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THE PROBLEM OF DUAL FUNDING
IN
STATE GOVERNMENT
OF
SOUTH CAROLINA

LEGISLATIVE AUDIT COUNCIL

APRIL 15, 1976

ABSTRACT

It is estimated that State agencies are retaining 20 to 40 million dollars in Federal reimbursements each year, thus circumventing the legislative budget process. Further, these funds now lie outside the direct monitoring of any independent authority.

When the annual Appropriations Act is passed, it does not clearly define all programs and/or services being funded. A significant portion of the appropriation is being used to support direct and indirect costs of Federal programs. These same costs are then being collected from the Federal government by State agencies and used for a variety of purposes, at the agencies' discretion. In essence, State agencies are preempting the vested right and authority of the Legislature and the Budget and Control Board to determine State funding priorities. The lack of restrictions on these funds allows for excessive latitude in their use. This may generate inefficiencies in their management and opens the door to undetectable misappropriation and/or misuse of State funds.

This Position Paper discusses the most important details of the problem, its principal effects, and offers recommendations for its solution.

BACKGROUND

The costs of administering Federal programs can be recovered for the State from the Federal Government. These costs may be broken down into two types, internal and state-wide. For example, the operation of the State Purchasing Division and the State Treasurer's Office, among others, indirectly benefit Federal programs within State agencies. The costs associated with these benefits are known as state-wide indirect costs. The State Auditor annually prepares a "State-wide Cost Allocation Plan" which authorizes the recovery of these costs for the State. Some agencies recover the costs and some do not.

Also, agencies may institute indirect cost allocation plans to recover the internal administrative costs of the agency which were paid to administer Federal programs. Currently, some agencies recover internal administrative costs and some do not.

The problem of dual funding arises when appropriated State funds are used to cover the cost of administering Federal programs, and are subsequently reimbursed by Federal programs within the agencies. In essence, the agency receives State appropriated funds and Federal reimbursements for identical costs. Due to the lack of laws and guidelines, agencies utilize the dual funds at their own discretion. State agencies are able to circumvent the Legislature's Constitutional authority to determine State funding priorities by placing the dual funds in "Federal" agency accounts. Since these accounts are not closed out yearly the funds can be carried forward and allowed to accrue from year to year and be expended at the discretion of the agency.

Another example of how an agency may evade Legislative control of Federal reimbursements can be seen in the area of payroll fringe benefits. Agencies are required by law to remit the employer's share of payroll fringe benefits when employees are paid from Federal funds. The Appropriations for 1975 - 1976 State of South Carolina, Section 13 states ".....it is the intent of the General Assembly that any agency of the State Government whose operations are covered by funds from other than General Fund appropriations shall pay from such other sources a proportionate share of the employer costs of retirement and social security and the cost of health and other insurance provided by the State for the agency's employees." This requirement presently can be waived by the Budget and Control Board when circumstances so justify. Under the present system it is solely the agencies' responsibility to remit such funds. In the case of the Retirement System, the State appropriates funds to cover all costs of the employer's share for all State employees' payroll fringe benefits. Here again, the State appropriates funds for Retirement and agencies receive Federal reimbursements for fringe benefits in agency Federal accounts for whatever use the agency may desire. Based on observations and interviews with personnel from the Budget and Control Board, we estimate that the agencies may be withholding as much as \$4,000,000 annually for all fringe benefits.

ORIGIN OF THE PROBLEM

The origin of the problem of dual funding is complex. However, there appear to be three major factors in its development.

One of these factors is the incrementalism in the evolution and proliferation of Federal programs since the early 1960's. The rate of growth and the large size of these programs has helped to establish a precedent and a "tradition" wherein agencies have handled Federal reimbursements of State funds as so-called "earned revenues". Another significant factor is the absence of a statute which clearly defines these funds and provides comprehensive procedural guidelines for their proper management. The third factor is the absence of a statute which clearly delegates oversight and enforcement authority to an existing State agency in regard to the proper disposition of Federal reimbursements.

There are certain basic criteria for evaluating the dual-funding situation and the problems associated with it. The most important is the Legislature's obligation for complete accountability to the public. The current practice allows State agencies to interfere with the Legislature's efforts to render a full and accurate accounting for the expenditure of public funds.

A second criterion is that the Federal Government has recognized the need of states to recover administrative and other indirect costs for support provided to Federal programs. However, the Federal position is that reimbursements are for actual costs expended under the grant programs. Agency spending of Federal reimbursements for anything other than allowable costs is in violation of the intent of Federal provisions.

PRINCIPAL EFFECTS

Application of these criteria to all State agencies may have the appearance of unduly harsh criticism of their management. However, when one looks carefully at the present and potential effects

associated with the dual funding issue, it is quite apparent that the issue is more than a question of managerial efficiency in particular agencies.

One effect was noted in an interview about this problem with the State Auditor's Office. It was stated that it is difficult to apply a uniform audit procedure to State agencies because of the varying ways in which Federal reimbursements are managed among different agencies.

