JOINT LEGISLATIVE AUDIT AND REVIEW COMMISSION

THE VIRGINIA GENERAL ASSEMBLY

FEDERAL FUNDS IN VIRGINIA

Findings and recommendations from JLARC's reports on federal funds — January, 1981

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FEDERAL FUNDS IN VIRGINIA

January 1981

Joint Legislative Audit and Review Commission

Federal funds make up approximately 25 percent of all revenues of the Commonwealth of Virginia. During FY 1979, over 300 federal programs provided $1.7 billion to the State and its localities – a 300 percent jump over the past ten years.

Concern over the growing federal influence on State programs prompted the General Assembly to pass House Joint Resolution 237. The resolution directed the Joint Legislative Audit and Review Commission (JLARC) to study the impact of federal funds on State agencies and local governments. Seven areas of inquiry were specified:

- The dollar amounts of federal funds received by the Commonwealth and its localities.
- The distribution of such funds among programs.
- The dependence of the Commonwealth and its localities on federal funds.
- An analysis of the funds that Virginia would lose for failing to comply with the requirements of the federal programs which condition the grant.
- The growth of federal funds and the resulting growth of federal influence on State and local policies and programs over the last ten years.
- 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.
- The methods and procedures by which federal funds are sought, utilized, monitored, and controlled.

A JLARC REPORT SUMMARY

An interim report on this subject was issued in December 1979 and published as House Document 16 of the 1980 Session. The report detailed the extent to which the Commonwealth is dependent on federal funds and focused attention on legislative and executive oversight measures.

A second report, released in October 1980, suggested further measures for strengthening the State's use of federal funds. Key findings, conclusions, and recommendations from both reports, and the status of implementation measures, are presented in this summary.

Federal funds make up approximately 25 percent of all revenues received and spent by the Commonwealth of Virginia. During FY 1979, over 300 federal programs provided $1.7 billion to the State and its localities – a 300 percent jump over the past ten years. As federal funding of State programs has increased, so, too, has federal influence on State programs.

Virginia's Role in the Intergovernmental Aid System

About $12.5 billion in federal funds was spent in the Commonwealth in FY 1978. Direct federal spending in such areas as the military and civil service accounted for most of this money – $11 billion. The remaining expenditure – $1.5 billion – was in the form of intergovernmental aid. These figures increased to $13.3 billion and $1.75 billion in FY 1979. The figure below illustrates these two types of federal spending.

