

**Minnesota  
State Legislature**

# **LEGISLATIVE AUDIT COMMISSION**

**Program Evaluation Division**

**FEDERAL  
AIDS  
COORDINATION  
SEPTEMBER 2, 1977**



STATE OF MINNESOTA  
**LEGISLATIVE AUDIT COMMISSION**  
VETERANS SERVICE BUILDING  
SAINT PAUL, MINNESOTA 55155  
(612) 296-4708

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## FOREWORD

The Program Evaluation Division of the Legislative Audit Commission was established by Chapter 204, Section 91 of the Laws of Minnesota for 1975. The Division is authorized to "determine the degree to which activities and programs entered into or funded by the state are accomplishing their goals and objectives, including an evaluation of goals and objectives, measurement of program results and effectiveness, alternative means of achieving the same results, and efficiency in the allocation of resources." This evaluation, *Federal Aids Coordination*, is the third study undertaken by this Division.

For each report, a uniform review procedure is followed. After a preliminary draft is completed, it is submitted to all agencies directly involved in the evaluation for their verbal and written comments. Written replies by the Minnesota Department of Finance and the State Planning Agency are included in the Appendix. A written response by the executive director of the Legislative Commission to Review Administrative Rules is also included. In addition, the report is reviewed by a subcommittee of the Legislative Audit Commission prior to its release.

We thank Gerald W. Christenson, Commissioner of Finance, and A. Edward Hunter, Deputy Director of the Minnesota State Planning Agency and their staffs for their valuable time and assistance on this project. We also thank staff persons from the Senate Finance, House Appropriations and House Research staff agencies for their valuable comments and suggestions on the draft report.

Leif Hartmark was project director and author of this report. Gary Miller also reviewed various drafts and made suggestions on the conduct of the research.

Tradition dictates that the chairmanship of the Legislative Audit Commission alternate between the House of Representatives and the Senate. Representative Fred C. Norton was chairman for 1976 and was succeeded in 1977 by Senator William McCutcheon.

September 2, 1977

Bruce Spitz  
Deputy Legislative Auditor  
for Program Evaluation

# INTRODUCTION

The Program Evaluation Division of the Legislative Audit Committion was asked to evaluate the federal grant-in-aid system in Minnesota. Of specific concern were the policy and budgetary implications of the federal aid planning process and the overall effectiveness of the state's information and control systems.

This report deals with three primary functions of federal aid coordination: financial tracking, policy oversight and budgetary review. Regarding the tracking of federal funds, we assess the need for a computerized information system to maintain an ongoing record of all federal aids administered by the state. In the area of oversight of federal aids, we discuss possible procedures for reviewing the policy implications of federal aid applications and plans. Finally, the report analyzes several alternative procedures for budgetary review which could improve the legislature's ability to anticipate and control federal funds.

Chapter One begins with an overview of the federal aid system nationally by identifying eight problem areas which present difficulties to the states. This is based largely on a review of the literature, reports, and selected interviews. Although based on literature dealing with problems in several states, this chapter does identify many problems which are evident in Minnesota as well. Chapter Two briefly outlines Minnesota's current approach to federal aid coordination and discusses a series of potential means by which the state could exercise more fiscal and policy control. Chapter Three discusses the budgetary process in Minnesota, and makes suggestions how the state budget can be used more effectively in the oversight of federal aids. It also addresses the policy issue of state appropriations of federal funds. Chapter Four reviews all of our recommendations, describing the relationship of each suggested procedure to the overall federal aids coordination system.

# SUMMARY OF FINDINGS AND RECOMMENDATIONS

## PROBLEMS OF FEDERAL AID COORDINATION

### FINDINGS:

The dramatic increase in the number and size of federal aid programs available to state and local governments has resulted in the following problems in federal aid distribution and administration.

- Information on the availability of federal funds is not always reliable or timely.
- The level of federal funding anticipated once an application has been made is uncertain.
- Federal compliance requirements hamper the effectiveness of state comprehensive planning and grants administration.
- It is extremely difficult for states to write meaningful federal aid plans which can be used to monitor program effectiveness.
- The complexity of the federal aid system results in a lack of coordination in programming at the state and local levels.
- Federal funding incentives tend to distort state and local program priorities.
- State governments are often asked to pick up the cost of federally initiated programs.
- There is a lack of effective procedures for legislative and executive review of federal aid applications and plans.

## THE STATE'S ROLE IN FEDERAL AID COORDINATION

### FINDINGS:

- Improved executive and legislative oversight of federal aids is necessary in order to rectify many of the problems of coordinating federal aids.
- This oversight should focus on the three functions of fiscal tracking, policy review, and budgetary review.

## FISCAL TRACKING OF FEDERAL AIDS

### FINDINGS:

- The identification and tracking of federal aids flowing into the state is the key to policy oversight and informed budgetary review.
- Current sources of information, state accounting systems, and information flow within the state make the identification and tracking of federal aids extremely difficult.

## RECOMMENDATION 1:

We recommend that the Department of Finance be encouraged to continue the development of a federal aids information system based on the current statewide accounting system. We further recommend that this system be completed as soon as possible so that more detailed information on all federal aids received by state agencies is available in the 1980-81 biennial budget documentation, and available upon request during the 1978 legislative session. This information should include at a minimum the federal catalogue number, state agency and state budget activity number for each grant or contract. (pp. 11-14)

## POLICY REVIEW ON FEDERAL AIDS

### FINDINGS:

- The A-95 review process provides one point of policy review of federal aid applications and plans.
- The Department of Finance is charged with the responsibility of reviewing all federal aid applications.
- There is no formal mechanism for legislative review of federal aid applications and plans. Such a review could draw upon the information generated in A-95 reviews conducted by the State Planning Agency.

## RECOMMENDATION 2:

We recommend that the policy committees of the legislature consider means by which information on federal aid applications and plans could be reviewed by the appropriate committees for the purpose of alerting them to new federally funded programs and the policy implications of such programs. One means would be the screening of A-95 Part I notices by the State Planning Agency for referral to the appropriate legislative committees. In addition, federal aid applicants could be required to submit written "policy notes" on state plans covered by Part III — A-95 reviews. These policy notes should be referred by the State Planning Agency to the appropriate legislative committees. (pp. 17-18)

## BUDGETARY REVIEW

### ESTIMATING FEDERAL FUNDING

### FINDINGS:

- Several decisions on state appropriations should be influenced by the amount of federal aids available for these respective programs.
- Under the current biennial budget process, it is very difficult to estimate federal funding levels for the coming biennium. Estimates of federal funds for the second year of the biennium are made a full two years in advance of the actual receipt of federal aids for that year.
- The new federal fiscal year, which does not correspond to the state fiscal year, complicates the problem of estimating future levels of federal aids.

### RECOMMENDATION 3:

We recommend that the legislature consider the feasibility of conducting a minor budgetary review on even numbered years to update estimates of federal aids based on current receipts and make corresponding adjustments to state appropriations in the biennial budget. (pp. 26-27)

### STATE MATCHING FUNDS AND STATE APPROPRIATIONS TO REPLACE WITHDRAWN FEDERAL FUNDS

#### FINDINGS:

- So called "hard match" funds which are set by formula should be adjusted annually in light of actual federal receipts.
- State funds appropriated to compensate for projected losses of federal funds are sometimes retained by state agencies, even when federal funding is restored.
- It is difficult to anticipate the termination of federally aided programs, and such terminations often result in unanticipated state support.

#### RECOMMENDATIONS:

- 4) We recommend that the legislature consider adjusting the appropriations for state matching funds for federal aids on a current year basis rather than one year in advance; and that state matching funds, or state funds appropriated in lieu of federal aids be adjusted annually in light of actual federal receipts. (pp. 26-29)
- 5) We recommend that the Department of Finance annually collect information on the projected termination date of all federally-aided programs. We further recommend that such information be included in the 1980-81 Biennial Budget documentation and in the proposed Policy Notes recommended in Chapter II of this report. (pp. 25-29)

### STATE APPROPRIATION OF FEDERAL FUNDS

#### FINDINGS:

- Some federal aids are reflected in state budgets in a majority of states.
- Specific appropriations of federal aids may require that no federal funds in excess of the amounts appropriated be expended without prior legislative approval.
- Open or sum sufficient appropriations of federal aids also provides comprehensive information on federal aids, thereby improving budgetary decision-making. It also provides a softer form of control.
- The level of control over federal funds which the Minnesota Legislature needs to achieve is a basic policy issue which the legislature should consider.



## CHAPTER ONE

### OVERVIEW OF THE FEDERAL AIDS SYSTEM

The federal grant-in-aid system is characterized by an increasing degree of complexity, confusion and inefficiency. Governors, legislators, and program administrators have repeatedly voiced frustration over the problems of dealing with a system that is difficult to understand, and nearly impossible to control. The challenge of coping with the federal aids system is intensified by the scope and significance of federal aids to state and local governments. This chapter presents a broad overview of several basic problems inherent in that system. The chapter concludes with a discussion of those problems which appear to be at least partially amenable to state control.

The federal grant-in-aid system has grown dramatically since the early 1960's. Grants-in-aid represented one-fifth of all federal domestic expenditures in 1960. By 1973 grants-in-aid comprised nearly one-third of federal domestic expenditures. The cost of these numerous grant programs increased six-fold from \$10.6 billion in 1965 to 60 billion in 1976.<sup>1</sup> On the average, federal grants in 1975 accounted for 26.6 percent of all state and local direct general revenues. In other words, by 1975 the federal government was contributing an estimated 27 cents for each dollar raised by state and local governments. In Minnesota the federal contribution was approximately 24 cents for each dollar of state and local revenues.<sup>2</sup>

While this represents a significant source of revenue for state and local governments, these aids also carry a significant cost in the form of matching requirements. The Office of Management and Budget estimated in 1973 that matching funds accounted for an average of 10 percent of general expenditures of state and local governments over the preceding four year period. For example, in fiscal year 1973, state and local governments spent \$16 billion in matching funds in order to receive a total of \$45 billion in federal grants-in-aid.<sup>3</sup>

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<sup>1</sup>Advisory Commission on Intergovernmental Relations, "State Legislatures and Federal Grants", *Information Bulletin No. 76-4* (Washington, D.C., November, 1976), p. 1; and Sophie R. Dales, "Federal Grants to State and Local Governments, Fiscal Year 1975: A Quarter-Century Review", *Social Security Bulletin*, September, 1976, p. 23.

<sup>2</sup>Sophie R. Dales, *Ibid*, pp. 29 and 31.

<sup>3</sup>Tax Foundation, Inc., *Federal Grants: The Need for Reform* (Research publication No. 29, New York, N.Y. 1973), p. 21.

Depending upon the criteria one uses in classifying federal grant-in-aid programs, there are between 650 and 1,024 programs. The sheer number of programs results in a fractionalized delivery system at the federal level, encouraging program duplication and gaps in coverage. The following tables list the number of federal grants by function. Table I lists 444 programs of cash grants, in kind grants, services and loans and loan guarantees which are provided as direct aids to state and local governments. As Table I indicates, there are 92 separate programs in health, 91 in education and 58 programs in commerce and transportation.

**TABLE I**  
**FEDERAL GRANT PROGRAMS PROVIDING DIRECT AID TO**  
**STATE/LOCAL UNITS, BY FUNCTION**

<u>Function</u>	<u>Number of Programs</u>			
	<u>Cash Grants</u>	<u>In Kind</u>	<u>Services</u>	<u>Loans/Loan Guarantees</u>
National Defense	10	7	5	—
International Affairs and Finance	2	—	—	—
Space Research and Technology	—	—	—	—
Agriculture and Rural Development	10	1	1	4
Natural Resources	18	10	25	1
Commerce and Transportation	39	3	15	1
Community Development and Housing	24	—	1	3
Education	88	3	—	—
Manpower	14	—	1	—
Health	92	—	—	1
Income Security	25	2	6	—
Veterans Benefits and Services	5	—	—	—
General Government	5	6	16	—
Total	332	32	70	10

Source: Tax Foundation, Inc. Federal Grants: The Need for Reform (Research publication No. 29, New York, NY 1973), p 25.

The recent trend toward replacing narrow categorical grant programs with bloc grants has not significantly reduced the size or number of grant programs. In fiscal year 1975 nearly 10 percent of the total federal aid was distributed in the form of bloc grants, approximately 14 percent as general revenue sharing and the remaining 76 percent in the form of categorical grants. Even bloc grants tend to grow into new series of categorical programs. For example, the first bloc grant, the 1966 "Partnership for Health" legislation has subsequently had a string of categorical programs added so that the bloc grant component now represents only a small section of the total authorization.<sup>4</sup>

The fractionalism of the grant-in-aid system is compounded by the number of state and local governmental recipients and organizations. On the local level, programs often require several sources of federal funding, channeled through separate state agencies, using different fiscal years, reporting requirements, funding cycles, and bases of information. This all contributes to an extremely complex system of service delivery characterized by bureaucratic delays, gaps in funding and a general lack of coordination.

<sup>4</sup>Advisory Commission on Intergovernmental Relations, In Respect to Realities: A Report on Federalism in 1975 (Washington, D.C., April, 1976), p. 16.



One of the difficulties of research in this area is that there are so many fundamental problems in the federal aid system that it is difficult to determine which problems deserve the most attention. For our purposes, it is important to distinguish those problems which the state can affect from problems which also require concerted action by the federal government. Our review of the literature identified the following eight major problem areas:

1. Timeliness of information on the availability of funds.
2. Uncertainty regarding the level of federal funds anticipated once an application has been made.
3. The burdensome effect of federal compliance requirements, both in terms of the time required to make applications and write plans as well as the effect of these requirements on program implementation.
4. The lack of effective planning mechanisms at the state level, or meaningful review of plans at the federal level.
5. The lack of coordination among separate programs, administered by separate state agencies according to separate federal guidelines and rules.
6. The potential distortion of state priorities resulting from federal funding incentives.
7. The implied commitment on the part of states to pick up the costs of federally initiated programs when federal aid is withdrawn.
8. The lack of effective procedures for legislative and executive review of federal aid applications and plans.

