwestern State Hospital	22,892	3.6
Commission of Outdoor Recreation	16,697	87.9
Virginia Commission for the Visually Handicapped	4,704,408	49.3
Virginia Rehabilitation Center for the Blind	729,484	80.2
Governor's Employment & Training Council	5,493,892	100.0
Norfolk State University	5,246,502	21.5
Department of Corrections	5,284,583	30.2
Mecklenburg Correctional Center	2,171,783	2.2
Board of Correctional Institutions	1,144,516	2.2
State Penitentiary & State Prison Farm	311,129	4
Virginia Correctional Center for Women	8,295	3
Natural Bridge Learning Center	7,916	3
Virginia State Prison	5,223	3
Virginia Hall-Way House	5,223	1
Reception & Diagnostic Center for Children	453	6.0
	3,876,300	
		6.0

SOURCE: DEPARTMENT OF ACCOUNTS.



TOTAL EXPENDITURES = \$4.77 BILLION  
23% OF ALL EXPENDITURES WERE DERIVED FROM FEDERAL FUNDS

Department of Housing & Community Development	3,634,840	49.8
Department of Conservation & Economic Development		13.5
Division of Forestry and Reclamation	1,001,700	93.1
Division of Mineral Resources	1,392,242	31
Division of Parks	31,357	1.9
Virginia State Travel Service	81,975	1.0
Department of Transportation Safety	25,060	1.0
State Water Control Board	31,460,54	16.1
Rehabilitative School Authority	1,548,798	5.4
State Council of Higher Education	1,518,459	13.2
State Office of Higher Education	1,406,468	28.8
State Office of Labor & Industry	1,278,883	12.9
Department of Labor & Industry	1,261,784	18.6
James Madison University	1,248,220	34.0
Department of Military Affairs	1,232,348	3.4
Virginia State Library	1,042,721	54.9
Department of Agriculture & Forestry	1,041,945	17.8
Department of State Police		2.4
Virginia State Police	999,539	8.6
Virginia Historical Society	864,481	50.9
Supreme Court of Virginia	784,224	28.9
George Mason University	863,875	2.7
Virginia Developmental Disabilities		99.9
Department of Personnel & Training	851,628	15.5
Virginia Airports Authority	553,014	88.2
Virginia Commission of the Arts & Humanities	517,863	30.7
Virginia State Police	484,823	10.6
Longwood College	354,618	1.8
Secretary of Commerce & Resources	270,988	2.3
Secretary of Commerce & Resources	245,073	100.0
Virginia Department of Fisheries & Wildlife	245,702	38.4
Virginia Department of Fisheries & Wildlife	219,346	8.8
Attorney General	179,840	100.0
Attorney General	165,348	6.8
Commonwealth Attorney Services & Training Council	134,111	23.5
Virginia State Bar	133,295	42.0
Virginia School for the Deaf & Blind	129,759	62.8
Virginia Museum of Fine Arts	114,062	13.8
Virginia Commission of the Arts & Humanities	112,201	3.4
Virginia Commission of the Arts & Humanities	109,514	1.0
Virginia Commission of the Arts & Humanities	105,151	30.0
Christopher Newport College	87,233	29.9
DD Dominion University	60,229	8
State Education Assistance Authority	47,233	6.4
Virginia State Water Conservation Commission	19,500	1.0
Division of Legislative Services	12,054	1.0
The Science Museum of Virginia	8,756	5
Virginia State Prison	4,259	23.4
Virginia State Prison	4,053	23.4
Virginia State Prison	4,053	23.4
	\$1,063,684,862	23

\*Less than 1%

agencies spent federal funds. Nineteen agencies used federal funds for at least half of all program expenditures. In addition, almost one-half billion dollars in federal funding was received by Virginia localities (Table 1). This degree of support creates a corresponding measure of State dependence on continued federal funding.

There are three less prominent, but nevertheless important, ways in which federal funds affect the budget-making process: match requirements, assumption of costs, and maintenance of effort.

*Match Requirements.* In many cases the federal government requires the State to demonstrate a commitment to a program by budgeting State funds for a program supported by federal dollars. The amount of "State match" may vary, but usually a specified ratio is included in federal regulation. For example, the Rehabilitation Act of 1973 provides federal funds for rehabilitating the handicapped to each state on the basis of an 80:20 ratio. In other words, the State agency must budget one dollar for every four dollars in federal aid.

A survey of State agencies revealed the pervasiveness of federal matching requirements. Of 125 State agencies that reported spending federal funds in FY 1979, 101 agencies provided matching funds. These agencies reported spending \$335 million, or seven percent of all FY 1979 expenditures, to match federal funds. Overall, for every federal dollar spent in FY 1979, the State spent 31 cents.

Three State agencies accounted for 82 percent of the State's total match: the Department of Health (\$139.3 million), the Department of Welfare (\$85.6 million), and the Department of Highways and Transportation (\$50.2 million). The Department of Health spent 68 cents in State funds for every federal dollar spent. For the Department of Welfare and the Department of Highways and Transportation, the amounts were 51 cents and 17 cents, respectively.

Of the ten largest federal programs providing funds to Virginia, six required a match (Table 2). Matching dollars for these six programs totaled \$260.7 million.

Match requirements can be met through either direct cash expenditures on the program (cash match) or, if allowed by the federal program, through one application of agency overhead costs to the program (in-kind match). In FY 1979, 95 percent of the State's match was met through the expenditure of cash, \$256 million from the general fund, and \$64 million from nongeneral funds. The remaining \$16 million represented in-kind contributions.

Agency expenditures to match federal funds were substantially underrepresented in the State's central accounting records, the only central point of fiscal information for controlling federal funds. Only 32 percent of the cash match for FY 1979 was identified in the Commonwealth's Accounting and Reporting System (CARS). Included among the agencies that did not report match in CARS was DHT, which alone accounted for 15 percent of the State's match.

**TABLE 1  
FEDERAL FUNDS RECEIVED  
BY LOCAL GOVERNMENTS  
(FY 1979)**

**CITIES**

Alexandria	\$ 8,358,878	Manassas Park	\$ 581,963
Bedford	216,906	Martinsville	2,071,133
Bristol	2,966,684	Newport News	13,834,762
Buena Vista	621,441	Norfolk	26,203,959
Charlottesville	2,848,066	Norton	202,209
Chesapeake	10,036,206	Petersburg	6,019,231
Clifton Forge	527,817	Poquoson	549,163
Colonial Heights	955,566	Portsmouth	19,111,810
Covington	507,223	Radford	925,349
Danville	5,493,592	Richmond	36,030,079
Emporia	682,304	Roanoke	12,354,111
Fairfax	656,950	Salem	1,232,669
Falls Church	524,116	South Boston	960,297
Franklin	810,660	Staunton	1,983,112
Fredericksburg	1,429,018	Suffolk	4,905,025
Gatax	544,806	Virginia Beach	20,790,059
Hampton	16,188,721	Waynesboro	1,572,280
Harrisonburg	987,175	Williamsburg	774,499
Hopewell	2,982,092	Winchester	1,657,890
Lexington	491,621		
Lynchburg	7,601,535		
Manassas	675,854		
		Total	\$217,866,831

**COUNTIES**

Accomack	\$ 5,589,278	King William	\$ 713,870
Albemarle	1,781,293	Lancaster	952,397
Alleghany	828,392	Lee	2,561,872
Amelia	634,596	Loudoun	2,354,018
Amherst	1,409,502	Louisa	941,858
Appomattox	579,425	Lunenburg	882,984
Arlington	21,679,593	Madison	453,924
Augusta	2,202,811	Mathews	301,631
Bath	891,316	Mecklenburg	1,925,666
Bedford	1,252,613	Middlesex	438,030
Bland	502,342	Montgomery	3,206,854
Botetourt	775,698	Nelson	700,219
Brunswick	1,501,823	New Kent	443,490
Buchanan	4,206,133	Northampton	1,583,386
Buckingham	1,017,861	Northumberland	823,453
Campbell	2,361,396	Nottoway	1,045,250
Caroline	1,225,924	Orange	1,175,749
Carroll	2,292,451	Page	1,069,049
Charles City	677,503	Patrick	932,027
Charlotte	895,735	Pittsylvania	4,740,172
Chesterfield	4,429,366	Powhatan	408,050
Clark	411,789	Prince Edward	894,145
Craig	361,890	Prince George	2,458,416
Culpeper	837,847	Prince William	12,341,038
Cumberland	530,957	Putaski	2,069,513
Dickenson	2,145,774	Rappahannock	246,743
Dinwiddie	1,186,326	Richmond	36,030,079
Essex	1,528,794	Roanoke	2,841,878
Fairfax	50,575,617	Rockbridge	1,647,323
Fauquier	1,217,091	Rockingham	2,406,074
Floyd	603,474	Russell	3,182,674
Fluvanna	697,898	Scott	1,907,730
Franklin	1,557,640	Shenandoah	1,039,146
Frederick	1,885,888	Smyth	1,998,513
Giles	1,327,733	Southampton	1,755,002
Gloucester	1,080,823	Spotsylvania	1,774,561
Goochland	769,537	Stafford	4,217,564
Grayson	915,372	Surry	914,821
Greene	618,278	Sussex	984,537
Greensville	1,101,041	Tazewell	2,113,034
Halifax	5,366,095	Warren	1,054,766
Hanover	1,741,867	Washington	2,866,743
Henrico	7,173,793	Westmoreland	1,667,410
Henry	3,220,747	Wise	3,219,653
Highland	437,165	Wythe	1,100,044
Iste of Wight	1,412,433	York	5,289,590
James City	1,409,705		
King and Queen	379,392		
King George	686,254		
		Total	\$235,661,140

**GRAND TOTAL: \$454,151,427**

Source: Auditor of Public Accounts, Comparative Cost Reports, FY 1979.

Table 2

MATCH REQUIREMENTS FOR VIRGINIA'S TEN  
LARGEST FEDERAL FUND PROGRAMS

Program	FY 1979 Expenditures		Amount Agency Spent for Each Federal Dollar
	Federal Funds	State Agency Match	
Highway Research, Plan- ning & Construction	\$289,328,000	\$ 50,247,000	17¢
Medicaid	176,676,726	132,587,437	75
Aid to Dependent Children	82,646,405	62,344,115	75
Comprehensive Employment & Training (CETA)	69,964,879	None	-
Title XX	64,893,001	5,341,795	8
Educationally Deprived Children	51,384,777	None	-
General Revenue Sharing	48,949,381	None	-
National School Lunch	43,774,330	4,724,198	11
Rehabilitative Services	19,817,800	5,459,745	28
Employment Service	9,729,582	None	-
Total	\$857,164,881	\$260,704,290	30¢

Source: Agency fiscal officers.

Match amounts represent the State's obligation to the federal government to spend State funds. Information on expenditures to meet this obligation should be centrally available. The Department of Accounts should require State agencies to report through CARS all match expenditures.

*Assumption of Costs.* The federal government sometimes offers intergovernmental aid to "seed" programs. That is, State and local governments are encouraged to begin programs with federal funds and eventually assume most or all of the programs' cost. Seed money enables recipients to begin programs that may be desirable but expensive to initiate on their own. Seed money programs may be very attractive initially, but when federal funding begins to diminish, recipients may be hard-pressed to finance the programs on a continuing basis.

The largest single source of seed money in Virginia is the law enforcement assistance funding received by the Division of Justice and Crime Prevention (DJCP). These funds provided support for numerous

programs, including some mandated by the State such as training for local law enforcement officers. In the 1980-82 biennium, DJCP estimates that the demand for general fund money to continue such projects could be as high as \$5 million, and for 1982-84, almost \$9 million. The State has already had to assume significant costs in order to continue some of these programs. A total of \$3,266,500 was appropriated for the 1980-82 biennium to fund the Department of Corrections' Academy for Staff Development. Until this time the academy had been funded 100 percent by Law Enforcement Assistance Administration (LEAA) funds.

Under the Crime Control Act, the State's Council on Criminal Justice is responsible for establishing administrative policies, including the application of the cost assumption requirement. In 1974, in response to the LEAA General Counsel's interpretation of what the act meant by "reasonable length of time" for cost assumption, the council adopted its current policy. The first three years of a continuing program are 100 percent federally funded, in the fourth year the federal government pays 50 percent of the costs, and in the fifth year the recipient must assume all costs for continuing programs.

The problems that may be encountered are illustrated by the need, addressed by the General Assembly last session, to replace the federal funds used in law enforcement personnel training with State revenues.

*In 1977, the Council on Criminal Justice for the first time applied its cost assumption policy to the administrative costs of training programs. Previously, training had been excluded at the council's option.*

*Since the council realized LEAA funds would be diminishing, it wanted the State and localities to begin planning to assume program costs. Direct costs for training would continue to be 100 percent federally funded as long as LEAA funds come to the State.*

*Under the cost assumption policy, the State would have to begin assuming 50 percent of the costs in FY 1981 and 100 percent in FY 1982. An executive steering committee consisting of members of the State Crime Commission, JLARC, and the Secretary of Public Safety, and chaired by Senator Stanley C. Walker, reviewed the program with an advisory committee and recommended that the program be continued through State funding of administrative costs.*

*In the Appropriations Act, the General Assembly appropriated the 50 percent match of \$300,000 from the general fund for 1981. For 1982, the General Assembly appropriated \$360,000, 60 percent of what is needed. Localities may have to pay the remaining \$240,000, or 40 percent. Although final federal action has not yet been taken, it is anticipated that*

*LEAA direct training costs may have to be assumed as early as FY 1982. This could result in costs to the State of \$1.3 to \$1.8 million per year.*

Thus, both the State and its localities will have to pay the cost of continuing a program initiated with federal funds. If law enforcement funds are eliminated by the federal government, as is currently being considered, the cost will become much higher as direct training costs will also have to be funded if Virginia wishes to continue training its local law enforcement officers.

Seed programs affecting the State generally operate on a much smaller scale and have a more limited duration, as in the following examples:

*A Minority Business Development grant to the Office of Minority Business Enterprise will be reduced between FY 1979 and FY 1982 from \$139,700 to \$49,000 in federal funding, while State support will increase from \$46,570 in cash and in-kind match to \$121,800 general fund cash match.*

\* \* \*

*A Developing Institutions grant to J. S. Reynolds Community College is scheduled to decline from \$366,000 in FY 1979 to \$200,000 in FY 1982, while State support increases from \$44,000 to \$225,000.*

Seed programs can be beneficial from both State and federal perspectives. The federal government is able to encourage recipients to develop programs that will promote federal objectives. When these objectives are similar to those of Virginia, the State is able to take advantage of federal funding to pay program start-up costs.

As the DJCP law enforcement training program illustrates, however, the State must constantly be aware of the potential long-term effects such agreements may have. The State should, therefore, participate in federal programs with cost assumption requirements only when the long-term benefits of the program can justify State funding beyond the life of federal funding.

*Maintenance of Effort.* When intergovernmental aid is intended to support or expand an activity in which the State is already involved, the federal government may prohibit substituting State dollars with federal dollars. The recipient may be required to maintain the same, or some other approved, level of effort it gave the program before federal involvement. Some examples of maintenance of effort include:

*The funds received by the Virginia State Library (VSL) through a Library Services and Construction Act program illustrate a federally-assisted program with a maintenance of effort requirement. VSL must spend*



*at least the amount of money it spent in the second previous year to receive the federal funds this year.*

*As a result, \$3.4 million in State funds was required to be spent in FY 1979 to receive \$1 million. VSL has not had trouble meeting the requirement, but if the State considers reducing VSL's appropriation in the future, a loss of \$1 million in federal funds could result.*

\* \* \*

*The Air Pollution Control Board must maintain the level of effort it expended the previous year (\$1.5 million in FY 1979) to receive over \$1 million in federal funds each year.*

\* \* \*

*The Division of Mined Land Reclamation is required by the Surface Mining Control and Reclamation Act to maintain the level of effort expended in 1978. The division has been spending about \$1.2 million to receive \$3 million. In 1982 this will become a 50/50 match program, and State costs and obligations will be greater.*

In cases such as these, maintenance of effort requirements can affect budget decisions. Any State budget reduction in programs of this sort which would leave the agency below the federally-required threshold for State expenditures could result in the loss of the federal contribution. In each of the three examples above, State budget cuts that bring the programs below the previous year's expenditures could be met with the loss of over \$1 million in federal funds.

By taking advantage of federal funds which involve matching or maintenance of effort agreements, the State loses some of its budgetary flexibility. Shifts in resources from programs involving such agreements are difficult because of the potential loss of federal funding. Budgetary flexibility is also limited by cost assumption agreements because the State commits itself to a higher level of expenditure and must dedicate new revenues to fulfill long-term commitments.

### Policy and Program Influence

State policies and programs are also often influenced by the conditions of federal funding. Indeed, this is the intent of many federal funding programs, particularly those involving seed money and required matches.

Although federal influence over State policies and programs can take many forms, the review found four demonstrations of influence which best illustrate the scope of federal impact. These include broad grants

of authority, influence over program priorities, influence over spending priorities, and influence over legislative decision-making.

*Broad Grants of Authority.* Broad grants of statutory authority are usually given by the legislature to State agencies which administer programs that are heavily dependent on federal funds. These grants give the agencies sweeping authority to take any action deemed necessary to comply with federal funding requirements. In a review of the authorizing legislation for the agencies that received over \$10 million in federal funds in FY 1979 (excluding institutions of higher education), it was found that six of the seven State agencies had such broad grants of authority (Table 3).

That such broad grants of authority are considered necessary to comply with federal requirements illustrates a recognition of continuous federal involvement in program policy and management. These grants establish a legislative intent that agencies possess necessary flexibility to comply with federal requirements.

*Influence Over Priorities.* Many State programs which receive substantial federal funds also receive substantial direction from the federal government regarding service and client priorities. When federal priorities change, shifts in State programs result, often affecting the type and number of clients being served.

*In the Developmental Disability Act of 1978, Congress changed its definition of "developmental disabilities." Previously, the definition was categorical and persons with mental retardation, epilepsy, cerebral palsy, or autism were eligible for services.*

*The 1978 act's definition became functional. Persons were eligible if they had an impairment that resulted in substantial functional limitations in three or more of the following areas: self-care, language, learning, mobility, self-direction, capacity for independent living, and economic sufficiency.*

*Under the new definition, individuals are eligible for services regardless of the category of the impairment if they have severe functional limitations.*

*The new definition changed the client group for the Developmental Disabilities Planning Council and the Developmental Disabilities Protection and Advocacy Office. Those formerly ineligible--for example, persons who are deaf--can now receive services.*

*The council has had to engage in an extensive outreach effort to notify prospective clients of available services and began to fund projects under the new criteria on July 29, 1980.*

Table 3

BROAD GRANTS OF STATUTORY AUTHORITY GIVEN  
TO STATE AGENCIES TO COMPLY WITH FEDERAL REQUIREMENTS

HIGHWAY AND TRANSPORTATION COMMISSION

*Compliance with Federal Acts*--To comply fully with the provisions of the present or future federal aid acts, the Commission may enter into all contracts or agreements with the United States government and may do all other things necessary to carry out fully the cooperation contemplated and provided for by present or future acts of Congress for the construction, improvement and maintenance of roads. Section 33.1-12(5).

VIRGINIA EMPLOYMENT COMMISSION

*State-Federal Cooperation*--In the administration of the provisions in Section 60.1-51.1 of this Act, which are enacted to conform with the requirements of the Federal-State Extended Unemployment Compensation Act of 1970, the Commission shall take such action as may be necessary (i) to ensure that the provisions are so interpreted and applied as to meet the requirements of such Federal Act as interpreted by the United States Department of Labor, and (ii) to secure to this State the full reimbursement of the federal share of extended benefits paid under this Act that are reimbursable under the Federal Act. Section 60.1-44.

OFFICE ON AGING

*General Powers of Office*--To accept grants from the United States government and agencies and instrumentalities thereof and any other source. To these ends, the Office shall have the power to comply with such conditions and execute such agreements as may be necessary, convenient or desirable. Section 2.1-372(c).

DIVISION OF JUSTICE AND CRIME PREVENTION  
and  
COUNCIL ON CRIMINAL JUSTICE

*Powers and Duties of Division and Council*--To do all things necessary on behalf of the Commonwealth of Virginia and its units of general local government, or combinations thereof, to secure the full benefits available under the Omnibus Crime Control and Safe Streets Act of 1968 and any amendments thereto, and under other federal acts and programs designed to strengthen and improve law enforcement, the administration of criminal justice and delinquency prevention and control throughout the State, and in so doing to cooperate with federal and State agencies, departments, and institutions, private and public agencies, interstate organizations, and individuals to effectuate the purposes of those acts, and any amendments thereto, and the purposes of this chapter. Section 2.1-64.24(h).

DEPARTMENT OF REHABILITATIVE SERVICES

*Powers and Duties of Director*--To accept grants from the United States government and agencies and instrumentalities thereof and any other source and, to these ends, to comply with such conditions and execute such agreements as may be necessary, convenient or desirable. Section 2.1-580.3.

DEPARTMENT OF WELFARE

*Cooperation with Federal Agencies*--The Department shall cooperate with the federal Department of Health, Education and Welfare, and any other agencies of the United States, in any reasonable manner that may be necessary for this State to qualify for and to receive grants or aid from such agencies for auxiliary grants, social services, rehabilitation, personal adjustment, library and education services to the blind or visually handicapped in conformity with the provisions of this title, including the making of such reports in such form and containing such information as such agencies of the United States may from time to time require, and to comply with such provisions as such agencies of the United States may from time to time find necessary to assure the correctness and verification of such reports. Section 63.1-81.

Source: Code of Virginia.

*As a result of the definitional change, the client group is expected to grow from approximately two percent of the State population to three percent.*

In other cases, program changes may exclude some clients from continuing services.

*The Rehabilitation Act of 1973 produced a major shift in the services and direction of the Department of Rehabilitative Services. Prior to 1973, Virginia was using federal program money to serve the physically, mentally, and emotionally handicapped.*

*The new priorities required that the severely disabled be given service priority. Some Virginia programs had to be reduced, others eliminated. Included were programs in correctional institutions, welfare programs, and school programs.*

*With recent cutbacks in funding under the program, the Department of Rehabilitative Services has announced that services to the non-severely handicapped will have to be further reduced. Those currently being served will continue in programs until their case is closed, but new clients will not receive services.*

*Influence Over Spending.* In some cases federal actions designed to affect State priorities are implemented through spending decisions rather than direct mandates. In the following example, the mentally retarded were included as a group eligible for Medicaid to upgrade State facilities for the mentally retarded. The State subsequently spent \$20 million renovating facilities to qualify for funds.

*Amendments to Title XIX of the Social Security Act (PL 89-97) made the institutionalized mentally retarded eligible for Medicaid coverage, providing that institutional facilities met certification standards.*

*In 1970, the Commission on Mental, Indigent, and Geriatric Patients recommended that "maximum use be made of all applicable federal funding programs for the purpose of strengthening services to the mental, indigent, and geriatric patients." As a result, the Department of Mental Health and Mental Retardation began to use funds available as reimbursements through Medicaid and Medicare.*

*The State appropriated \$20 million to substantially renovate its mental retardation institutions to meet the standards of quality for services and facilities established by the federal programs.*

The impact of this influence over spending is demonstrated by the fact that, in 1980, in all but one institution, 100 percent of the beds were certified for Medicaid.