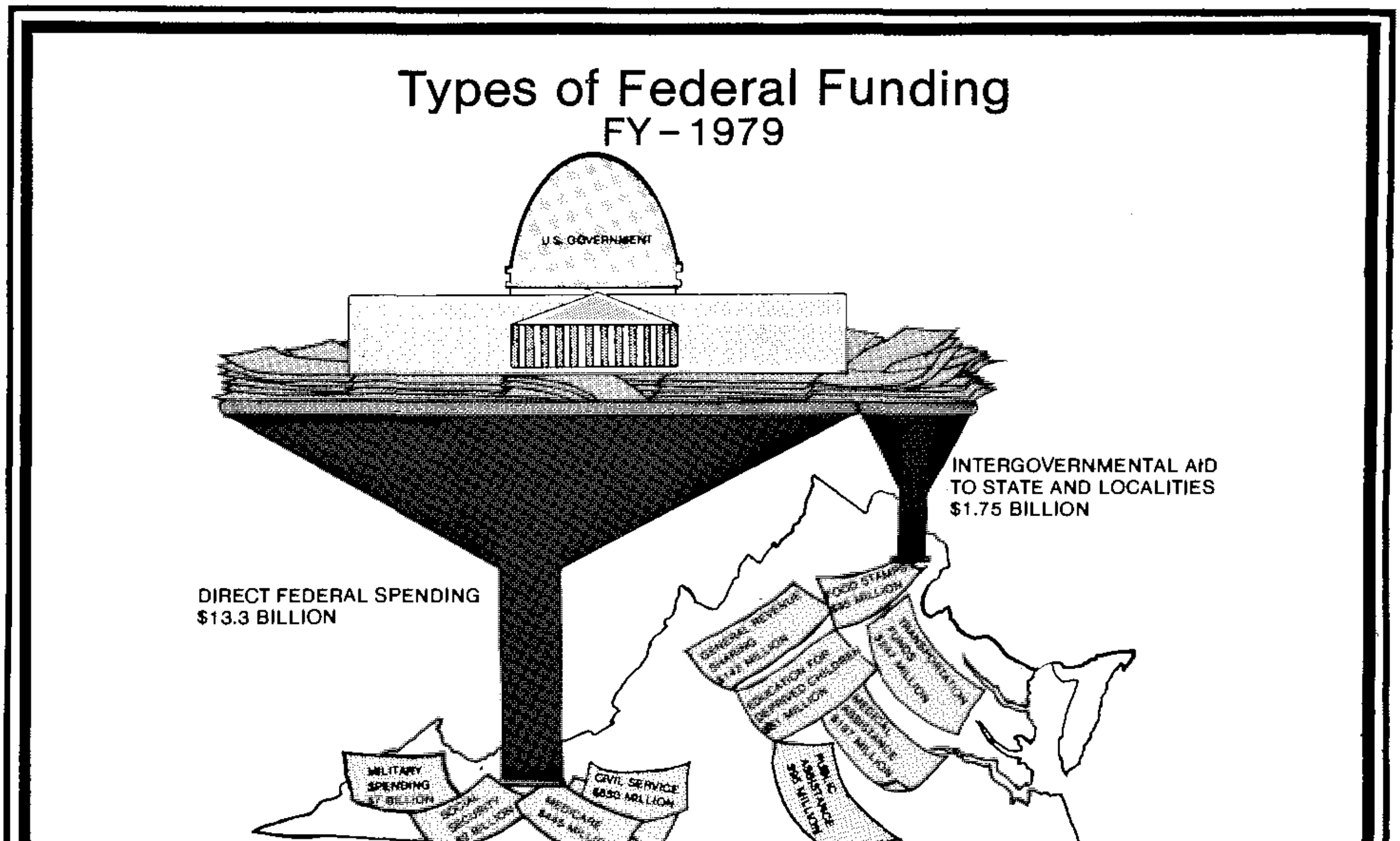
Direct federal spending is outside the control of the General Assembly. Intergovernmental aid involves both the State and localities in the decision-making and expenditure processes.

Under the intergovernmental aid system, federal dollars are funneled to State and local governments for their use in supporting programs which complement national objectives. Upon accepting federal funds, State and local governments must comply with numerous conditions and requirements.

One of the reasons that federal funds have attracted so much legislative attention in recent years is their phenomenal growth. Intergovernmental aid to all states has increased from $20 billion in 1969 to $83 billion in 1979. It has been difficult for state and local governments to adequately control this massive influx of federal funds.

Evidence of a lack of control was found in reviewing agency budget estimates. State agencies consistently understated their anticipated federal fund revenues during preparation of the biennial budget. Collections exceeded estimates of all nongeneral fund revenues by an average of 20 percent in each year of the past decade. In 1978, nongeneral fund revenues exceeded estimates by nearly $800 million.

Due to chronic underestimation, major portions of State expenditures have not been appropriated by the legislature. Instead, they have been authorized for expenditure by the Governor through emergency provisions authorized by the Appropriations Act. In FY 1979, $247 million in federal funds was authorized by the Governor for expenditure that was not subjected to the legislative



JLARC STAFF ILLUSTRATION

appropriation process. Twenty-two State agencies were authorized to spend more than $1 million above their FY 1979 legislative appropriations of federal funds. During the 1978-80 biennium, one-half billion dollars in federal funds was authorized for expenditure without legislative participation.

Several corrective measures in the use of federal funds were adopted in 1980. Significantly, the legislature reemphasized its long-standing policy that agencies include in their budgets all reasonable estimates of nongeneral revenues. It did so by including the following language in the 1980 Appropriations Act.