Most of these problems could at least be partially alleviated by a more effective and comprehensive system of state coordination and control of federal aids. State governments occupy a critical position in the federal aid system. Legislative oversight of federal aids could make a significant contribution to integrating state and federal program objectives by introducing some level of control over this system.

Before turning to a discussion of the role of Minnesota state government in federal aids coordination, each of the above eight problems are discussed briefly below.

### INFORMATION ON AVAILABILITY OF FEDERAL FUNDING

There are numerous information sources on the availability of federal funds. The most comprehensive source is the *Catalogue of Federal Domestic Assistance*. However, according to the Governmental Accounting Office, this catalogue is not always complete or up to date for some lesser known programs and does not indicate the amount of funds available for each program.<sup>5</sup> Most grant-in-aid announcements are published in the *Federal Register* which is the most current source of information on federal rules, regulations and grant-in-aid requirements. Other sources of information include congressional delegations, state federal aid coordinators, program administrators, national associations and interest groups. Keeping informed of available federal programs is a formidable task for state governments because of the large number of programs and the variability in application dates, eligibility requirements, and related policies. Eighteen states have offices in Washington, D.C., to cope with the maze of federal programs and offices attempt to cover sufficient sources of information to ensure that relevant opportunities for federal assistance are not overlooked.<sup>6</sup> In addition, Minnesota recently established a Washington office for this purpose.

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<sup>5</sup>Controller General of the United States, *Fundamental Changes are Needed in Federal Assistance to State and Local Governments*, Governmental Accounting Office (Washington, D.C., 1974), p. 21.

<sup>6</sup>*Ibid*, p. 22.

Grant application deadlines frequently allow inadequate lead time for states and localities to prepare applications and plans. By the time many potential applicants are informed of grant opportunities, insufficient time remains to prepare the necessary analysis and documentation. This problem is especially serious for governments where formal approval is required by a governing authority (city council, county board, legislature, etc.) prior to the submission of federal grant applications.<sup>7</sup>

The federally mandated A-95 review process, which requires a review of all federal aid plans by a regional or state clearinghouse, may also cause delays. In those cases where there is insufficient lead time provided for applications, such review procedures are often circumvented.

### UNCERTAINTIES REGARDING THE TIMING AND LEVEL OF FEDERAL AIDS

Uncertainty about funding reduces the value of planning on the part of state and local governments and makes such planning more difficult. Such uncertainty causes state and local governments to react to federal assistance as it becomes available and discourages planning for the integration of federal programs into ongoing state and local functions. This constraint on the planning process also makes program implementation more difficult and less efficient and effective.<sup>8</sup>

The level of federal aid for any given program cannot be anticipated with reasonable confidence until the money is actually in hand, due to the delayed passage of Congressional appropriations, executive vetoes and impoundments, and administrative delays in implementing grant programs or calculating state allocations for formula grants. In some cases, in order to maintain program continuity from year to year, personnel and spending commitments must be made in advance of federal funding commitments, based on projections, past experience, and faith.

Even when federal funds are committed, midstream changes in federal policies and priorities may affect the actual amount of aid received. One such case which directly affected Minnesota involved a federal alcohol and drug abuse program initially established by the federal government with no ceiling on total federal appropriations. As states began to participate more actively in this jointly funded federal-state matching program, the costs of the federal component began to increase dramatically. The Minnesota Legislature appropriated a high level of matching funds based on the state agency's projection of a high rate of federal participation. With the skyrocketing costs nationally, the federal government subsequently placed a ceiling on the federal funds, leaving Minnesota overcommitted. The resulting million dollar gap in funding in Minnesota was picked up by additional state appropriations.

Recent federal initiatives including the passage of the Congressional Budget Act should improve the timeliness of information on federal aids. States also need to play a role by maintaining better information on the availability of federal funds.

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<sup>7</sup>*Ibid*, pp. 27-30.

<sup>8</sup>*Ibid*, p. 26.

## FEDERAL COMPLIANCE REQUIREMENTS

"The way the Feds cut red tape is lengthwise"

*Governor Paul Castro of Arizona  
Los Angeles White House Public Forum, December, 1975<sup>9</sup>*

Applications and plans for federal aids must show evidence of how the state will comply with federal requirements for each respective grant-in-aid program. These requirements are of two basic types: general or generic requirements applicable to all federal aid programs and specific requirements unique to each program or group of programs.

Specific compliance requirements are more difficult to streamline since they reflect congressional intent or agency practice and influence the definition and scope of the grant program. Categorical grants present the greatest difficulty in that they are generally controlled by authorizing legislation which is quite specific regarding what groups are intended to receive services, in what geographic areas and by which mode of service delivery.

The generic requirements common to large numbers of grant programs fall into the following categories: affirmative action, merit system, career development, preservation of records, confidentiality of records, accounting/reporting, and property disbursement. These regulations cut across several programs and are based on provisions which are scattered throughout federal statutes, codes and agency rules and regulations resulting in duplicative and sometimes conflicting requirements for any given program.

A HEW National Task Force has recommended rationalizing these various compliance requirements into a single document which would be applicable to large groups of HEW grant-in-aid programs. HEW will be testing a pilot program of separating compliance requirements from planning documents for one program in each of the three HEW agencies: Public Health Service, Office of Education, and the Office of Human Development. The purpose of this pilot test is to attempt to simplify the planning document by setting all compliance issues in a separate simplified form so that they do not divert time and resources from the actual planning itself.<sup>10</sup>

## MANAGEMENT PLANNING VS. PAPER PLANS

Annual state plans required for federal aid applications primarily serve the functions of compliance documentation and grantsmanship. In practice, plans are written to reflect federal requirements on form and content rather than as blueprints for program implementation. The authors of the HEW Region X Study analyzed 35 HEW related state plans and conducted interviews with state and federal officials, drawing the following conclusions:

1. Federally required state planning documents are of little management value to the grant recipients.

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<sup>9</sup>U.S. Dept. of Health, Education and Welfare, Region X, *Ties That Bind: HEW National Management Planning Study — 1976*. (Seattle, Washington, 1976), p. 1.

<sup>10</sup>*Ibid*, pp. 28-32.

2. Some management planning occurs on an informal level in these state agencies, but it is largely unrelated to the federally required planning documents.
3. Few federal officials found these planning documents to be adequate as a sole basis of evaluating grantee performance and accountability.<sup>11</sup>

A Governmental Accounting Office study of HEW Public Health Service formula grants in three states similarly found a lack of systematic planning by state recipients and inadequate monitoring of plan performance by HEW.<sup>12</sup>

A study of planning for human services programs in Minnesota reached the following conclusion regarding the usefulness of state plans submitted as federal aid applications.

Annual state plans developed by the various human services agencies do not reflect an organizational perspective of resource allocation, program budgeting, systematic plan adjustment, and innovation. In essence, the current annual plans and related plan-development functions are removed from administrative decision-making and organizational problem solving. Formal state human services plans predominantly serve to fulfill federal reporting requirements for the acquisition of special categories of funds. Thus, the planning process is more a grantsmanship function than a problem-solution function.<sup>13</sup>

#### LACK OF COORDINATION WITHIN A FRAGMENTED DELIVERY SYSTEM

A fragmented delivery system is the result of a plethora of categorical grant programs each requiring a separate state plan, the diversity of federal agencies administering plans, the segmented character of most state bureaucracies, and the complex funding flows from federal to state and local units of government. Different federal programs require different forms of data and use different criteria of need. In addition, the jurisdictions of state agencies who channel funds to localities often overlap and conflict. Local programs become accountable to diverse state and federal funding agencies. Within this system, comprehensive planning as attempted in state plans for federal aids is not very successful. No single agency or group of planners can view the broader picture, but are limited to those specific facets of any given problem which are eligible for each type of federal funding.

Vocational education provides one illustration of the program duplication fostered by federal aids. Under the stimulus of federal aids, vocational education facilities are often built and programs initiated without regard to the availability of comparable facilities in secondary schools and community colleges. Programs are offered by several institutions within a single community without due attention to the manpower needs of the region. A study by the Governmental Accounting Office of federal assistance for vocational education drew the following conclusion based on their investigation in several states.

The Vocational Education Act requires that vocational programs be developed in consultation with representatives of the educational and training resources available to the area being served. It also provides for cooperative arrangements with other agencies, organizations, and institutions concerned with manpower needs and job opportunities.

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<sup>11</sup>*Ibid*, pp. 23-24.

<sup>12</sup>*Comptroller General of the United States, How States Plan For and Use Formula Grant Funds To Provide Health Services, Governmental Accounting Office (Washington, D.C., 1975).*

<sup>13</sup>*Minnesota State Planning Agency, Human Services Planning Study, Human Services Planning Unit (St. Paul, Minnesota; July, 1975), p. 10.*

However, we observed minimal coordination in activity at national, state or local levels between organizational entities providing vocational services, and even less cooperative effort. Without such collaboration, there is little opportunity to improve the use of federal funds or to insure that student and community needs are being met.<sup>14</sup>

### IMPACT OF FEDERAL FUNDING ON LOCAL PRIORITIES

Since state government priorities are seldom articulated explicitly, specific cases of altered priorities resulting from federal aids are difficult to document. It is difficult to know how state and local funds would have been spent if there had been no federal incentives to invest in certain programs.

There are two basic types of infringements on state prerogatives which result from federal aids. The most direct constraint is federal rules and regulations which induce states to conform to often formalistic and counterproductive requirements. One illustration is the effect of new federal rules for Intermediate Care Facilities for the mentally retarded on the existing MR program in Wisconsin. The new federal standards required 100 square feet for single rooms and 80 square feet per resident for multiple sleeping rooms. Several Wisconsin facilities built since 1968 currently have single rooms with 90 square feet of space. The effect of the federal regulations will be to require the conversion from single to double rooms, reducing privacy and quality of care, at a cost of \$3.1 million. The irony is that precise space standards have no demonstrable relationship to quality of care. Further, the standards apply to sleeping space, but MR residents spend most of their time in common activity rooms where the rehabilitation takes place.<sup>15</sup>

The impact of federal aids on local funding priorities is subtle. A recent case in Minnesota was an application for vocational education aids, which if fully funded had the potential of diverting state funds from nonvocational secondary school programs to meet the matching requirements for federal vocational educational funds, and similarly tip the balance between vocational and nonvocational programming in Minnesota public schools.

In summary, the basic problems are that federal aids offer a powerful incentive to state and local governments to do things which may not have been viewed as high priority in the absence of strong federal fiscal incentives. Indeed some federal officials see the purpose of federal aid as a catalyst to state and local governments; to induce them to undertake programs which they otherwise would not attempt to initiate on their own. Second, as states become involved in the complex web of categorical grant programs, they become increasingly bound by narrow, often conflicting federal rules and requirements. A third form of federal distortion of local priorities results from the termination of federal support for programs which were established in response to the availability of federal aids.

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<sup>14</sup>Comptroller General of the United States, What Is The Role of Federal Assistance For Vocational Education?, Governmental Accounting Office (Washington, D.C.; 1974), p. 25.

<sup>15</sup>Wisconsin Department of Administration, Roadblocks to Efficient State Government: A Sampling Of The Effect Of Federal Red Tape in Wisconsin (Madison, Wisconsin; June, 1976).

## **STATE PICKUP OF FEDERAL PROGRAMS**

The clearest clash of priorities and interests occurs when federal support of federally initiated programs is reduced or withdrawn. Just as it is difficult to anticipate whether federal funds will be received, it is also difficult to anticipate the duration and firmness of any federal commitment. Consistent with the role of federal aid as a catalyst, a large share of federal aid is intended to be short-term in nature. Project grants, as opposed to formula grants, are most susceptible to short range federal commitments. As programs are initiated on federal funds, position commitments and supporting constituencies often require the state to pick up the costs of such programs when federal support is withdrawn.

## **THE LACK OF LEGISLATIVE AND EXECUTIVE OVERSIGHT**

The most significant problem from our perspective is the lack of legislative and executive involvement in the federal aid system. The federal aid process is dominated by administrators who apply for federal aids, write plans, set policies and spend federal funds largely in terms of the conditions placed on those funds by federal administrators. The application, planning, expenditure process for federal aid is on-going and does not correspond to the state's budgetary review cycle. Until recently, any informed review of federal funds in the state's budgetary process was made difficult by the lack of basic information on the amount of federal aids received by state agencies.

In many states legislatures exercise virtually no control over the use of federal funds, and very few states even possess basic information on the amount and types of federal aid entering the state. We believe that improved executive and legislative oversight of the federal aid system is the first step toward rectifying many of the problems discussed above. This is the single area in which the state can unilaterally affect the federal aid system and begin to impose some accountability where no effective accountability currently exists. What is needed is accountability by state administrators to the policy preferences of elected officials and their constituencies, accountability for expressed or implied policy commitments made by administrators in the pursuit of federal aid, and the accountability of the federal bureaucracy to the states regarding the appropriate limits of federal influence over state policy.

The balance of this report is focused on the role of state government in federal aid coordination. The oversight problem is viewed in terms of three functions or objectives: financial tracking of federal aids received by the state, more effective procedures for policy review, and the role of legislative budgetary review in the oversight of federal aids.

## CHAPTER TWO

### FEDERAL AIDS COORDINATION IN MINNESOTA

This chapter outlines the procedures currently used in Minnesota to track federal aids received by the state and to review the policy implications of those federally aided programs and activities. It presents recommendations on how the state can more effectively track federal aids, monitor their expenditure, and review the effects of federal aids on state policies and priorities.

#### FISCAL TRACKING OF FEDERAL AIDS

The identification and tracking of federal aids flowing into the state is the key to policy oversight and informed budgetary review. One must first identify the source, magnitude and use of federal funds which are under the state's control before one can attempt to assess the impact of these funds on state policy. Similarly, more accurate and timely information on federal funds is needed in order to make better informed appropriations of state funds in areas which are affected by large amounts of federal funding such as social services and education.