*Influence Over Legislative Decision-Making.* A final manifestation of federal policy and program influence is in the area of legislative decision-making. A particularly forceful exercise of such influence occurred during the 1980 Session of the General Assembly when the legislature debated the costs of complying with requirements of the Environmental Protection Agency.

*At the 1980 Session of the General Assembly, the U. S. Environmental Protection Agency threatened Virginia with funding and economic growth sanctions if an acceptable auto emission inspection and maintenance bill was not passed.*

*An estimated \$250 million in federal funds, including highway and sewage treatment project monies, was said to be endangered. In addition, air quality permit applications for shopping centers and heavy industry could be suspended, stifling economic growth.*

*An EPA representative went so far as to lay out before a Virginia Senate committee "base minimums for compliance" and to state that a particular bill had been "approved by EPA." Many legislators objected to this blunt exercise of influence, but the potential sanctions were enormous.*

*After considerable resistance, the "approved" bill (HB 116) was finally passed. It provides for an auto emission inspection and maintenance program in the Northern Virginia and Richmond areas beginning in 1982, and the setting of standards by the Air Pollution Control Board. To administer the program, \$1,346,097 was appropriated.*

The EPA case illustrates how a wide range of federal sanctions can be brought to bear on a relatively narrow issue. Federal influence over the General Assembly's decision-making manifests itself frequently. It appears in the form of threatened sanctions. It appears in the broad grants of authority delegated to State agencies by the legislature. Federal influence is also evident in the myriad legislative decisions which appropriate federal funds. It cannot be said that federal influence removes legislative prerogatives in these areas. However, faced with the potential loss of federal funds if certain decisions are not made, legislative options and prerogatives are unquestionably constrained.

## Administrative Influence

The final major category of federal influence is in the organizational and administrative requirements placed on State government. Practices are prescribed to help ensure that programs are conducted efficiently and effectively and that funds are used for legitimate purposes. Individually, many of the requirements do not appear significant, but taken collectively, the extent of federal influence on program administration is substantial.

Influences have been found in all major phases of administration, including accounting, program reporting and evaluation, and personnel. Often the State must bear the costs of federal requirements.

*Accounting.* All federal programs detail financial management and reporting procedures to be used with their funds. In some cases, State agencies have to meet two sets of requirements, one for the State and one for the federal government.

*The Office on Aging collects data to comply with federal accrual reporting requirements. The State requires accounting on a modified cash basis, reflecting actual expenditures and cash balances. Accrual accounting, which includes not only actual expenditures but also obligations incurred, was required for federal reports beginning in 1978.*

*Federal agencies are not allowed to require states with different accounting systems to modify their systems, but they can require accrual reporting. This requirement has placed a burden on the Office on Aging to collect information on obligations from its subgrantees.*

Not all agencies find the requirement to be a hardship. The Virginia Employment Commission must also report on an accrual basis, but it has been under the requirement since 1946. It implemented an automated accrual accounting system in 1970, eight years before the State automated its cash accounting system.

*Program Reporting and Evaluation.* Increasingly, the federal government is demanding more documentation of program activities and results. Fulfilling these requirements can be costly and, as the following examples demonstrate, the demands are not always accompanied by additional federal funds.

*By October 1982, the Developmental Disabilities Planning Council is to have completely developed and implemented a federally required evaluation system.*

*The mandated system will be used to track clients in programs funded by the Developmental Disabilities Planning Council. No additional funds have been provided by the federal government to meet this requirement.*

*The council's alternatives for this system's development and implementation include:*

- Tie in with the Department of Mental Health and Mental Retardation's plans for a client monitoring system, at yet unknown costs.*
- Develop a stand-alone system to meet the requirement, at a probable cost of \$2-3 million.*
- Drop out of the program and forfeit \$1 million in federal support for people with developmental disabilities.*

If the cost of establishing the evaluation system proves to be too high, the State will have to consider foregoing the federal funds it receives. In another case, a State agency was recently required by the Department of Health, Education and Welfare to provide annual evaluations of its subgrantees' programs for compliance with cross-cutting requirements.

*Beginning in 1980, the Department of Education must evaluate the vocational education programs of its 174 subgrantees for compliance with the nondiscrimination provisions of the Civil Rights Act.*

*The requirements for the evaluations are very specific, including that 20 percent of all the service providers must be evaluated each year, and that 25 percent of the evaluations must be conducted on-site.*

*This means that 35 evaluations must be conducted annually, and nine of these must be on-site. The department estimates that it will take three or four days for a team of eight or nine evaluators to complete each on-site review.*

*The department estimates that the cost of implementing these evaluations will be \$157,015. The federal government imposed the requirement without providing any additional funds for administration.*

*Personnel.* The federal government has an impact on State employment practices in a number of ways. Most prominent among these is prohibiting discrimination against applicants on the basis of age, sex, race, and religion in federally-assisted programs.

To ensure that persons are employed on the basis of their ability to do a job, and not due to non-job-related characteristics, the federal government sometimes requires a system of personnel administration based on merit for programs it funds. Recipients of funds through designated programs must meet merit system standards established by the federal government.

Personnel standards are among the oldest federal standards, and to comply with them the State established the Joint Merit System in 1942. Virginia has chosen to restrict the system to agencies administering programs which are required by the federal government to be covered. During FY 1979, 12 State agencies and over 12,000 State positions were covered by the requirement (Table 4). Some positions in local government agencies on welfare, aging, and emergency services have also been covered.

Table 4  
POSITIONS COVERED BY THE JOINT MERIT SYSTEM  
(As of May 1980)

Total Positions = 12,257

<u>Agencies Entirely Covered</u>		<u>Agencies Partially Covered</u>	
Department of Welfare	5,623	Commission for the Visually Handicapped	110
Department of Health	4,216	Department of Mental Health and Mental Retardation	45
Virginia Employment Commission	1,921	Department of Labor and Industry	96
Office of Emergency and Energy Services	147	Department of Personnel and Training	41
Office on Aging	25		
Governor's Employment and Training Council	20		
Developmental Disabilities Planning Council	7		
Developmental Disabilities Protection and Advocacy Office	6		

Source: Joint Merit System administration.

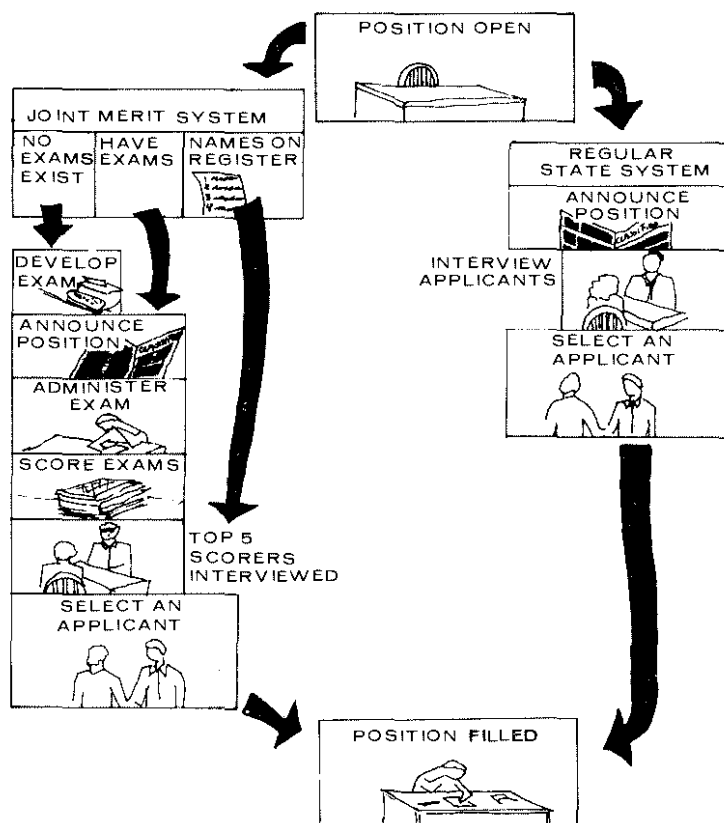
Federal merit standards are met by the State's regular personnel system in most respects, except for recruitment and selection on the basis of performance on competitive examinations. This requirement often results in long delays in filling positions because valid exams must be developed, administered, and scored before applicants can be interviewed (Figure 3).

The Joint Merit System is currently experiencing difficulty in the validation of exams. Only 107 of approximately 600 exams have been validated, resulting in the State being sued three times in the past two years for allegedly using invalid exams. Although completion of the test validation studies is a priority, it takes approximately a month to do each exam and, with the staff currently available for this type of analysis, the Department of Personnel and Training estimates that validation may not be completed for up to three years. This delay potentially opens the door to more suits by applicants.



Figure 3

### RECRUITING DIFFERENCES IN STATE AND JOINT MERIT SYSTEMS



Source: JLARC representation of Joint Merit System information.

Federal influence is an unavoidable consequence of the State's receipt and use of federal funds. As a rule, when the State accepts federal funding, it accepts the influence which accompanies the funding. While the State may accept this circumstance as a rule, the State's interpretation of actions necessary to comply with federal requirements can differ significantly with that of the administering federal agency. Such differences produce a variety of State-federal conflicts.

### State-Federal Conflicts

State-federal conflicts over programs receiving funds are inevitable given the multitude of requirements, the magnitude of federal funding, and the pervasiveness of federal influence. Most State agency

personnel interviewed by JLARC emphasized that, although federal requirements were sometimes unwelcome, they were rarely onerous and usually represented an acceptable "cost of doing business" with federal grantors. At the same time, given the scope of activity, there are numerous examples of State-federal conflicts.

The Attorney General's office identified 17 conflicts between State agencies and five federal departments during the 1978-80 biennium. In addition, several dozen equal opportunity and civil rights cases initiated by individuals were identified. Federal funds for some programs were suspended pending resolution of these conflicts but no significant amount of funding was actually lost.

Most of the conflicts concerned compliance with requirements attached to individual federal programs. Some of the federal agencies alleging noncompliance with program-specific requirements were the Environmental Protection Agency and the Departments of Labor, Interior, and Health, Education and Welfare.

One dispute caused the withholding of funding for a multi-million dollar program for almost six months.

*The Department of Health, Education and Welfare withheld FY 1980 funding for the State's vocational education programs because the method by which the State allocated funds to community colleges allegedly did not comply with regulations.*

*The federal government previously approved Virginia's funding procedure, even though the regulation became effective in October of 1977 and Virginia's 1979 State plan had used the earlier procedure.*

*The funding was cut off for all programs, including those in secondary schools and four-year colleges, from July 1, 1979, until December 7, 1979, when a tentative resolution was reached.*

*Virginia's fiscal year allocation of \$16 million was retroactively restored. However, colleges and schools were required to either use their own resources to cover the six-month gap of almost \$8 million in federal funding, or postpone planned activities and projects.*

*Considerable disruption occurred in vocational education because the funding of several construction projects was delayed, and a large portion of the funds had to be carried over into the next fiscal year. Further, the tentative resolution provided for release of the community college portion only after the State implemented the new system for distribution.*

*The State completed this process and full funding for the community colleges was released in May 1980, with just two months left in the State fiscal year.*

Even though the violation of the allocation requirement applied only to the Community College System, funding for the State's entire program was withheld, causing an adverse impact to a number of State and local educational systems.

The following is an example of a suspension of funding which affected the programs of a single State agency.

*The U. S. Department of the Interior temporarily suspended funding for a regulatory enforcement program operated by Virginia's Division of Mined Land Reclamation. At issue was the State's interpretation and enforcement of federal regulations on surface mining.*

*The suspension was in place from March 24, 1979, through August 10, 1979, and resulted in the withholding of approximately \$500,000. The agency was able to use its other resources to continue the program until, after a series of negotiations between federal and State officials, the dispute was resolved and the funding was restored.*

As the examples illustrate, disputes with federal agencies regarding program requirements can delay the State's receipt of large amounts of funding. This places a burden on the State to provide interim financing for affected programs.

Most of the conflicts arising from cross-cutting requirements involved nondiscrimination provisions. These conflicts typically focused on allegations of race and sex discrimination in employment.

No instances of actual delays or suspensions of federal funding resulting from these disputes were reported. However, a potentially severe loss of funding was threatened in one case.

*In early 1978, the Department of Health, Education and Welfare notified Virginia that further delays in adopting an acceptable plan for integration among 41 public higher education institutions would result in a cutoff of HEW funding to these institutions.*

*Although civil rights laws had been applicable to states since 1972, HEW and Virginia had not reached agreement on a desegregation plan.*

*Potentially, the flow of over \$300 million to the State could have been halted. The matter was finally resolved in January 1979 after an extended period of intense negotiations.*

Because cross-cutting requirements do affect a wide range of federal programs, the potential loss of federal funding can reach enormous proportions.

A review of compliance conflicts involving both program-specific and cross-cutting requirements indicated that federal agencies are not reluctant to cut off funding. To enforce its position, the federal government has the option of withholding funds for the specific program and State agency involved in a conflict, for the entire program, or even possibly a large number of programs.

In some instances, the withholding of federal funds places serious stress on the State's resources to carry out budgeted programs pending resolution. Even if no funds are lost, the State experiences costs in terms of personnel used to negotiate or litigate disputes and of its resources tied up to continue programs when federal funds are temporarily withheld.

## **Actions Available to the State**

Virginia could avoid federal influence and resulting conflicts by refusing to participate in federal programs. In practical terms, however, this is not feasible, particularly since cross-cutting requirements are associated with nearly all federal funds. In addition, there are manageable solutions to most State-federal conflicts. Often, the State can mitigate some, if not all, of the negative consequences of federal influence. Options are available to the State short of withdrawal from programs through administrative, legal, and political channels.

### Administrative Options

State-federal conflicts often arise at the program or implementation level and they can frequently be resolved there. Federal programs and their accompanying rules and regulations often are developed with opportunities for input. Administrative options also exist for the State to seek waivers to some requirements.

*Rule-Making Inputs.* Administrative rule-making procedures allow interested parties to comment on rules and regulations as they are being developed. The State can use this opportunity to try to ensure that the regulations do not conflict with State policies and practices. Although participation in the process does not guarantee success, it does provide the State with the opportunity to mitigate arbitrary regulations which do not take Virginia's interests into account.

*Waivers.* Provisions for waivers of some requirements are sometimes available in federally-funded programs. Some waivers apply to individual programs, while others apply to all programs due to central federal directives.

One broad requirement applicable to many programs is subject to such a general waiver. Many federal programs require that a single state agency be established to administer grant programs. Congress, in the Intergovernmental Cooperation Act of 1968, allows for the waiver of such requirements at the request of a state if the head of the administering federal agency is given "adequate showing that such provision prevents the establishment of the most effective and efficient organizational arrangements within the State government. . ."

*Flexibility.* There is often a degree of flexibility in federally-funded programs that can be used to the State's advantage. In the following case, an agency used a program's flexibility to select an option favorable to the department.

*The Department of Welfare (SDW) used a Department of Health, Education and Welfare program provision to merge HEW funding with that provided by another agency for a similar program.*

*In the Fuel Assistance program that was initiated in 1979, SDW received funds from both HEW and the Community Services Administration (CSA). SDW had the option of using HEW funds to supplement the CSA program or to establish a separate program.*

*SDW decided that a merger of the funding into a single program would be more efficient and adequately serve the target population.*

Effective agency management of federally-funded programs includes knowledge of administrative options the State has. Where appropriate, administrative resolutions of State-federal conflicts should be sought. Where they are not adequate or successful, however, there are legal and political forums available.

### Legal Options

Few legal principles have been established in the area of intergovernmental aid. It is generally recognized that traditional rules of contract law do not apply to the grantor-grantee relationship that exists between federal and state governments. There is a consensus, however, that recipients of federal funds do have rights, including withdrawal from programs and legal and political redress.

Paramount among the rights of the state is refusal of federal funds. A state can withdraw from any grant program offered by the federal government. There is no continuing obligation to receive federal funds and operate programs.

Withdrawal is not a practical course of action, however, when a state disputes cross-cutting requirements such as those dealing with environmental protection, nondiscrimination, labor standards, and access by the handicapped. Withdrawal in these cases would amount to an almost complete withdrawal from the intergovernmental aid system, and the loss of huge amounts of federal aid.

Virginia has the right to challenge in court most federal decisions with which it disagrees. The requirements of standing are met by the State to use the courts as long as the dispute actually poses harm to the State's interests, such as the termination or suspension of funding for a program.

When federal legislation for a program provides an administrative appeal process, however, a state must seek a resolution under available administrative procedures before it can obtain judicial review.

Finally, it is important to note that, in most cases, the courts and Congress have not afforded the states the right to due process. That is, the state does not generally have the right to notice and a hearing prior to a federal agency taking an action, even when the action may have severe and immediate consequences to the state, such as termination of funding.

### Political Options

Political avenues are also available to Virginia for seeking favorable resolution of conflicts with the federal government. These avenues include appeals to the State's congressional delegation, appeals to the President or his advisors for intervention, and enlistment of support from other states for a unified stand on common issues.

Although political action is perhaps the fastest and most direct method of settling disputes, it is practical only for issues of major consequence.

## **Conclusion and Recommendations**

Agency participation in federally-funded programs can require major policy, budgetary, and program commitments of the Commonwealth. For this reason, the General Assembly should be kept fully informed of significant policy and program impacts resulting from federally-mandated requirements. This can be accomplished by amending the 1980-82 Appropriations Act.

Section 4-3.05(a) directs the Governor to prepare a quarterly report summarizing nongeneral fund revenues in excess of appropriated amounts. The report is to summarize the approvals granted to agencies to spend above appropriated amounts, the reasons for the approvals, and implications.

*Recommendation (1). Section 4-3.05(a) of the Appropriations Act should be amended to require the Governor to identify for each approved request the anticipated budgetary, policy, and administrative impacts of significant program requirements which accompany the funding.*

Section 4-3.05(b) calls for the Governor to prepare for each agency a written reconciliation of the difference between revenues authorized for expenditure and estimates contained in the budget bill. The reconciliation is to emphasize:

. . . The identification of programs that were initiated, expanded, or which underwent a significant change in anticipated levels of effort during the previous year as a result of the availability of additional funds.

The report of the Governor is to be furnished to the chairmen of the House Appropriations Committee and the Senate Finance Committee by December 1 of each year.

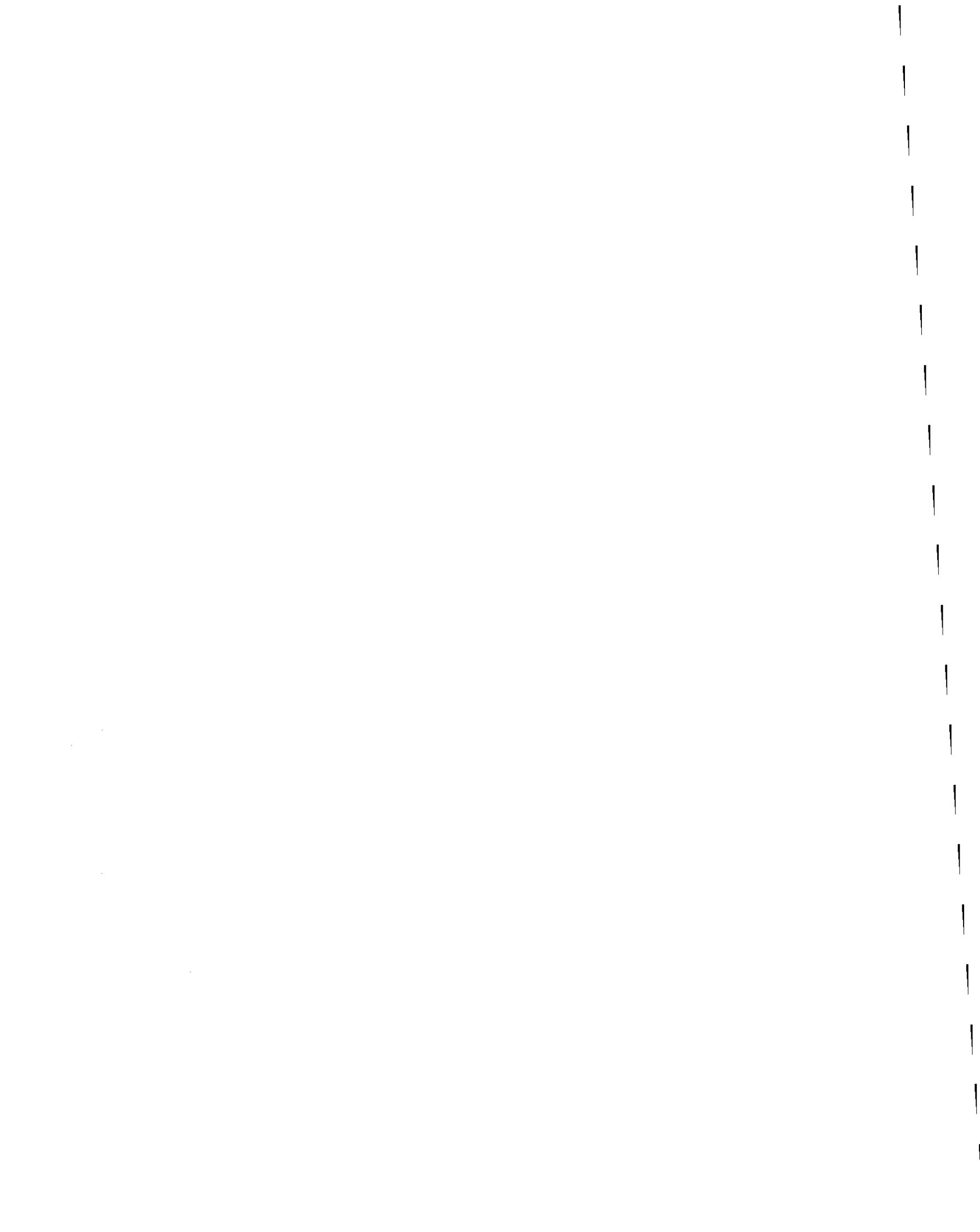
*Recommendation (2). The General Assembly should amend Section 4-3.05(b) of the Appropriations Act to require that the Governor include in his annual report a summary of significant federal requirements and their associated budgetary, policy, and administrative influence on State government. The report should also include a summary statement on the overall effect of cross-cutting requirements which have had significant budgetary, policy, or administrative influences on State government.*

As evidenced by the receipt of almost one-half billion dollars in federal funds in FY 1979, local dependence on federal funds is great. Participation in federally-funded programs provides valuable resources to all Virginia localities. However, the ability of Virginia localities to identify and seek federal funds varies significantly. Some localities have special staffs to identify and apply for federal funds. Others have minimal capabilities. Although the Department of Intergovernmental Affairs has statutory responsibility to assist localities in seeking federal grants, this function has been given low priority.

*Recommendation (3). The Secretary of Administration and Finance should review the Department of Intergovernmental Affairs' present priorities and procedures with localities to ensure that its legislative mandate is satisfied and that all Virginia localities have adequate information and expertise to identify and solicit federal funds.*

Of the 125 State agencies that reported spending federal funds in FY 1979, 101 agencies provided matching funds. The State's central accounting records, however, identified less than one-third of the State's match of federal funds, a substantial underrepresentation of the State's commitments to match federal funds.