> ... 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.)

As a result of increased legislative and executive attention to the appropriation of federal funds, the 1980-82 budget more accurately reflects projected State spending. Appropriations identified as federal funds increased by almost $400 million over the 1978-80 amounts. This increase occurred although approximately $90 million in general revenue sharing funds was not included in the Appropriations Act. Significantly, $29 million resulted from agency-initiated amendments requested during the 1980 budget session. These appropriations clearly reflected legislative insistence on fuller identification of anticipated federal funding.

During the fall of 1979 the Secretary of Administration and Finance developed and initiated comprehensive new procedures to control the receipt, management, and expenditure of federal

In FY 1979, $247 million in federal funds was authorized by the Governor for expenditure that was not subjected to the legislative appropriations process. Federal fund expenditures of $271 million in FY 1980 were similarly authorized. Thus, for the 1978-80 biennium, one-half billion dollars in federal funds was authorized for expenditure without legislative participation.

Legislative intent was also clarified by amending the Act to require the executive to furnish 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.)

funds. Most new procedures were laid out in Administration and Finance Directive 1-80, which took effect July 1, 1980.

Under the new procedures, there is no central review and approval of individual grant solicitations by the Department of Planning and Budget. A&F Directive 1-80 provides that agencies may solicit, accept, and spend any funds appropriated by the General Assembly. Revenues in excess of 110 percent of the agency's appropriation, however, must be approved by the Governor. This limitation is intended to give agencies an incentive to accurately estimate anticipated federal revenues during the appropriations process. The directive also addresses manpower limits, assumption of costs, reporting requirements, and control of cash flow. Properly implemented, A&F Directive 1-80 should correct many of the deficiencies noted throughout the course of the federal funds study.

Impact and Influence of Federal Funds

The impact of federal funds on State agencies and local governments was the focus of the second JLARC report. During FY 1979, although one-quarter of State expenditures were supported by federal funds, 19 agencies used federal funds for more than 50 percent of their expenditures. Virginia's largest federal fund programs are shown below.

VIRGINIA'S TEN LARGEST FEDERAL FUND PROGRAMS

Program	Federal Funds FY 1979
Highway Planning & Construction	$289,328,000
Medicaid	176,676,726
Aid to Dependent Children	82,646,405
Comprehensive Employment & Training	69,964,879
Title XX Social Services	64,893,001
Educationally Deprived Children	51,384,777
General Revenue Sharing	48,949,381
National School Lunch	43,774,330
Rehabilitative Services	19,817,800
Employment Service	9,729,582
	$857,164,881

These federal dollars are accompanied, of course, by specific spending requirements. There are two types of requirements: program-specific and cross-cutting.

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

Requirements for the Older Americans Act, which provides funds to Virginia's Office on Aging demonstrate the scope of program-specific requirements. Programs funded under the act must have:

1. A State match — at least 25 percent of administrative costs must be borne by state and local agencies.
2. A specific organization — a sole state agency must be designated to administer the program.
3. Preferential staffing — persons over 60 will receive preference for staff positions.
4. Periodic planning — three-year state and area plans must be developed and annually updated.
5. Specified priorities — 50 percent of funds must be spent in three priority areas: access to services, in-house services, and legal services.
6. Limitations on service delivery — no direct services can be provided by state or area agencies if an alternate provider is available.
7. Identification of special needs — special menus necessitated by health or religious requirements or ethnic backgrounds should be provided where appropriate and feasible.
8. Special programs — for example, an ombudsman program for long-term facility residents must be established.

Cross-cutting requirements, in contrast, are specifically designed to gain the cooperation of recipients in attaining broad federal objectives. Thus, while grantees may be concerned with just one particular goal, such as providing services to the handicapped, they frequently must also assist in attaining federal goals promoted by cross-cutting requirements, such as protection of the environment and protection of privacy.

There are currently 59 cross-cutting requirements, up from one in 1934. Most of these requirements, have been added during the past decade and are intended to affect the socio-economic policies of recipients. Others prescribe administrative and fiscal practices. These cross-cutting requirements are illustrated on pages VI and VII.