Minnesota state agencies received approximately \$700 million in federal aids in fiscal year 1976 (not including general revenue sharing funds).<sup>1</sup> This total includes funds that were directly administered by state agencies as well as federal funds which were "passed through" to local units of government. The percentage of "pass through" funds varies with each grant category. Generally the larger grants in health, social services, and education have a higher percentage of pass through money. In addition to state controlled and pass through funds, federal aids are allocated directly to local units of government by the federal government. Federal receipts by Minnesota state and local governments for fiscal year 1976 totaled \$1.1 billion.<sup>2</sup> Consequently, the portion of federal aids allocated directly to local governments in Minnesota could be estimated as \$400 million for fiscal year 1976 out of a total of approximately \$1.1 billion in federal aids to Minnesota state and local governments.

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<sup>1</sup> These data are based on a preliminary compilation of federal aids for fiscal year 1976, provided by the Office of Federal Relations, Minnesota Department of Finance.

<sup>2</sup> Minnesota State Planning Agency, Federal Grants-In-Aid in Minnesota (St. Paul, Minnesota; April, 1977) p. 3.

A small number of state agencies account for the majority of federal aids. Of the state controlled and pass through money, nearly half is received by the Department of Public Welfare. Ninety-five percent of federal aids received by the state in fiscal year 1976 was received by the following seven state agencies in rank order: Welfare (49%), Highways (20%), Education (14%), Governor's Manpower Office (4%), Employment Services (3.6%), Crime Control Planning Board<sup>3</sup> (2.1%), and Health (1.8%).<sup>4</sup>

## SOURCES OF INFORMATION ON FEDERAL AIDS

Given current capabilities and sources of information, the identification of federal aids by state agency or program is extremely difficult and complex. The federal funding cycle does not correspond with the state's budgetary cycle. Federal funds are received throughout the fiscal year so that the level of receipts varies from month to month. There are three basic types of federal payment mechanisms. Some grants are funded on an advance payment, for other programs expenditures are made on the basis of a letter of credit, and the third mechanism is retroactive reimbursement for actual expenditures. State agencies currently do not account for federal funds in a consistent manner. Complete and timely department-wide information on federal receipts is generally not available.

There are several sources of information on federal aids in Minnesota, but each type of information has its limitations. The primary source of data has been through federal publications. An annual report published by the U.S. Treasury Department on federal domestic assistance was the primary source of data for the Minnesota State Planning Agency's annual reports on federal aids to the state.<sup>5</sup> While the Treasury Department's data are comprehensive, there are problems. The data are not timely since the report is published several months after the close of the federal fiscal year. Second, none of the totals distinguish between federal aids to local governments versus those aids allocated directly to state governments. Third, while the federal reports do show the total funding by federal agency and by broad functional areas, they do not show how these funds are allocated among state agencies. For example, it shows how much federal money was spent in Minnesota for education, but it does not show the distribution of federal education money among the State Education Department, local school districts, HECB, state universities, etc.

One other source which was intended to provide more timely and detailed information on federal grants is the Treasury Circular 1082 (formerly OMB Circular A-98) process, whereby federal agencies are required to notify the state clearinghouse (the State Planning Agency in Minnesota's case) of all awards of federal grants in aid within the state's jurisdiction. Definitional problems and lack of consistent or timely reporting by the federal agencies has made this procedure inoperative. In fiscal year 1976 no more than 75 percent of federal grants received in Minnesota were accounted for by these 1082 notices.<sup>6</sup>

Because of the inadequacies of federal sources of information, some states are attempting to collect this information themselves from sources within the state. For example, the Illinois legislature has established a special federal aids staff which conducts annual surveys of all state agencies to produce a comprehensive report on federal aids received by the state. The Minnesota Department of Finance established a federal relations office in 1976 which worked for several months to collect basic information on the total amounts of federal aids by state agency and program. However, it has proven to be very difficult and time consuming to cull information from several agencies and aggregate the data in a consistent format.

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<sup>3</sup>Formerly the Governor's Crime Commission. Similarly Employment Services and the Governor's Manpower Office were merged by the creation of the Department of Economic Security in July, 1977.

<sup>4</sup>Based on preliminary data compiled by the Department of Finance.

<sup>5</sup>See for example, Minnesota State Planning Agency, Federal Grants in Minnesota (St. Paul, Minnesota; April, 1977).

<sup>6</sup>Estimate made by State Planning Agency staff.



## MINNESOTA'S STATE-WIDE ACCOUNTING SYSTEM

Recent improvements in the state's accounting and budgeting systems present the opportunity for providing more timely and detailed information on federal aids. The state-wide accounting system (SWA) is the most reliable source of information on federal aids, since all funds (including federal funds) must be entered into the system in order to be spent. A related improvement is the state's shift to "clean fund accounting", in which federal funds are accounted separately from state funds rather than being transferred into the state general fund as in the past.

While the state-wide accounting system serves the purposes of fiscal accounting well, it is not capable of providing program information as it is currently designed. It can identify total federal expenditures on the basis of state account numbers, but a single account may include several individual grants. In addition, individual grants may be subgranted to other agencies or split up among more than one account in the same agency. Consequently, until recently, individual grants or federal program categories could not be readily identified through the state-wide accounting system.

The state's 1978-79 biennial budget also contained more information on federal funds than was available previously. In the 1976-77 program budget federal funds were only identified at the agency level, or in some cases at a broad program level. The current 1978-79 budget documentation breaks out sources of funds at the program and activity (subprogram) levels. Each activity page also gives three year trends (fiscal years 1975, 1976, and 1977) and two year projections (fiscal years 1978 and 1979) by source of funds. In this manner actual and projected federal funds can be identified on a five year basis. Since the biennial budget system is built directly off the state-wide accounting system, any improvements in the level of information available on the SWA will also improve the quality of information in the 1980-81 biennial budget documentation. It should be noted that these biennial budget projections would need to be updated periodically in order to provide realistic projections during the course of the biennium.

## LEGISLATIVE INFORMATION NEEDS

It is difficult to define the information needs of policymakers. As a practical matter the level and nature of legislative interest in federal aids will vary from one committee to the next, and from one legislative session to the next. However, we would suggest the following general criteria for information which would be useful to the legislature in their review of how federal funds are spent and the impact of these funds on state policy.

### Program Based

Federal funding information needs to be capable of being displayed on a program by program basis. By program we mean funds identified by each federal grant program, and matched with functional program categories of state government. While aggregate information on the total federal aids by state agency is useful for showing general trends in funding, federal aids tend to be program specific rather than general revenues. Federal funding is comprised of a diversity of grant programs with different program purposes and target groups, different state matching requirements, and committed for varying periods of duration. Especially in the area of categorical grants, each federal program has different sets of strings attached. Consequently, we would anticipate that most of the questions that would arise about federal aids will deal with specific federal programs rather than aggregate levels of federal funding for any given state department or agency.

Information on federal grants by program would allow the legislature and the executive to identify program duplication, identify areas in which state funds could be supplemented by federal aids, or other programs where the state is over matched with state appropriations. What is needed is a system of information which can identify the source of federal funds (by federal agency and grant program) so that the legislature can know how much federal aid is being spent in a program area such as education for example; as well as information on how and where the federal funds are being spent (by which state agencies and for what state programs).

## Duration

Legislators need to know the duration and firmness of federal funding commitments. Some form of information on when grants are scheduled or anticipated to expire was mentioned by several legislators and staff as necessary to inform decisions on whether to accept federal funds, and to provide lead time for the legislature to consider whether to pick up the costs of terminated federal programs.

## Timeliness

The collection of information on federal aids should be an ongoing process. Annual surveys yield aggregate information on the federal funds for the prior fiscal year. However, there may be cases where information is needed on whether a specific grant has been awarded, or the likelihood that such funds will be awarded during the current fiscal year.

Timing is also a factor in the speed with which inquiries for information can be answered. If a legislative committee is reviewing an appropriation for a program which includes a high level of federal funding, information on present and projected levels of federal aids needs to be available on a timely basis.

## Flexibility

Information needs to be available in a form that is useful for decision-making.

Legislative interest in federal aid information is specific and episodic. Legislators and staff should not be inundated with massive documents or computer printouts on a large number of federal grants if they request information on a limited number of specific federal grants. Consequently, there is a need for a system that is sufficiently flexible to respond to specific requests on a timely basis, without including extensive documentation on less pertinent information.

## Expenditure Data Versus Information on Receipts

Information on expenditures of federal aids should be sufficient for legislative purposes. Federal aid is received through various payment mechanisms and is allocated at different points during the fiscal year, causing the volume of federal receipts to vary throughout the year. Expenditures of federal funds, whether through advanced funding or reimbursement, is relatively constant and ongoing. Strictly speaking, the monitoring of federal receipts is an executive responsibility in terms of controlling the state's cash flow and maintaining a balanced budget. It is the responsibility of the executive branch to ensure that agencies do not spend money without prior commitments from the federal government that funds are forthcoming to cover those authorized expenditures. The legislature has a role in the appropriations process to ensure that agency projections of federal receipts are accurate so that state funds are not appropriated in lieu of federal aids which never materialize. This is a special problem which is discussed more fully in the next chapter.

For the purposes of information and oversight, it should be sufficient for the legislature to receive information on federal expenditures and budgeted amounts by program. No automated information system can predict the level or timing of federal receipts. However, program by program information on budgeted and expended federal funds should be sufficient for the purposes of legislative budgetary review.

## PROPOSED INFORMATION SYSTEM ON FEDERAL AIDS

The Program Evaluation Division staff sent a memo to the Department of Finance on September 28, 1976, making several suggestions on alternative approaches to federal aids coordination. One of the central recommendations was to develop an information system on federal aids which would identify the source of funds by federal agency and program and the distribution of funds by state agency and program. Since that time our staff has met with the Department on several occasions to discuss the feasibility of adapting the Statewide Accounting System (SWA) to provide more detailed information on federal aids. The Department of Finance is currently working on several changes in data coding in the SWA which, if fully implemented would result in a system capable of providing the following types of information. It would identify all federal funds (including pass through monies) which are controlled by each state agency. The system is expenditure based, i.e., it will show the budgeted, encumbered and unexpended balances of each federal grant program. By using Catalogue of Federal Domestic Assistance (CFDA) numbers each grant can be identified by federal agency and grant program. In addition the AID numbers on the SWA will identify each grant by the state agency and state program for which it is spent. All of the above information can be obtained by including the Catalogue of Federal Domestic Assistance (CFDA) number for each grant in the SWA information system. The Department now expects to be able to produce this information in a report prior to the 1978 legislative session.

In addition, the Department initially considered including codes for the type of grant (project, formula or research grant) and whether the grant is new or a continuation of a previous grant. They had also proposed including a code for the type of state matching required for each grant. We had also urged the Department to include information on the duration of each grant, i.e., whether the grant is short term or long term and the date at which the grant is scheduled to expire. This information is difficult to code, however, and it could be obtained on a case by case basis using agency sources of information rather than including it on a statewide computerized information system. Moreover, information on the anticipated expiration of grants is difficult to collect, and is subject to error since it is somewhat speculative. Nonetheless, the Department should collect such information annually and report it to the fiscal committees of the legislature. The Department is developing this system gradually, and it is unclear whether these additional informational categories on federal aids will be implemented without a clear statement of need by the legislature.

If fully implemented, the proposed system would meet nearly all of the criteria we could determine for legislative information needs. By use of the SWA, the resulting system would be quite versatile. It could identify all federal funds received by the state by functional area (such as education) as well as identify all the federal funds being spent within a specific state program area such as vocational education for example. It could also display the total federal funds received by each state agency.

Since the information is computerized, the system could become quite flexible. If there is sufficient demand for this information, the federal aid data should be put "on line" so that specific information on federal grants could be retrieved by remote computer terminals. Under current plans, the Department will be able to produce periodic printed reports covering all federal aids budgeted and expended by state agencies.

### Cost of the System

The federal aids information system would "piggyback" on the current SWA. It would not require a separate system but would merely require a few additional codes to be punched when federal funds are entered into the SWA. The Department of Finance could control the system to ensure that all data are properly coded and entered into the system. In practice, federal funds would not be released for expenditure until the federal grant information was correctly entered in the SWA. The Finance Department controllers would have the responsibility for reviewing the accuracy of all federal funding information. The day to day file maintenance of this system would require some increase in workload by the Department of Finance and the state agencies. However, the Department does not intend to request any new positions for this purpose. Based on what we currently know about the proposed system it would appear that any increased costs for including the federal grant information on the SWA would be marginal.

The Department of Finance is currently working on the development of this information system. To some extent, this was encouraged by the earlier suggestions and consultation by the Program Evaluation Division. Even in its current form, the new system will provide accurate and timely information on federal grants, which is not now available.

## RECOMMENDATION 1

We recommend that the Department of Finance be encouraged to continue the development of a federal aids information system based on the current statewide accounting system. We further recommend that this system be completed as soon as possible so that more detailed information on all aids received by state agencies is available in the 1980-81 biennial budget documentation, and available upon request during the 1978 legislative session. This information should include at a minimum the federal catalogue number and state agency and state budget activity for each grant or contract.

## POLICY REVIEW

Federal grants are awarded to states on the basis of applications or formal state plans describing how the funds are to be spent. As indicated in the first chapter, these grants often impose requirements for state matching funds and other restrictions on how federally assisted programs are to be planned and implemented. Federal requirements and program priorities may conflict with state policies or priorities. It is very difficult to generalize about the impact of federal aids on state policy. In our view, the most direct means of identifying policy problems resulting from federal aid requirements is through a more effective system of legislative review.

Governors and legislators are generally not involved in the federal grant-in-aid process. The responsibility for seeking federal funds, planning, and administering federally aided programs has been assumed by program administrators and agency planners. There are at least two points in the federal funding cycle where policy review would be appropriate and useful. The first opportunity for review is at the planning and application stage. A second review point would be as the funds are being spent, and this could be done in conjunction with the state budgetary review. The balance of this chapter describes the current process in Minnesota for the review of applications and plans and suggests some means by which the legislature could become involved in this review.