*Recommendation (4). State funds spent to match federal funds should be consistently represented in the Commonwealth's Accounting and Reporting System (CARS). The Department of Accounts should require State agencies to use the capability of CARS to record match expenditures.*





### **III. Controls on Federal Funds**

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Federal programs provided \$1.2 billion in FY 1979 to fund services and activities of State government. These funds are a valuable resource which must be managed efficiently and effectively.

Control of cash flow is important in managing federal funds. However, JLARC's review of management procedures found that some agencies use inefficient procedures for the receipt and expenditure of federal funds. In particular, problems were found regarding reimbursement procedures, indirect cost recovery, payments to subgrantees, and general fund loan procedures. JLARC identified an additional \$286,000 in investment revenue that could have been gained by better cash flow management practices by agencies. Also, Treasury loans totaling \$7 million for advance financing of federally-funded programs could have been avoided.

Alterations in existing policies of managing and controlling federal funds were encouraged in Administration and Finance Directive 1-80. While the directive addressed important policy concerns, it will require agency action to fully correct present weaknesses.

#### **Reimbursement Procedures**

There are three basic mechanisms for receiving federal funds: cash advance, letter of credit, and reimbursement (Figure 4). The most favorable mechanisms for the State are cash advances and letters of credit which provide federal funds as needed to meet program expenditures. The Office of Management and Budget (OMB) has formally encouraged federal agencies to utilize these two mechanisms rather than reimbursement arrangements when dealing with state and local programs. OMB has also stated that a letter of credit is to be used instead of cash advances when the funded program lasts 12 or more months and involves \$120,000 or more.

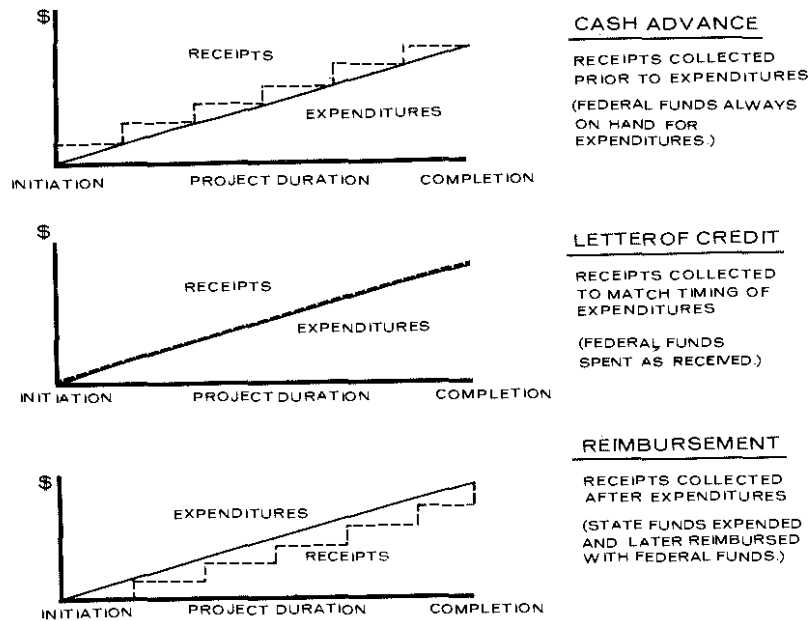
The reimbursement mechanism is least advantageous to the State. When an agency expends State funds and is later reimbursed with federal funds, the State loses the use of its funds until expenditures are reimbursed. Because of the State Treasury's investment program, loss of return on unreimbursed funds averages about one percent per month. (The investment performance of the State Treasury during the 1978-80 biennium averaged better than ten percent.)

#### Unnecessary Reliance on Reimbursement Method

Despite the disadvantages of reimbursement financing, several programs have been unnecessarily operated on this basis, thereby tying up State funds and costing the State significant amounts of investment revenues.

Figure 4

# MECHANISMS FOR RECEIVING FEDERAL FUNDS



Although a letter of credit has been available since early 1976, the Commission of Game and Inland Fisheries received funds from the U. S. Fish and Wildlife Service on a reimbursement basis. From \$400,000 to \$800,000 in billings were usually outstanding, awaiting reimbursement by the federal government.

Subsequent to JLARC inquiries on the agency's use of reimbursement financing, the Commission of Game and Inland Fisheries arranged to establish a letter of credit with the U. S. Fish and Wildlife Service, effective July 1, 1980.

This conversion to a letter of credit basis should make approximately \$600,000 available for investment by the Treasury or for other uses. The return on the investment of this sum should approximate \$72,000 per year.

\* \* \*

*The Division of Justice and Crime Prevention has a letter of credit with the Law Enforcement Assistance Administration. The division distributes LEAA funds to other State agencies and localities.*

*DJCP routinely distributes State funds, and then makes a drawdown in the amount of the distribution. This practice is comparable to a reimbursement arrangement and has the same disadvantages.*

*The average amount of distributed State funds that has been expended but not reimbursed at any given time is about \$200,000.*

*Better use of the DJCP letter of credit to draw down federal funds as needed to meet distributions would allow the Treasury to invest these otherwise committed State funds.*

*Each drawdown should be deposited prior to, but as close to as possible, the time the distributions are made. The approximate investment return on these monies would amount to \$24,000 annually.*

\* \* \*

*The State Department of Agriculture and Consumer Services is paid by the U. S. Department of Agriculture for one-half of its expenses in conducting a meat and poultry inspection program.*

*Payments totaling \$668,321 were received from the USDA in FY 1980 through monthly reimbursements. However, the Department of Agriculture and Consumer Services has a letter of credit and could have requested payments as needed to cover expenditures.*

*Proper use of the letter of credit would have increased the funds available for investment by the Treasury. Approximately \$6,000 in investment revenues would have been generated in FY 1980 by proper use of the letter of credit.*

In these three cases, the unnecessary use of reimbursement arrangements reduced State funds available for investment, resulting in the loss of an estimated \$102,000 annually.

A&F Directive 1-80 recognized the problem created by poor cash flow management by directing that agencies use letters of credit and cash advances when available. The Department of Planning and Budget, which has responsibility for implementing the directive, should review each agency reimbursement arrangement to ensure that the most advantageous mechanism is used.

### Timing of Requests for Reimbursement

A problem with reimbursement procedures was noted in regard to the timing of agency requests for reimbursement. Some federal programs do not allow the use of letters of credit or cash advances. In these cases, agencies need to submit reimbursements as frequently as possible to minimize the time that State funds are tied up. This would reduce the average amount of unreimbursed funds outstanding and increase the investment return on those funds.

The review found several instances of agencies delaying for long intervals before requesting payment.

*The Virginia Community College System received federal funds from the State Department of Education to provide vocational education programs. The terms of the contract allowed VCCS to submit requests for reimbursements on a quarterly basis.*

*However, VCCS submitted these requests only semiannually. As a result, the average monthly expenditures from State funds were \$150,000 more than would be needed if reimbursements were submitted quarterly. Investment by the Treasury of this sum over the period of a year would produce about \$18,000 in revenues.*

\* \* \*

*The State Department of Welfare, through contracts with other agencies, reimburses for Title XX social services provided by State agencies. Agencies are allowed to claim reimbursement as frequently as monthly, with SDW providing federal funds through transfers to the individual agencies.*

*During FY 1979 the State Department of Health and the Department of Mental Health and Mental Retardation delayed requesting some reimbursements for up to 18 months. The results of these delays included:*

- The unnecessary use of \$1,604,485 in State resources beyond the time that federal funds were available.*
- The loss of approximately \$63,000 in interest on expended State funds.*

\* \* \*

*The University of Virginia obtained a \$6.4 million grant from the Public Health Service to assist in the construction of its new primary care center. The facility was substantially completed in July 1979.*

*Because of conflicts in the use of PHS funds with another federal grant awarded for the facility, no reimbursements under the PHS grant were permitted from late 1978 until March 6, 1980, when the matter was finally resolved.*

*Yet, UVA did not submit a billing to PHS until May 22, 1980, two and one-half months later. The amount of the reimbursement was \$1,227,836.*

*Another delay of one month occurred before the funds could be collected because the billing, when combined with other federal expenditures, exceeded the monthly letter of credit maximum approved by the Department of Health, Education and Welfare. This was a foreseeable situation for which UVA should have requested an increase in the maximum for the month of billing.*

*If UVA had processed the billing and the related increase in letter of credit authorization more expeditiously, the reimbursement could have been collected as much as three months earlier. The loss of investment revenue due to the delayed receipt of this reimbursement was approximately \$37,000.*

*\* \* \**

*In October 1977, the Department of Corrections received approval from the Department of Planning and Budget to solicit food assistance funds from the USDA to serve juveniles within youth-care institutions.*

*Corrections' central office compiled the institutions' reports and made monthly requests to the USDA for reimbursement.*

*A reorganization of the Department of Corrections beginning in September 1978 caused the program to go unmonitored, and reimbursement requests stopped being sent to the USDA.*

*The institutions still provided the necessary information to the central office; however, Corrections did not bill the USDA from September 1978 until February 1980.*

*After JLARC inquiries, Corrections obtained back payments covering a 15-month period totaling \$783,711.*

*Had these funds been available to the State, \$60,000 in interest could have been earned on State money needlessly used to finance the program.*

\* \* \*

*Beginning in May 1979, James Madison University entered into a \$436,883 contract with the Army Corps of Engineers to conduct archeology research at a reservoir site. Reimbursement requests were submitted as late as five months after expenditures had been made.*

*If reimbursements had been requested on a timely basis, the increase in funds on deposit in the State Treasury would have generated about \$4,000 in investment revenues.*

\* \* \*

*The State Water Control Board participates in the National Dam Safety Program administered by the Army Corps of Engineers. FY 1980 receipts under the program were \$121,786.*

*The funds could have been requested on a monthly reimbursement basis. However, reimbursement requests typically covered a five-month period. Thus, the investment revenue lost through the delayed reimbursements totaled about \$2,000.*

Although the interest lost on individual programs may seem to be small, in the aggregate, increased attention to cash flow management of federal funds may increase the opportunity to earn significant interest on investment revenues. Potential earnings of approximately \$286,000 that could have been realized from the programs above are summarized in Table 5.

Table 5

EXAMPLES OF ANNUAL INVESTMENT GAINS THAT  
COULD BE GAINED BY IMPROVED AGENCY CASH FLOW MANAGEMENT

<u>Agency</u>	<u>Estimated Annual Gain</u>
Commission of Game and Inland Fisheries	\$ 72,000
State Department of Health/Department of Mental Health and Mental Retardation	63,000
Department of Corrections	60,000
University of Virginia	37,000
Division of Justice and Crime Prevention	24,000
Virginia Community College System	18,000
Department of Agriculture and Consumer Services	6,000
James Madison University	4,000
State Water Control Board	<u>2,000</u>
Total	\$286,000

The receipt of federal funds by reimbursement should only occur when letters of credit or cash advances are not permitted by the federal grantor. In addition, submitting reimbursement requests in a timely manner would reduce the State funds tied up while awaiting federal reimbursement. Both of these practices are now State policy under A&F Directive 1-80. Full implementation of this policy will free substantial funds, thereby increasing the cash on hand in the Treasury and generating additional revenues through the State's investment programs.

### Recovery of Indirect Costs

JLARC found that some agencies do not recover administrative or indirect costs for operating federal programs. In these cases, State general fund dollars were used for indirect costs, such as utilities, office supplies, and administrative staff, even though federal funds were available to offset these costs.

Indirect costs have not been recovered fully in the following cases:

*For FY 1980, the Commission on Outdoor Recreation has a negotiated indirect cost rate of 1.8 percent with the Department of Interior, and will recover about \$70,000 of administrative costs.*

*However, the rate does not include costs of office space and other allowable items which the commission is permitted to include in the determination of indirect cost rates.*

\* \* \*

*The University of Virginia receives a number of federal subgrants from other State agencies. Typically, no indirect costs for UVA are budgeted by the State agency in the subgrant.*

*Presently, UVA is conducting nine subgrants totaling over \$1.5 million for which it cannot receive indirect costs.*

The 1980-1982 Appropriations Act and A&F Directive 1-80 now require full recovery of indirect costs, unless exempted by the Governor or prohibited by the grantor. The Secretary of Administration and Finance will need to monitor the indirect cost recovery rates of all State agencies to ensure compliance with General Assembly policy.

Beginning in August 1980 with the promulgation of DPB Directive 8-80, the Department of Intergovernmental Affairs has been charged with offering comprehensive assistance to State agencies in identifying and recovering indirect costs. DIA had offered similar assistance to agencies on a request basis since 1977. Under the new directive, DIA is

responsible for reviewing all agency indirect cost proposals. This new procedure was adopted in response to Appropriations Act provisions requiring the full recovery of indirect costs. Developing an indirect cost allocation plan can be complicated, and some agencies are underrecovering costs to which they are entitled. A central agency with special knowledge of this subject can be helpful in identifying and justifying cost figures.

### Payments to Subgrantees

A number of federal programs are set up so that a single State agency receives and, in turn, distributes federal funds to secondary recipients including other State agencies and local governments. These secondary recipients are considered "subgrantees." Generally, State agencies make payments to their subgrantees on a reimbursement basis. This practice imposes additional costs on the subgrantees because they must use other funds to finance program expenditures while awaiting reimbursement.

The U. S. Office of Management and Budget has recommended that subgrantees be provided financing arrangements on the same basis as grantees. Thus, a State agency with a federal letter of credit can draw down federal funds as needed to make cash advances to subgrantees and to operate letters of credit with subgrantees. The following case illustrates the burden placed on subgrantees.

*The State Department of Welfare (SDW) operates several programs, such as Title XX, under which it provides federal funds to localities on a subgrant basis. The federal funds are available to SDW through a letter of credit, which means that the funds are unavailable to the State until they are drawn down for reimbursement of localities.*

*However, localities have to use local funds to operate the programs for at least 30 days before reimbursements are processed by SDW.*

*The combined cost borne by all localities pending reimbursement is in the millions. The State has recognized the burden placed on localities by such programs and is currently developing a system whereby checks issued by local welfare boards will be drawn against the State Treasury. This system will eliminate the need for localities to operate as subgrantees.*

## **General Fund Loan Procedures**

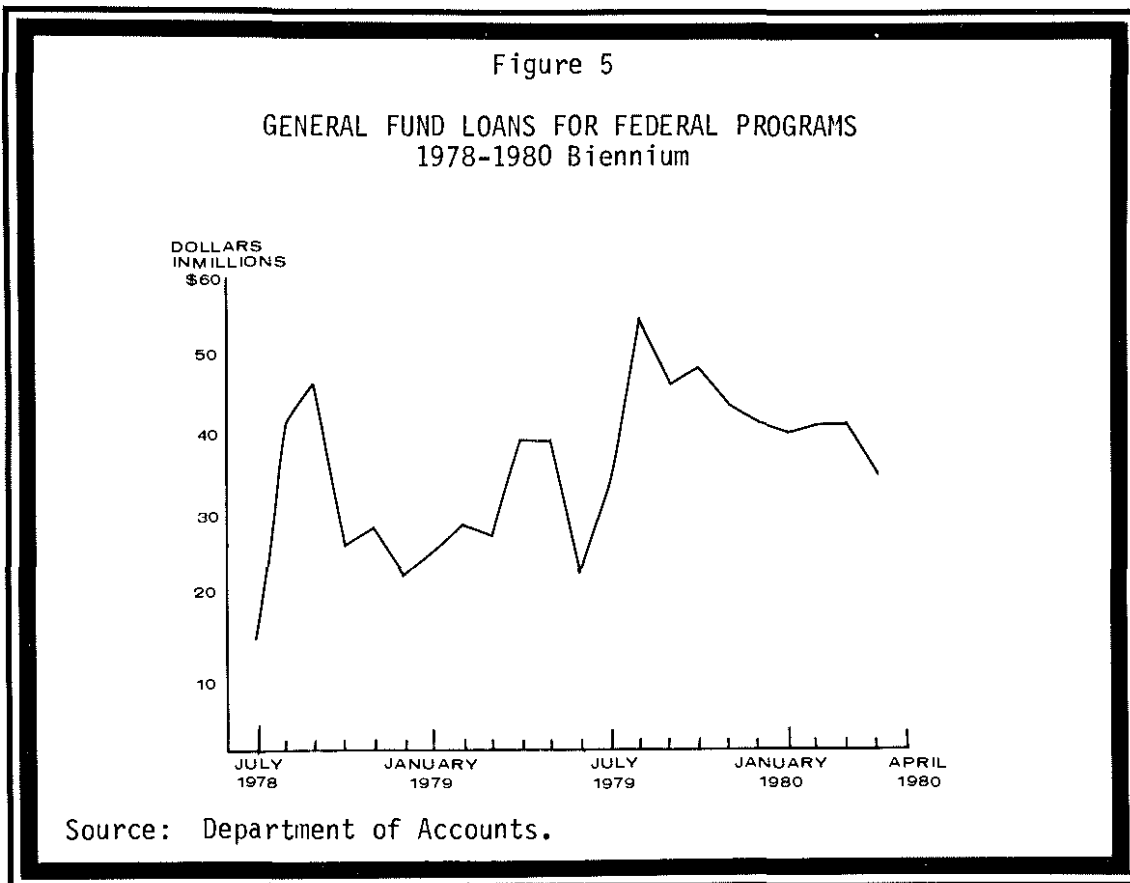
Improved review needs to be given to the issuance of general fund loans in anticipation of reimbursement from federal sources. Loans



are often made for amounts larger than an agency reasonably requires to meet its expenditures between reimbursements. As of February 1980, over \$7 million in loans was acknowledged to be outstanding in excess of agency needs. In some cases loans are made without identification of an adequate repayment source.

#### Review of Loan Use

When agencies receive federal funds by reimbursement arrangements, they generally seek approval from the Department of Planning and Budget for a general fund loan to provide advance funding. The amount of general fund loans outstanding for federal programs has ranged from \$13 million to \$54 million during the 1978-1980 biennium (Figure 5). Low points occur at the close of each fiscal year when old loans are repaid. However, new loans for the same purpose and in the same amount are frequently issued at the beginning of the following year.



To assess the control over the issuance of loans, JLARC examined the files maintained by the Department of Accounts for all loans

made in anticipation of federal revenues between July 1, 1978, and February 1, 1980. A total of 133 loan authorizations were made to 58 State agencies.

To test loan procedures, agencies with loan balances over \$100,000 and outstanding for at least 18 months were reviewed in-depth. The 18-month period was selected because of the increased potential that loans outstanding this long could conceal a cash deficit. That is, loans are generally needed for the period of a grant, typically 12 months, plus a closeout period, typically several additional months. Therefore, the need for loans in excess of 15 months could be questionable.

Loan renewal periods were included in computing the length of a loan. Also, individual loan periods separated by a month or less were combined when they involved the same program.

The 14 agencies having loan balances meeting these criteria are listed in Table 6. Twenty-nine loan authorizations contributed to the

Table 6

AGENCIES HAVING LOAN BALANCES  
IN ANTICIPATION OF FEDERAL FUNDS  
OF AT LEAST \$100,000  
FOR PERIODS OF 18 MONTHS OR MORE  
(February 1, 1980)

<u>Loans to Finance Specific Grants or Contracts</u>	<u>Loan Balance*</u>
Division of Justice and Crime Prevention	\$ 7,500,000
Commission of Game and Inland Fisheries	2,525,930
Department of Mental Health and Mental Retardation	1,194,633
Virginia Department of Transportation Safety	955,400
Rehabilitative School Authority	346,700
Department of Housing and Community Development	111,000
Virginia School for the Deaf and Blind (Staunton)	100,000
George Mason University	100,000
<u>Loans to Finance University-Sponsored Programs</u>	
Virginia Institute of Marine Science	\$ 4,825,531
State Board of Community Colleges	2,500,000
Virginia Tech - Research Division	1,500,000
University of Virginia	1,200,000
Virginia Tech - Extension Division	400,000
College of William & Mary	100,000
Total	\$23,359,194

\*Loan balances for some agencies have increased or decreased during the period reviewed due to loan additions and repayments.

Source: Department of Accounts.

total loan balance. The loan balance for these agencies represented 57 percent of all loans made in anticipation of federal revenues that were outstanding on February 1, 1980.

The loans for these 14 agencies can be separated into two categories, according to the purpose of the loan. The first category consists of loans to provide advance financing for specific federal grants or contracts.

The second category involves loans used as revolving funds to pay advance expenses under sponsored programs, a term which, in general, encompasses numerous research grants and contracts received throughout the year by institutions of higher education.

#### Specific Grants or Contracts

Two of the eight agencies in this category were found to have loans for the proper amount, secured by adequate sources of repayment. In six cases, general fund loans were unnecessarily high.

To issue a loan, the Department of Planning and Budget (DPB) simply required a letter from the agency identifying the source of repayment for the loan and the authority to receive the federal funds. The authority cited for receiving the funds was either a legislative appropriation or a standard application form (formerly Form DPB-16, which was submitted to DPB for approval prior to soliciting the grant).

Basically, agencies should request, and DPB should approve, loan amounts necessary to operate a program through an appropriate reimbursement cycle. However, DPB has approved loans in the amount requested by an agency without analysis of the actual amount needed by the agency.

When questioned, six of the eight agencies identified in Table 7 acknowledged that they had loan amounts greater than necessary for the operation of their programs over a normal reimbursement cycle. A total of \$7,331,330 was loaned to these agencies in excess of their needs.

For example, the Virginia Department of Transportation Safety (VDTS) did not need most of the \$955,400 loan which it obtained for FY 1980 for its federal programs. Only twice during FY 1980 did VDTS need to utilize any proceeds from the loan and the maximum amount used was slightly more than \$117,000. The department has acknowledged that a loan of no more than \$300,000 would have been sufficient.

In one case the amount of the loan was not only greater than needed, but apparently the loan itself had an inappropriate basis.

*George Mason University requested and received approval from the Department of Planning and Budget for a \$100,000 loan in April 1979. The loan was to provide funds in advance of reimbursement from a grant awarded by the National Endowment for the Humanities.*

Table 7

AGENCY LOAN BALANCES COMPARED  
WITH AMOUNTS NEEDED FOR PROGRAM OPERATION  
(February 1, 1980)

<u>Agency</u>	<u>Loan Balance</u>	<u>Needed for Program Operation</u>	<u>Difference</u>
Division of Justice & Crime Prevention	\$ 7,500,000	\$ 3,000,000	\$ 4,500,000
Commission of Game & Inland Fisheries	2,525,930	800,000	1,725,930
Department of Mental Health & Mental Retardation	1,194,633	894,633	300,000
Virginia Department of Transportation Safety	955,400	300,000	655,400
Rehabilitative School Authority	346,700	346,700	0
Department of Housing & Community Development	111,000	111,000	0
Virginia School for the Deaf & Blind	100,000	50,000	50,000
George Mason University	<u>100,000</u>	<u>0</u>	<u>100,000</u>
Total	\$12,833,663	\$ 5,502,333	\$ 7,331,330

Source: Department of Accounts, JLARC interviews.

*However, the application form cited in the loan request and reviewed by DPB clearly stated that the National Endowment for the Humanities would provide all funding necessary for the grant on a cash advance basis.*

*Under these circumstances, the loan was unnecessary and should not have been requested by the university or approved by DPB.*

Another agency was given a loan greater than the amount of funds which could be collected from the repayment source as shown on the documentation supporting the loan request.