It is important to recognize that federal programs are subject to both program-specific and cross-cutting requirements. For a small agency or program, in particular, requirements can be extremely complicated and cumbersome. However, compliance is "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 a juvenile justice program and promotion of clean rivers. Rather, federal requirements are exactly what they are designed to be — powerful levers of influence intended to promote broad social, economic, and administrative goals.

Budgetary Influence

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. To determine the extent of match requirements in Virginia, JLARC conducted a census of State agencies. This census revealed the pervasiveness of federal matching requirements.

Of 125 State agencies that reported spending federal funds in FY 1979, 101 provided matching funds. At least $352.4 million, or seven percent of all FY 1979 expenditures, was spent to match federal funds. Overall, for every federal dollar spent on federally-assisted programs in FY 1979, the State was required to spend approximately 30 cents.

Three State agencies accounted for 83 percent of the State's total match:

- The Department of Health spent $139.3 million, or 68 cents for every federal dollar spent.
- The Department of Welfare spent $85.6 million, or 61 cents for every federal dollar spent.
- The Department of Highways and Transportation spent $50.2 million, or 17 cents for every federal dollar spent.

Agency expenditures to match federal funds were substantially underrepresented in the State's central accounting records. For FY 1979, only 30 percent of the cash match was identified in the Commonwealth's Accounting and Reporting System, the only central point of fiscal information for controlling federal funds. Match amounts represent the State's obligation to the federal government to spend State funds, and information on expenditures to meet this obligation should be centrally available.

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.

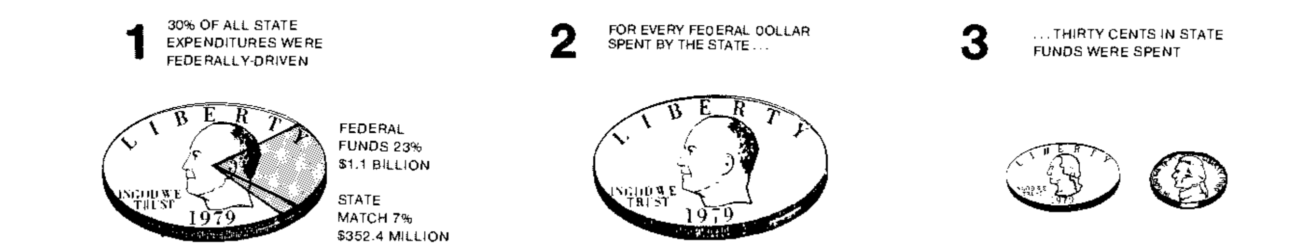
Seed money programs may be very attractive initially, but when federal funds begin to diminish, recipients may be hard-pressed to finance the programs on a continuing basis. The State should, therefore, participate in federal programs with cost assumption requirements only when long-term benefits of the program can justify State funding beyond the life of federal funding.

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 another approved level of effort it gave the program before federal involvement. 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.

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.

Budget Matching Requirements

FY 1980



JLARC STAFF ILLUSTRATION

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 humane 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)