## THE A-95 REVIEW PROCESS

The A-95 process is the primary mechanism for the statewide review of federal aid applications and plans in Minnesota. A-95 refers to the Federal Office of Management and Budget circular which mandated states to establish statewide clearinghouses to coordinate the submission and review of plans and applications for a majority of federal grant-in-aid programs. Through the designation of one statewide clearinghouse, the A-95 process was intended to rationalize the federal aid planning process and to alert the governor to potential conflicts resulting from overlapping or competing federally aided programs at the state and local levels. The State Planning Agency serves as the A-95 clearinghouse for Minnesota.

### Part I and Part III Reviews

The A-95 agency reviews two types of federal aid applications. Part I reviews cover project grants and other applications which do not require a state plan. Agencies applying for grants covered by Part I must submit a notification of intent to apply for federal funds to the A-95 clearinghouse.

The Part I notices contain information on the proposed project, the applicant, the project duration, location, intended beneficiaries of the project, the amount and types of funding requested, and the level of state or local matching funds required. Local units of government applying for grants covered by Part I of A-95 must submit a notification of intent to their respective regional development commissions (which serve as area-wide A-95 clearinghouses) as well as the State Planning Agency. The purpose of the A-95 notices is to inform all affected state and local agencies of applications for grants in related program areas and geographical locations to minimize duplication and encourage coordination and cooperation.

There are approximately 1,500 A-95 Part I notices submitted to the State Planning Agency by local agencies each year. According to an estimate by the State Planning Agency staff, approximately ten percent of these grant applications have statewide significance. In addition, state agencies submit between 100 and 200 A-95 Part I notices each year.

Part III of A-95 provides for the review of state plans submitted as applications for federal aids. The State Planning Agency is allowed 45 days to review each plan and solicit comments and reviews from other affected agencies. Federal policy requires that the A-95 agency "sign off" on all plans submitted for federal funding in order for such applications to be considered by the federal government.

Approximately sixty plans are submitted to the state A-95 clearinghouse each year. These plans vary widely in their form and level of detail. For renewed funding under formula grants (federal AFDC, medical assistance, etc.) states may submit a simple checklist form which indicates compliance with a number of federal requirements. Other formal plans are simply amended each year. In some instances full planning documents are sent to the federal government each year. In the case of Minnesota's LEAA plan, the document exceeded 900 pages. Obviously, some plans require more review than others. Further, the checklist and amendment type of planning document is the most difficult type of plan to screen for policy content, since so much policy is implicit or was established in previous plans. Nonetheless, the A-95 process does provide some level of screening and review of the policy implications of state plans for federal aid. The A-95 process covers approximately eighty percent of all federal funds received by state agencies. Since the largest 20 grant programs cover most of the funds received by the state,<sup>7</sup> the State Planning Agency is selective in which plans they review. Not all plans are given the same degree of scrutiny.

There have been several national studies and evaluations of the A-95 process. Regarding the Part I notification process, the general consensus of these evaluations is that the review process has improved since the early 1970's. Several studies have indicated that simple notification of pending federal aid applications does not ensure effective coordination among grant programs at the state or local level. Other critics of the A-95 Part I system have cited the increased complexity and delays added to the grantsmanship process as a result of A-95 requirements.<sup>8</sup>

Studies of the Part III A-95 plan review process have been more critical of the effectiveness of this review mechanism in achieving coordination. Although it was intended to assist governors in keeping informed of federally aided programs in their respective states, governors and other high level officials are seldom involved in the preparation or review of state plans for federal aid. According to a Council of State Governments study:

Even though Part III of A-95 established guidelines requiring the governor or his designated agency to review federally mandated state functional plans, little effective coordination is taking place in many states.<sup>9</sup>

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<sup>7</sup>Estimates provided by State Planning Agency staff.

<sup>8</sup>Advisory Commission on Intergovernmental Relations, *Improving Federal Grants Management, The Intergovernmental Grant System: An Assessment and Proposed Policies* (Washington, D.C.; 1977), pp. 271-228.

<sup>9</sup>Leonard U. Wilson and L. V. Watkins, *State Planning*, Council of State Governments, August 27, 1975, p. 108, cited in Advisory Commission on Intergovernmental Relations, *Ibid*, p. 231.

An HEW survey of state and local administrators in several northwestern states found that although administrators, planners and budget officers were involved in the A-95 process, their participation was limited primarily to submitting their plans for A-95 review, as required, rather than reviewing or commenting on plans submitted by other agencies, as the A-95 concept originally intended.<sup>10</sup>

It should be noted that in Minnesota, at least, the A-95 process does serve a useful screening and early notification function. For example, it was the State Planning Agency, through its A-95 review, which alerted the governor's office and several legislators to the 1977 Vocational Education Plan, which would have required a significant shift in state funds toward vocational education in response to federal matching requirements.

The original expectations for the A-95 process far outstripped the priority and funding given to A-95 at both the federal and state levels. While A-95 does not automatically result in effective statewide coordination of federal funds, it does serve a useful function as a central clearinghouse for information on federal grant applications and can serve as one means of avoiding duplication and unnecessary competition in the development of federally aided programs. The principal weaknesses of the A-95 process are two-fold. First, in terms of policy review, it is extremely difficult to cull out the policy behind the jargon in state plans. This requires extensive knowledge of each program and some familiarity with state policy and legislative interest in each of the program areas. This is difficult to accomplish given the small staff assigned to the A-95 reviews. Second, there is limited involvement by policy makers, and legislators in particular, in the federal aids review process.<sup>11</sup> Consequently, it is difficult to anticipate conflicts between state priorities and commitments made on behalf of the state by planners in their federal aid applications.

## LEGISLATIVE REVIEW OF FEDERAL AID APPLICATIONS

Prior to 1973 the Minnesota statutes required that all applications for federal aids be approved by the governor and submitted to the legislature for review by the House Appropriations and Senate Finance Committees or the Legislative Advisory Committee during the interim.<sup>12</sup> With the growing volume of federal aid applications, this procedure evidently became unworkable and the provision was repealed in 1973. A new statutory provision was created to require that all applications for nonstate funds be approved by the Commissioner of Finance prior to their submission to the federal government.<sup>13</sup>

The requirement for Department of Finance review is difficult to enforce, since there is currently no other information available with which to verify that all applications are in fact submitted to the Department for review. An information system on federal funds would provide one post-hoc verification on whether all applications which subsequently received funding had been submitted to the Department for review. According to one source, the review of federal grant applications has not been a high priority for the Department in the past. However, current plans indicate that Finance controllers will be responsible for reviewing all the federal aid applications and that greater emphasis will be placed on this function in the future. Even with such a process, the reviews may be more fiscally oriented than concerned with program policy.

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<sup>10</sup>HEW Region X, *Ties That Bind*, Op. Cit., p. 62.

<sup>11</sup>One major exception is the legislature's historical practice of reviewing all State LEAA plans submitted by the Crime Control Planning Board and making recommendations on state LEAA projects. This practice is now formalized by Chapter 260, 1977 laws.

<sup>12</sup>Laws of Minnesota, 1953, Chapter 461, Section 1.

<sup>13</sup>Minn. Statutes, Section 16A.30 as amended by Chapter 231, 1976 laws.

The problem with the reviews envisioned by both the current and earlier statutes is that the review process is not sufficiently selective or flexible. There may be numerous applications and plans which do not need to be reviewed. In the case of plans, these documents are not always binding upon the state; programs are carried out somewhat differently than indicated in the plans, and plans are often mere compliance documents rather than guides for program implementation. An across-the-board requirement to review all applications did not work for the legislature in the past because it did not differentiate between the important applications and the mundane ones. The volume of paper flow produced by an ongoing plan and application review responsibility is yet another problem.

On the other hand, legislative involvement in the review process would allow interested legislators to be informed of pending federally aided programs before commitments are made by state administrators to implement a program that may be inconsistent with legislative priorities. There are several alternatives to across-the-board review of federal aid applications by the legislature. There are already two separate reviews of these applications which can be made; A-95 reviews and fiscal reviews by the Department of Finance. If the legislature wants to become involved in the review process it would appear to be more sensible to make use of the review mechanisms already available. We would suggest the following procedures for consideration by the legislature.

### **PROPOSED LEGISLATIVE POLICY REVIEW**

First, the State Planning Agency could be asked to forward copies of A-95 Part I "notifications of intent to apply for federal aids" to the appropriate legislative committees. This would serve as an "early warning system" for the legislature by informing them in advance of new programs being developed by the agencies. In those cases where such proposals involve significant policy decisions, the legislative committee and its staff would be in a position to influence the design of the program. The State Planning Agency should exercise some discretion by referring only those notices for applications which have clear statewide significance. The legislature may wish to set other criteria by which to screen these applications. For example, the legislature may want to review only proposals for grants above a certain dollar level, such as \$50,000.

For state plans covered under Part III of A-95, the State Planning Agency could perform a similar screening and referral function. It probably would not be fruitful for the legislature to review all sixty plans submitted for A-95 review each year. Given the esoteric nature of many of these plans, legislative staff review of the entire planning document may also have limited benefit. Consequently, we suggest that the agencies be required to attach a short "policy note" to each state plan for federal aid submitted for A-95 review. The "policy note" would be a summary of the major provisions of the plan, program goals and objectives, the amount and type of state matching required, and the effects of the plan on current state policy and practice. These "policy notes" could be reviewed by the State Planning Agency for accuracy and completeness and forwarded to the appropriate legislative committees for their information and review.

In light of the current legislative interest in oversight of administrative rules, we would further suggest that these policy notes and A-95 Part I notices include a statement by the applicant agency specifying what rules must be adopted to conform with federal requirements under each respective application or plan. These notices and policy notes should also be referred by the State Planning Agency to the Legislative Commission to Review Administrative Rules.<sup>14</sup>

There are several advantages to the Part I notification and "policy note" referral procedure suggested here over other forms of review attempted to date. First, the suggested process would tie into the existing A-95 process without creating a separate information system or layer of bureaucratic review. Second, the State Planning Agency could screen Part I notices and Part III plan policy notes according to predetermined legislative information needs. This would allow for a more selective review by the

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<sup>14</sup>This procedure was suggested by the executive secretary of the Legislative Commission to Review Administrative Rules.

legislature, and would avoid the overload of being flooded with paper dealing with minor and extraneous federal grant applications. Third, it would draw upon the expertise of legislative committee members and staff, who are familiar with the programs within their committee's jurisdiction. Finally, it would provide an opportunity for legislative input into the federal aid process in order to avoid sunk commitments which are later questioned by the legislature because they received too little information too late in the process.

There are two questions remaining regarding the need and utility of such a legislative review process. It is very difficult to define in advance the interests and information needs of the legislature. Legislative concerns arise in response to specific issues. Similarly, different committees will have varying levels of interest in federal funds. The legislature may want to limit the policy review process to those seven state agencies which receive 95 percent of all federal aids. The legislature may want to begin a policy review process selectively with two or three committees with jurisdictions in areas where there are numerous federal grant programs. Before any policy note and application notification process could be attempted, the State Planning Agency would need to determine which legislative committees could use this information, and what specific grant programs are within the jurisdiction of each committee.

The second question deals with how this information should be used, specifically, what role should the legislature play in reviewing federal aid applications and plans? This is a policy issue which needs to be addressed by the legislature. However, a requirement for formal legislative approval of plans and applications may present serious difficulties. There are already two review points, the Department of Finance and the A-95 Agency, at which a "sign off" is required prior to the submission of an application to the federal government. Another formal approval at the legislative level may result in costly delays and increase the complexity of an already complicated federal grant application process. Such delays would be accentuated when the legislature is not in session.

An alternative form of oversight would be for the legislature to review selected applications and plans for informational purposes, and either influence these policies informally, or hold hearings on the issues to identify any problems and work toward their solution. The legislature has considerable leverage over the agencies through the appropriations process. In extreme cases where a federally funded program continues to conflict with state priorities, appropriate action could be taken to influence the agency through the appropriations process.

## RECOMMENDATION 2

We recommend that the policy committees of the legislature consider means by which information on federal aid applications and plans could be reviewed by the appropriate committees for the purpose of alerting them to new federally funded programs and the policy implications of such programs. One means would be the screening of A-95 Part I notices by the State Planning Agency for referral to the appropriate legislative committees. In addition, federal aid applicants could be required to submit written "policy notes" on state plans covered by Part III — A-95 reviews. These policy notes should be referred by the State Planning Agency to the appropriate legislative committees.

## COORDINATION OF FEDERAL AID INFORMATION AND REVIEW FUNCTIONS

There are currently three agencies which are assuming responsibility for some facet of the federal aids coordination process; the State Planning Agency, Department of Finance and Lieutenant Governor's Office. The State Planning Agency has been responsible for the A-95 process since the inception of that process in the late 1960's. In addition, the State Planning Agency has prepared reports and analyses of federal aid received in Minnesota, and projections of the impact of federal executive budgets on Minnesota's federal aid allocations. Finally, the State Planning Agency is the receptacle for 1082



notices which announce federal grant and contract awards. The Department of Finance is currently assuming the responsibility for tracking federal funds received by state agencies, and reviewing federal aid applications submitted by state agencies.

Early in his term, Governor Perpich assigned Lieutenant Governor Olson the responsibility for inter-governmental relations, with a particular emphasis on liaison activities with the federal government. According to a staff member of the Lieutenant Governor's office, the office intends to perform the following activities. The primary function of the Lieutenant Governor's office will be to keep the state informed of pertinent legislation, bills, federal rules and regulations and executive orders which affect Minnesota's interests and programs. The office will coordinate information on federal policies and disseminate this information to the affected state agencies. The Lieutenant Governor's office will also coordinate or be informed of federal liaison activities of state agencies so that Minnesota can present a consistent position to the federal government.

The Lieutenant Governor has established a Washington office, with a full-time staff member responsible to contact federal agencies to keep the state informed of pending policies and rule changes, and to maintain contact with the Minnesota congressional delegation.