*The Department of Mental Health and Mental Retardation (DMHMR) received a loan for \$1,194,633 in July 1979. A review of the applications submitted for federal funding and referenced in DMHMR's loan request showed that only \$894,633 could be collected, \$300,000 less than the amount of the loan.*

*In April 1980, DMHMR paid back \$300,000 to reduce the loan to the amount receivable.*

The Department of Planning and Budget needs to establish better procedures for analyzing loan requests. Loans should be limited to actual amounts needed by agencies to operate their programs pending federal reimbursement. In addition, the source of repayment for loans should be carefully scrutinized to ensure that adequate revenues will be collected to repay a loan.

#### Sponsored Programs

JLARC's review of loans for federally-sponsored programs at six institutions of higher education found similar problems with the procedures used by the Department of Planning and Budget. Specifically, the review found that loans have been made on the basis of grant applications rather than actual awards. DPB also has provided loans for amounts greater than the amount to be collected during the loan period, and for amounts greater than needed to operate sponsored programs during a normal reimbursement cycle.

The integrity of general fund loans for sponsored research has been a documented concern since July 1976, when a JLARC review first noted problems with loans made to the Virginia Institute of Marine Science (VIMS). Since that review, investigations have found cash deficits in VIMS financing which have accumulated over a number of years. As of July 17, 1980, the president of the College of William and Mary estimated the VIMS accumulated deficit to be approximately \$8 million.

This level of deficit was possible in part because of the approval of State loans that the institute used to permit operations beyond appropriated limits. JLARC's review of VIMS loans found problems including:

- Authorization of loans based on grant proposals rather than awards.
- Inclusion as loan collateral of a grant paid by letter of credit rather than reimbursement.
- Approval of a loan based in part on proposals whose grant revenues could not be collected until after the due date for the loan.

As illustrated by the VIMS loans, the Department of Planning and Budget needs to establish better procedures for controlling loans made for sponsored programs. DPB should require all agencies to provide information on awards received, the duration of the project, and the amount and timing of expenditures which need to be financed over a normal reimbursement cycle. The amount of loans made should not be greater than the federal award. Loans made for sponsored programs covered by letters of credit or cash advances are generally unnecessary and should be made only in exceptional cases.

## Budget Information

Agency and executive budgets have not provided the General Assembly with sufficient information on federal fund receipts. The executive does not require that agencies provide information on actual awards of federal funds when authorizing an increase in their budgets. In addition, information on subgrants of federal funds between State agencies is not consistently depicted in agency budget exhibits. Finally, the executive has not provided the information required by statute in the biennial budget on federally mandated programs.

### Information on Awards

The Department of Planning and Budget has relied on revenue estimates without follow-up information on actual awards to increase agencies' appropriations of federal funds. This practice creates a weak link in the control of agency budgets and excessive increases in agency budgets have resulted.

*In February 1979, the Department of Planning and Budget increased the Commission on Outdoor Recreation's budgeted appropriation by \$3,550,000 from federal funds for the Young Adults Conservation Corps. The approval of this increase by DPB was based on a notification of intent form originally approved in July 1978.*

*The agency's request for the additional appropriation included the statement that this form was being revised to reflect expected funding. However, no revisions of this form were received by DPB.*

*In fact, actual federal awards totaled \$3,171,511, or almost \$400,000 less than the amount DPB allocated the agency based on the request of \$3,550,000.*

The use of revenue estimates to increase agencies' appropriations does not always provide accurate information on federal funding for State activities. Provisions should be made to report actual awards, possibly on an exception basis for those cases in which the award differs substantially from anticipated funding. Award information, instead of estimates, is the only accurate basis for increasing appropriations and would provide greater control over federal funds.

Because State agency estimates of federal revenues are developed before the federal budget is passed, these estimates are subject to error. Changes in funding levels for federal programs in which the State participates can have a dramatic effect on the State's budget. Thus, it is important for State agencies to keep the General Assembly informed of potential and actual changes in federal funding levels. At the request of the House Appropriations Committee, the Department of Planning and Budget has begun reporting information of this type on a monthly basis.

### Subgrant Information

A review of agency budget exhibits showed that agencies did not consistently reflect federal revenues received from other State agencies in their revenue estimates. Frequently, no narrative statement is included on the source or use of these revenues even if they are included in the budget.

*Although all State community colleges received federal vocational education funds from the State Department of Education, only 12 of 23 colleges detailed these revenues in their budget exhibits. Consequently, only \$605,120 of a total federal amount of \$1,599,900 was identified in the revenue descriptions provided by the colleges.*

*While these funds were included in the total amount of revenue estimated for each college, the source of the revenue was not identified.*

*Thus, the budget exhibits for 11 colleges cannot fully inform a reader about the funding of their vocational education program. Nor can the General Assembly be adequately informed of the degree to which vocational education programs are dependent on federal funds.*

Agency budget exhibits should provide information on estimated revenues which clearly identifies federal funds to be received through subgrant arrangements. Clarification of executive budget policy is needed to improve the quality of information provided to the Governor and General Assembly.

### Statutorily Required Information

The Department of Planning and Budget has not satisfied statutory requirements in its preparation of the 1980-82 budget. Section 2.1-398 of the *Code of Virginia* states:

*As nearly as practicable for each program there should be included an identification of the authority for operation (i) mandated by the federal government, (and) (ii) necessary to avoid losses in federal revenues . . .*

Budgetary information of this type has not always been provided, even though the statute has been in effect since 1976.

For example, the State must achieve and maintain clean air and clean water standards under several federal environmental statutes. Yet, no mention of these federal statutes is found in the 1980-82 budget bill for the two State agencies responsible for fulfilling the requirements of

these standards--the State Water Control Board and the State Air Pollution Control Board. The only authority cited for the programs of these two agencies is the *Code of Virginia*.

The executive should comply with this statutory requirement. Information of this type would more accurately detail to the General Assembly the commitments of the State to continue funding specific programs, and would avoid potential losses of federal funds.

### Seeking Federal Funds

Although most agencies are successful in obtaining appropriate federal funding, one agency was found not effectively identifying and seeking available federal funds. In general, agencies should use federal funds for carrying out programs which have received legislative endorsement through the appropriation process. In some cases, however, agencies fail to seek funding which is appropriate and could supplement or offset the use of other State resources.

*Southside Virginia Training Center has not applied for and does not receive any nutritional assistance funds from the U. S. Department of Agriculture, despite the training center's eligibility and the fact that similar mental health and mental retardation institutions receive this support.*

*Approximately \$50,000 annually in federal funds would be available to improve food services, according to center officials, were they to apply for them.*

Agencies and departments need to assess the availability and appropriateness of federal resources for support of their programs. Internal agency policies and procedures need to address the role of federal funds in financing agency programs.

## **Conclusion and Recommendations**

Federal funds are a valuable resource available to the Commonwealth for financing its programs and services. To ensure that federal funds are efficiently and effectively utilized, several recommendations are in order.

### Administration and Finance Directive 1-80

In issuing A&F Directive 1-80, the executive recognized the need to replace an ineffective grant-by-grant review of agency applications for federal funds. The new system emphasizes agency responsibility to seek and accept only funds consistent with legislative and executive mandates. It further limits agency acceptance of federal funds to 110 percent of their legislative appropriations, except in emergencies.



While A&F Directive 1-80 is an improvement over former policies, it is inconsistent with existing language in the Appropriations Act.

Section 4-4.01. No donations, gifts, grants or contracts whether or not entailing commitments as to the expenditure, or subsequent request for appropriation or expenditure, from the general fund shall be solicited or accepted by or on behalf of any State agency without the prior written approval of the Governor; provided, however, that these requirements shall not apply to donations and gifts to the endowment funds of the institutions of higher education. The use of these funds for land, structures or equipment is subject to Sections 4-4.03, 4-7.01 and 4-9.05 of this act.

*Recommendation (5). The General Assembly should consider revising Appropriations Act language to reflect the decentralized procedures of A&F Directive 1-80. Such an amendment would reflect legislative endorsement of the policy.*

Sections 4-3.05 and 4-4.01 of the Appropriations Act do not represent the technical sequence of solicitation and acceptance of funds. The Act would be clearer if the normal processes followed by agencies in soliciting and accepting funds were to be reflected by the language of the Act.

*Recommendation (6). The language of Sections 4-3.05 and 4-4.01 should be reordered to reflect the sequence of actions followed by agencies in soliciting and accepting funds.*

#### Reimbursement Procedures

There are three basic mechanisms for receiving federal funds: cash advance, letter of credit, and reimbursement. Effective use of these mechanisms is necessary to support the State's investment program. JLARC identified an additional \$286,000 in investment revenue that could have been gained by better cash flow management practices by agencies. State funds are also used unnecessarily to finance federal programs when agencies do not apply for all allowable indirect costs.

*Recommendation (7). The Department of Planning and Budget should carefully monitor provisions of A&F Directive 1-80 which address the methods by which federal funds are received. Cash advances and letters of credit should be used whenever possible. When agencies are restricted by federal grantors to receiving funds by reimbursement, the Department of Planning and Budget should monitor such arrangements to ensure that agencies submit requests for reimbursement in a timely manner.*

*Recommendation (8). The Department of Planning and Budget should review subgrant financing arrangements used by State agencies to*

*ensure that subgrantees are relieved, whenever feasible, of the need to provide advance financing for federal programs.*

*Recommendation (9). The Department of Intergovernmental Affairs should periodically evaluate agency indirect cost practices to ensure that full recovery is taking place. State agencies seeking federal funds for programs that will subsequently be carried out by a subgrantee should be encouraged to include the indirect costs of the subgrantee when possible.*

#### General Fund Loan Procedures

Procedures for making general fund loans to agencies for expenditures pending federal reimbursement need to be reviewed. JLARC identified loans totaling \$5 million for advance funding of programs that could have been avoided. Unnecessary loans to agencies increase the risk of overexpenditure and subsequent deficits and decrease incentives for sound cash flow management.

*Recommendation (10). General fund loan requests should be thoroughly analyzed by the Department of Planning and Budget to ensure that the need for advance financing by the State exists, that the amount of the loan is secured by an adequate repayment source, and that the amount is limited to that necessary to cover an anticipated reimbursement cycle. Loans which are required for the operation of particular grant programs should be based whenever possible on award notices. When a loan must be made based on anticipated funding, the difference between anticipated and actual awards should be reported and an adjustment made to the loan amount.*

#### Improved Budgeting Information

Essential to legislative oversight of federal funds is accurate budgetary information on the amounts and requirements of federal funding. Decisions by the Governor or his designee to increase agency budgets between legislative sessions must be based on accurate information. Required information on federal funds has not been provided to the General Assembly in all cases.

*Recommendation (11). The Department of Planning and Budget should require agencies to furnish information on actual awards of federal funds whenever the award differs from the anticipated amount. A report of these differences should be provided to the House Appropriations Committee and Senate Finance Committee as part of the quarterly reports required under the Appropriations Act.*

*Recommendation (12). The Department of Planning and Budget should continue to monitor federal budget reduction proposals and their potential impact on the programs of the Commonwealth and its localities. Findings should be reported to the House Appropriations and Senate Finance committees.*

*Recommendation (13). Agencies which receive federal funds as subgrantees or secondary recipients should be required to identify consistently in their budget exhibits the federal source of such subgrantee funding.*

*Recommendation (14). The Department of Planning and Budget should ensure that agencies comply with Section 2.1-398 of the Code of Virginia and provide identification of the authority for operation of a program.*

### Seeking Federal Funds

In general, agencies should use federal funds for carrying out programs which have received legislative endorsement through the appropriation process. In some cases, however, agencies fail to seek funding which is appropriate and could supplement or offset the use of other State resources.

*Recommendation (15). State agencies and departments should take steps to assess whether they are effectively identifying and utilizing federal resources available for programs that have been authorized by the General Assembly or Governor.*



## IV. Financial Administration of Research Grants

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Federal grants and contracts to institutions of higher education account for the majority of the State's individual federally-sponsored projects. In FY 1979, for example, Virginia's six doctoral degree-granting institutions submitted proposals for more than 3,000 federally-funded projects, compared to about 400 proposals for the rest of State government combined.

Federally-funded research grants and contracts are a valuable resource which can and should be utilized by State universities and colleges. Virginia institutions have become strong competitors for federal grants and contracts, a development that generally reflects well on the quality of a university. The State's three leading research institutions--the University of Virginia, Virginia Polytechnic Institute and State University, and Virginia Commonwealth University--rank among the top 100 research institutions in the nation, and have shown increased competitiveness in recent years (Table 8).

Table 8

FEDERAL RESEARCH AND DEVELOPMENT FUNDING  
(Ranking in Top 100 in United States)

<u>Institution</u>	<u>Rank in 1973</u>	<u>Rank in 1979</u>
University of Virginia	62	53
Virginia Polytechnic Institute & State University	97	72
Virginia Commonwealth University	96	84

Source: National Science Foundation.

The General Assembly and the Governor have recognized the value of research grants and contracts, as well as their unique characteristics, and have recently taken several actions to improve the climate for research funding.

- The General Assembly added language to the Appropriations Act which treated retention of 70 percent of university indirect cost recovery funds as a legislative appropriation in support of research activities (Section 4-4.03). At the same time, the General Assembly required institutions to recover the full amount of indirect costs. This action should result in increased recovery of indirect costs because some universities have purposely waived some of these costs in the belief that this made their grant applications more competitive during federal review.

- The Governor discarded a cumbersome federal grant preapplication process and exempted higher education research programs from new conditions relating to the solicitation and acceptance of nongeneral funds.
- The General Assembly exempted from prior approval by the Department of Management Analysis and Systems Development (MASD) university purchases of data processing equipment costing less than \$50,000 or \$2,000 per month, when it is determined by MASD that the equipment is grant or contract related and not an integrated part of the university's total automated data processing system (Section 4-9.03).

These actions should have the effect of expediting and encouraging grant and contract research.

#### Scope of Sponsored Research in Virginia

Research constitutes the major portion of what are called "sponsored programs" in the budgets of institutions of higher education. Sponsored programs include a wide range of externally-funded university activities that are usually, but not always, research-related. Examples of sponsored programs include conferences, demonstration projects, and teaching and training activities.

The majority of sponsored research in Virginia occurs in the institutions which grant doctoral degrees. Almost 90 percent of all grant and contract awards are received by the three institutions--UVA, VCU, and VPI--which also confer about 90 percent of all doctoral degrees awarded. The six principal research institutions and the scope of their sponsored program activity in FY 1979 are shown in Table 9. Combined, these institutions were awarded over \$77 million in federal money in FY 1979.

Table 9  
SPONSORED PROGRAM GRANT AND CONTRACT AWARDS  
FY 1979

	<u>Total Number of Awards</u>	<u>Federal</u>	<u>Nonfederal</u>	<u>Total</u>
UVA	639	\$31,406,550	\$ 5,138,558	\$36,545,108
VCU	452	19,756,215	4,914,511	24,670,726
VPI	555	15,875,310	3,007,149	18,882,459
ODU	113	3,228,058	535,675	3,763,715
W&M	53	1,245,723	175,772	1,421,495
VIMS	57	5,583,419	58,820	5,642,239
Total	1,869	\$77,095,275	\$13,830,485	\$90,925,742

Source: University reports, JLARC survey.

Sponsored research also enhances research facilities and capabilities. Funds are received to support the institution's share of indirect costs (Table 10), and indirect cost recovery funds may be used by the universities to acquire equipment or facilities, or support research faculty and staff.

Table 10  
INDIRECT COST REVENUE AND EXPENDITURES  
FY 1979

	<u>Recoveries Received</u>	<u>Payments to General Fund</u>	<u>Expenditures</u>	<u>Year End Account Balance</u>
UVA	\$5,596,000	\$1,654,000	\$3,097,000	\$4,589,000
VPI	2,668,527	876,309	1,806,020	345,335
VCU	3,335,466	1,000,639	1,601,182	4,039,307
ODU	733,049	88,000*	530,361	163,909
W&M	335,517	74,223	160,801	315,168
VIMS	792,639	0**	1,218,381	246,200

\*The 30 percent payment rule has not applied to ODU because the State does not pay the ODU Research Foundation administrative overhead.

\*\*VIMS was not required to make such payments.

Source: Appropriations Committee survey, 1979.

Federal funds at the six institutions also supported over 800 full-time equivalent (FTE) faculty positions and more than 1,100 FTE classified positions (Table 11).

It should be noted that George Mason University achieved doctoral degree-granting status in July 1980 and will most likely increase its sponsored research activities. In addition, the Virginia Institute of Marine Science became part of the College of William and Mary during FY 1979. Old Dominion University totals also include expenditures and faculty of the Old Dominion University Research Foundation, a private, nonprofit institution created primarily for the administration of sponsored research. In addition, Norfolk State University and Virginia State University each received more than \$5 million in federal funds in FY 1979, principally in non-research Basic Educational Opportunity Grant funding.

#### Need for Control Over Research Funding

Controlling grant and contract research funding presents special problems. The volume of relatively small projects with a wide range of purposes requires internal controls which are both flexible and capable of satisfying the accountability requirements of a variety of federal and other sponsors.

Table 11

UNIVERSITY FULL-TIME EQUIVALENT (FTE)  
POSITIONS FUNDED BY FEDERAL FUNDS  
March 1980

	Total FTE Faculty	Faculty FTE Funded By Federal Money	Total FTE Classified Personnel	FTE Classified Personnel Funded by Federal Money
UVA	2046	388	2622	372
VCU	1777	148	2439	297
VPI	2039	226	3557	304
ODU	671	15	756	0
(ODU Foundation)	33	30	36	33
W&M	349	10	606	3
VIMS	*	*	323	112
Total**	6915	817	10,339	1121

\*VIMS personnel not classified as faculty at time of report.

\*\*Totals may not add, due to rounding.

Note: Full-time equivalent positions are used to estimate the number of positions totally funded from a given revenue source. Some qualifications apply to university figures.

Source: University reports to JLARC.

In addition, there is a long-standing concern that dependence on federal funding for sponsored programs may lead to the State being asked to absorb the costs of programs and personnel if federal funding is removed. State policy currently makes it clear that the State is under no obligation to universities to assume the cost of programs if federal grants or contracts are terminated. Furthermore, staff hired for sponsored programs are informed, pursuant to State policy, that their employment is contingent on the receipt of adequate sponsored program revenues. Nevertheless, a major reorientation caused by a decline in research funding or problems with internal controls could have a significant impact on State support for universities.

The absorption of the Virginia Institute of Marine Science (VIMS) as a school of the College of William and Mary (W&M) provides an example of such a reorientation. Several factors, including the inability of VIMS to effect necessary controls over its financial affairs, caused the reorientation. An audited accumulated deficit of \$6.9 million existed from past years as of January 1, 1980. Subsequent expenditures will likely result in a total deficit of \$8 million.



While W&M has sought to establish financial integrity at VIMS, State appropriations are seen as the principal means by which the institute's accounts will ultimately be balanced.

- An additional appropriation of \$1.8 million was made by the General Assembly and subsequently released by the Governor to permit the continuation of VIMS activities.
- Despite the fact that the institute long operated at a level of activity beyond that appropriated, future supplemental appropriation requests of approximately \$1.8 million per year are expected to enable the institute to continue established operations.
- An appropriation request of approximately \$300,000 is expected as the one-time cost for payments to employees for accumulated annual and sick leave. This expense will result when VIMS scientists are converted from classified to faculty status.

Although any institutional reorientation due to funding declines or losses due to inadequate controls would have unique characteristics, it is incumbent on each institution to develop and maintain an adequate control system.

#### Review Criteria

JLARC evaluated the administrative controls of the six State institutions with major grant and contract research activities. Four criteria were used for this evaluation: proposal services, proposal review and approval, account administration, and program reports and audits.

*Proposal Services.* Services are provided to assist institutional faculty and staff in developing sound and competitive proposals. The most basic proposal service is a grant and contract manual stipulating university procedures and requirements. Without a manual or its equivalent, the many departments and faculty members involved in sponsored programs may not be aware of established controls.

*Proposal Review and Approval.* Review and approval constitutes the university's assurance that departments and faculty members have conformed to established procedures and controls. The use of a standard approval sheet is essential because it provides documentation that required steps have been taken and approved by the appropriate authorities. Review of the proposal approval sheet by a fiscal section safeguards against the submission of grant proposals that are fiscally unrealistic or that do not take full advantage of indirect cost recovery and other funding advantages.

*Account Administration.* Account administration primarily involves the monitoring of accounts, the timeliness of record-keeping, and record organization. Account monitoring provides day-to-day control

over the hundreds of individual sponsored projects. Timely posting of changes to accounts is important, as is the availability of well-organized records for administrative review and audit.

*Program Reports and Audits.* Universities are directly accountable to the federal government for the proper use of grant funds. The two primary federal controls are the periodic fiscal reports provided to federal sponsors on a grant-by-grant basis and comprehensive audits that are made of all grants and contracts.

Generally, adequate controls and management practices were found at four of the six institutions reviewed by JLARC staff (Figure 6). At these four institutions, the administration appeared to have access to accurate and reliable information on the status of research grants and contracts. In each case a manual was provided to faculty, and the review and approval procedures appeared appropriate. No major audit exceptions were outstanding at these institutions.

Figure 6

#### ADMINISTRATIVE PERFORMANCE IN SELECTED AREAS

	UVA	VPI	VCU	ODU	W&M	VIMS
<b>PROPOSAL SERVICES</b>						
Provides grant manual or equivalent	✓	✓	✓	✓	✓	●
<b>PROPOSAL REVIEW AND APPROVAL</b>						
Uses a standard approval sheet	✓	✓	✓	✓	✓	●
Fiscal section reviews proposal	✓	✓	●	✓	✓	✓
<b>ACCOUNT ADMINISTRATION</b>						
Actively monitors accounts and follows-up	✓	✓	●	✓	✓	●
Maintains timely and well-organized records	✓	✓	●	✓	✓	●
<b>PROGRAM REPORTS AND AUDITS</b>						
Submits timely reports to sponsor	✓	✓	●	✓	✓	✓
Received no significant audit exceptions	✓	✓	●	✓	✓	●

KEY: ✓ No significant problems noted.  
 ● Significant problems noted.

The controls and procedures at the other two institutions--VCU and VIMS--had weaknesses in several key areas.

### Virginia Commonwealth University

VCU's federally-sponsored programs have grown substantially in recent years. From FY 1975 to FY 1979, federally-sponsored research

alone grew from \$5.4 million to \$12.1 million per year. Fiscal control over these funds is the responsibility of the university controller through the grants and contract accounting section.

VCU has two major problem areas: (1) problems in grant and contract control procedures, and (2) a major audit exception on its former time and effort reporting system.

### Weaknesses in Control

Weaknesses in control over the receipt and expenditure of research grant and contract funds were evident in several areas. Although VCU has an automated Financial Accounting System (FAS), entries were often inaccurate, diminishing the value of FAS as an effective management tool of federal grants and contracts. Problems with FAS were evidenced by 101 fiscal reports to federal sponsors which were overdue, one by as much as a year, as of May 2, 1980. Major control problems noted by the JLARC staff included:

- Negative balance accounts inappropriately reconciled.
- Ineffective use of encumbrances.
- A large number of dormant accounts.

*Negative Balance Accounts.* The review found that 197 of the 1,044 federal grant and contract FAS accounts had negative balances when they were examined as of May 30, 1980. The combined value of these negative balances totaled \$1.1 million.