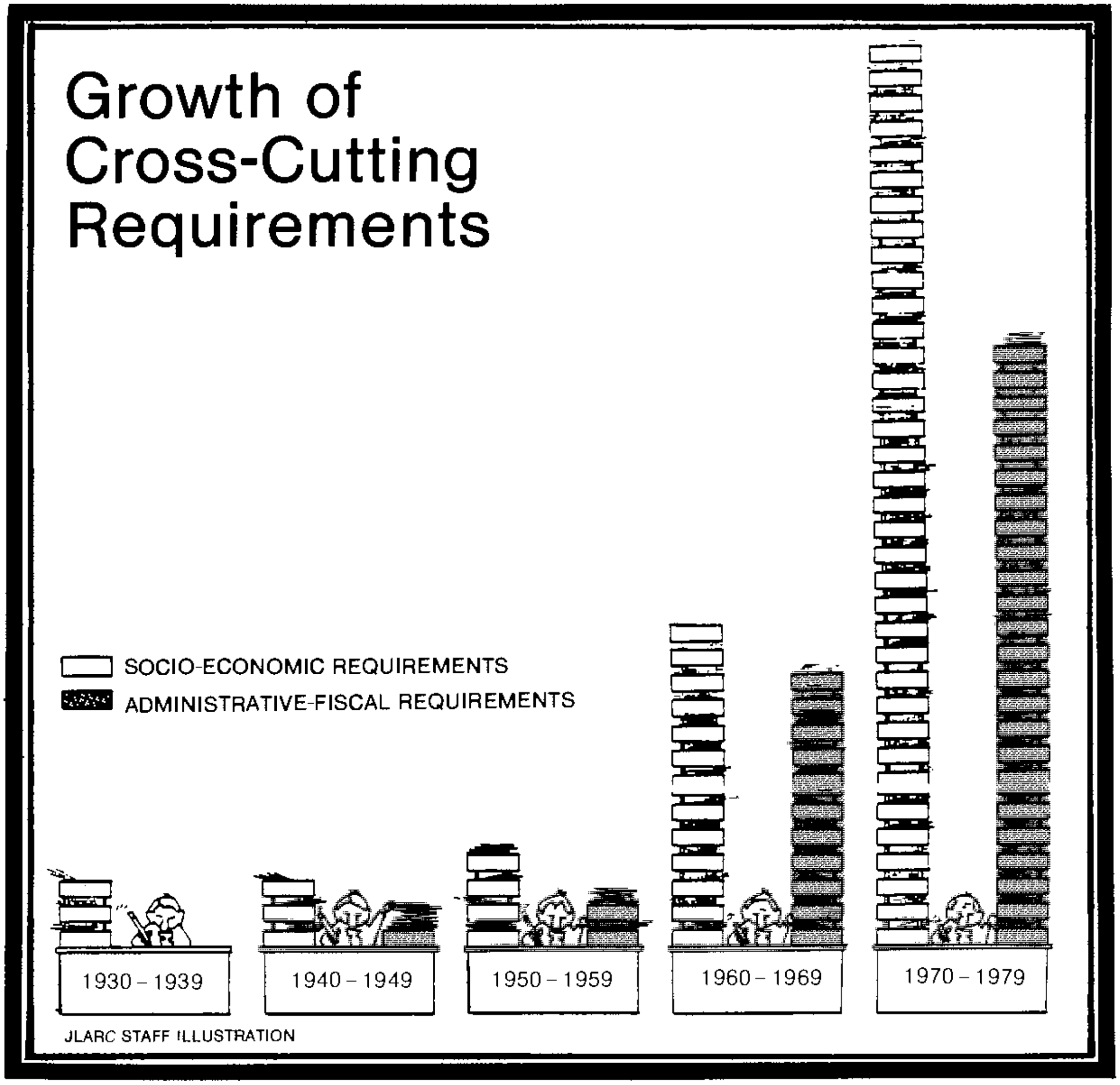
1974 — combine federal and state resources in support of projects
(OMB Circular A-111: Jointly Funded Assistance to State and Local Governments and Nonprofit Organizations, Policies and Procedures)

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)



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

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 key illustrations of 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 statutory authority are usually given 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. That such broad grants of authority are considered necessary to comply with federal requirements illustrates a recognition that continuous federal involvement in program policy and management will occur.

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 some cases federal actions designed to affect State priorities are implemented through spending decisions rather than direct mandates.

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 infuence, 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 also illustrates how a wide range of federal sanctions can be brought to bear on a relatively narrow issue. Faced with the potential loss of federal funds if certain decisions are not made, legislative options and prerogatives are unquestionably influenced.

Administrative Influence

The final 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.

All phases of administration can be affected, from initial planning to post-activity evaluation. Often the State must bear the costs of federal requirements. Administrative influences are found in areas such as accounting, program reporting and evaluation, and personnel.