While on the surface it may appear that Minnesota's institutional arrangement for federal aids coordination is complex, each agency will be performing distinct and important functions. Under this arrangement, the State Planning Agency will retain responsibility for plan review and grant application notification under A-95. This is primarily a planning function which is consistent with the Agency's mission and expertise. The fiscal tracking and grant application review functions of the Department of Finance both have a financial orientation, and complement the fiscal control and oversight responsibilities of the Department. Similarly, the Department has control over the statewide accounting system and employs a staff of budget controllers which gives them access to the types of information necessary for this fiscal oversight function. The Lieutenant Governor's office will evidently be focusing on liaison activities in Washington and coordination of information on federal rules and policy for the state. The role of representing the state of Minnesota to federal agencies and the congressional delegation is consistent with the stature and constitutional status of the Lieutenant Governor's office.

It should be apparent that these three offices will benefit by ongoing communication and cooperation. For example, the Lieutenant Governor's office would need to be informed by the Department of Finance on the amounts of federal aid received by state agencies. The Lieutenant Governor's office would also need to be kept apprised of major grant applications submitted by state agencies, and some of this information could be drawn from the A-95 process.

There are two areas in which these offices may need to coordinate their respective activities. First, the State Planning Agency should continue to be responsible for receiving notifications of grant awards (1082 notices) since these notices cover all applications submitted throughout the state. The 1082 process is not now useful as a control point, since these notices do not account for all federal funds received. However, 1082 notices could be used as a check on the accuracy of the data entered on the statewide accounting system. Consequently, the Finance controllers should receive copies of 1082 notices to verify the information on federal grants provided by the state agencies.

The second area which needs to be addressed by these three offices is the responsibility for preparing reports on federal aids received in the state and analyses and projections of federal aid programs. These reports had been prepared by the State Planning Agency in the past. It would be consistent with these emerging roles for the Department of Finance to publish annual reports on federal aids received by state agencies. The State Planning Agency may find it useful to publish reports on federal aids received by state and local governments (based on federal reports), and the Lieutenant Governor's office may be in a position to publish analyses and projections of the impact of federal budgets and appropriations of federal aids in Minnesota. The relative needs for these kinds of reports should be determined by the three offices, and their respective responsibilities in disseminating information should be allocated by them in order to avoid potential duplications.



## CHAPTER THREE

### FEDERAL AIDS AND THE STATE BUDGETARY PROCESS

The state budget is a powerful tool by which the legislature can set priorities and influence the design and implementation of state programs. To the extent that legislative budgetary review provides oversight on state funded activities, it may also be used to influence the purposes for which federal funds are spent by state government. The previous chapter discussed various means by which the legislature can obtain more timely information on the level and uses of federal aids in the state, and perform selective reviews of the policy implications to the state of the uses of federal aids. Given the historical legislative power of the purse, the greatest degree of influence over federally aided expenditures can be obtained through the budgetary process.

This control can take several forms. The legislature could influence the executive agencies regarding what forms of federal aid should be sought or accepted by the state, and the types of programs which could be effectively conducted with federal funds. Second, the legislature determines the appropriate level of state funding for participation in federally aided programs. Third, the legislature ultimately determines whether state funds should pick up the costs of programs for which prior federal support has been withdrawn or reduced. The three functions can be performed during the course of the normal legislative review and appropriations process.

All of these functions assume the availability of the following types of information. First information is needed on the level of federal funding currently expended in specific program areas. Information is also required on the level of state matching funds required, or in cases where no firm matching formula applies, the amount of state funding that currently supports those and related programs. Third, some indication of the firmness and duration of federal grants is required if the legislature is to be able to anticipate which federal programs may later become the state's responsibility. In the case of appropriating state funds for programs which are affected by federal funding, more reliable information on the anticipated levels of federal funding during the course of the biennium is a basic need. Finally, there has been a growing interest in a number of states to control the uses of federal funds by appropriating federal dollars in the state budget.

This chapter discusses three areas which bear on the above information needs. There are several improvements in the congressional budget process and reporting procedures being developed by federal agencies which should improve the timeliness of information and projections of federal aids. Several possible modifications in the state budget process to provide better control of joint state and federally funded programs are discussed. Finally, the advantages and disadvantages of state appropriations of federal funds are discussed.

## IMPROVED BASES OF INFORMATION ON FEDERAL APPROPRIATIONS AND ALLOCATIONS

The federal government has initiated several procedural changes and is studying others which should improve the availability of information on pending federal aids, and expedite the process of appropriating and allocating federal resources. The new congressional budget process includes several features which should be of benefit to the states. On or before November 10 of each year the President is required to submit to the Congress a current services budget projection for the next succeeding fiscal year. This current services budget is essentially a base budget or projection of the costs to continue programs and services at the current authorization levels into the next fiscal year.

The current services budget may provide a base for preliminary planning by state and local governments. These projections do not anticipate any changes which occur during the Congressional budget process, and as such the projections would not predict the final levels actually received by the states. The Department of Health, Education and Welfare (HEW) is currently considering a recommendation to publish state-by-state breakdowns of the continuing services budget for each HEW program. Such projections would be available to the states in September or October each year.<sup>1</sup>

The new Congressional Budget Act has expedited the appropriations process which provides an earlier indication of what the final congressional appropriations levels will be. Under this process, appropriations are guided by joint resolutions which set targets for all appropriation bills. Two such resolutions are passed. The first resolution is due on April 15 after all authorization bills are reported out of committee. The resolution sets targets for each appropriations subcommittee and breaks out the total ceiling into sixteen categories. On September 15 Congress is to pass the second resolution which is intended to reconcile the earlier ceilings with actual appropriation bills passed during the summer. In the 1976 congressional session, the second resolution was very close to the first resolution. As a result, the first resolution was a very accurate predictor of the aggregate spending levels of the final appropriation bills.

According to the Congressional Budget Act, every appropriation bill must contain information on its impact on state and local governments. In addition, the Congressional Budget Office and the Office of Management and Budget are required to publish a report on the state and local impact of the congressional budget resolutions. Although these reports are as yet quite aggregate and unrefined, the Congressional Budget Office is attempting to develop improved projection procedures. The importance of these changes is that it should be possible to get reasonably reliable estimates of future federal appropriations and projections of their state impact months in advance of the beginning of the new federal fiscal year on October 1.

The greatest improvement is in the timing of appropriations. In the past, Congress passed appropriation bills throughout the federal fiscal year, often on a retroactive basis. This late passage of appropriation bills was compounded by executive vetoes and impoundments. Even after passing these hurdles, formula grant allocations and competitive grant announcements were delayed even further by the executive agencies. Under the new procedure, all appropriation bills must be passed prior to the beginning of the October 1 fiscal year. During the 1976 Congressional session, all executive vetoes were either overridden or accommodated by compromise appropriation bills prior to the fall adjournment of Congress. Unilateral executive impoundments are prohibited by the Congressional Budget Act. In addition, HEW, the largest domestic agency, is currently considering a recommendation to publish the state allocations of formula grants within 30 days of passage of the relevant appropriation bills.<sup>2</sup>

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<sup>1</sup>HEW Region X, *Ties That Bind*, Op. Cit., p. 74.

<sup>2</sup>Ibid, p. 74.

## POTENTIAL MODIFICATIONS IN THE STATE BUDGETARY PROCESS

### PROJECTING FEDERAL AID RECEIPTS

The new Congressional Budget cycle and the October-September federal fiscal year present an opportunity for Minnesota to take full advantage of the more timely information on federal aids, and avoid much of the budgeting based on uncertainty and unreliable estimates as has been necessary in the past. Under the old congressional budget cycle, state decisions on matching funds and appropriations for state programs which had some level of federal participation were necessarily made on the basis of projections and informed guesses of probable future levels of federal support. Budgeting on a biennial basis, estimates of federal funds for the second year of the biennium were often made a full three years in advance. While the legislative fiscal committees did update these estimates from time to time for certain federal programs, these reestimates were not done systematically for all federally aided programs. It was difficult to make any midstream adjustments in state matching funds, because the actual federal allocations were received late in the fiscal year, long after the biennial budget had been enacted. Figure 1 depicts the timing of the federal and state budgeting cycles. As indicated on the chart, state legislative appropriations are made as much as one year in advance of the receipt of federal allocations for the same July to June fiscal year.

The new Congressional Budget process should alleviate this uncertainty by making appropriations prior to the beginning of the federal fiscal year, allowing for more timely allocation of formula and project grants to state and local governments. Even with more timely passage of appropriation bills, however, the new October to September federal fiscal year still means that state legislatures will appropriate funds in March, six months in advance of final Congressional appropriations in September.

A second anomaly is that the Minnesota fiscal year no longer corresponds to the federal fiscal year. When the state fiscal year ends on June 30, there are still three months remaining of the federal fiscal year which expires on September 30. Consequently, new federal appropriations will not be received until at least three months into the state fiscal year. When federal funding levels or state matching requirements change from one federal year to the next, the state would be operating on two different bases during the first three months and remaining 9 months respectively of the state fiscal year. Thus, for example, when the legislature made appropriations for the 1978-79 biennium, they appropriated funds for a two year period which included portions of three federal fiscal years: federal fiscal year 1977 (July '77 to September '77), federal fiscal year 1978 (October '77 to September '78), and federal fiscal year 1979 (October '78 to June '79).

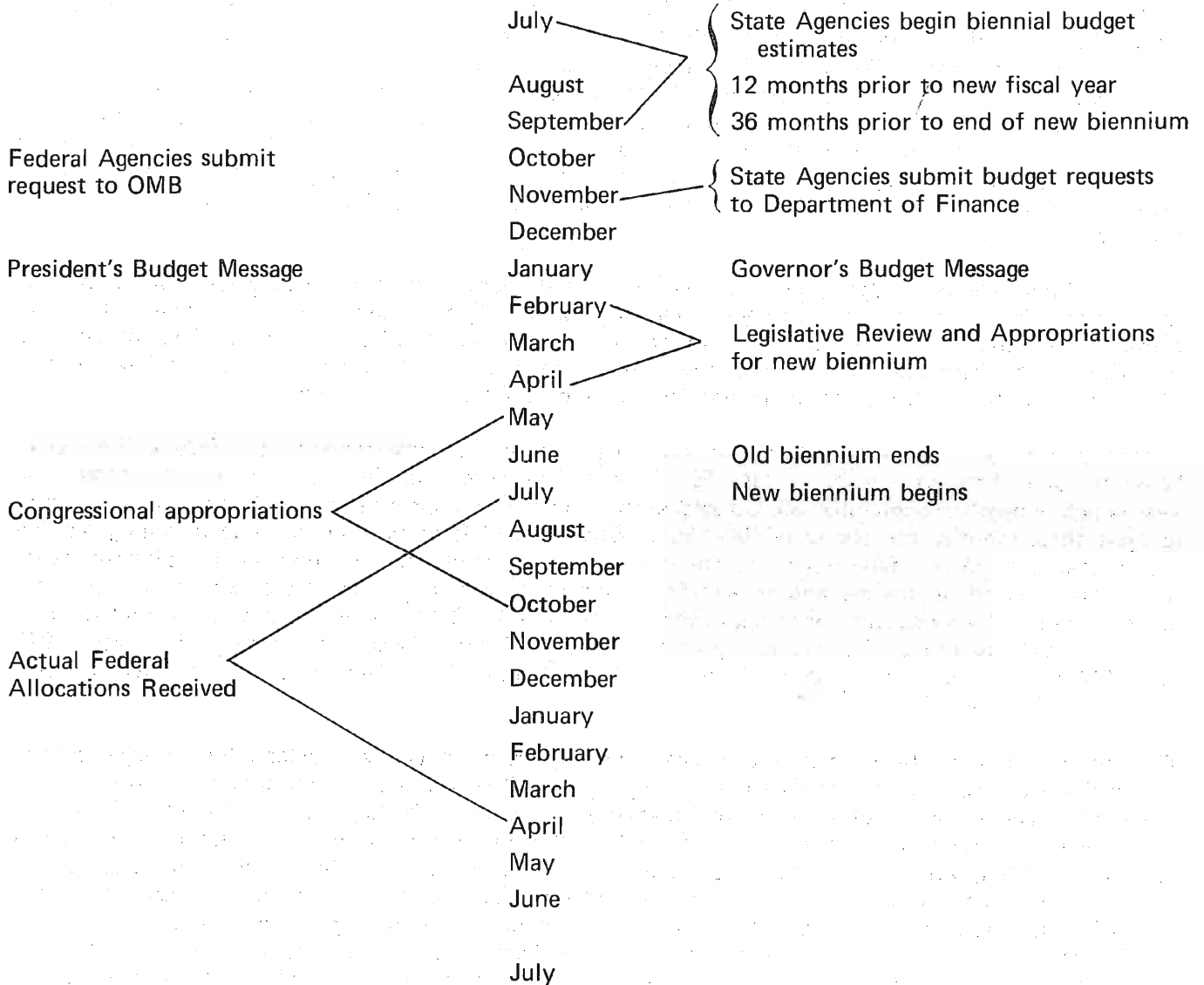
This lack of symmetry between state and federal fiscal years presents new problems for the legislature in influencing state participation in federally aided programs. One would anticipate that most major federal funding changes (increases, decreases or terminations) will occur at the beginning of the federal fiscal year on October 1 of each year. Under the old procedure, the state legislature could be reasonably confident of federal funding levels for the new fiscal year (which then began on July 1) when final state appropriations were made in April. However, the new federal fiscal year introduces more uncertainty at the time when the state makes its appropriations in April, since the beginning of the federal fiscal year in October is still six months away. When setting the state appropriation for a biennial period, this means that it will be more difficult to anticipate federal funding changes which will affect the state for 21 months of the 24 month biennial period.