In subsequent discussion with JLARC staff, VCU estimated that approximately \$600,000 of the negative balance was due to inaccuracies resulting from incorrect budget and accounting entries. Another \$400,000 was said by VCU to be the result of account structure, particularly the practice of establishing multiple accounts for one award. Forty-seven accounts of this nature were overspent, but the total allowed by the award itself may not have been exceeded at the time of the review. VCU is reviewing the remaining awards for potential deficits. Deficits that are verified as the result of overspending will have to be made up from other funding sources.

In spite of the many accounts shown with negative balances, VCU did not automatically monitor or follow up on FAS-reported deficits. Vouchers were routinely submitted and processed against accounts which showed negative balances. Reliance was placed on the academic department and the principal investigator to note problems occurring as a result of overspending. Essentially, there was no central control because a principal investigator could continue to spend against an account with a negative balance.

A summary financial report of a typical negative balance account is shown in Figure 7. The figure shows examples of problems noted in the review. The first four items relate to negative balance accounts and are shown by the shaded areas on the figure.

Figure 7

EXAMPLE OF SUMMARY FINANCIAL  
REPORT IN DEFICIT STATUS

RUN DATE 05/31/80  
REPORT=A61R090  
PGH=12415061 RPT=AM090  
SEQUENCE=01 0  
FIS ADMIN

VIRGINIA COMMONWEALTH UNIVERSITY ACCOUNTING SYSTEM REPORT

BUDGET PERIOD 06/78-11/79

SUMMARY FINANCIAL REPORT FOR THE PERIOD ENDED 05/31/80

REPORT PAGE 3083  
G/L 0-20284 UNIV ACCT  
DEPT  
DEPT ADDR  
RESP PERS  
AWARD ID  
PROJ PERD - 06/77-05/79

	ORIGINAL BUDGET	REVISED BUDGET	EXPENDITURES & REVENUES THIS MO.	TO DATE	BAL BEFORE COMMITMENTS	5 COMMITMENTS	BUDGET BALANCE	PERC AVAIL
PERS SER EXPEND	13,000	1,045.42			1,045.42		1,045.42	
FACILITY SERY		8,992.50		8,992.50				
CLASSIFIED SERY			876.00					
WAGES HOURLY		2,962.08		2,962.08				
OTHER OPER EXPEND		1,799.28-			1,779.28-		1,779.28-	
FRINGE BENEFITS	1,352	101.18-			101.18-		101.18-	
ALLOC FR BENE		1,453.18		1,453.18				
TRAVEL	600	323.60			323.60		323.60	
CONV&EDUC TRAV		110.00		110.00				
TRAVELAGE-CONVSTC		166.40		166.40				
OTHER REPROOCT		21.00		21.00				
SPON PGNS PUB		75.20			72.50	72.50		
SUPPLIES	5,264	1,200.21-			1,100.21-		1,200.21-	
NEO & LAB SUP		6,201.81		5,812.18	389.63	389.63		
ANIMALS		67.70		67.70				
CENT ANI FAC CHG		212.58		212.58				
OFFICE SUP		21.78		21.78				
VISUAL ED CHGS		346.25		346.25				
OTHER SUP&NATI		72.50		72.50				
HEED&LAB EQUIP		1,236.37		1,236.37				
SUBSCRIPTIONS		31.00		31.00				
TOTAL DIRECT EXPENDITURES	20,236	20,236.00	2	21,505.52	1,269.52-	462.13	1,731.65-	
IND COST&TRANSFER								
INDIRECT COST	9,750	9,750.00		9,750.00				
TOTAL INDIRECT COST&TRANSFER	9,750	9,750.00		9,750.00	1		4	
% TOTAL %	29,986	29,986.00	876.00	31,255.52	1,269.52-	462.13	1,731.65-	4-

6

OPEN COMMITMENT STATUS

REF.	DATE	DESCRIPTION	ORIGINAL AMOUNT	CURRENT AMOUNT	LAST ACTV
X040361	03/21/79	BIOCHEMICAL SDC	72.50	72.50	03/27/79
A051909	11/01/79	FISHER	38.88	38.88	11/07/79
A051962	10/23/79	RES PRODUCTS INTERNA	136.00	136.00	10/26/79
X595657	08/01/78	CONT WATER COND	151.00	151.00	08/01/78
X595661	07/14/78	CONTINENTAL WATER CD	63.75	63.75	07/21/78

Source: VCU FAS System.

- Item 1: The account has been charged for \$1,269.52 more in expenditures than the amount of the grant budget.
- Item 2: In spite of the fact that the account had a negative balance, a charge of \$876 was made to the account.
- Item 3: Encumbrances totaling \$462.13 are outstanding.
- Item 4: The encumbrances plus expenditures resulted in a total negative balance of \$1,731.65.

*Lack of Control Over Encumbrances.* A second problem with VCU's control system is highlighted by Figure 7. The column headed "commitments" (Item 5 on Figure 7) is a record of encumbrances against the account. Many accounts had encumbrances, or open commitments, which dated back to 1978 (Item 6 on Figure 7). Since it was unlikely that vendors would wait several years for payment, the presence of these old commitments was evidence of the questionable accuracy of the statements.

*Dormant Accounts.* Accounts on VCU's financial accounting files have never been purged. As a result, as many as one-half of the accounts in FAS were dormant. That is, the date for project termination had passed and the account showed little or no recent activity. Dormant accounts represent projects which have been completed, or project continuations which are recorded in a new account. Monthly summary reports continue to be generated on accounts which have been inactive for as long as two years.

Numerous dormant accounts pose a serious problem of potential fraud or abuse. VCU accounts, although dormant, could be routinely accessed for payment of billings. This is contrary to sound internal control which requires a procedure to automatically freeze accounts which become dormant. For example, dormant accounts at UVA cannot be accessed without the written approval of the university controller. Without this kind of control, dormant accounts could be looted through fraudulent billings.

Control weaknesses in VCU grant and contract accounting existed primarily because available reports and controls designed into the system were not used.

- Deficit accounts were identified by FAS, but were not monitored and reconciled.
- Encumbrances were programmed into the FAS system, but were not used to stop payments on accounts which exceeded budgeted amounts.
- Dormant accounts could be frozen, but were not.

Without improved use of existing controls, VCU's grants and contracts accounting section could not provide adequate control over the expenditure of sponsored research funds.

A final factor contributing to the weaknesses in internal control at VCU was the grant and contract accounting office's lack of an internal procedures manual for employees. The office has experienced substantial turnover in recent years, particularly at the supervisory level. The lack of a manual can contribute to lack of consistent application of existing procedures and controls.

#### Federal Audit Exceptions

VCU is currently involved in a major audit dispute with the National Institute of Health (NIH). An audit report claimed that "the overall labor distribution system was not acceptable for recording the costs charged to federal grants and contracts." The original audit exception was for \$27.5 million.

This dispute resulted from a 1978 audit by HEW of direct costs incurred by VCU under federal research and training grants and contracts for the period July 1, 1971, to June 30, 1976. Funds audited totaled \$38 million. In this audit, HEW stated the following:

The University needed to establish procedures to assure that charges to Federal grants and contracts for direct labor costs accurately reflected actual effort expended. Under current procedures, such charges appeared to be based primarily on budget estimates and anticipated effort. As a result, over \$27.5 million of personal service costs for professional, professorial, and administrative personnel charged to Federally sponsored programs were not adequately supported . . .

VCU disputes the federal claim that the entire \$27.5 million of direct costs for personal services is unsupported. In spite of the claim that none of the \$27.5 million was adequately supported, NIH has recognized that research was done and reports submitted. As the basis of a settlement, NIH elected to disallow two percent of the \$27.5 million total, approximately \$500,000. Negotiations between VCU and NIH have since focused on this repayment claim. VCU has offered to settle for substantially less. The dispute is still not resolved.

Any repayment of direct costs by VCU would most likely come out of its indirect cost recovery accounts, according to VCU's Vice President for Financial Affairs. In this regard, VCU has set aside about \$500,000 in indirect cost funds which were paid to it as a result of a separate under-recovery settlement. This money has been placed in an interest-bearing account as a source for repaying the potential direct cost audit exception. Of note is the fact that the State's 30 percent share of the indirect cost recovery provided for by the Appropriations Act has not yet been credited to VCU's educational and general accounts as an offset of general fund appropriations.

Since the audit, VCU has worked to prepare an acceptable effort reporting system. Among other actions, VCU has employed a private con-

sultant, Peat, Marwick, Mitchell and Company, for two effort reporting projects totaling \$43,022. These projects were designed to comply with new effort reporting requirements of the Office of Management and Budget.

In an effort to mitigate future difficulties, VCU has submitted its new effort reporting system to federal authorities for their review. Once agreement is reached, it is essential that the university administration take steps to fully implement the new system.

## **Virginia Institute of Marine Science**

Problems in the management of the Virginia Institute of Marine Science (VIMS) have been documented since a special study of the institute in 1976. Serious problems in the financial administration of grants and contracts continue to exist. A State-mandated audit of the institute by the firm of Coopers and Lybrand reported that VIMS had an audited accumulated deficit of \$6,933,181 as of December 31, 1979. The total deficit, which would include the first six months of 1980, has been estimated at \$8 million.

The Coopers and Lybrand audit also showed contingent liabilities of \$1.3 million in federal audit exceptions and the possibility of additional exceptions of some portion of a \$1.9 million payment for work completed prior to 1975, during a period when VIMS accounting records have been subsequently found to be inadequate. As noted in the 1976 JLARC review of VIMS management, and in several subsequent reports, much of this deficit resulted from the receipt and use of State loans which proved to be inadequately secured by the funds actually available from federal research grants and contracts.

The College of William and Mary assumed control of VIMS in July 1979. Since then college officials have been working to improve the controls and procedures used at VIMS. The JLARC on-site review conducted in March 1980 found that, although progress had been made, several important areas still required more attention.

### Lack of Records and Controls

The most fundamental problem at VIMS was the lack of records, which has created basic weaknesses in internal control. On May 28, 1980, a status report to the president of William and Mary noted delays due to staff expending far more time than anticipated in assisting commercial auditors employed by the State in reconstructing records. This delay, it was reported, "is due primarily to the lack of and poor condition of the accounting records . . ." Evidence from existing files indicated instances of disregard in the past for essential record-keeping practices.

One file included a 1977 note written on an envelope, which stated: "Budgets were messed-up. (Accountant) told me not to worry 'bout monitoring sheets. Therefore, I didn't do them. (Initialed)." No resolution of the budget errors was noted.

Record-keeping deficiencies were confirmed by the Coopers and Lybrand audit of VIMS which noted that:

Grant/contract cost records have not been kept current as required for effective grant/contract administration. As a result, overruns developed presumably before principal investigators were advised their projects were reaching critical financial limitations.

\* \* \*

Grant/contract files are difficult to examine because the information is so dispersed. Contract amount, amendments, match requirements, cost accumulations to date, billings to date, and collections to date can be found on any number and variety of documents.

The lack of records and associated accounting procedures resulted in poor internal control. A VIMS grant administrator told JLARC that no one at VIMS had ever checked on the federal balance of a multi-million dollar Sea Grant letter of credit. VIMS did not know what the balance was, and had never reconciled its own records against it. Such loose procedures inevitably cost the institute, as the example below illustrates.

*On one occasion an employee of the institute authorized the expenditure of \$846,564 in cost overruns on a Bureau of Land Management contract.*

*The VIMS employee acted on the basis of telephone conversations with the BLM which were never documented. BLM has since challenged the overrun and \$471,564 remains in dispute.*

The condition of existing records will continue to be a problem at VIMS for years to come. In many instances, it will be difficult to establish the audit history necessary to support direct cost audits and indirect cost rates. The following example illustrates that federal agencies may require documentation to support expenditures made against a series of grants over a number of years.

*Questionable costs totaling \$2,498,594 were reported to VIMS on April 18, 1980. The audit exceptions were the result of an audit of National Marine Fisheries grants totaling \$3,514,415 made to VIMS covering the period July 8, 1965, through September 30, 1975. The audit cited:*

- *unrecorded claimed costs of \$277,984;*
- *unsupported claimed costs for personal services totaling \$1,612,873; and*



- *unsupported claimed indirect costs totaling \$607,737.*

The federal audit was completed in early 1977 but not released until April 1980. This long, and questionable, delay notwithstanding, VIMS may have difficulty refuting the audit findings due to the condition of agency records from the period in question.

#### Lack of Current Reports and Manuals

Improvements were needed in internal financial reporting and a grants manual and approval cover sheet needed to be developed.

*Financial Reports.* Internal financial reports have not been provided in the past in a timely manner. In April 1980, the most recent report available on the account balances of VIMS research grants was as of December 1979. Data almost 100 days old is of questionable value in controlling expenditures and places almost total reliance on the principal investigator to avoid overspending. In recognition of this problem, the Acting Associate Director for Financial Affairs implemented interim control procedures, including a manual account system to provide data only 15 days old.

VIMS is in the process of implementing a computerized Financial Accounting System (FAS) to provide current information on the status of grant and contract accounts. As observed at VCU, however, effective control requires that the information be both accessible and accurate. Progress on FAS implementation should be carefully monitored by the College of William and Mary.

*Cover Sheet and Manual.* VIMS was the only institution reviewed which did not use a standard approval cover sheet for routing grant and contract applications. VIMS was also the only institution without any form of grants manual.

The cover sheet is essential for fixing responsibility and certifying the consideration of essential points. William and Mary's proposal approval sheet, for example, addresses the following issues:

- Proposal Status (new or other)
- Summary of Costs
- Human Subject Involvement
- Availability of Space
- Personnel Involvement
- Faculty Release Time
- Departmental Approval

VIMS should adopt a similar cover sheet with the Associate Director for Financial Affairs as the final signator.

A grant and contract manual was also greatly needed at VIMS. While it is acknowledged that procedures have yet to be fully established, the early production of a manual for use by departments and

principal investigators is essential. As an interim measure, the Acting Associate Director for Financial Affairs has published several memos outlining various procedures.

## **Conclusion and Recommendations**

The State needs to take several steps to extend the generally adequate financial administration of research grants and contracts to all State-supported universities. Adequate procedures are already in place in several institutions which can serve as models where needed.

Federal audit exceptions are an important indication of weaknesses in the financial administration of research grants and contracts. At present, the State lacks a clear policy that appropriate State officials be informed of audit exceptions. As a result, audit exceptions are sometimes not reported outside the university.

*Recommendation (16). The General Assembly should require that copies of all federal audits be forwarded to the Office of the Auditor of Public Accounts and the Department of Planning and Budget as soon as they are received by agencies of State government. In light of the magnitude of audit exceptions found at VCU and VIMS, the Auditor of Public Accounts should consider putting a high priority on grant and contract accounts while conducting State audits.*

Several weak practices in the financial administration of research grants and contracts were found at Virginia Commonwealth University and the Virginia Institute of Marine Science, now a school of the College of William and Mary. Although the institutions have identified and are addressing known problems, several areas need continuing attention.

*Recommendation (17). VCU should continue to strengthen internal controls over grant and contract accounting, including the following:*

- a. All Financial Accounting System (FAS) accounts with negative balances should be identified and reconciled by the grant and contract office with the responsible academic department or faculty member. VCU should establish a policy that no expenditures should be made from any account with a negative balance without written authorization of the university controller.*
- b. VCU should develop a procedure whereby all FAS accounts which indicate that the grant or contract has terminated are protected from additional encumbrance and expenditure without the written authorization of the university controller.*

*Recommendation (18). VCU's administration should take steps to fully implement its effort reporting system as soon as an understanding is reached with federal authorities. This should include appropriate training sessions and aggressive supervisory post-audits to ensure compliance with reporting requirements.*

*Recommendation (19). VCU should develop an internal procedures manual for the grant and contract accounting section. Among the areas addressed should be procedures to prevent the submission of late fiscal reports to federal grantors.*

*Recommendation (20). The ongoing implementation of a financial accounting system at VIMS should be carefully monitored by the administration of the College of William and Mary.*

*Recommendation (21). VIMS should develop a standard grant and contract approval cover sheet to be maintained as part of each file. VIMS should also put a high priority on developing a procedures manual governing the administration of grants and contracts.*



## V. New Sources of Information

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Lack of basic information on the amount, distribution, and impact of federal funds in Virginia was one of the principal reasons the General Assembly asked JLARC to study federal funds. The finding that one-fourth of all State revenue comes from federal funds justified the legislature's concern that more information was needed on this important revenue source. The continuing legislative need for current, accurate information on federal funds became evident during the course of the study.

To address this need, JLARC authorized its staff to apply to the National Conference of State Legislatures (NCSL) for technical assistance and funding to explore the feasibility of developing a computer program for legislative information on federal funds. NCSL awarded the Commission \$5,000 for this purpose.

The feasibility project is nearing completion, and programs on State agency and program expenditures on federal funds have been developed using data currently available in State computer systems. Other sources are continuing to be explored. The project has been a cooperative effort with NCSL, other states, the federal government, and legislative and executive agencies in Virginia.

### Reports for Legislative Information on Federal Funds

Several reports have been designed for presenting federal fund expenditure information contained in the Commonwealth's Accounting and Reporting System (CARS). Four reports were developed using a complete fiscal year's expenditure data.

These reports provide for the first time comprehensive information on federal fund expenditures using the State's program structure. The Department of Management Analysis and Systems Development (MASD) developed the specifications for the reports. The Department of Accounts (DOA) programmed the applications. Using the applications developed for this project, similar reports can be generated at the close of each fiscal year on a continuing basis.

Two of the reports provide information on State programs across all State agencies, while the other two report on programs receiving federal support within State agencies. The type of information available on the reports is illustrated in Figure 8.

Legislative fiscal staffs have reviewed and commented on both the program and agency reports. The reports will be used to review agency budget requests and monitor the use of federal funds. These reports will be delivered to the fiscal committee staffs within two months of the close of each fiscal year. Information of this type was

Figure 8

FEDERAL AGENCY DEPENDENCE ANALYSIS  
EXAMPLE OF PROGRAM DETAIL REPORT

REPORT NO: FAIT04CR	COMMONWEALTH OF VIRGINIA		PAGE NO: 191
	AGENCY DEPENDENCE ANALYSIS: PROGRAM DETAIL		RUN DATE: 06/12/80
	FISCAL YEAR 1979		RUN TIME: 11:37:50
*****			
2 1 AGENCY PROGRAM	201 457		
	5 FUNO	4 AUTHORIZATIONS	3 EXPENDITURES
PROGRAM RECAP	GENERAL	\$ 5,143,015.00	\$ 4,953,591.85
	NONGENERAL	\$57,639,328.98	\$50,319,440.69
	FEDERAL	\$57,639,328.98	\$50,319,440.69
	03	\$ 0.00	\$ 0.00
	04	\$ 0.00	\$ 0.00
	07	\$ 0.00	\$ 0.00
	10	\$57,639,328.98	\$50,319,440.69
	OTHER	\$ 0.00	\$ 0.00
6 TOTAL		\$62,782,343.98	\$55,273,032.54
	PCT GENERAL	008.2%	009.0%
	PCT OTHER	000.0%	000.0%
	PCT FEDERAL	091.8%	091.0%
	FEO PCT NONGEN	100.0%	100.0%

- ① *State program code*--the program in which the agency spent federal funds. Program "457" is Nutritional Services.
- ② *State agency code*--the agency that expended federal funds, in this case "201," the Department of Education.
- ③ *Expenditures*--the amounts spent by the agency in the program from each fund.
- ④ *Authorizations*--the amounts authorized to be spent by the agency in the program through legislative appropriations, executive authorizations, and appropriations transfers.
- ⑤ *Funds*--the amounts authorized or expended in each State fund including:

General funds

All nongeneral funds

- The federal component of nongeneral in

(03) Higher Education and Trust

(04) Highway Maintenance and Construction

(07) Trust and Agency

(10) Federal Trust

- Other nongeneral funds

- ⑥ *Total amounts*--authorized or expended for all funds.

not available to the legislature in the past until after the budget was submitted in December or January. Reports for FY 1980 will be used in reviewing budget requests during the 1981 Session.

#### Future Availability of Information on Federal Funds

In addition to the computer reports which have been generated, two additional sources of comprehensive data on federal funds are being developed. The U. S. Office of Management and Budget (OMB) is developing a nationwide system on grant award information to states. In addition, future reports of the Auditor of Public Accounts will include more reliable information on federal funds in localities.

*OMB Grant Award System.* OMB has designed a system which will provide comprehensive data on a quarterly basis to states on federal awards made within their boundaries--information not previously available. Since the system reports awards quarterly, the data can be compiled on the basis of either the state or federal fiscal year. Because the report focuses on awards, as opposed to expenditures, it is somewhat prospective in nature, particularly where multi-year grants are involved.

The OMB system, the Federal Assistance Award Data System (FAADS), replaces the Federal Assistance Information Test (FAIT), a pilot test of the system in which Virginia and 12 other states participated. FAADS extends the system to the entire country, effective October 1, 1980.

FAADS information will provide state planners and decision-makers with current and comprehensive data on federal awards made to state agencies and localities. This information could play a role in the allocation of state resources to agencies and localities and the coordination of program activities.

An important feature of FAADS is the opportunity for flexible use by the states. OMB has designed FAADS to include a 20-character field for "State Application Identifier" numbers. States can use this field to encode data significant to the state and necessary for report generation. The Department of Intergovernmental Affairs is taking the lead in developing this coding scheme with other executive agencies.

Virginia's work on FAADS is not yet complete, but to date it is promising. The system can provide information on awards to agencies, their subunits, and localities. This data can be aggregated within State secretarial areas and planning district jurisdictions. Eventually, Virginia may be able to crosswalk the information with data from State accounting systems.

Although the FAADS system shows promise, its full implementation is not expected until 1983. While this delays the use of the system to the State, it also provides substantial planning time for developing programs to use the information when it is available. In addition, the partial information that will be provided in the interim should prove useful.

*Locality Reports.* Comparative cost reports on Virginia localities, published by the Auditor of Public Accounts, include data on federal funds. Through FY 1980, however, data in these reports have been inconsistently reported by the localities. Beginning in FY 1981, reporting for cities and counties will be uniform. Direct federal revenues will be identified, as will funds passed through the State to localities. The local share of any federal-State-local matching programs will also be reported. Overall, future comparative cost reports should give an accurate picture of local government receipts of federal funds.

### Using Federal Funds Data

The availability of new information sources on federal funds provides both the legislative and executive branches with powerful tools for analysis. Basic information gaps that existed when this study was initiated by HJR 237 have been closed, largely through the restructuring of available information.

The CARS programs can be used to construct a history of program and agency federal fund expenditures. These expenditure reports can be used to assess the accuracy of agency projections of federal funds available in the future. FAADS data, when available, can be used as a check to ensure that other federal fund reports accurately reflect the full range of awards received, both by agencies and localities, and to assist in coordinating programs. FAADS will also provide comparative data among Virginia localities and between Virginia and other states.

The use of these data systems will always be constrained somewhat by the vagaries and flexibility of the federal system. The federal budget has been extremely volatile in recent years. Major programs affecting the states, such as general revenue sharing, have been in and out of the budget on a weekly basis. Monitoring the federal budget process is essential. Any usage of federal fund data must take into account the overall character of this process.