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. As a rule, however, the State must expect to be subject to federal influence whenever it accepts federal money.

Controlling Federal Cash Flow

Control of cash flow is an important element in managing federal funds. However, some agencies use inefficient procedures for the receipt and expenditure of federal funds. In particular, problems were found regarding receipt procedures, indirect cost recovery, payments to subgrantees, and general fund loan procedures.

Receipt Procedures

There are three basic mechanisms for receiving federal funds: cash advance, letter of credit, and reimbursement. The most favorable mechanisms for the State are cash advance and letter of credit, which provide needed funds before or at the time program expenditures are made.

The reimbursement mechanism is least advantageous to the State. When an agency expends State funds and is later reimbursed, the State loses the use of its funds for investment purposes until the expenditures are reimbursed. Because of the State Treasury's investment program, loss of return on unreimbursed funds averages about one percent per month.

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

Although a letter of credit has been available since early 1976, one State Commission 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.

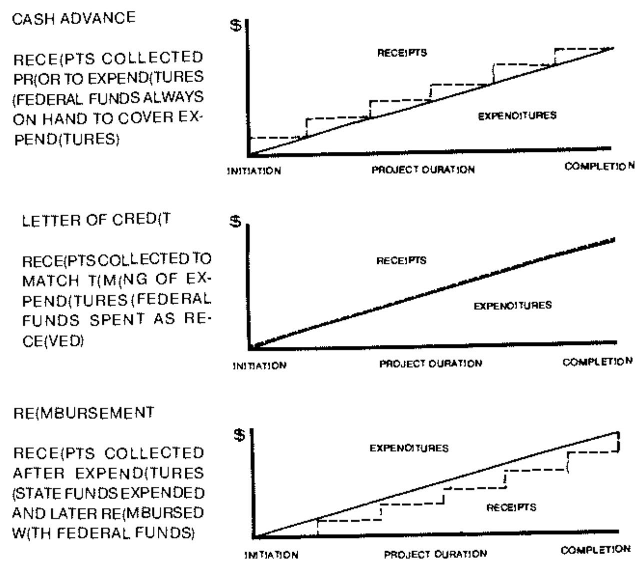
Subsequent to JLARC inquiries on the agency's use of reimbursement financing, the Commission arranged to establish a letter of credit, effective July 1, 1980.

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 following case illustrates agency use of a letter of credit as if it were a reimbursement.

Another State agency had a letter of credit with the Law Enforcement Assistance Administration. The agency distributes LEAA funds to other State agencies and localities.

Mechanisms for Receiving Federal Funds



State funds are routinely distributed and then a drawdown in the amount of the distribution is made. 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 agency's 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 before, 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.

In these two cases, the use of reimbursement arrangements reduced State funds available for investment and resulted in the loss of the opportunity to earn about $100,000 annually in interest. JLARC identified $286,000 in annual investment gains that could have been achieved by improved agency cash flow management.

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. Such improved procedures 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.

Indirect Cost Recovery

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.

Both the 1980-1982 Appropriations Act and A&F Directive 1-80 require full recovery of indirect costs. On August 19, 1980, the Department of Planning and Budget issued DPB Directive 8-80 entitled "Recovery of Allowable Indirect Costs Under Federal Grants." This directive gave the Department of Intergovernmental Affairs responsibility for assisting agencies in preparing indirect cost proposals.

General Fund Loan Procedures

Improved review needs to be given to general fund loans issued in anticipation of reimbursement from federal sources. Loans are often made for amounts larger than an agency reasonably requires to meet its expenditures. 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.

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 ranged from $13 million to $54 million during the 1978-80 biennium.

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. It was determined that a total of $7,331,330 was loaned to these agencies in excess of their needs.

For example, one agency 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 the agency 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.

The most serious problems involving State agency use of Treasury loans involved a Virginia research institute. In this case, loans enabled this institute to operate at levels exceeding its revenues. As a result, the institute has accumulated over the years a deficit estimated at $8 million.

State 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. The Secretary of Finance and Administration has begun to take steps which should improve Treasury loan procedures.