A second anomaly is that state commitments to partially fund or match federal aided programs will "roll over" into the next succeeding state fiscal year. For example, if the state needed \$100,000 to match a federal grant for fiscal year 1979, the state's matching appropriation would cover the period from October 1978 to June 1979 for \$75,000 but the remaining \$25,000 in matching funds could not be appropriated until the 1980-81 biennium, since the legislature can only commit the state to appropriations for one biennial period. However, by appropriating \$75,000 for nine months of the first biennium, there would be an implied commitment to appropriate the remaining \$25,000 for the first three months of the next biennium. By the same token, this built-in commitment could be used as leverage by the agencies to commit the state to a \$100,000 annual rate of funding for the balance of the second biennium as well. In other words, the offset timing of the federal fiscal year will increase

**FIGURE 1**  
**FEDERAL AND STATE FUNDING CYCLES**  
**PRIOR TO CONGRESSIONAL BUDGET REFORM**

**Old Federal Cycle**  
**(July-June Fiscal Years)**

**State Budget Cycle**  
**(July-June Fiscal Years)**

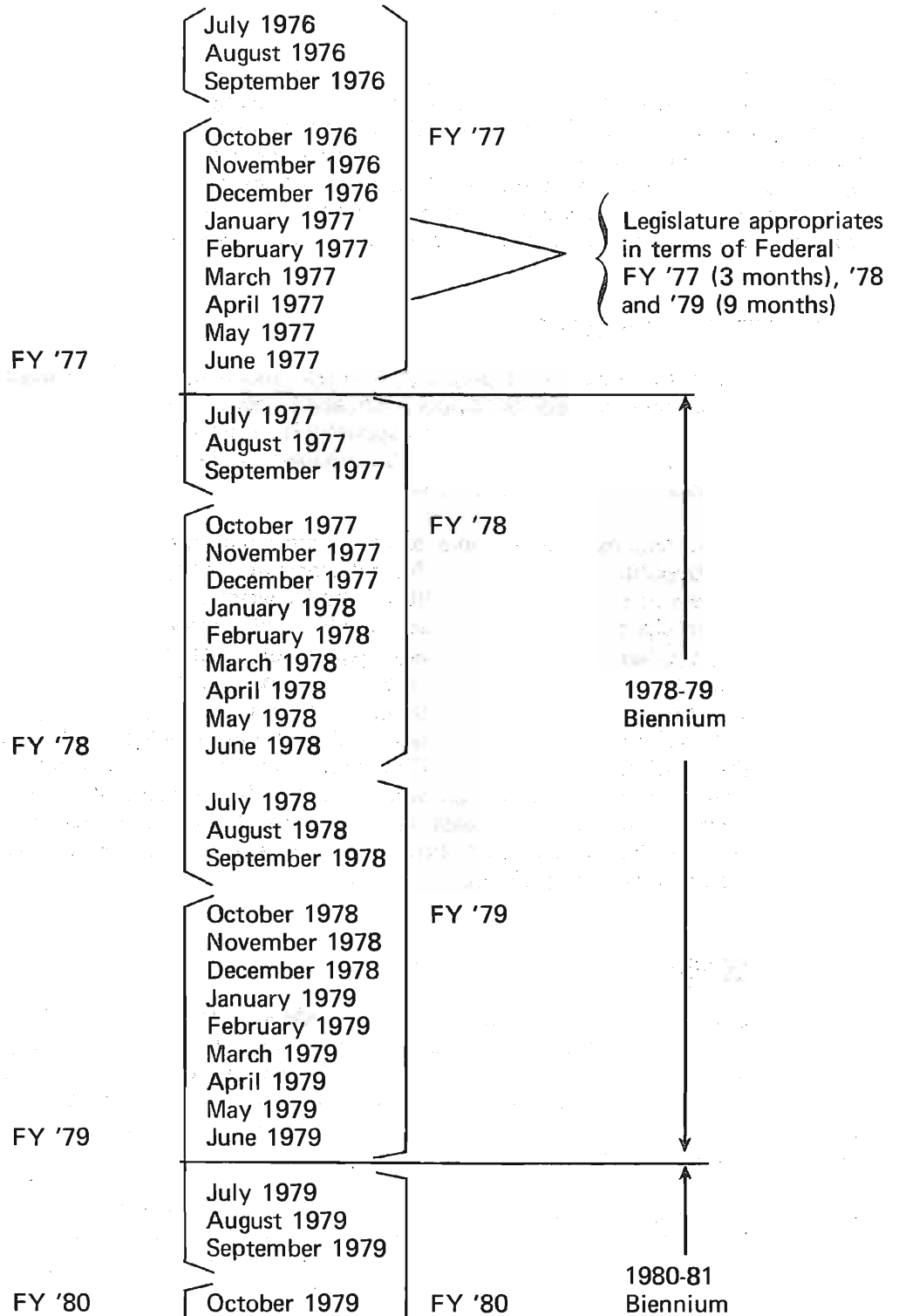


**FIGURE II**  
**EFFECT OF NEW CONGRESSIONAL BUDGET CYCLE ON**  
**FEDERAL AND STATE FISCAL YEARS**

New Federal Years

State Fiscal Years

Transitional Quarter



pressures to maintain federally aided programs from one biennium to the next through a type of "foot in the door" commitment that automatically carries over from one state fiscal year to the next.

This underscores the need to update estimates of federal receipts on a more timely basis, and to review the state funding implications of federally aided programs on a regular basis.

## **STATE PICKUP OF FEDERALLY FUNDED PROGRAMS**

There are at least three types of situations in which state funds may be used to replace or supplement federal aids: 1) when federal aid is terminated or withdrawn, 2) when federal funding falls short of original projections, and 3) when federal aids exceed original projections. This is an extremely difficult problem for several reasons. Some of these federally aided programs are established with little or no legislative review. Even when the legislature is aware of new federally supported programs, it is difficult to determine whether federal support will be consistent in amount or duration. There are also political costs of opposing what is initially presented as a "free" federal program.

### **Federal Funding Terminations**

The most difficult of these three problems is when federal support is reduced or withdrawn. If a program survives long enough on federal support, an active constituency is developed which will pressure the legislature to replace withdrawn federal support with state funds. The most obvious way to avoid this is for the state to decline participation in the program in the first instance. This may not be desirable or politically feasible in most cases, however.

A more realistic remedy is to be able to anticipate which programs will terminate when. Consequently, the proposed Department of Finance federal aids information system should include data on whether each grant is new or continuing. In addition, the Department should annually collect information on the scheduled or anticipated duration of each grant. Similar information on grant duration, and whether a grant is project oriented (which generally expire) or a general program formula grant (which tend to continue) should also be included on the policy notes and A-95 notices recommended for legislative distribution in the last chapter. In addition, in preparing the biennial budget, the Department of Finance should include information on the anticipated duration of all federal funds. If this information were provided, the legislature could be notified earlier on the probable termination status of federal grants and aids. While this early notification will not solve the problem of necessary state pickup of federally financed programs, it would at least allow the legislature to better anticipate these expirations or reductions before they occur, and allow them to review programs and set priorities regarding which federally aided programs to pick up.

### **Federal Shortfalls**

The second major area of difficulty is when federal aids do not meet projections upon which state funding decisions are based. For example, for a number of welfare formula grant programs, the legislature has traditionally appropriated the full program costs in state funds in anticipation of federal receipts. The federal funds then reimburse the state general fund as applied receipts. The danger with this approach is when federal receipts are less than projected, the state appropriations automatically cover the gap in federal funding.

This problem was alleviated in the 1976-77 biennium by use of a rider in the Health, Welfare and Corrections bill requiring that the state appropriation be reduced in direct proportion to any shortfall in federal receipts, so that state funds do not inadvertently supplement federal funds in the event of a federal shortfall.



## Federal Windfalls

Legislative staff reported cases where Minnesota agencies have requested and received state supplements or restorations based on anticipated reductions of federal support. However, during the course of the fiscal year, these federal funds were restored as well, resulting in a net increase in total funding for that activity. In effect, the support for the program could double as a result of state funding for a federal cutback which did not actually occur.

The budget committees of the legislature have instituted changes in several areas which help control this problem. The current State Departments appropriation bill contains a rider requiring that if federal receipts exceed the projection upon which the state matching appropriation is made, that the state share be reduced to offset the excess federal receipts. In the case of federal land and water conservation funds, all federal receipts are deposited in a special account which has a \$1 million ceiling. Any excess is automatically transferred to the general fund. The \$1 million account can be spent for environmental projects, but each project is subject to Legislative Advisory Committee review. On federal reimbursement for forestry programs, DNR is allowed to spend any excess federal receipts, but any shortfall must be absorbed by DNR and does not commit the state to additional general fund allocations. In these areas where the legislature has instituted formal controls, the problems of shortfalls and windfalls are greatly alleviated.

One of the challenges of controlling state financing in areas affected by federal aid is in the extent to which federally aided programs tend to expand without legislative review, raising the state's liability to eventually assume support of new or expanded programs. For the current biennium, the legislature adopted a new policy of imposing position complements on non-state funds. Under this procedure, the Commissioner of Finance must review and approve any additional federal positions in excess of the complement, and the budget committees of the legislature are to be notified of all increases in position complements. This serves as one form of notification of additional federal receipts above the projections upon which the biennial appropriations were made. However, this procedure would not alert the committees to excess federal receipts where no new state complement positions are required, such as in pass through funds or local aids.

All these new policies indicate a high level of legislative interest in assuming more control over the receipt and disposition of federal aids. Although some of these provisions are automatic adjustments, the legislature may need to expand its oversight responsibilities to monitor the flow of federal funds and the implementation of these controls by the executive branch. The difficulty of projecting federal aids on a biennial basis, and the need for ongoing oversight of these various controls both suggest the need for more systematic and frequent review of federal funds.

## **FEDERAL AIDS REVIEW ON EVEN NUMBERED YEARS**

Under a biennial budget system, appropriations are made in the spring of each odd numbered year for the biennial period commencing on July 1 of that year. The difficulty of anticipating federal funds for the first year of the biennium has already been mentioned. It is even more difficult during the normal budgetary review session on odd numbered years to estimate the level of federal aids anticipated for the second year of the biennium. Consequently, the legislature should consider the advantages of conducting a formal review of federally funded programs, federal receipts, and levels of state matching on an annual basis. Specifically, thorough reviews should be conducted during each legislative session on even numbered years to update federal funding estimates and make necessary adjustments in state matching funds and other appropriations for programs affected by federal aids. Rather than projecting federal aids two years in advance, as is presently done, such an annual review would allow the legislature to adjust funding for the second year of the biennium, based on the actual receipts and federal obligations received during the first year of the biennium. By March of each even numbered year the federal funds for the first state fiscal year of the biennium would have been received or obligated, and estimates of federal receipts and state matching funds for the second year of the biennium could be adjusted accordingly.

The legislature may wish to take this one step further to routinely adjust state matching fund appropriations for each current year in March of that year to reflect the federal aids received or awarded for that fiscal year. In other words, rather than setting state appropriations for federally aided programs on a forward basis, in terms of projections of anticipated federal aids, the legislature could adjust state appropriations for federally affected programs on a retroactive basis. Under this procedure final adjustments in state matching funds could be made after the appropriate federal funds had been received. The legislature would continue to make biennial appropriations, but state funding for programs affected by federal aids could be adjusted annually.

Figure 3 portrays the coordination of the new federal budgetary cycle to the proposed state budget process. The example starts with the 1978 legislative session, in which the legislature would review federal receipts for the current year (fiscal 1978), and make adjustments in state appropriations for fiscal years 1978 and 1979 based on the actual federal funding experience up to that time in March 1978. Presumably all federal aids for fiscal year 1978 would have been received by the time the legislature conducts its annual review so that the fiscal 1978 adjustments would be based on actual receipts, and fiscal 1979 adjustments would be based on the most recent projections. During the 1979 session, the legislature would again make "fine tuning" adjustments for the 1979 fiscal year, and project federal aids for the 1980-81 biennium based on the 1980 Congressional Budget Resolution, state agency projections and actual 1979 federal funding experience. In the 1980 session, the legislature could make "fine tuning" adjustments to fiscal 1980 appropriations based on actual federal funding experience, and adjust federal estimates and state matching funds for fiscal 1981 as necessary. This cycle would allow for annual re-estimates of federal aids one year in advance, followed by fine tuning adjustments of the current year matching funds based on actual federal receipts.

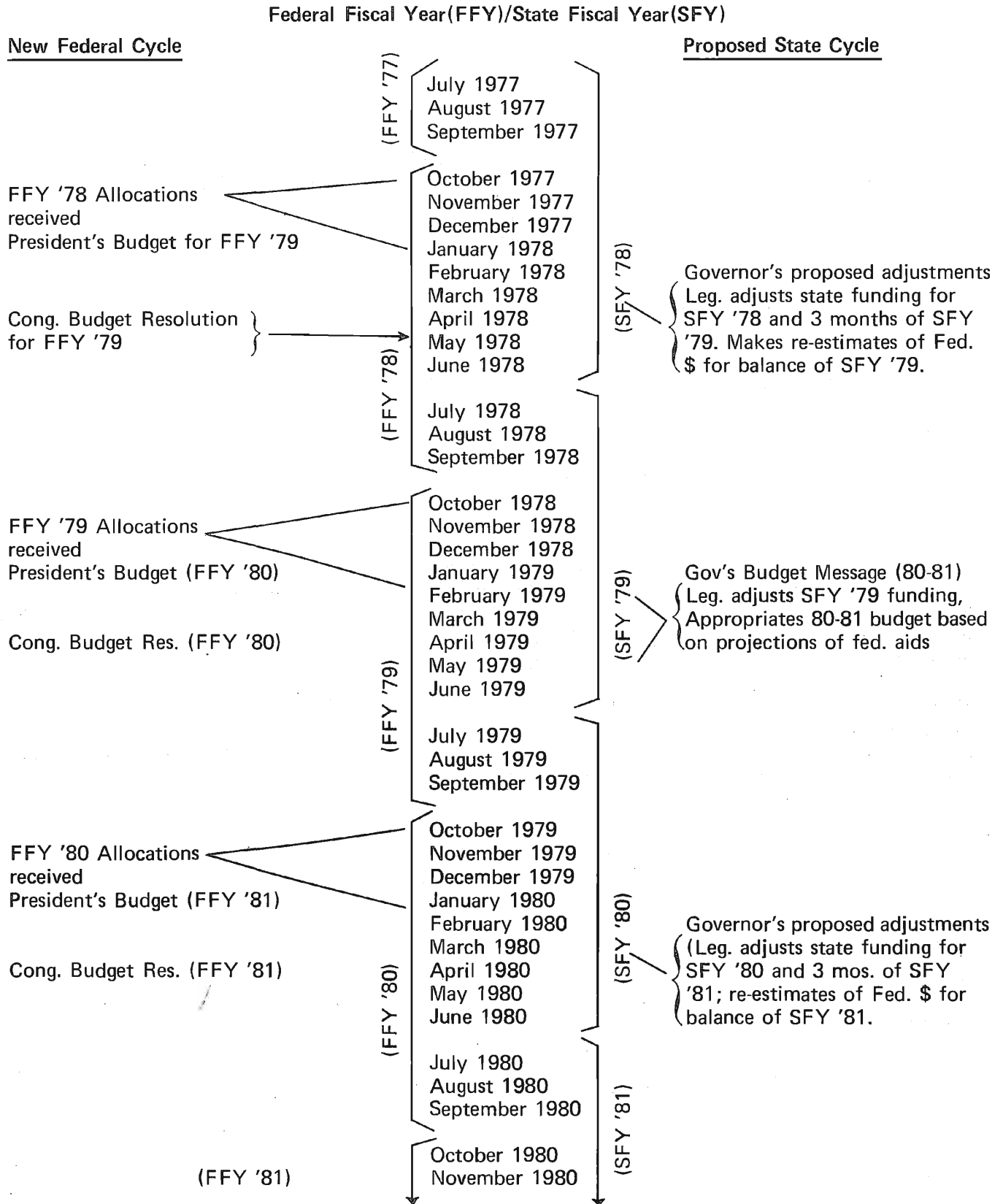
Through such annual reviews, the legislature could monitor federal funding levels for state programs more systematically, and respond to changes in federal funding priorities as they occur. It would allow for a more careful review of new federally funded programs, and more frequent adjustments of state participation in these programs based on actual federal funding levels and program performance. Annual reviews would also enable the legislature to better anticipate federal terminations or shortfalls so that those programs requiring state assumption could be reviewed more carefully.

