California State Auditor

BUREAU OF STATE AUDITS

Federal Funds:

The State of California Takes Advantage of Available Federal Grants, but Budget Constraints and Other Issues Keep It From Maximizing This Resource

August 2003
2002-123.2

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August 6, 2003 2002-123.2

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents the second of two audit reports examining whether California is maximizing the amount of federal funds it is entitled to receive for appropriation through the Budget Act.

This report concludes that California as a whole receives a share of federal funding for grants that is near its share of the United States' population (population share). However, on a grant-by-grant basis, grant allocation formulas can result in a California grant share that is lower than California's population share, largely because of unfavorable demographics and the use of out-of-date statistics. Because grant formulas are created at the federal level, the State has little control over these factors. On the other hand, state and local policies have limited California's share of federal funds in a few cases, and departments have sometimes lost federal funding due to the lack of state matching funds. In addition, the State has lost some federal funds because of an inability to obligate funds timely, federal sanctions, and other budget constraints.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE
State Auditor

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SUMMARY

Audit Highlights . . .

Our review of federal grant funding received by California found that:

- ☑ ***California's share of nationwide grant funding, at 11.8 percent, was only slightly below its 12 percent share of the U.S. population.***
- ☑ ***Factors beyond the State's control, such as demographics, explain much of California's relatively low share of 10 large grants.***
- ☑ ***Grant formulas using out-of-date statistics reduced California's award share for another six grants.***
- ☑ ***In a few cases, California policies limit federal funding, but the effect on program participants may outweigh funding considerations.***
- ☑ ***California could increase its federal funding in some cases, but would have to spend more state funds to do so.***
- ☑ ***In some instances, California has lost federal funds because of its noncompliance with program guidelines or by not using funds while they are available.***
- ☑ ***The statewide hiring freeze and a pending 10 percent cut in personnel costs may further limit federal funds for staff.***

RESULTS IN BRIEF

Overall, California's share of total federal grant awards is slightly less than its 12 percent share of the nation's population (population share). During fiscal year 2001–02, California received $42.7 billion, or 11.8 percent of the total amount of federal grants awarded. We reviewed the 86 grants accounting for 90 percent of total nationwide federal grant awards in fiscal year 2001–02. California's share of 50 of these grants exceeded 12 percent, providing $4.9 billion more than an allocation based on population share alone. California's share of the remaining 36 grants was $5.3 billion less than an allocation based on population share alone. Several factors come into play when the federal government awards federal grants. Some are under the State's control and some are not. Grants where California's share falls below its population percentage include the following:

- Grants where demographics work against California. Of the 36 grants where the State's share of grant awards fell below its population share, 10 are explained by California's low share of a particular demographic group, most notably its low rural and elderly populations.

- Grants where the selected factors are unfavorable to the State. Many federal formulas for the Highway Planning and Construction grant (highway grant) do not favor California, which paid an average of 10.1 percent of the nation's federal fuel taxes and fees during federal fiscal years 1998 through 2001, but received only an average of 9.3 percent of the highway grant.

- Grants with formulas that use out-of-date statistics or include minimum funding levels for each state. For example, much of a grant for maternal and child health services is distributed according to a 1983 allocation for earlier programs, when California's share was only 5.8 percent.

Federal funds also are limited by state and local policies for which benefits may outweigh the loss of funding. California's share of the Special Education-Grants to States (Special Education) grant, for example, is less than would be expected given its number of children because of assessment practices

and rigorous screening of children being considered for special education services. Also, California's federal funding for the In-Home Supportive Services program is less than it could be because the State of California (State) pays legally responsible relatives to be caregivers, a type of activity that is ineligible for federal reimbursement.

In other cases, the State could increase its federal funding, but would have to spend more state dollars to do so. Some federal dollars have been lost because departments could not obtain the required state matching funds. For example, the Department of Health Services (Health Services) lost federal funds for a component of the Medical Assistance program due to the lack of matching funds. Other federal money has been lost because according to some state agencies they have lacked the staff to apply for or administer the federal programs. In addition, local agencies could risk losing federal funds because of a drop in state funding for transportation projects.