Use of Federal Grants in Sponsored Research

Federal grants and contracts to institutions of higher education account for the largest number 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. These grants, however, comprise less than ten percent of the federal dollar total.

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.

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

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

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

In addition, federal funds of $77 million at the six institutions supported in 1979 over 800 full-time equivalent faculty positions and more than 1,100 full-time equivalent classified positions.

To review university controls over federal grants and contracts, JLARC evaluated the administrative procedures of the 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. The results are shown in the checklist below.

Proposal 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 which stipulates 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 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. Fiscal review of the proposal approval sheet 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 primarily involves monitoring accounts, timely record-keeping, and records 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 were reviewed because universities are directly accountable to the federal government for the proper use of grant

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

KEY: ✓ No significant problems noted
● Internal control changes suggested

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.

JLARC found generally adequate controls and management practices at four of the six institutions. At these four institutions, the administration appeared to have access to accurate and reliable monitoring 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 any of these institutions.

Controls and procedures at two institutions, however, were found to be weak in several key areas.

Improving Sources of Legislative Information

Lack of 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. A continuing legislative need for current and accurate information on federal funds became evident during the course of the study.

To address this need, JLARC applied 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.

As a result of the project, four reports have been designed for presenting federal fund expenditure information contained in the Commonwealth's Accounting and Reporting System (CARS). These reports provide comprehensive information on federal fund expenditures based on the State's program structure. 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 reports will be used to review agency budget requests and monitor the use of federal funds. They will be delivered to the fiscal committee staffs within two months of the close of each fiscal year. In the past, comprehensive information of this type was not available to the legislature until the budget was submitted in December or January.

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.

The OMB source, the Federal Assistance Award Data System (FAADS), replaces a pilot test system in which Virginia and 12 other states participated. FAADS extended the test 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 key role in the allocation of state resources to agencies and localities and the coordination of program activities.

Although the FAADS system shows promise, its full implementation is not expected until 1983. Virginia's work on FAADS is also not 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.

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 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.

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 changeable 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. While constant monitoring of the federal budget process is essential, any use of federal fund data must take into account the overall character of this process.

INTERIM RECOMMENDATIONS	ACTIONS TAKEN
Six recommendations were made by JLARC with the release of the interim report. These recommendations focused largely on necessary improvements in estimating and reporting federal funds.	*Substantial progress has been made in better controlling federal funds in Virginia. The State's heightened awareness of the impact of federal funds is reflected in the actions taken in response to legislative recommendations as well as by related executive branch initiatives.*
Recommendation 1. The General Assembly should consider including language in the Appropriations Act for the 1980-1982 biennium which clarifies the desire of the legislature to be kept fully informed of the flow and use of federal funds in the Commonwealth. Specifically, the General Assembly may wish to: (a) require inclusion in agency budget estimates for 1982-1984 of all federal revenues which can be reasonably anticipated, whether or not a written agreement is in force; and (b) require agencies to make a written reconciliation of all differences between federal funds that were originally appropriated, and funds actually received. Particular emphasis could be placed on identifying programs which are initiated or expanded, or which undergo an increase in the level of effort, as a result of federal funds received under the Governor's authorization during the legislative interim. Reconciliations should be provided on a timely basis to the House Appropriations and Senate Finance Committees.	*1. Language to implement Recommendation 1 was adopted as Sections 4-3.05(a) and 4-3.05(b) of the 1980-82 Appropriations Act. Mechanisms for accomplishing this were promulgated in Administration and Finance Directive 1-80 issued on May 6, 1980.*
Recommendation 2. The Department of Planning and Budget should clarify its policies governing the notification of intent process to ensure that all agency heads are aware of notification requirements.	*2. Procedures for soliciting, accepting, and expending federal funds are clarified by A&F Directive 1-80.*
Recommendation 3. For the 1980-1982 biennium the General Assembly may wish to reenact as a separate section those portions of Section 4-3.05 of the 1978-1980 Appropriations Act which require the Governor to submit quarterly reports of approvals given to agencies to expend federal grants and other nongeneral funds in excess of legislative appropriations. Such action would clearly distinguish between the approval authority and the reporting responsibility of the Governor.	*3. No action reported.*