There has been a perennial debate in the literature on the merits and weaknesses of annual vs. biennial budgeting. In calling for an annual review of federal aids, we are not recommending a full transition to annual budgeting. There is always a risk in opening up the budget process on an even-numbered year, after the state's spending plan has been set and delicate balances between competing priorities have been made in the biennial budget. Consequently, we recommend that any such annual reviews on even-numbered years be limited to a review of federal funds, and adjustments to state matching funds and "soft match" funds (where the state co-participates in programs which are heavily dependent on federal support). Runaway budgeting or increased spending in other categories can be constrained by the comparatively low level of uncommitted state revenues available during the even-numbered year. The advantage of federal aid reviews during the even-numbered year is that the legislature would not be diverted by the crush of passing the biennial budget, allowing more time to review federally aided programs.

### RECOMMENDATION 3

We recommend that the legislature consider the feasibility of conducting a minor budgetary review on even-numbered years to update estimates of federal aids based on current receipts and make corresponding adjustments to state appropriations in the biennial budget.

**FIGURE 3**  
**PROPOSED STATE BUDGETING CYCLE**  
**AND NEW FEDERAL CYCLE**



## RECOMMENDATION 4

We recommend that the legislature consider adjusting the appropriations for state matching funds for federal aids on a current year basis rather than one year in advance; and that state matching funds, or state funds appropriated in lieu of federal aids be adjusted annually in light of actual federal receipts.

## RECOMMENDATION 5

We recommend that the Department of Finance annually collect information of the projected termination date of all federally-aided programs. We further recommend that such information be included in the 1980-81 Biennial Budget documentation and in the proposed Policy Notes recommended in Chapter II of this report.

## STATE APPROPRIATION OF FEDERAL FUNDS

There has been a great deal of interest in recent months regarding the feasibility and desirability of state legislatures exerting more control over federal funds by appropriating federal receipts in the state budget. Much of the discussion has been initiated by the Advisory Commission on Intergovernmental Relations (ACIR), which recommended in August of 1976 that state legislatures adopt provisions to make appropriations for all federal funds received by the state and require legislature review and specific approval before any federal funds in excess of the appropriated amounts can be received or spent by state agencies.<sup>3</sup>

The practices in the fifty states vary widely and show the range in degrees of control which is achieved by appropriating federal funds. Appropriations are limited in two ways: amount and duration. Generally, direct appropriations limit spending to a specific (or sum certain) amount. Open appropriations do not limit the amount which can be spent but provide a general authorization to spend as much as required (sum sufficient) for a specific purpose.<sup>4</sup> Appropriations may also designate duration (annual, biennial) or be an ongoing authorization (standing appropriation).

Minnesota is one of the few states that does not appropriate federal funds in appropriations bills.<sup>5</sup> Forty-eight states, including Minnesota, have general enabling language in the statutes for the receipt and expenditure of federal funds. In Minnesota's case, this appropriation is both open and standing.<sup>6</sup> Only forty states appropriate federal funds by including them in appropriation bills.<sup>7</sup>

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<sup>3</sup>Advisory Commission on Intergovernmental Relations, "State Legislatures and Federal Grants", Information Bulletin No. 76-4 (Washington, D.C.; Nov., 1976), p. 13.

<sup>4</sup>For example, contributions to retirement accounts are difficult to estimate precisely and are often appropriated on an open basis.

<sup>5</sup>With the exception of federal funds for soil and water conservation, game and fish conservation and federal highway construction and research, which are appropriated in the biennial budget.

<sup>6</sup>Section 4.07 Minnesota Statutes.

<sup>7</sup>National Association of State Budget Officers "Federal Funds and Budgetary Practices in State Governments: Preliminary Report" (Washington, D.C.; July, 1977).

Twenty-four states make direct appropriations of federal funds (specific amounts are included in the budget act). The other fourteen states appropriate federal funds on open appropriation bases. However, direct appropriations by the legislature are controlling in only half of the 24 states, since adjustments to authorize the receipt of additional funds not formally appropriated can be made independently by the executive branch in all but twelve states.<sup>8</sup> To summarize, the forty states which include federal funds in appropriations bills achieve varying degrees of control, ranging from open appropriations to specific appropriations requiring legislative approval of expenditures in excess of the appropriated amounts. Either approach provides a broader view of state and federal spending and the level of state funds committed to programs for which there is federal support.

For those states which appropriate specific amounts of federal funding, the real issue becomes the level of control that is legally, politically and administratively feasible as a result of limiting federal funds to specific amounts. At most, ten states require some form of legislative review before federal funds in excess of the appropriated amounts can be spent. In several of these states, legislative review is either limited to federal funds for which the state appropriates state matching funds (Colorado), or the Governor has the final authority to accept federal funds and the legislative review is only advisory (Alaska and Montana). There have been legal challenges in several of these ten states which have centered on three issues. The first deals with the definition of public funds; specifically whether state constitutional requirements for legislative appropriation of public funds include federal funds within that definition of the term. The second legal issue arises from the need for an ongoing legislative body to review excess federal receipts during the interim. In several states, the constitutionality of the delegation of legislative authority to a legislative committee (such as an emergency or supplemental budget committee) has been challenged. The basic issue regarding who controls federal funds, the state executive or state legislature, is currently being tested in state court in Pennsylvania. The outcome of this court case will undoubtedly influence other states considering making specific appropriations of federal funds.<sup>9</sup>

There are several problems inherent in attempting to control state agency expenditures of federal funds through direct or specific appropriations. The federal funding process is complex. The state agencies which receive the bulk of federal funds receive it through numerous grants of various amounts. Further, these funds are received throughout the state fiscal year; the federal funding cycle does not correspond to the state budgeting cycle. What direct, limiting appropriations would require then, is an ongoing review throughout the year of specific federal aids on a grant-by-grant basis. It may be questionable whether this level of detailed review is justified in terms of the benefit which the legislature would obtain from such a review.

There is also a question of who would conduct the reviews. Each time that an agency received funds in excess of the appropriated amounts, the legislature would need to review the grant and act affirmatively to allow the agency to expend the funds. Since most of these instances would arise during the interim, an interim body, such as the Legislative Advisory Committee, would need to assume the responsibility for reviewing these grants and adjusting the federal appropriation levels. We did not attempt to determine whether such a delegation of appropriations power is constitutional in Minnesota. However, assuming that the Legislative Advisory Committee does have the authority to make such interim appropriations, it is a policy question for the legislature whether they wish to delegate this federal aid review responsibility to the Legislative Advisory Committee or some comparable body. It is conceivable that such an interim body could approve federal aid expenditures which a policy committee or full fiscal committees would not wish to see approved, or deny expenditure authority for a grant which the affected standing committee or fiscal committees would have supported during the legislative session.

Specific appropriations of federal aids may have the opposite effect of that intended. First, if the amounts in the appropriation lines are controlling, agencies will have an incentive to inflate their estimates of federal aids to "pad" the federal appropriation lines in order to avoid having to come back

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<sup>8</sup>Based on analysis of several tables contained in *National Association of State Budget Officers, "Federal Funds and Budgetary Practices in State Governments."*

<sup>9</sup>Advisory Commission on Intergovernmental Relations, *"State Legislatures and Federal Grants."*

to the legislature seeking approval for federal funds that exceeded a more conservative original estimate. Instead of improving the reliability of federal aid projections, the implied threat of a legislative veto may distort agency projections.

The second problem deals with how the appropriations for federal aids are structured. If there is a limited number of appropriation lines, corresponding to one line for each major agency program, each line may be comprised of a number of separate federal grant programs. Unless the legislature devotes a significant amount of attention to each federal aid appropriation, the grants which fall within the original appropriation estimate will generally receive a cursory review. However, if one grant is received later in the year which exceeds the aggregate amount for that appropriation line, more attention would be given to that increment above the appropriated level, than to the entire base amount which was originally appropriated. For example, if there were a \$1 million appropriation for some activity, and the subsequent receipt of a \$20,000 project grant in the same area caused the federal funds to exceed the \$1 million limit, more attention would be given to the \$20,000 grant than the entire \$1 million program which was appropriated initially during the legislative session. Legislative review would not necessarily correspond to the importance of each federal grant but rather to the order in which the grants were received. Grants awarded early in the fiscal year would not exceed the appropriation ceiling, while grants received later in the year may exceed the ceiling and therefore receive more legislative attention. Consequently, specific, controlling appropriation limits on federal aids would not contribute to a comprehensive or programmatic review of federal funding, but rather an incidental, incremental review of a few grants which go over the ceiling of the appropriation line.

On the other hand the experience of Michigan in appropriating federal funds indicates that such a system is workable and may have positive results. In 1976 the Michigan legislature included language in its appropriations bills requiring that no federal funds could be expended without prior legislative approval in the form of appropriations. According to an interview with the director of the Senate Fiscal Agency in Michigan any federal aids received in excess of the appropriated amounts must be reviewed by the Senate and House fiscal committees and included in a supplemental appropriations bill, which follows the normal legislative process for passage by both houses of the legislature. As a result of this requirement, the legislature and executive budget office now have a more comprehensive view of all federal aids received by state agencies, and greater control over how these funds are spent.

Michigan has two procedural differences which make appropriations of federal funds more workable. First, the legislature is in session year-round, so that the House and Senate fiscal committees are able to review federal funds throughout the year. Second, their budgetary process has traditionally produced two or three supplemental appropriation bills during each fiscal year. Consequently, any new federal funds can be reviewed and included in the supplemental bills on a regular basis rather than requiring special legislative reviews outside the normal budgetary process. It should be noted that direct appropriations of federal funds is workable in Michigan largely because the budgetary process is a full-time activity. Consequently, Minnesota would do well to approach the issue of direct appropriations of federal funds with caution.

There may be some advantages to including federal funds in appropriation bills on a sum sufficient basis. Under this approach agencies would be required to submit estimates of federal funds with their biennial budget estimates, but the specific amounts on each appropriation line would not limit the receipt or expenditure of federal funds. These estimates could be updated periodically at the time of the biennial appropriations and during the annual review in even-numbered years, as per our earlier recommendations. If the Department of Finance proceeds with its information system on federal aids, federal funds would be controlled through the Statewide Accounting System (SWA). Specifically, no federal funds would be spent without being coded and entered onto the SWA. In this fashion, the same level of information on federal aid expenditures would be available through the SWA as would be available if the legislature set specific direct appropriations. By including all federal funds as sum sufficient appropriations, the legislature would be better able to review the effects of federal expenditures and coordinate state and federal funding on a program-by-program basis. However, under sum sufficient appropriations specific grant-by-grant review and approval would not be required during the interim. Any new funds beyond those projected would show up on the SWA and could be reviewed annually when the federal aid appropriations are adjusted to reflect actual receipts. This would allow for a

type of post-expenditure review and control where agencies would still be accountable by reporting unanticipated federal receipts and updating each appropriation annually. This type of expenditure oversight would complement the position control system on federal funds noted earlier in the chapter.

The level of control over federal funds which the Minnesota Legislature needs to achieve is a basic policy issue for the legislature to consider. Open or sum sufficient appropriations of federal funds is consistent with the practice of a majority of states and is offered here as an alternative to direct appropriations of federal funds. Whether the legislature wishes to appropriate federal funds on any basis, and the relative costs and benefits of such a procedure are issues that the legislature may wish to consider during the 1978 legislative session.





## **CHAPTER FOUR**

### **SUMMARY OF SUGGESTED FEDERAL AIDS COORDINATION AND REVIEW PROCEDURES**

This report has suggested a number of means by which the legislature could become more involved, or at a minimum, better informed on the federal grant-in-aid process. Several approaches have been suggested by which the legislature could utilize existing and developing review mechanisms available through the State Planning Agency, Department of Finance, and to a lesser extent the Lieutenant Governor's office, to participate in fiscal tracking, policy review, and budgetary review of federal funds. This final chapter is a synopsis of all the procedures recommended in the report.