## **Recommendations**

*Recommendation (22).* The Department of Intergovernmental Affairs should continue to develop, with the Department of Management Analysis and Systems Development, user programs for the Federal Assistance Award Data System (FAADS).

*Recommendation (23).* Programs using CARS data on federal fund expenditures should continue to be generated as a means of providing comprehensive and timely information for legislative budget analysis.

*Recommendation (24).* The General Assembly should continue to have active communication, through JLARC, the House Appropriations Committee, and the Senate Finance Committee, with the Department of Intergovernmental Affairs and the Office of Management and Budget on FAADS and related projects.



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## Agency Responses

As part of an extensive data validation process, each State agency involved in JLARC's review and evaluation efforts is given the opportunity to comment on an exposure draft of the report.

Appropriate corrections resulting from the written comments have been made in the final report. Page references in the agency responses relate to the exposure draft and may not correspond to page numbers in the final report. Agency responses addressing only technical corrections already incorporated into the report are not printed here.

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## House Joint Resolution No. 237

*Directing the Joint Legislative Audit and Review Commission to conduct a study of federal funds coming into the Commonwealth.*

Agreed to by the House of Delegates, February 16, 1979

Agreed to by the Senate, February 22, 1979

WHEREAS, the increasing growth of the federal government and its programs has resulted in rapidly escalating amounts of money to be granted for various programs at the State and local level; and

WHEREAS, these funds are made available for a proliferating multitude of programs in the Commonwealth, the actual size, distribution and impact of which are unknown to the Commonwealth; and

WHEREAS, these funds may be used to augment or conflict with programs funded by the General Assembly of Virginia through its appropriations process; and

WHEREAS, the federal government's influence in the Commonwealth has increased at an alarming rate, partially through the distribution and control of these federal funds; and

WHEREAS, the experiences of other states have shown that federal aid can result in a total level of expenditure for specific programs that is in excess of that authorized by the legislature, thereby creating a distortion or preemption of the legislative prerogative; and

WHEREAS, the federal government is considering the possibility of shifting to the states the costs of various federally mandated programs; and

WHEREAS, the General Assembly may better perform its appropriations function if more complete information regarding the extent and impact of federal funding is available; and

WHEREAS, the Commonwealth has a duty to be fully aware of the amounts, extent, and effect of the federal funds that flow into and pass through the Commonwealth; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That the Joint Legislative Audit and Review Commission is directed to undertake a study of the total funds coming into or passing through Virginia from federal government sources. The Commission shall make an interim report to the Governor and the General Assembly by December one, nineteen hundred seventy-nine and shall make a final report by December one, nineteen hundred eighty.

The study shall include, but not be limited to: (1) the dollar amounts of federal funds received by the Commonwealth and her localities; (2) the distribution of such funds among the various types of programs; (3) the dependence of the Commonwealth and her localities on the federal funds for the various types of programs; (4) an analysis of the funds that Virginia would lose for failing to comply with the requirements of the federal programs which condition the grant; (5) the growth of federal funds and the resulting growth of federal influence on State and local policies and programs over the last ten years; and (6) the substantive and procedural rights and duties available to, and incumbent upon, the Commonwealth in the event of federal action to withdraw federal funds or shift federal program costs to the agencies and institutions of State and local governments; and (7) the methods and procedures by which such federal funds are sought, utilized, monitored and controlled.

## **Technical Appendix**

JLARC policy and sound research practice require the use of rigorous research methodology. A number of such research methods were applied to gather data on federal programs participated in by State agencies and localities. Some of the major data collection efforts were:

1. A census of State and non-State agencies was conducted to determine the extent of federal fund expenditures and the use of State funds to match federal funds. Responses were received from the 255 agencies queried.

2. An extensive series of structured interviews were held with agency heads, program managers, and fiscal officers. Personnel were interviewed at 20 State agencies which receive more than 90 percent of all federal funds.

3. Central files at the Department of Accounts and the Department of Planning and Budget were reviewed and analyzed to assess the basis for loans made with federal funds as collateral. Follow-up discussions were held with agency personnel on questionable loans or potential losses of interest due to the use of an inappropriate, questionable cash flow mechanism. Potential interest loss was calculated at one percent per month of the amount outstanding. One percent per month represents the approximate average yield of State investments during the biennium.

4. Special programs were developed to retrieve revenue and expenditure data available in the Commonwealth's Accounting and Reporting System. The reports generated were used to compute the percentages of State revenues and expenditures derived from federal funds.

5. A survey of assistant attorneys general was conducted regarding federal fund disputes between State agencies and the federal government.

6. Project files and financial records were reviewed for grants and contracts at six institutions of higher education.



# COMMONWEALTH of VIRGINIA

*Office of the Governor*

*Richmond 23219*

Charles B. Walker  
Secretary of Administration and Finance

September 25, 1980

Mr. Ray D. Pethtel  
Joint Legislative and Audit  
Review Commission  
Suite 1100  
910 Capitol Street  
Richmond, Virginia 23219

Dear Ray:

I have reviewed the second exposure draft of Federal Funds in Virginia with the assistance of the staff of the Department of Planning and Budget.

I am pleased to say that your revised draft provides a more objective analysis of the initiatives taken by the Administration dealing with the control of federal funds. There are, however, a couple of areas which, I believe, require correction or clarification and I have noted these in Attachment 2. One area in particular, the consistency of Administration and Finance Directive No. 1-80 with the Appropriations Act, requires more careful review on your part, the Directive is not in conflict with the Act.

I appreciate having the opportunity of reviewing the draft and would be glad to expand upon any of my comments.

Very truly yours,

A handwritten signature in cursive script that reads "Charles".

Charles B. Walker

CBW/dkj  
Attachments

cc: Mr. Stuart W. Connock

EXECUTIVE ACTIONS DIRECTED AT CONTROLLING RECEIPT  
AND EXPENDITURE OF FEDERAL FUNDS

- 1) Issued in September 1978, Directive No. 12 required each agency to gain approval from its respective Secretary for the solicitation of grants that included positions. As a result of this procedure, most of the Secretaries expanded the approval requirement to all grants.
- 2) Issued in May 1978, a memorandum informed all college and university presidents that higher education institutions could not expect allocations of additional nongeneral funds beyond those listed in the Appropriation Act.
- 3) Issued in November 1978, the 1980-82 Budget Manual Instructions required each agency to include all nongeneral fund revenue in its budget submission. In August of 1979, DPB budget analyst contacted their agencies to ensure that all anticipated nongeneral fund revenue was included.
- 4) The Budget Bill as introduced in the 1980 General Assembly included the following new provisions:
  - The Governor shall withhold from expenditures a portion of appropriations from the general fund equivalent to that provided from additional revenues earned and collected.
  - Each State agency receiving general funds which accepts a federal grant shall recover full Statewide and agency indirect cost as defined by the Department of Planning and Budget, unless prohibited by the grantor, and deposit such recoveries into the general fund.

- Excluded the Mental Health and Mental Retardation Revenue Fund from the ongoing provision which requires that general fund appropriations to State agencies are supplemental to revenues earned and collected by the agencies. (This exclusion was later restored by the General Assembly)
- 5) Issued in May 1980, Secretary of Administration and Finance Directive 1-80, established a basis for agency solicitation and acceptance of nongeneral fund revenue. Included in the Directive are prohibitions for soliciting grants that are not appropriated by the General Assembly, for State absorption of programs after the grant terminates and for increasing personnel beyond the manpower targets. (While A & F Directive 1-80 was issued in May, revisions to the grant procedure began in September 1979.)
  - 6) Issued in June 1980, DPB distributed implementing procedures for A & F Directive 1-80. The procedures require each agency to report quarterly the collection of nongeneral fund revenue.
  - 7) Issued in May 1980, Treasury Loan guidelines establish the procedures for the request, approval and management of treasury loans. The procedures include prohibitions of loans for grants which provide letter of credit or cash advance and for more than fifty percent of a grant award.
  - 8) Issued in August 1980, DPB Directive No. 8-80 requires agency which participates in a Federal grant to recover indirect costs and to deposit such recoveries into the general fund.

Comments on JLARC, Federal Funds in Virginia,  
Exposure Draft Dated September 16, 1980

RECOMMENDATION (1). SECTION 4-3.05 (a) OF THE APPROPRIATIONS ACT MIGHT BE AMENDED TO REQUIRE THE GOVERNOR TO IDENTIFY FOR EACH APPROVED REQUEST THE ANTICIPATED BUDGETARY, POLICY, AND ADMINISTRATIVE IMPACTS OF ANY PROGRAM REQUIREMENTS WHICH ACCOMPANY THE FUNDING.

RECOMMENDATION (2). THE GENERAL ASSEMBLY MIGHT AMEND SECTION 4-3.05 (b) OF THE APPROPRIATIONS ACT TO REQUIRE THAT THE GOVERNOR INCLUDE IN HIS ANNUAL REPORT FOR EACH AGENCY SIGNIFICANT FEDERAL REQUIREMENTS AND THEIR ASSOCIATED BUDGETARY, POLICY, AND ADMINISTRATIVE INFLUENCE ON STATE GOVERNMENT. THE REPORT SHOULD ALSO INCLUDE A SUMMARY STATEMENT ON THE OVERALL EFFECT OF CROSS-CUTTING REQUIREMENTS WHICH HAVE HAD SIGNIFICANT BUDGETARY, POLICY, OR ADMINISTRATIVE INFLUENCES ON STATE GOVERNMENT.

COMMENT: The Department of Planning and Budget currently reviews the budgetary, policy, and administrative influences of grant funding as a part of the regular budget process and in reviewing proposed exceptions to A & F Directive 1-80. Those grants which have been continuing over the years are reviewed both during budget review and as a part of planned program evaluations. This information is available to the Legislature upon request.

With respect to the proposed Code Amendments, the law of Virginia should not prescribe administrative or procedural directives, but rather it should enact policy.

The annual report should not contain the level of detail expressed in the cited recommendation since to compile this information on an annual basis would

be time-consuming and would be of questionable utility. A & F Directive 1-80 will eliminate most actions to increase legislative appropriations pursuant to the Section 4-3.05 provision. Under the procedures of the Directive, an agency may solicit, accept and expend nongeneral fund revenues derived from grants, gifts, donations and contracts only if such funds have been appropriated to the agency by the General Assembly.

RECOMMENDATION (3). THE SECRETARY OF ADMINISTRATION AND FINANCE SHOULD REVIEW DIA'S PRESENT PRIORITIES AND PROCEDURES WITH LOCALITIES TO ENSURE THAT ITS LEGISLATIVE MANDATE IS SATISFIED AND THAT ALL VIRGINIA LOCALITIES HAVE ADEQUATE INFORMATION AND EXPERTISE TO IDENTIFY AND SOLICIT FEDERAL FUNDS.

COMMENT: This recommendation appears to be based on the expression of local concern (made at the JLARC Subcommittee Hearing on Federal Funds) about the adequacy of State support in providing information and assistance to localities regarding federal funding programs, without an adequate assessment of previous and current State services.

Information such as newsletters on federal programs, quarterly summaries of federal grant awards and direct assistance in preparing grant applications were provided by the Division of State Planning and Community Affairs (DSPCA) in the late 1960's through the mid-1970's. When evaluations were conducted on the usefulness and desirability of continuing or expanding the services, the majority of local governments felt the planning district commissions, local employees, the federal agencies and other sources of information and assistance were available for grant development. Therefore, comprehensive services were terminated. However, throughout the remainder of the 1970's the Department of Intergovernmental Affairs (DIA) and the Department of Housing and Community Development (DHCD) have used their resources and staff to assist localities on a need or request basis. DHCD is significantly more active than DIA in providing



technical assistance and information on federal issues to both local governments and planning district commissions. For DIA to become more involved would be encouraging duplication of services.

RECOMMENDATION (4). STATE FUNDS SPENT TO MATCH FEDERAL FUNDS SHOULD BE CONSISTENTLY REPRESENTED IN THE COMMONWEALTH ACCOUNTING AND REPORTING SYSTEM (CARS). THE DEPARTMENT OF ACCOUNTS SHOULD REQUIRE STATE AGENCIES TO USE THE CAPABILITY OF CARS TO RECORD MATCH EXPENDITURES.

COMMENT: Information on State funds spent to match federal funds would have to control for in-kind and cash match, Agency and State indirect costs, dedicated and discretionary match, and variations based upon the distribution of funds to grantee Agency programs and subgrantees such as other State agencies, local governments, and non-profit corporations which also may be required to make some types of match. Although each of these types and combinations of match could conceivably be identified in CARS through the use of expenditure, revenue and project codes, such an effort would be costly, time consuming, and would yield marginal information for the allocation of resources.

RECOMMENDATION (5). THE GENERAL ASSEMBLY MIGHT CONSIDER REVISING APPROPRIATIONS ACT LANGUAGE TO REFLECT THE NEW PROCEDURE OF A & F DIRECTIVE 1-80. SUCH AN AMENDMENT WOULD ELIMINATE THE DISCREPANCY BETWEEN THE LANGUAGE OF THE ACT AND THE DIRECTIVE. IT WOULD ALSO REFLECT LEGISLATIVE ENDORSEMENT OF THE POLICY. IF THE ACT'S LANGUAGE IS NOT CHANGED, A & F 1-80 SHOULD BE AMENDED TO CONFORM WITH THE LANGUAGE OF THE ACT.

COMMENT: The intent of Sections 4-3.05 and 4-4.01 is to require that each agency receive approval for the solicitation, acceptance and expenditure of nongeneral funds. The requirement that all nongeneral funds be appropriated in the Act, that the appropriation of funds pursuant to A & F Directive 1-80, constitutes approval. Therefore, A & F Directive 1-80 is not inconsistent with Sections 4-3.05 and 4-4.01.

Section 4-4.01 of that Act indicates that agencies may not solicit or accept donations, gifts, grants or contracts without the prior written approval of the Governor. The Governor delegated the authority to Secretary Walker to act for him under this section.

The Directive provides the approval required by the Appropriations Act under certain conditions. Specifically, if funds requested are contained in Agency Budget Submissions, agencies may solicit or accept funds. For funds in excess of their appropriations they may do so after seeking an exception, as set forth in the Directive. Thus, in all cases agencies have either been given or must seek prior written approval prior to their solicitation or acceptance, as required by the Appropriations Act. It is not in our best interest to have the appropriations language reflect the new procedures. The Act should provide the general policy framework within which the Governor, Secretary Walker, and others must operate. The inclusion of the language of the Directive in the Appropriations Act would limit ability to meet changing conditions. As long as the procedures are consistent with legislative mandate, there is no reason or need to incorporate them within the body of the Act itself.

RECOMMENDATION (6). THE LANGUAGE OF SECTIONS 4-3.05 and 4-4.01 SHOULD BE RE-ORDERED TO REFLECT THE SEQUENCE OF ACTIONS FOLLOWED BY AGENCIES IN SOLICITING AND ACCEPTING FUNDS.

COMMENT: DPB plans to propose total revisions to the General Provision of Law Sections to maintain its integrity as a policy and legal instrument rather than an administrative procedures document.

RECOMMENDATION (7). THE DEPARTMENT OF PLANNING AND BUDGET SHOULD CAREFULLY MONITOR PROVISIONS OF A & F DIRECTIVE 1-80 WHICH ADDRESS THE METHODS BY WHICH FEDERAL FUNDS ARE RECEIVED. WHEN AGENCIES ARE RESTRICTED BY FEDERAL GRANTORS TO RECEIVING FUNDS BY REIMBURSEMENT, THE DEPARTMENT OF PLANNING AND BUDGET SHOULD MONITOR SUCH ARRANGEMENTS TO ENSURE THAT AGENCIES SUBMIT REQUESTS FOR REIMBURSEMENT IN A TIMELY MATTER.

COMMENT: Under the provisions of Administration and Finance Directive 1-80, the Department of Planning and Budget is responsible for developing the necessary procedures and reporting requirements to implement the policies. Agencies adherence to the Directive and the Treasury Loan Procedure are being monitored. In those cases where reimbursement payments are used and an anticipation loan has been approved, the agencies will be compelled to "draw down" reimbursements as soon as practical. Such loans are authorized for the amounts of the first reimbursement cycle, not to exceed 50% of the grant award. This action will minimize the amount of the loan and will provide agencies with operating cash for each succeeding cycle.

RECOMMENDATION (8). THE DEPARTMENT OF PLANNING AND BUDGET SHOULD CONDUCT A REVIEW OF SUBGRANTEE FINANCING ARRANGEMENTS USED BY STATE AGENCIES TO ENSURE THAT SUBGRANTEES ARE RELIEVED, WHENEVER FEASIBLE, OF THE NEED TO PROVIDE ADVANCE FINANCING FOR FEDERAL PROGRAMS.

COMMENT: The federal government will not in most cases advance funding. Therefore, advance financing for federal programs operated by subgrantees of State agencies is difficult to provide since State agencies are prohibited from using their funds for purposes other than that for which the appropriation was made. One option would be to provide more treasury loans for this purpose, however, that would result in significant lost investment income. In addition, letter of credit procedures to subgrantees could foster unallowed costs being charged to projects since subgrantees would not be required to submit expenditure records before drawdown.

RECOMMENDATION (9): THE DEPARTMENT OF INTERGOVERNMENTAL AFFAIRS SHOULD PERIODICALLY EVALUATE AGENCY INDIRECT COST PRACTICES TO ENSURE THAT FULL RECOVERY IS TAKING PLACE. STATE AGENCIES SEEKING FEDERAL FUNDS FOR PROGRAMS THAT WILL SUBSEQUENTLY BE CARRIED OUT BY A SUBGRANTEE SHOULD BE ENCOURAGED TO INCLUDE THE INDIRECT COSTS OF THE SUBGRANTEE WHEN POSSIBLE.

COMMENT: On August 19, 1980 the Department of Planning and Budget issued DPB Directive No. 8-80 entitled "Recovery of Allowable Indirect Costs Under Federal Grants".

Under the Directive's implementing procedures, the Department of Intergovernmental Affairs is responsible for providing technical assistance to the agencies. This assistance includes the review of an agency's indirect cost proposal on an annual basis. Furthermore, DIA is responsible to assist the agencies in preparing and negotiating the indirect cost proposals, if requested.

Concerning the recovery of indirect costs by subgrantees, the Directive states that: "Each State agency receiving federal monies for 'pass-through' purposes shall include an indirect cost recovery component for the federal monies in the subgrant if: (1) the subgrantee has an approved indirect cost proposal and computes indirect costs in accordance with federal regulations and if (2) there are no federal restrictions or prohibition against such payment."

RECOMMENDATION (10). GENERAL FUND LOAN REQUESTS SHOULD BE THOROUGHLY ANALYZED BY DPB TO ENSURE THAT THE NEED FOR ADVANCE FINANCING BY THE STATE EXISTS, THAT THE AMOUNT OF THE LOAN IS SECURED BY AN ADEQUATE REPAYMENT SOURCE, AND THAT THE AMOUNT IS LIMITED TO THAT NECESSARY TO COVER AN ANTICIPATED REIMBURSEMENT CYCLE.

COMMENT: The DPB Treasury Loan procedure implemented in May of 1980 has provisions which require more thorough information from agencies to verify need, duration, amount, and source of repayment. Revenue revisions by revenue source codes as required by A & F Directive 1-80 are used to verify repayment sources. All Treasury Loan authorizations stipulate that if any change occurs in the condition of the revenue source, the agency is responsible for notifying DPB.

RECOMMENDATION (11). THE DEPARTMENT OF PLANNING AND BUDGET SHOULD REQUIRE AGENCIES TO FURNISH INFORMATION ON ACTUAL AWARDS OF FEDERAL FUNDS WHENEVER THE AWARD DIFFERS FROM THE ANTICIPATED AMOUNT. THE "EXCEPTION REPORT" SHOULD BE PROVIDED TO THE HOUSE APPROPRIATIONS COMMITTEE AND SENATE FINANCE COMMITTEE AS PART OF THE QUARTERLY REPORTS REQUIRED UNDER THE APPROPRIATION ACT.

COMMENT: The provisions contained in A & F Directive 1-80 procedures and 1980-82 Budget Manual: Revenue require agencies to report all revenue revisions actual and anticipated by revenue source. The data will be monitored at the fund source level and not at the program award level. A return to the level of detail contained in the Form 16 procedure is costly, time-consuming, and discounts agency management abilities.

RECOMMENDATION (12). THE DEPARTMENT OF PLANNING AND BUDGET SHOULD CONTINUE TO MONITOR FEDERAL BUDGET REDUCTION PROPOSALS AND THEIR POTENTIAL IMPACT ON THE PROGRAMS OF THE COMMONWEALTH AND ITS LOCALITIES AND REPORT FINDINGS TO THE HOUSE APPROPRIATIONS AND SENATE FINANCE COMMITTEE.

COMMENT: This has been done since late 1979 when DPB and the Department of Intergovernmental Affairs set up an interagency Federal Budget Impact Project Team. The Team has made several reports, the most recent of which was presented to the Senate Finance Committee on September 19, 1980.

RECOMMENDATION (13): AGENCIES WHICH RECEIVE FEDERAL FUNDS AS SUBGRANTEES OR SECONDARY RECIPIENTS SHOULD BE REQUIRED TO IDENTIFY CONSISTENTLY IN THEIR BUDGET EXHIBITS THE FEDERAL SOURCE OF SUCH SUBGRANTEE FUNDING.

COMMENT: Funds from federal programs which are stable and/or formula driven will be appropriated to the subgrantee, rather than the grantor for the 1982-84 biennium. Specific instructions will be provided to affected agencies in March of 1981 for the preparation of budget submissions.

RECOMMENDATION (14): THE DEPARTMENT OF PLANNING AND BUDGET SHOULD ENSURE AGENCIES COMPLY WITH SECTION 2.1-398 OF THE CODE OF VIRGINIA AND PROVIDE IDENTIFICATION ON THE AUTHORITY FOR OPERATION OF A PROGRAM.

COMMENT: OPB conferred with the patrons of this statute in 1978 in order to decide the format for the 1980-82 budget. It was agreed that the appropriate code citation would be sufficient for identification purposes due to the inability to uniformly distinguish between mandated and discretionary costs. It also was decided that in those instances (e.g. State Air Pollution Control Board, State Water Control Board) in which federal and State law are identical, the State law takes precedence and would be cited.

RECOMMENDATION (15): STATE AGENCIES AND DEPARTMENTS SHOULD TAKE STEPS TO ASSESS WHETHER THEY ARE EFFECTIVELY IDENTIFYING AND UTILIZING FEDERAL RESOURCES AVAILABLE FOR THEIR PROGRAMS.

COMMENT: This recommendation appears to be contrary to the expression of caution stated in the JLARC Report. However, the Governor, and to some extent governing boards, have and will continue to assess participation in federal programs. For instance, this year the Governor limited the State's participation in the CETA program due to such an assessment. Those federal programs which are compatible with State priorities and of direct benefit will be the standard for participation.

RECOMMENDATION (16): THE GENERAL ASSEMBLY SHOULD REQUIRE THAT COPIES OF ALL FEDERAL AUDITS BE FORWARDED TO THE OFFICE OF THE AUDITOR OF PUBLIC ACCOUNTS AND THE DEPARTMENT OF PLANNING AND BUDGET AS SOON AS THEY ARE RECEIVED BY AGENCIES OF STATE GOVERNMENT. IN LIGHT OF THE MAGNITUDE OF AUDIT EXCEPTIONS FOUND AT VCU AND VIMS, THE APA SHOULD CONSIDER PUTTING A HIGH PRIORITY ON GRANT AND CONTRACT ACCOUNTS WHILE CONDUCTING STATE AUDITS.