Recommendation 4. The Governor's 1982-1984 budget bill should 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.	4. *Increased estimates were provided in the 1980-82 budget bill. An additional $29 million in federal funds were added by amendment. Supporting detail was provided. Numerous executive initiatives should contribute to increasingly accurate estimates. A&F Directive 1-80 limits agencies to solicit, accept, and expend only appropriated funds, except for emergencies approved by the Governor. Secretarial approval is required for acceptance and expenditure of revenues above appropriations, but not in excess of 110 percent of the amount in the Appropriations Act. Approval of the Governor is required for larger amounts.*
Recommendation 5. The Department of Accounts should require all agencies to use the appropriate federal identification program codes when reporting deposits to the State Treasury. These codes would provide important information for improved executive control and legislative review.	5. *As part of its standard procedures, the Department of Accounts is beginning to require agencies to properly encode revenue source identifiers. Codes are being assigned where they do not currently exist. A revision to the Commonwealth Accounting Policy Manual is planned to clearly state this policy.*
Recommendation 6. The State should continue its participation in the Federal Assistance Information Test and examine ways to link this information system to central State accounting records for legislative reporting purposes.	6. *Participation in the test project has been successfully completed. The Department of Intergovernmental Affairs and JLARC staff continue to work on the test's successor, the Federal Assistance Awards Data System, and explore related sources of information. The National Conference of State Legislatures awarded JLARC a $5,000 grant to develop federal funds reports for the General Assembly.*

FINAL RECOMMENDATIONS / ACTIONS TAKEN

Actions taken or in progress on the final recommendations are summarized below.

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 1980-1982 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.

1. Amendment drafted.

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.

2. Amendment drafted.

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.

3. The Secretary of Administration and Finance has considered the recommendation but rejected it as duplicative.

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.**

4. The Department of Accounts is planning to monitor agency use of match codes against the Appropriations Act as part of its standard procedures.

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.

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

> 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...

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.**

5. Amendment drafted.

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.**

6. Amendment drafted.

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.	*7. The Department of Planning and Budget is monitoring the use of receipt methods. Some agencies using post-expenditure reimbursements have switched to letters of credit.*
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.	*8. No action reported.*
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.	*9. DIA was charged with the responsibility to provide technical assistance for indirect cost proposals by DPB Directive 8-80 issued August 9, 1980. Indirect costs of subgrantees are also addressed in Directive 8-80.*
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.	*10. Loan procedures were addressed in part by Administration and Finance Directive 1-80 and revised Treasury loan procedures were issued in May 1980.*
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.	*11. Procedures under A&F Directive 1-80 regarding revenue revisions are based on revenue sources rather than awards, as was recommended.*
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.	*12. DPB is providing regular reports to the 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.	*13. Implementing instructions are to be provided for the 1982-84 Budget Bill.*
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.	*14. No action reported.*
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.	*15. Standards for participation in federal programs were issued in Administration and Finance Directive 1-80.*
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.	*16. Legislation drafted.*

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.

17. A review of negative balances at VCU has taken place. Although VCU has reviewed its controls, it disagrees with portions of the recommendations.

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.	*18. An effort reporting system has been implemented by VCU.*
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.	*19. Additional resources have been requested by VCU to address late reports and other problem areas.*
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.	*20. The FAS is fully implemented at VIMS according to officials at 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.	*21. A contract approval sheet is now in use at VIMS. A procedures manual is being developed with a target completion date of July 1, 1981.*
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).	*22. On August 25, 1980, the Department of Intergovernmental Affairs was designated as the Commonwealth's coordinator with OMB on this project.*
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.	*23. Four programs using CARS federal funds data have been developed by JLARC and the Department of Accounts for legislative use.*
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.	*24. Continuing communication on FAADS and related projects is taking place.*

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JLARC

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