The State Treasurer's Office, in an interview, pointed out that agency balances in Federal accounts are monitored by the Treasurer's Office. The Treasurer is responsible for investing these monies and does. However, the agencies have near unlimited authority to draw down from those accounts as needed.

Because the agencies have a reservoir of funds from the accumulations in Federal accounts, they may not find it necessary to employ maximum efficiency in the management of their appropriated funds. This is a subtle problem which appears in varying degrees in different agencies.

An additional effect is that an accurate cost effectiveness analysis of an agency cannot be performed. This is because the amount of funds the agency actually employs in its yearly operations is made flexible through the accumulation of State funds in Federal accounts. If we are ever to manage our State resources based upon objective and accurate interpretations of need/cost/benefit, it is mandatory that program costing be accomplished.

A detailed analysis of the dollar amount involved in the problem has not yet been conducted. It is doubtful that a precise determination can be made because of the various ways in which the agencies now manage their Federal accounts. However, Federal program monies in South Carolina now total approximately \$1 billion.

It is estimated that 2% (\$20 million) to 4% (\$40 million) of this amount is being retained by agencies and is available for agency use.

Again, the most important impact is that under the current system the Legislature has no reliable mechanism for accurately monitoring current balances and flows of State monies in State agencies. Therefore, the elected representatives of the people are prevented from rendering a complete and accurate accounting for the disposition of public resources.

SOLUTION

In developing a comprehensive and effective resolution of the overall problem, there are certain basic concepts which must be made clear and addressed ultimately to the satisfaction of the Legislature. These are (1) the constitutional issue, (2) the managerial procedures issue, and (3) the issue area made up of opposing arguments.

In the constitutional area, we recognize that elected representatives of the people are obligated to account for every aspect of the allocation of the public's resources, and to ensure that resource expenditure is carried out in the most efficacious and judicious manner possible. To this end, both Federal reimbursements for State funds expended in support of Federal programs and payroll fringe benefits received from Federal sources should be immediately returned to the State General Fund. The funds will thus be under the direct control of the State Legislature through its authorized agents.

In the area of managerial procedures, the argument can be simply presented. The State budget can be viewed as a single, immense accountancy cycle that is managed and monitored by the State Legislature as an agent representing the best interests of the people. Currently, the practices employed to manage reimbursement funds are so inconsistent that the operational integrity of the State's central accountancy system is not being maintained.

Agency arguments in opposition to the notion of centralized accountability and tightened control of State monies can be anticipated. For instance, Federal reimbursements for the expenditures of State funds are frequently viewed by agencies as "earned revenues" which agencies believe they are entitled to use as discretionary funds. Another argument has been that the use of these reimbursed monies as discretionary funds serves as an incentive to the agencies to ensure their collection. An extension of this position is that the use of these funds allows "flexibility" in agency management. A final opposing argument that may have the most confounding impact is that since there is no precise State statutory prescription for the proper use of the reimbursements, the management of the funds reverts by default to the agency.

It will be no easy task to correct these misconceptions. The agencies first must clearly understand that Federal reimbursements are rightfully to be considered State appropriations and not "earned revenues".

The legal requirements in some instances, the fiscal advantages accruing to the State, and the idea of "doing the job right" should be more than adequate incentive for the efficient collection of allowable reimbursements. In this case "flexibility" is merely

another word for "slush-funding" which allows unauthorized expenditures of State appropriated funds and can lead to inefficient use.

The argument of "reversion by default" is clearly a non-issue because of the Legislature's Constitutional obligation for complete accountability to the public.

RECOMMENDATIONS

In regard to monies reimbursed to State agencies by the Federal Government in payment for the State's allowable costs in support of Federal programs, it is the position of the Legislative Audit Council that the proper disposition of these monies is their immediate return to the State General Fund.

It is our recommendation that legislation be enacted which has three objectives in dealing with this issue: (1) to enable the Legislature to regain control of all State funds; (2) to ensure that State agencies recover from the Federal Government all entitled costs; (3) to ensure that South Carolina does not subsidize Federal programs at the cost of sacrificing State programs. We recommend that a proviso be added to the current budget appropriation which clearly defines the monies at issue. Further, it should delegate oversight and enforcement authority, in regard to these funds, to the State Auditor's Office. The proviso should also direct that all agencies administering Federal programs immediately begin preparation of indirect cost allocation plans which would ensure reimbursement of both internal and State-wide indirect costs.

Agency accounting records should be established to identify Federal program reimbursements for immediate return to the State General Fund. Agencies should be required to clearly identify by line item in their next annual budget request all anticipated Federal reimbursements for administrative costs, fringe benefits, and any other reimbursements which constitute dual funding.



Additionally, in preparation for a long range solution, the Legislative Audit Council has been directed to initiate an in-depth audit of dual funding in South Carolina and to prepare detailed recommendations for consideration prior to the 1977 Legislative session.

Implementing these recommendations will allow the Legislature to determine State funding priorities for an estimate twenty to forty million dollars not currently controlled in the budget process.