COMMENT: We concur with the recommendation that copies of all federal audits be forwarded to the Department of Planning and Budget.

RECOMMENDATION (17): VCU SHOULD TAKE TWO INITIAL STEPS TO STRENGTHEN INTERNAL CONTROLS OVER GRANT AND CONTRACT ACCOUNTING.

- a. All FAS accounts with negative balances should be identified and reconciled by the grant and contract office with the responsible academic department or faculty member. VCU should establish a policy that no expenditures should be made from any account with a negative balance without written authorization of the university controller.
- b. VCU should develop a procedure whereby all FAS accounts which indicate that the grant or contract has terminated are protected from additional encumbrance and expenditure without the written authorization of the university controller.

COMMENT: This recommendation is being assessed by VCU and their response will be reviewed by the Executive.

RECOMMENDATION (18). VCU's ADMINISTRATION SHOULD TAKE STEPS TO FULLY IMPLEMENT ITS EFFORT REPORTING SYSTEM AS SOON AS UNDERSTANDING IS REACHED WITH FEDERAL AUTHORITIES. THIS SHOULD INCLUDE DEVELOPING APPROPRIATE TRAINING SESSIONS AND CONDUCTING AGGRESSIVE SUPERVISORY POST-AUDITS TO ENSURE COMPLIANCE WITH REPORTING REQUIREMENTS.

COMMENT: This recommendation is being assessed by VCU and their response will be reviewed by the Executive.

RECOMMENDATION (19). VCU SHOULD DEVELOP AN INTERNAL PROCEDURES MANUAL FOR THE GRANT AND CONTRACT ACCOUNTING SECTION. AMONG THE AREAS ADDRESSED SHOULD BE PROCEDURE TO PREVENT THE SUBMISSION OF LATE FISCAL REPORTS TO FEDERAL GRANTORS.

COMMENT: This recommendation is being assessed by VCU and their response will be reviewed by the Executive.

RECOMMENDATION (20). THE ONGOING IMPLEMENTATION OF A FINANCIAL ACCOUNTING SYSTEM AT VIMS SHOULD BE CAREFULLY MONITORED BY THE ADMINISTRATION OF THE COLLEGE OF WILLIAM AND MARY.

COMMENT: The administration of the College of William and Mary is carefully monitoring the implementation of VIMS accounting system and providing periodic reports to the Secretary of Administration and Finance.

RECOMMENDATION (21). VIMS SHOULD DEVELOP A STANDARD GRANT AND CONTRACT APPROVAL COVER SHEET TO BE MAINTAINED AS PART OF EACH FILE. VIMS SHOULD ALSO PUT A HIGH PRIORITY ON DEVELOPING A PROCEDURES MANUAL GOVERNING THE ADMINISTRATION OF GRANTS AND CONTRACTS.

COMMENT: This recommendation is being assessed by the College of William and Mary and their response will be reviewed and acted upon by the Executive.



RECOMMENDATION (22): THE DEPARTMENT OF INTERGOVERNMENTAL AFFAIRS SHOULD CONTINUE TO DEVELOP, WITH THE DEPARTMENT OF MANAGEMENT ANALYSIS AND SYSTEMS DEVELOPMENT, USER PROGRAMS FOR THE FEDERAL ASSISTANCE AWARD DATA SYSTEM (FAADS).

COMMENT: On August 25, 1980 the Secretary of Administration and Finance informed the Office of Management and Budget that the Department of Intergovernmental Affairs will serve as the Commonwealth's coordinator with OMB on this project.

RECOMMENDATION (23): PROGRAMS USING CARS DATA SHOULD CONTINUE TO BE GENERATED AS A MEANS OF PROVIDING COMPREHENSIVE AND TIMELY INFORMATION FOR LEGISLATIVE BUDGET ANALYSIS.

COMMENT: The Department of Planning and Budget has no comment on this recommendation.

RECOMMENDATION (24): THE GENERAL ASSEMBLY SHOULD CONTINUE TO HAVE ACTIVE COMMUNICATION, THROUGH JLARC AND HOUSE APPROPRIATIONS AND SENATE FINANCE COMMITTEE STAFF, WITH THE DEPARTMENT OF INTERGOVERNMENTAL AFFAIRS AND THE OFFICE OF MANAGEMENT AND BUDGET ON FAADS AND RELATED PROJECTS.

COMMENT: The Department of Planning and Budget has no comment on this recommendation.



# COMMONWEALTH of VIRGINIA

Office of the Governor

Charles B. Walker  
Secretary of Administration and Finance

Richmond 23219

May 6, 1980

## Secretary of Administration and Finance Directive No. 1-80

Subject: Solicitation and Acceptance of Nongeneral Fund Revenues and Grants, Gifts, Donations, Contracts or Agreements.

Purpose: This Directive establishes the basis for State agency solicitations and acceptances of nongeneral fund revenues from grants, gifts, donations, contracts or agreements from any source or entity. It is promulgated in accordance with § 4-4.01 of the 1980-82 Appropriations Act and Executive Order Number 37 (80). The purpose is to:

1. Simplify the process of soliciting and accepting nongeneral fund revenues from grants, gifts, donations, contracts or agreements.
2. Eliminate the approval, with certain exceptions, of solicitations and acceptances which are consistent with the policies set forth in this Directive; and
3. Hold agency heads strictly accountable for the implementation of the policies set forth in this Directive.

The Department of Planning and Budget shall be responsible for developing the necessary procedures and reporting requirements to implement these policies.

Applicability: This Directive applies to the solicitation and acceptance of nongeneral fund revenues from grants, gifts, donations, contracts or agreements by any State agency. It does not apply to nongeneral fund revenues derived from donations and gifts to the endowment funds of institutions of higher education or from grants, gifts, donations, contracts or agreements to support sponsored research programs in such institutions, except that the institutions shall comply with the monitoring and reporting requirements of this Directive for such funds.

Effective Date: The policies and procedures set forth in this Directive are effective July 1, 1980.

Policies: State agencies are hereby authorized to solicit, accept and expend nongeneral fund revenues derived from grants, gifts, donations, contracts or agreements consistent with the following policies:

1. State agencies may solicit, accept and expend non-general fund revenues derived from grants, gifts, donations, contracts or agreements on the authority of the agency head if such funds have been appropriated to the agency by the General Assembly.
2. State agencies may accept and expend nongeneral fund revenues from grants, gifts, donations, contracts or agreements:
  - (a) For those revenues appropriated to the agency but not in excess of 110 percent of the amount included in the Appropriations Act, and then with the approval of their respective Secretary.
  - (b) For those revenues in excess of 110 percent of that amount appropriated to the agency, in the case of an emergency approved by the Governor, in accordance with the Exception provisions of this Directive.
3. State agencies, except in the case of an emergency approved by the Governor in accordance with the Exception provisions of this Directive, shall not solicit, accept and expend nongeneral fund revenues from grants, gifts, donations, contracts or agreements:
  - (a) Whose specific sources have not been included in its budget submission terminology and/or have not been appropriated to the agency.
  - (b) When the federal government provides the funds and the option exists for either the State or the federal government to administer the program supported by such funds.
  - (c) When a grant, gift, donation, contract or agreement has, as a condition of acceptance, that the State absorb the services should funds be reduced or terminated, unless such has been provided for in the Appropriations Act.
  - (d) When the purpose of such grant, gift, donation, contract or agreement is inconsistent with an agency's legislative or administrative mandate.

Secretary of Administration and Finance Directive No. 1-80


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May 6, 1980

- (e) When such grant, gift, donation, contract or agreement obligates an agency to (1) additional positions and/or employment levels beyond that provided under the Manpower Utilization Program, (2) additional office space and/or (3) additional costs beyond those provided for in the Appropriations Act.
- 4. Each State agency funded in part by the general fund and which accepts a federal grant shall recover full statewide and agency indirect costs and include in the grant sufficient funds for rental and space charges, unless prohibited by the grantor agency.
- 5. Upon the acceptance of a federal grant or contract, State agencies shall take appropriate action to maximize the cash flow associated with the grant or contract by: (1) utilizing letters of credit or cash advance techniques, where available, as opposed to the reimbursement of expenses method of payment; (2) processing claims in a timely fashion; and (3) seeking reimbursement of expenses within the fiscal year in which they are incurred.

Exceptions: Agencies may request a declaration of an emergency or seek an exception to the policies stated above by submitting a letter to their respective Secretary with a copy to the Department of Planning and Budget. The requests should set forth the reasons why an emergency exists or why the agency is seeking an exception, and include an impact analysis which contains: (1) the reason the agency was unable to anticipate the revenues in the budget submission; (2) a description of the proposed use of the revenues; (3) implications on State operations and funding, both short-term and long-term; (4) the revenue amount and source and (5) the effect on the agency's full-time equivalent positions and full-time equivalent employment levels as provided for in the Manpower Utilization Program. Emergencies and exceptions shall be approved by the Governor and communicated to the House Appropriations and Senate Finance Committees.

Directives Rescinded: This Directive rescinds Secretary of Administration and Finance memorandum dated March 19, 1977, entitled "Procedure for Approval to Solicit and accept Donations, Gifts and Grants - DPB Form 16/SF 424, DPB Form 16-A and DPB Form 16-B" and Secretary of Administration and Finance Directive No. 12, dated September 1, 1978, entitled "Preliminary Authorization to Apply for Federal Grants Requiring Additional Staff."

  
Secretary of Administration and Finance



# COMMONWEALTH of VIRGINIA

CHARLES A. CHRISTOPHERSEN  
DIRECTOR

B. C. LEYNES, JR.  
DEPUTY DIRECTOR

## DEPARTMENT OF INTERGOVERNMENTAL AFFAIRS

September 18, 1980

916 Ninth Street Office Building  
Richmond, Virginia 23219  
Telephone (804) 786-4407

Mr. Kirk Jonas  
Principal Analyst  
Joint Legislative Audit and Review Commission  
Suite 1100, 910 Capitol Street  
Richmond, Virginia 23219

Dear Kirk:

Thank you for your letter of September 16 transmitting the exposure draft of Federal Funds in Virginia. We appreciate the opportunity to comment on the draft report.

Recommendation 3 (page 46) states that the Department of Intergovernmental Affairs (DIA) should review its priorities concerning grant information for local governments. I understand that the Secretary of Administration and Finance has already responded to this recommendation, and I concur with Mr. Walker's reply.

Pages 54 and 55 of the report address DIA's role in assisting state agencies with indirect cost recovery. I would like to bring to your attention an error on page 54, paragraph four. It is stated that DIA began assisting agencies on July 21, 1980, while, in fact, we have been providing such assistance since 1977.

We certainly agree that indirect cost recovery is complicated and that a central agency with special expertise is desirable. DIA serves a central agency role and, jointly with the Department of Planning and Budget, is continuing to pursue policies which are leading to increased cost recovery at both the statewide and the agency level.

Recommendation 9 (page 69) is likewise currently in effect. Pursuant to DPB Directive 8-80, DIA reviews all agency indirect cost proposals to ascertain if full recovery is taking place. Agencies which fail to recover full costs are notified that subsequent proposals must be modified. This review occurs on an annual basis.

We concur with recommendation 22 (page 96) that DIA should continue to develop the FAADS system. We have

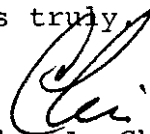
Mr. Kirk Jonas  
Page Two  
September 18, 1980

been designated as Virginia's lead agency for implementation of FAADS and look forward to serving both the General Assembly and state agencies as FAADS achieves the sophistication necessary to provide timely and accurate information on the amount and type of federal funds coming into Virginia.

If you would like further explanation of any of these comments, I will be happy to discuss them. We are grateful for the opportunity to participate in JLARC's study of federal funds in Virginia.

With kindest regards, I am

Yours truly,



Charles A. Christophersen

CAC/ja

cc: Honorable Charles B. Walker

S. MASON CARBAUGH  
COMMISSIONER



RAYMOND D. VAUGHAN  
DEPUTY COMMISSIONER

## COMMONWEALTH of VIRGINIA

DEPARTMENT OF AGRICULTURE AND CONSUMER SERVICES

P. O. Box 1163, Richmond, Virginia 23209

September 24, 1980

Mr. Kirk Jonas, Principal Analyst  
Joint Legislative Audit and Review Commission  
Suite 1100, 910 Capitol Street  
Richmond, Virginia 23219

Dear Mr. Jonas:

We acknowledge receipt of your letter under date of September 16, 1980, with reference to the study of federal funds in Virginia which was directed by House Joint Resolution 237 of the 1979 session of the General Assembly with attachments.

This matter has been reviewed and action is being taken to facilitate the use of the letter of credit to draw advances rather than monthly reimbursement as has been done in the past.

We are concerned, however, that this will involve preparation of estimates which will subsequently need to be compared and reconciled with actual expenditures. This will essentially double the administrative paperwork required to obtain these funds. We are hopeful that the cost of this additional paperwork will be more than offset by gain in funds.

Nevertheless we commend you on the work you have done and feel that it will be beneficial to our staff in dealing with similar accounts.

Sincerely yours,

*S. Mason Carbaugh*  
S. Mason Carbaugh  
Commissioner

SMC:vdw

cc -- Dr. Paul J. Friedman  
Mr. Henry H. Budd



# COMMONWEALTH of VIRGINIA

## *Department of Mental Health and Mental Retardation*

September 24, 1980

LEO E. KIRVEN, JR., M.D.  
COMMISSIONER

MAILING ADDRESS  
P. O. BOX 1797  
RICHMOND, VA. 23214

Mr. Kirk Jonas  
Principal Analyst  
Joint Legislative Audit and Review Commission  
Suite 1100, 910 Capitol Street  
Richmond, Virginia 23219

Dear Mr. Jonas:

This is in reference to your letter dated September 16, 1980, asking for this agency's comments on your draft report, "Federal Funds in Virginia."

Members of my staff have reviewed the report and offer the following comments:

### Federal Grants

Under the current budget process, agencies no longer can solicit for Federal grants unless the grants have been identified in the agency's budget. This presents State agencies with a problem when Federal agencies announce one time Federal grants in cycles which make it difficult to anticipate during our budget process.

### Title XX Funds

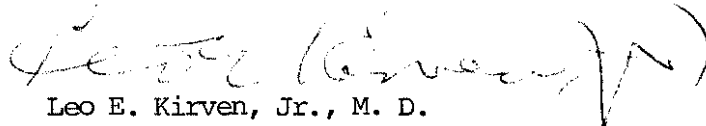
The Department of Mental Health and Mental Retardation receives monthly invoices from community services boards for services provided under State level contract by approved Title XX providers. The Department compiles all invoices from the community services board into one major report (interagency invoice) and submits this invoice to the Welfare Department for reimbursement. The Department of Welfare reimburses the Department of Mental Health and Mental Retardation monthly, based on the interagency transfer invoice.



The Department of Mental Health and Mental Retardation does not hold invoices for reimbursement. If the State Welfare Department has expended the Federal funds allocated for a fiscal year, they will notify us; otherwise, we continue to invoice the State Welfare Department on a monthly basis.

I hope these comments will be of assistance to you in developing your final report. I would like to take this opportunity to thank you for giving us the opportunity to comment.

Yours very truly,



Leo E. Kirven, Jr., M. D.  
Commissioner

LEKjr:CWB:eg

cc: The Honorable Jean L. Harris



# COMMONWEALTH of VIRGINIA

COUNCIL ON CRIMINAL JUSTICE  
BEVERLY A. DAVIS, III, Chairman

## *Division of Justice and Crime Prevention*

8501 MAYLAND DRIVE RICHMOND, VA. 23229  
(804) 281-9276

RICHARD N. HARRIS  
Director

October 3, 1980

Mr. Kirk Jonas  
Principal Analyst  
Joint Legislative Audit &  
Review Commission  
Suite 1100, 910 Capitol Street  
Richmond, VA 23219

Dear Kirk:

Thank you for providing us the opportunity to review the exposure draft of Federal Funds in Virginia. The following are our comments. Some of them are for clarification, whereas others address conclusions or implications we feel are inaccurately portrayed.

Your attention is first directed to the first paragraph on page 23. When one reads that, the implication is that all DJCP funds are used for training purposes. The facts are that DJCP funds are used for many other excellent programs and projects. We suggest that the paragraph be re-drafted to remove that implication.

It is further suggested that the \$5 million amount mentioned for 1980-82 and the \$9 million amount mentioned for 1982-84 is the amount needed to assume all programs, not just training programs. Once it is decided whether the paragraph is to be re-worded it will be necessary to make sure the correct amounts are used. If the paragraph is going to deal with all programs, then the amount as given appears to be correct. If the paragraph is to deal with training only, then the amounts need changing. In any event, it is suggested that you should call Ron Bell at this office to discuss these items.

There is another point that needs to be made. In that paragraph, the first non-italicized paragraph on page 24, and the second non-italicized paragraph on page 25, one gets the impression that the State and local units of government were inveigled into starting training programs with federal funds and are now having to face the cost assumption problem. What is totally and completely missed or ignored is that the very programs referred to in the Department of Corrections and at the local government level provide training mandated by the General Assembly which has never, since the programs were inaugurated, appropriated any general funds other than required match, to support those mandates until faced with the assumption of cost

Mr. Kirk Jonas  
Page 2  
October 3, 1980

requirement. It would seem that in the interest of a balanced, factual report that this has to be included.

On page 24 at the end of the first paragraph (*italicized*) it is suggested that the following be added, "...as long as LEAA funds come to the State".

The remainder of our comments is an attempt to clarify Division of Justice and Crime Prevention cash disbursements and cash control policies.

In the report the Division is cited for certain negative cash control practices. At the outset, it should be explained that the DJCP cash transfers to other State agencies is approximately \$5 million dollars annually. While this amount is shown as an expenditure to the account of the Division of Justice and Crime Prevention, the amount is not an expenditure to the State until the actual grant recipients make expenditure from the transferred funds.

Since the inception of the LEAA Program in Virginia, the Division has followed the practice of advancing grant money to local units of government and to State agencies on a quarterly basis. This practice had a positive affect in that it eliminated personnel needed to process draw-down requests more frequently at both the disbursing point (DJCP), and at the receiving point (sub-grantee). One accountant has handled grant disbursement at the Division of Justice and Crime Prevention. During FY 1980, approximately 1500 grant disbursement requests were processed, representing about \$12,000,000. To disburse money more frequently would necessitate the hiring of additional accounting personnel to handle the increased work and related duties.

However, to accomplish a quarterly disbursement of grant funds, the DJCP was required to have either the federal cash or secure a loan in lieu of cash. Under the Department of Treasury Circular 1075, federal cash balances held by either the DJCP or its grant subgrantees were to be at a minimum. Subsection 205.4 of Circular 1075 states "Cash advances to a recipient organization shall be limited to the minimum amounts needed and shall be timed to be in accord only with the actual, immediate cash requirements of the recipient organization in carrying out the purpose of the approved program or project. The timing and cash amount of advances shall be as close as it is administratively feasible to the actual disbursement by the recipient organization for direct program cost and the proportionate share of any allowable indirect cost." Cash on hand has been held to be the minimum cash needed for cash disbursement for disbursements within a few days. The maintenance of a minimum cash amount on hand and a disbursing of grant money quarterly was reconciled by securing a State Treasury loan. The cash loan enabled the DJCP to disburse money less frequently and reduced general fund administrative costs, and kept the State in compliance with Treasury guidelines. It should be noted that failure to comply with Circular 1075 could have resulted in the revocation of the unobligated portion of the letter of credit.

Mr. Kirk Jonas  
Page 3  
October 3, 1980


At the time the Division secured a loan agreement for fiscal year '80, which by the way, averaged about \$1 million, we were cognizant of the fact that it could be argued that interest income on the general fund loan could be considered as a loss to the State. However, it was our determination that it was more beneficial to the State, both administratively and for cash flow control, to proceed and use a Treasury loan and comply with the Treasury disbursing policies. It was our estimate that the increase in administrative costs to the State would be far greater than any anticipated lost interest.

In summary, DJCP's use of a Treasury loan was guided by the following factors:

1. Treasury Circular 1075 mandates minimum cash balances.
2. State Comptroller requires cash or a loan in lieu of cash.
3. Loan assurance permits advanced grant disbursement quarterly for convenience of grant subgrantees and to reduce administrative overhead at all points of a disbursement.
4. Maintenance of a cooperative system with federal treasury, state treasury, agency, and grant recipients.

It is hoped that these comments will be taken into account when the final draft is prepared. If you feel the need for any further facts in any of the above, please call me or Eddy Hegamyer.

Very truly yours,

  
Carl N. Cimino  
Deputy Director

sgs

JLARC NOTE: The report does not suggest that the Division of Justice and Crime Prevention (DJCP) process grant disbursements more frequently. The report states that DJCP could draw down federal funds in advance of these disbursements. There is no basis for assuming that this procedural change would significantly increase administrative costs.



# COMMONWEALTH of VIRGINIA

TERRELL DON HUTTO  
DIRECTOR

*Department of Corrections*

P. O. BOX 26963  
RICHMOND, VIRGINIA 23261  
804/257-1900

November 26, 1980

Mr. Kirk Jonas  
Joint Legislative Audit and Review Committee  
Suite 1100, 910 Capitol Street  
Richmond, Virginia 23219

Dear Mr. Jonas:

It is my understanding that you have had discussions with one of my staff members concerning an apparent discrepancy in the timetable for recovery of USDA funds. I have been told that, as a result of these discussions, it has been determined that the time frames reported in your study are substantially correct with the first billings to the USDA occurring in December, 1980, covering the period September, 1978 - June, 1979. I would, therefore, ask that you withdraw my letter of September 25, 1980, as the discrepancies now seem to have been resolved. Evidently, confusion over the Department's ability to file for recovery of funds during the time care labor study resulted in a much later submission of the bills than we had originally believed. Your patience and cooperation in resolving these differences have been greatly appreciated.

I would, however, like to reiterate a more general comment concerning federal "seed monies." It seems to me that there is a rather significant difference between the assumption of law enforcement training grants and the type of grants mentioned at the top of page 25. The Legislature has mandated that compulsory training be provided to all law enforcement officers and certain other individuals (Sections 9-107 through 9-111.14 COV). The federal dollars used over the past several years to provide this training simply removed the financial burden of these programs from the State and the localities during the grant period. Had these dollars not been available, the total

Mr. Kirk Jonas  
Page 2  
November 26, 1980

cost of the training would, of necessity, have been absorbed from the time of the mandate. This is very different from a truly "seed money" situation where a program is begun without legislative mandate and must be assumed later in the project life. It is estimated that through the use of LEAA funds at the Academy for Staff Development, \$2,716,969 in federal funds have been used, dollars which otherwise would have had to come from the State general fund. It might be helpful to the Legislature for this basic difference to be delineated.

Again, thank you for the opportunity to review this document and for your assistance over the past several weeks. I hope that these comments have been useful and that they will help to strengthen an already excellent study. Should you have additional questions or need more information, please do not hesitate to contact my office.