#### **POLICY REVIEW**

Legislative notification and review of the policy implications of federal aid applications could be achieved through the review of policy notes (plan summaries) and Part I "Notifications of Intent" referred by the State Planning Agency to the appropriate legislative standing committees. The committees could either investigate specific aspects of the plan or application by requiring the agency and affected groups to testify, as necessary, or the committee could defer legislative action until the session, in which case the policy notes and notices would serve as an early warning system regarding the agency's intended use of federal funds. Presumably, legislative review at the grant application stage would be advisory and used primarily for informational purposes. Requiring another level of "sign off" approval would need to be weighed against the disadvantages of delaying the grant application process.

Another form of policy review would be achieved through the appropriations process when the entire budget for an agency (including federal funds) would be reviewed and appropriations made. It is conceivable that the legislature may set general guidelines in some cases to influence what types of activities should be supported by federal funds and what types of federal compliance requirements the legislature finds to be unacceptable for the state.

## **FISCAL TRACKING**

The identification and tracking of federal funds would be an ongoing process through the statewide accounting system. This would serve both purposes of control and information. Control is achieved through the requirement that all federal funds be clearly identified and coded in the SWA prior to expenditure. Another level of control could be achieved if the legislature deemed it appropriate to set specific appropriations of federal funds. Under this system, no federal aids could be entered into the SWA which would exceed the aggregate amount appropriated by the legislature for that appropriation line without affirmative legislative action. If the legislature were to make sum sufficient appropriations of federal dollars, excess federal receipts above the appropriated level could be automatically reported to the fiscal committees of the legislature, which provides a useful form of oversight without the features of more direct control.

The informational capabilities of the proposed SWA information system on federal aids would present several advantages over the level and quality of information currently available. Such information would be maintained on an ongoing basis, allowing periodic reports on the total amount of federal aids received as well as information on the current and anticipated levels of federal aid on a program-by-program basis. Hopefully, the availability of timely information would assist the legislature in anticipating shortfalls and windfalls of federal aids when they occur, rather than months later during the legislative budgetary review.

## **BUDGETARY REVIEW**

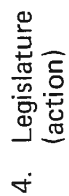
Annual budgetary review of federal funds with annual adjustments and re-estimates of federal receipts and projections and corresponding adjustments to state appropriations would increase the level of control over the use of federal aids, and keep the legislature informed on recent federal funding patterns. It should provide more lead time for the legislature to deal with requests for state pickup of federally funded positions and programs, and better control against state funds being used to cover shortfalls in federal receipts.

## **THE FEDERAL AIDS REVIEW PROCESS**

Each of the three facets of policy review, financial tracking, and budgetary review impact the federal aids system at different points in the process. Figure 4 portrays several stages of the federal grantmanship process from the writing of an initial application or plan to the expenditure of federal funds. The linkages of each proposed form of oversight or review by the State Planning Agency, Department of Finance, and the legislature is indicated with a brief description of each form of review and its relationship to the overall process. The legislature would be involved through either notification or review at three stages of the federal funding process: 1) plan and application review, 2) the receipt of federal funds, and 3) the expenditure of federal funds.

Any one of these three mechanisms — policy notes and notices, SWA information system, and annual budgetary reviews and federal fund appropriations — would be an improvement over existing bases of legislative information and control. There may be some possible trade-offs among the three approaches, depending upon what role the legislature views as most critical. For example, it would be possible to not appropriate federal funds depending upon the extent to which the SWA provides sufficient information and the standing committees review of federal aid applications works as an effective check on the state agencies. On the other hand, the legislature may wish to emphasize the budgetary review and appropriations process, in which case the review of applications may be less critical. It would appear that the information on financial tracking is a basic prerequisite of either policy review of applications or budgetary review of federal aid expenditures. By attempting to establish procedures in all three areas, as outlined above, the legislature would have a fairly comprehensive system of oversight of federal aids.

## FIGURE 4



## COSTS AND IMPLEMENTATION

Since all of these suggested procedures build upon existing processes and staff, the costs of implementing such a program would be marginal. The policy note process would represent an increased workload for the State Planning Agency as well as legislative standing committee staff. The information system built on SWA would similarly increase the workload of the controllers in the Department of Finance, and the financial staff of the agencies. Annual budgetary reviews would place increased demands upon the House Appropriations and Senate Finance Committees and their staff, but it is unclear whether staff additions for any legislative committees would be required, at least initially.

All of the recommendations contained in this report are offered as suggested improvements to the current level of oversight of federal aids in Minnesota. We have not attempted to present any detailed design for any of these procedures and many of the suggestions, such as legislative appropriation of federal funds and which committees should be involved in reviewing policy notes and application notices, raise policy questions which need to be addressed by the legislature. Consequently, we suggest that the fiscal committees and policy committees with jurisdictions over agencies with significant amounts of federal aids study these issues during the interim with the objective of implementing some or all of the recommendations on an experimental basis for the 1978 legislative session.

**APPENDIX**

**COMMENTS OF DEPARTMENT OF FINANCE  
STATE PLANNING AGENCY**

**and**

**LEGISLATIVE COMMISSION TO  
REVIEW ADMINISTRATIVE RULES**



DEPARTMENT of Finance*Office Memorandum*TO : Bruce Spitz, Deputy  
Legislative Audit Commission

DATE:

FROM :  Gerald W. Christenson  
CommissionerPHONE: X-2438

SUBJECT: Draft Report on Federal Aids Coordination

Peggy Kenny of my staff has met with Leif Hartmark to discuss various items in the report, but I feel additional comment is necessary. The report has some good recommendations but does not fully describe the data available now or in prior years. For example, the breakout of federal funds by activity provides some purpose of the funds because of the descriptive nature of the program/activity structure. Prior to the program budgets, the printed document did not include federal fund information, but the detail documents provided information by appropriation account (in many cases appropriation account was a general program or even individual grants) with a reconciliation displaying transfers, carry forward, and etc.

Legislative Audit Commission Recommendation II-1

We recommend that the Department of Finance be encouraged to continue the development of a federal aids information system based on the current statewide accounting system. We further recommend that this system be completed as soon as possible so that more detailed information of federal aids is available in the 1980-81 biennial budget documentation, and available on request during the 1978 legislative session.

Department of Finance Comments II-1

Information from the statewide accounting system by federal source of funds (federal catalogue of domestic assistance number) will be available within the next few weeks. As stated in your report, the cost of obtaining this information is minimal. The additional information such as type to grant, new or continuation, matching and term of grant will not be included in this system. At the present time, it is our intention to obtain this information from reports requested of the agencies.

Legislative Audit Commission Recommendation II-2

We recommend that the standing committees of the legislature consider means by which information on federal aid applications and plans could be reviewed by the appropriate committees for the purpose of alerting them to new federally funded programs and the policy implications of such programs. One means would be the screening of A-95 Part I notices by the State Planning Agency for referral to the appropriate legislative committees. In addition, federal aid applicants could be required to submit written "policy notes" on state plans covered by Part III A-95 reviews. These policy notes should be referred by the State Planning Agency to the appropriate legislative committees.

Department of Finance Comments II-2

This recommendation would be workable and useful if distribution to "appropriate committees" were made from the Senate Finance and House Appropriations Committees, and if approvals were not required by the committees, but used for review purposes.

Legislative Audit Commission Recommendation III-1 and 2

We recommend that the Legislature consider the feasibility of conducting a minor budgetary review on even numbered years to update estimates of federal aids based on current receipts and make corresponding adjustments to state appropriations in the biennial budget.

We recommend that the legislature consider adjusting the appropriation for state matching funds for federal aids on a current year basis rather than one year in advance; and that state matching funds, or state funds appropriated in lieu of federal aids be adjusted annually in light of actual federal receipts.

Department of Finance Comments III-1 and 2

A rider could be added to the appropriation bills for all state matching appropriations which cancels state match appropriations in the same proportion of reductions in federal receipts. This type of language is now in effect for the Welfare Department (Laws 77, Chapter 453, Section 2, Subd. 1). In those instances, where additional funds are required, it would be the agencies responsibility to submit requests to the Department of Finance for inclusion in an Omnibus Appropriation Bill or supplemental appropriation bill in the off year.

Legislative Audit Commission Recommendation III-3

We recommend that the Department of Finance maintain information on the projected termination date of all federally-aided programs when such information is available. We further recommend that this information be included in the 1980-81 Biennial Budget documentation and in the proposed policy notes recommended in Chapter II of this report.

Department of Finance Comments III-3

As noted in Recommendation II-1, it is our intention to gather data on federal funds from reports requested of the agencies. The projected term of the grant would be gathered as part of this process. A separate report of federal funds would be included as part of the biennial budget documentation.

If you have any questions concerning these suggestions, please do not hesitate to call Al Yozamp (X-5188) or myself.

/mk





## STATE OF MINNESOTA

STATE PLANNING AGENCY  
101 CAPITOL SQUARE BUILDING  
550 CEDAR STREET  
ST. PAUL, 55101

October 21, 1977

The Honorable Roger D. Moe, Chairman  
Finance Committee  
Minnesota State Senate  
Room 121  
State Capitol  
St. Paul, Minnesota 55155

Dear Senator *Roger* Moe:

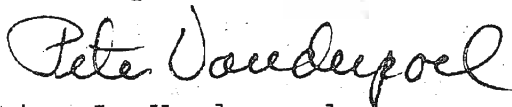
Thank you for the opportunity to review and comment on the summary of findings and recommendations from the report of the legislative auditor on federal aid coordination. I have reviewed the findings and recommendations with the staff of the State Planning Agency responsible for federal aid review and would like to make the following comments regarding the proposal outlined on the last page of the information provided:

1. If the legislature is truly interested in conducting a policy review of federal grants-in-aid received by state agencies, it may be wise to use some system other than the Office of Management and Budget (OMB) Circular A-95 process. The information presently being received from the notices circulated through the A-95 system do not contain enough information to allow for a policy review of the applications submitted by state agencies. A simpler system may be to require the state agencies to send a copy of their application directly to the legislature prior to the submission to the federal funding agency.
2. As the A-95 review system is now being operated by the State Planning Agency, we process approximately 2,000 notices of federal grant applications annually. Of these notices only about 200 are from state agencies. I am assuming that the legislature is only interested in being notified of the grants being submitted by state agencies. The proposal outlined is not clear on this point.

3. If the legislature is interested in using the A-95 review process as a source of information about federal grant applications, the State Planning Agency will be more than happy to cooperate, needless to say. I hope, if this is to be done, that clear procedures for transmitting the information can be developed. It would be advantageous for the State Planning Agency to have a single contact point in each of the houses of the legislature. The Senate Finance Committee and the House Appropriations Committee would seem to be logical points. These two committees could then circulate the notice to other committees they feel should review the proposed federal grants. We would be somewhat uncomfortable if the State Planning Agency were left, for example, with the responsibility to "select" the appropriate committee to send each notice to.
4. The chart outlining the proposal is not clear regarding the legislature's intention in its review. Will the legislature approve or disapprove applications, make recommendations for changes in the applications or simply use the notification process as an information system? If the former is intended, time could be a problem, since the State Planning Agency is allowed a maximum of only 30 days for its review. I think this point should be clarified.

Thanks again for the opportunity to comment on the proposal outlined in the findings and recommendations.

Sincerely,



Peter L. Vanderpoel  
Director

/dlg

cc: Peter Wattson



## Legislative Commission to

## Review Administrative Rules

Marshall R. Whitlock  
Executive Secretary

September 8, 1977

Leif Hartmark  
Program Evaluation Coordinator  
Legislative Auditor's Office  
Veterans Service Building

SUBJECT: Draft report on Federal Aid Coordination

I appreciate the opportunity to review your study on Federal Aids Coordination. The Legislative Commission to Review Administrative Rules is vitally interested in the impact of federal grants on the state of Minnesota.

I find the draft report on federal aids coordination to be an excellent summary of the problem area, and commend you on the approach you took in your recommendations. I would hope that the Legislative Audit Commission might adopt the recommendations made in this report, and introduce substantive legislation which would improve Minnesota's tracking, policy review and coordination of federal aid.

With regard to Minnesota's system of policy review, you recommend that federal aid applicants might be required to submit written "policy notes" on state plans covered by part III-A-95 reviews. You suggest that these policy notes should be referred by the State Planning Agency to the appropriate legislative committees. One of the concerns of certain members of the Legislative Commission to Review Administrative Rules has been the increasing number of federal rules which must be adopted by Minnesota state agencies in order to qualify for federal aid. Representative Neil Haugerud has suggested that this Commission might oversee federal grant applications in order that the legislature might be better informed as to the impact of grant applications on state agency rules. While this Commission does not have the capacity to effectively review all federal grant applications, I believe that the procedure that you suggest in your report allows for constructive input by appropriate legislative committees in the federal aids application process. Our only concern is that policy notes of the type and variety which you suggest do not make it incumbent upon a state agency to specify in advance what rule-making responsibilities there are accompanying federal aid to Minnesota. Because of this, my suggestion is to include an additional substantive area which must be included in such policy notes accompanying federal grant applications. This new area centers on the anticipated rule-making effects accompanying federal aid. Such policy notes would include

a statement specifying what rules must be adopted to conform with federal requirements. I would also suggest that such policy notes be routinely forwarded not only to the appropriate committees of the House and Senate but also to the Legislative Commission to Review Administrative Rules. As a result of this requirement, the Legislative Commission to Review Administrative Rules would have increased capacities to effectively oversee state administrative rules.

Thank you for the opportunity to respond to your report.

Sincerely yours,

A handwritten signature in cursive script, reading "Marshall Whitlock".

Marshall R. Whitlock  
Executive Secretary  
Legislative Commission to  
Review Administrative Rules

MRW:bcm

## **PROGRAM EVALUATION DIVISION**

### **PROFESSIONAL STAFF**

Daniel B. Aronson

Edward Burek

Martha R. Burt

James Cleary

Stephen Feldman

Debra Froberg

Leif S. Hartmark

Barbara A. Homce

Daniel J. Jacobson

Elliot Long

Charles E. Rogers, Jr.

Bruce Spitz

Sharon Studer

Jo Vos

Carol Weisberg

Robert Scheffel Wright

John H. Yunker

Dean Ziemke

### **ADMINISTRATIVE STAFF**

Jody Johnson

Peggy Lowell

Bev Marx