Sincerely,

  
(Terrell Don Hutto

jf

cc: Mr. William E. Weddington  
Mr. Robert Zukowski



# COMMONWEALTH of VIRGINIA

DEPARTMENT OF EDUCATION

P. O. BOX 60  
RICHMOND, 23216

September 23, 1980

Mr. Kirk Jones  
Principal Analyst  
Joint Legislative Audit  
and Review Commission  
Suite 1100, 910 Capitol Street  
Richmond, Virginia 23219

Dear Mr. Jones:

Dr. Davis, Superintendent of Public Instruction, has asked that I respond to your letter of September 16 relative to the draft report which the JLARC staff has completed on federal funding. We have reviewed the report and find no reason to make any recommendations for a change. It appears to be carefully done and should prove to be informative for the legislature.

Sincerely yours,

A handwritten signature in cursive script, reading "William H. Cochran".

William H. Cochran  
Deputy Superintendent

WHC:smm

cc: Dr. S. John Davis



VIRGINIA COMMONWEALTH UNIVERSITY  
910 West Franklin Street • Richmond, Virginia 23284

ACADEMIC CAMPUS SCHOOLS

The Arts  
Arts and Sciences  
Business  
Community Services  
Education  
Social Work

MEDICAL COLLEGE OF VIRGINIA  
CAMPUS SCHOOLS

Allied Health Professions  
Basic Sciences  
Dentistry  
Medicine  
Nursing  
Pharmacy

Mr. Kirk Jonas  
Joint Legislative Audit and  
Review Commission  
Suite 1100  
910 Capitol Street  
Richmond, VA 23219

Dear Mr. Jonas:

This has reference to your letter of September 16 to Dr. Edmund F. Ackell of Virginia Commonwealth University, concerning your study of federal funding in Virginia. Members of my staff have discussed certain sections of this report with you, and we note that appropriate adjustments have been made in the draft that was forwarded to us. We appreciate the opportunity at this time to formally respond to your draft report.

As you know, we presented on August 6, 1980, a rather detailed response to your initial draft. Certain of our comments below will be redundant with those that were transmitted earlier.

Generally, your report addresses (1) what you believe to be inadequate internal accounting controls and (2) a large backlog of delinquent reports required to be submitted to federal agencies. With regard to the first item, we continue to believe that basic accounting controls are in place which provide reasonable assurance that funds are expended in accordance with federal regulations and that expenditures in excess of budget are readily identified and corrected.

With respect to the second item, the backlog of Reports of Expenditures (ROE) was created at the time of the implementation of our new accounting system on July 1, 1978. Since that time, we have sustained extraordinary turnover in our Grant and Contract Accounting section, particularly at the supervisory level. In addition, we have been understaffed in this area and have taken steps to increase the staffing (subject to State approval) and improve the effectiveness of this organization. Although the number of delinquent reports has not decreased, this is due primarily to the large number of reports coming due at this time. With improved staffing, we feel optimistic that this problem can be substantially alleviated by the end of this fiscal year.

For your convenience in reviewing this response, we have identified the appropriate page number in your draft of September 16, 1980.



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One of the criteria utilized in the evaluation of grant and contract administrative performance is the "proposal review and approval process." At VCU, proposals are reviewed by the Office of Research Administration in accordance with the Manual on Grants and Contracts, an internal policy and procedures document. This manual clearly states that the federally-approved indirect cost and fringe benefit rates are to be used when submitting proposals. You suggest that a review of the proposal by a fiscal section would provide certain safeguards, but we contend that such a review would simply verify that the Office of Research Administration is properly performing its review function. The Grants and Contracts Accounting section of the Controller's Office, which would perform this review function, would have little way of determining that a proposal is fiscally realistic in that research proposals are typically submitted and awards granted on a competitive basis after peer review, and without an understanding of the details of a research project (most of which are highly sophisticated and complex), it would be impossible for this group to understand the financial needs of a project. Therefore, we believe that it would be redundant and ineffective to have a review made by the Controller's Office and that this issue should not be considered a significant problem as represented in figure 9, page 78.

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You indicate that the backlog of Reports of Expenditures (ROE) to federal sponsors was due to the ineffective use of the Financial Accounting System (FAS). While it is true that the current backlog was created during the implementation of FAS on July 1, 1978, we feel that FAS no longer contributes to this backlog. Overdue reports are more a function of understaffing and organization of work flow.

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Although Grants and Contracts Accounting does not have in place a formal procedure for the periodic review of FAS negative balance accounts, appropriate management personnel are aware of these accounts and do not believe that they represent or indicate a serious overspending problem at VCU.

A number of control features allow us to monitor the over-budget status of federal accounts.

- The quarterly review of federal grant expenditures compared with the budget during the preparation of the Departmental Federal Assistance System report (DFAFS).

- The review by the fiscal administrators and/or departmental support persons of FAS-generated reports prior to distribution to principal investigators.
- The submission of financial report inquiry forms regarding erroneous charges or budget entries.

These controls did alert management to the two major causes of negative balances, namely, (1) incorrect budget entries and (2) incorrect accounting entries. We do recognize that adjustments to these accounts were not made responsively due to staffing problems.

You also state that "there is no central control because a principal investigator can continue to spend against an account, even one with a negative balance." If the controls mentioned above failed to reveal an overexpended account, the principal investigator could only continue to spend against this account until the end of that account's budget period.

With regard to item 2 of the summary of a typical negative balance account, we would point out that the \$876 charge was a retroactive adjustment, made by journal entry, which originated in Grants and Contracts Accounting. This charge was to correct a credit made in error, and it consequently zeroes-out expenditures for that particular code.

With respect to the lack of control over encumbrances, Grants and Contracts Accounting does have a procedure whereby a daily diagnostic listing is reviewed to determine that disbursements liquidate the proper encumbrances.

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We are aware of the number of dormant or inactive accounts and are addressing the establishment of policy and procedures to "purge" accounts from the FAS system. We intend that this policy and procedures include the following points.

- The requirement of an interface between our Effort Reporting System (ERS) and FAS and the need to access certain data fields in FAS to make ERS operational.
- The need for an interface between the federal DFAFS system with FAS since the DFAFS expenditures must be available on file until submission of the final ROE for the project.
- The time (15 months) allowed by federal agencies to revise a ROE.

We plan to evaluate all user needs prior to the establishment of a workable policy to remove dormant accounts from the system.

The comment is also made that the number of unpurged dormant accounts poses serious problems for potential fraud or abuse. We do not agree with this assessment since we feel that the following control features prevent abuse.

- The review by the Invoice Processing Section of the expiration date of all accounts when voucherizing an invoice for payment. Any invoice processed for payment after an account's expiration date is reviewed to determine that the charge does, in fact, relate to goods or services received during the grant period as evidenced by appropriate purchasing and receiving documents.
- Disbursement adjustments, the method by which charges are transferred from one account to another, require the approval of an individual in a supervisory position within the Grants and Contracts Accounting section.
- The FAS system rejects the processing of current payroll transactions against a dormant account.
- The FAS monthly reports are sent to fiscal administrators and principal investigators for their review.

We do not concur with your comment that "control weaknesses in VCU grants and contracts accounting exists primarily because available reports and controls designed into the system have not been used." We believe that our internal accounting control procedures, although different from those in place at other State institutions, are effective and adequate. Certain system-related controls were consciously not implemented, and we have utilized other control procedures.

With respect to freezing dormant accounts, we would like to point out that, effective in April, 1980, Grants and Contracts Accounting instituted the following procedures regarding such accounts.

- At the time the ROE is prepared, all necessary adjusting entries are also processed. When these adjustments appear on the monthly FAS report, the account is frozen. This fact is then noted on a 10-step check list, with the appropriate initials of the person freezing the account, which is reviewed by an appropriate supervisor.
- Grants and Contracts Accounting is also reviewing, retroactively, the FAS accounts for which ROE's have been submitted to federal agencies, and these accounts are being frozen.

We also disagree with your comment that we are "unable to provide adequate control over the expenditure of sponsored research funds." We have recited a number of control features that are in existence at VCU and that have not been noted in your report. We feel that there are controls which ensure that the charges made to grants and contracts as reported to federal agencies are proper and in conformity with federal regulations.

With respect to an internal procedures manual for Grants and Contracts Accounting, you are correct that we do not yet have a formalized manual for employees. There are, however, a number of existing sources of information available to aid employees in the application of procedures and controls. Among these are the following.

- The Detailed Design for Grants and Contracts, which is a document specifying detailed procedures for the accounting group and prepared as part of the implementation of the new accounting system on July 1, 1978.
- Check list used in the preparation of ROE's, the creation of accounts, and for contract billings.
- Flow charts developed by the VCU Internal Audit Department.
- The FAS Users Manual.
- The Effort Reporting System (ERS) Manual.
- The Manual on Grants and Contracts prepared by the Office of Research Administration.
- The Public Health Service (PHS) Grants Policy Statement and other literature from federal sources.

The sources are currently used to achieve a consistent application of accounting procedures and controls and pertinent elements will be incorporated in an internal procedures manual which will be under development in the very near future.

Page 84

The Effort Reporting System which has recently been designed has been implemented. We are not waiting for final federal approval or review. We have presented the system to the Department of Health and Human Services and to the National Institutes of Health for their comments, and we expect a letter from them expressing their concerns, if any, about the system.

Page 89

With respect to recommendation 17b, we already have procedures to monitor and approve charges to dormant accounts. In addition, accounts are frozen after the ROE has been prepared.

Page 90

With respect to recommendation 18, we have already implemented the Effort Reporting System, and as mentioned above, we are not waiting for final federal approval or review. We have conducted a number of training sessions with fiscal administrators, faculty and principal investigators, and a rather extensive Effort Reporting Manual is available. Furthermore, detailed instructions are provided to schools and departments each academic term concerning effort reporting requirements.

With respect to recommendation 19, we agree that an internal procedures manual should be developed. Since the main cause of late fiscal reports is understaffing, however, we fail to see what procedures could be developed to prevent this from happening. We have requested additional resources in the Grants and Contracts Accounting section to address the backlog situation as well as the many new requirements imposed by the recently issued OMB Circular A-21. Furthermore, we report monthly to appropriate management personnel the status of all ROE's that are due or coming due within the next 90 days.

Once again, we appreciate this opportunity to respond to your draft report. If you would like additional information on any of the comments that we have made, please let us know.

Very truly yours,



James G. Guerdon  
Vice President for Finance

JLARC NOTE: Sponsored research activity at VCU has grown substantially over the past decade. This growth may well have contributed to the understaffing which the university cites as the principal cause of the conditions observed by JLARC staff during the study.

These conditions -- including 101 overdue reports to federal sponsors, account errors totalling \$600,000, and numerous unfrozen dormant accounts -- provided the basis for JLARC's concern for VCU's controls over federal grants and contracts.

Improvements have taken place that were not present when JLARC reviewed VCU records. Management attention is being focused on delinquent reports. Negative balance accounts found by JLARC are being reconciled. A process has been adopted to freeze dormant accounts. Additional staffing has been requested.

The data cited in the report are correct and are not disputed by the VCU response. The conclusions and recommendations of the report reflect that data.



CHARTERED 1693

THE COLLEGE OF WILLIAM AND MARY IN VIRGINIA

OFFICE OF THE PRESIDENT

WILLIAMSBURG, VIRGINIA 23185

October 2, 1980

Mr. Ray D. Pethtel, Director  
Joint Legislative Audit and Review Commission  
Suite 1100, 910 Capitol Street  
Richmond, Virginia 23219

Dear Ray:

I am pleased to provide you with our written comments on the draft report of your review of the Federal Funds in Virginia.

While the College does not have any serious objections to the report, there is one area that needs to be clarified. As was discussed by Paul Koehly and Kirk Jonas, we suggest that the following comments be included as an addendum to the report.

Reference: Page 76, second paragraph

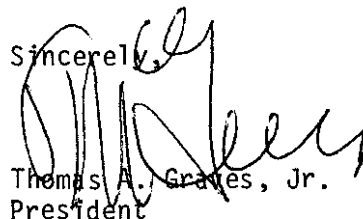
It is true that for years VIMS operated improperly in its service center activities and in other areas of financial management. The supplemental appropriation request for 1981-82 amounting to \$1.78 million will enable VIMS to maintain its present research capability in order to meet the mandated requirements of the General Assembly. A portion of the \$1.78 million is needed to provide the minimal essential support services for adequate control of the funds appropriated. If these requirements and objectives are not met, VIMS will lose its credibility in the scientific community and its future capacity to obtain research funds from external sources.

The one time faculty conversion cost of \$300,000 in 1981-82 is an accumulated financial obligation of the state and is in no way a means of balancing the Institute's accounts.

If you have any questions concerning this request, I am available to discuss this matter further.

With best wishes,

Sincerely,



Thomas A. Graves, Jr.  
President



Office of the Vice President  
for Business Affairs  
Harrisonburg, Virginia 22807  
(703) 433-6434

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September 26, 1980

Mr. Kirk Jonas, Principal Analyst  
Joint Legislative Audit and Review Commission  
Suite 1100  
910 Capitol Street  
Richmond, Virginia 23219

Dear Mr. Jonas:

Your letter concerning the JLARC draft report studying federal funds in Virginia has been referred to me for response in Dr. Carrier's absence. We do not dispute the facts presented on page #52 of the draft concerning the contract between James Madison University and the Army Corps of Engineers. However, as I discussed with you by telephone on Wednesday, I would like to share with you our perspective in reviewing a report that cites us as an agency delaying for long periods before processing reimbursement requests in connection with this project.

Two years ago our Department of Sociology, Anthropology and Social Work entered into a contract with the Army Corps of Engineers to retrieve all they could about the people and history of the Jackson River basin before its 12,000 acres were flooded upon completion of the Gathright Dam. This turned out to be the largest archeological project ever undertaken in Virginia, and the problems and challenges encountered were new to us. The archeology staff and students were in the field all of the time weather would permit, living in tents, to complete the field work before the flooding began. Accounting for expenses was methodically accomplished, but summarizing the data into the required format for reimbursement was done only after the pressure from the demands of work on the site lessened. As our experience in these situations grows, we are certain that we will be able to reduce the time required to file reimbursement requests.

We believe that the history of the region revealed by the work put into the project is proving to be very worthwhile to the citizens of the Commonwealth, and the field training experience afforded our students is irreplaceable. Furthermore, the \$42,500 received to date in indirect cost recovery and deposited with the State Treasurer as part of the \$436,883 contract more than offsets the \$4,000 in potential investment revenue lost by the Commonwealth.

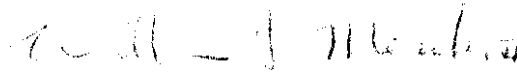
Mr. Kirk Jonas

-2-

September 26, 1980

We do understand the point the study is making. However, it is necessary to recognize the benefits derived from the project as well as the costs so as not to imply that the results were totally counterproductive to the interests of the State.

Sincerely yours,

A handwritten signature in dark ink, appearing to read "W. F. Merck, II".

William F. Merck, II  
Assistant Vice President

WFMII/ec

cc: Dr. Ronald E. Carrier, President



# GEORGE MASON UNIVERSITY

THE STATE UNIVERSITY IN NORTHERN VIRGINIA • 4400 UNIVERSITY DRIVE • FAIRFAX • VIRGINIA • 22030

OFFICE OF THE PRESIDENT

September 23, 1980

Mr. Kirk Jonas, Principal Analyst  
Joint Legislative Audit and Review Commission  
Commonwealth of Virginia  
Suite 1100, 910 Capitol Street  
Richmond, Virginia 23219

Dear Mr. Jonas:

I have received the Joint Legislative Audit and Review Commission staff report draft on federal funds in Virginia, and I appreciate the opportunity to comment on the report as it relates to George Mason University. Our review of the draft report has found the report to be factually correct in most instances, but a few points need to be clarified. Additionally, the entire context relative to the University's borrowing needs to be reexamined if you are to give an accurate presentation of the circumstances surrounding the state loans.

There are three specific items in the draft report which require clarification. First, on page 58 of the report you cite George Mason University as one of fourteen agencies with loans of over \$100,000 outstanding for 18 months or more as of February 1, 1980. The loan which you reference in this table was initiated in April of 1979, retired in full in November of 1979, and was never renewed. Neither the original loan cited nor a renewal thereof was active on February 1, 1980. The total term of this initial loan was seven months, not more than 18 months.

Although the University did have an active loan in the amount of \$100,000 in February of 1980, the loan was for a different set of grants and can in no way be considered a renewal of the earlier loan. The second loan was authorized on November 15, 1979, and the University actually borrowed the funds on December 10, 1979. The grants cited as justifying the loan were legitimate reimbursement grants and contracts.

Secondly, the draft report states (page 59) by implication that George Mason University "acknowledged that (it) had loan amounts greater than necessary for the operation of (its) programs over a normal reimbursement cycle." You support this statement on page 61 by noting that the grant application form cited in the loan request stated that the National Endowment for the Humanities would fund the grant on a cash advance basis. The University has admitted that the grant cited was erroneously a cash advance grant, but we have never acknowledged borrowing beyond the requirements of our sponsored programs operation.

The loan application was the University's first experience in borrowing to meet the cash flow needs of sponsored programs, and, unfortunately, we

cited a single, cash advance grant rather than a series of smaller reimbursable grants totalling more than \$100,000. The University had more than enough reimbursement grants active in April, 1979, to justify the borrowing. (See table below.)

Reimbursement Grants Active April, 1979

<u>Granting Agency</u>	<u>Term</u>	<u>Amount</u>
State Dept. of Education	7/78-6/79	\$ 42,000
VIMS Sea Grant	1/79-12/79	46,100
VIMS Sea Grant	1/79-12/79	36,200
Va. Dept. of Welfare	7/78-6/79	<u>132,940</u>
TOTAL		\$257,240

In addition, a number of new reimbursement grants began during the term of the loan, which would have further supported our need. (See table below.)

Reimbursement Grants Beginning between 4/79 and 11/79

<u>Granting Agency</u>	<u>Term</u>	<u>Amount</u>
Va. Dept. of Welfare	9/79-6/80	\$204,062
State Dept. of Education	7/79-6/80	45,000
VIMS Sea Grant	7/79-8/79	<u>6,977</u>
TOTAL		\$256,039

All of these grants were part of our sponsored programs effort, yet on page 60 you state that George Mason had zero need for loans to support programs operation. While we obviously could not have justified our need to borrow based upon the one grant which, through our own error, was cited in our loan application, we nevertheless had a substantial need to borrow to operate our program. In addition, if the grant application had been questioned at any point in the process, we would have cited the above mentioned reimbursement grants as the proper justification in support of the application.

The third item is a technical distinction which should be remedied relative to the categorization of our loan. Based upon the full range of sponsored activities at George Mason University, our loan clearly should have been identified as "University Sponsored Programs," rather than "Specific Grants and Contracts." (Table 4, page 58.) My letter of March 14, 1979 to Stuart Connock, Director of the Department of Planning and Budget, is clear in identifying numerous grants as the basis for our borrowing. I am confident that your statement that George Mason had zero need to borrow could have been avoided, if the loan had been properly categorized.

Mr. Kirk Jonas

- 3 -

September 23, 1980

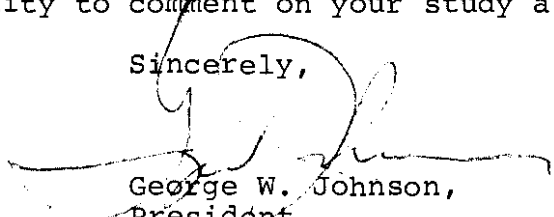
To more fully support the statements I have made in this letter, I am attaching the following materials for your reference.

- Loan Request (March 14, 1979) to Stuart Connock from George Johnson.
- Loan Authorization No. 79 (April 2, 1979).
- Letter (October 18, 1979) to GMU Vice President Henry Adams from Department of Accounts notifying the University of repayment date.
- Letter (October 23, 1979) to Department of Accounts from GMU Vice President Maurice Scherrens authorizing repayment.
- Notification of repayment (November 21, 1979).
- Loan Request (November 5, 1979) to Stuart Connock from Vice President Scherrens.
- Loan Authorization No. 162 (November 15, 1979).
- Loan Takedown Requests (December 10, 1979) approved by State Treasurer.

I understand that the primary purpose in studying federal funds in Virginia is to evaluate the procedures by which such funds are acquired and expended, and I fully support the need for such a study. However, it is critically important that such a report be completely accurate, and I believe that the comments which I have provided are essential to insure this necessary degree of accuracy.

I am available to discuss any of my points further if you desire. Once again, I appreciate the opportunity to comment on your study at this time.

Sincerely,

  
George W. Johnson,  
President

Attachments (9)

GWJ/jeb

cc: Mr. Maurice W. Scherrens  
Mr. Andrew Soll

JLARC NOTE: The enclosures cited in the letter are available from JLARC upon request.



**VIRGINIA COMMUNITY COLLEGE SYSTEM**

**7 NORTH 8TH STREET, P.O. BOX 1558, RICHMOND, VIRGINIA 23212, AREA CODE 804/786-2231**

September 24, 1980

Mr. Kirk Jonas  
Principal Analyst  
Joint Legislative Audit  
and Review Commission  
910 Capitol Street  
Richmond, Virginia 23219

Dear Kirk:

Thank you for the opportunity to respond to the Federal Funds in Virginia Exposure Draft dated September 16, 1980.

My comments are directed to the section labeled State-Federal Conflicts beginning on page 37. I would like to bring to your attention an example of conflict between Federal program objectives and State practices.

The Vocational Education Act of 1963, as amended, provides for Federal grants to assist the States in carrying out vocational education programs. Department of Health, Education, and Welfare rules and regulations implementing the Act provide:

*that Federal funds made available under this Act will be so used as to supplement, and to the extent practicable, increase the amount of State and Local funds that would in the absence of such Federal funds be made available for the uses specified in the Act, and in no case supplant such State or Local funds.*

The Vocational Education funds made available to VCCS colleges are included in the appropriation for Educational and General Programs instead of Sponsored Programs. This means the funds are applied as unrestricted funds in support of Educational and General Program requirements.

The methodology dictated for use in developing budget requests leading to the appropriation by the General Assembly clearly establish that Vocational Education funds are considered a funding source, along with the general fund and tuition and fees, to support the total educational and general program requirements of VCCS colleges. This practice appears to be in conflict with the HEW rules and regulations quoted above.

Mr. Kirk Jonas  
September 24, 1980  
Page Two

The following comments apply to the first paragraph on page 39 of the Exposure Draft. The dispute as described on page 38 of the Exposure Draft was between the Department of Health, Education and Welfare and the State Department of Education regarding the methodology proposed by the State Department of Education to allocate Vocational Education funds to VCCS colleges. VCCS colleges were the "victims" of this dispute rather than the "violators". Therefore, request the first paragraph on page 39 of the Exposure Draft be deleted.

Thank you.

Sincerely,



Billy J. Kittrell, Vice Chancellor  
Administrative and Fiscal Affairs

BJK/ml

cc: Dr. J. Wade Gilley, Secretary of Education  
Dr. James H. Hinson, Jr.  
Dr. Melvin H. Garner, Department of Education  
Mr. Ray T. Sorrell, Department of Planning and Budget  
Dr. Donald J. Finley, Staff Director,  
House Appropriations Committee  
Mr. Paul W. Timmreck, Staff Director, Senate  
Finance Committee  
Chancellor's Staff

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