The State has not complied with some program guidelines, resulting in other losses of federal funds over the last three years. In addition, departments sometimes lose federal funds by failing to obligate the funds within a grant's period of availability. The largest such loss was about $1.45 billion lost to California's State Children's Health Insurance Program because of a slow start-up of the program. Since 1998, California also has paid penalties to the federal government for failing to implement a statewide child support automation system. Finally, the statewide hiring freeze has limited agencies from spending available federal funds on grants staff, and a pending budget cut of 10 percent in personnel costs may further limit federal funds for staff.

RECOMMENDATIONS

As federal grants are brought up for reauthorization, the Legislature, in conjunction with the California congressional delegation, may wish to petition Congress to revise grant formulas that use out-of-date statistics to determine the share of grants awarded to the states.

The Legislature may wish to ask departments to provide information related to the impact on federal program funding when it considers cuts in General Fund appropriations.

Health Services should continue to work with the Department of Social Services to determine the feasibility of pursuing an Independence Plus waiver that may allow the State to claim federal reimbursement for a portion of the expenditures for caregiver services provided by family members to participants in the In-Home Supportive Services program.

The Department of Finance should ensure that it considers the loss of federal funding before implementing personnel reductions related to departments' 10 percent reduction plans.

AGENCY COMMENTS

The agencies we reviewed generally agreed with the report's findings and recommendations. The California Department of Education chose not to formally respond to the report. ■

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INTRODUCTION

BACKGROUND

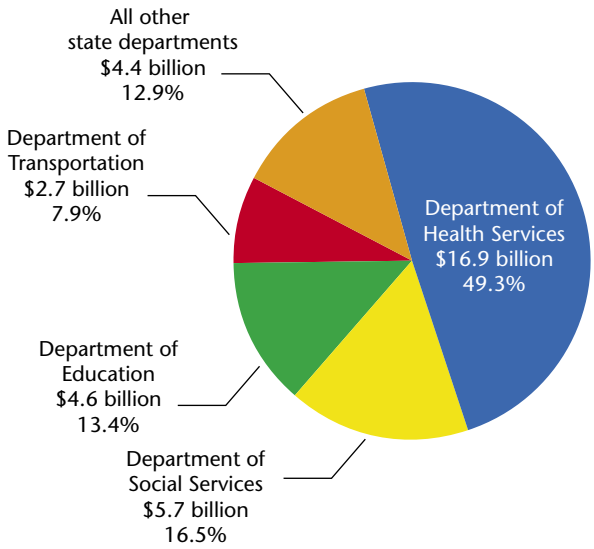
California as a whole, including individuals, private organizations, and state and local governments, received 11.8 percent, or $42.7 billion, of all federal grants awarded during fiscal year 2001–02. This share was slightly below California's 12 percent share of the nation's population (population share). The State of California (State) received the overwhelming majority of this funding. In fact, the State and state-run institutions of higher education accounted for 85.3 percent of California's fiscal year 2001–02 grants, with governmental special districts and nonprofit organizations a distant second and third at 3.8 percent and 3.6 percent, respectively. Four state departments administered more than 87 percent of the $34.3 billion in federal grants awarded directly to the State, excluding state-run higher education institutions. Figure 1 on the following page shows that the Department of Health Services managed nearly half of the State's federal grant funding, primarily for the Medical Assistance program. The Department of Social Services and the Department of Education also administered large portions of the grant funds.

The vast majority of the State's grant funding—more than 95 percent in fiscal year 2001–02—relates to formula grants. Formula grants are awarded according to formulas prescribed in law or regulation and fund ongoing activities that are not confined to a specific project. Formulas generally are based on statistical data, such as poverty rates, that indicate a need for services as determined by Congress or the federal awarding agency. The statistics used to calculate the amount awarded to a specific grantee come from a variety of sources, including the U.S. Census Bureau, the Bureau of Economic Analysis, and other federal agencies. For example, the formula for the Special Programs for the Aging, Title III, Part C, Nutrition Services grant is based primarily on a state's proportion of the national population age 60 years and older, as estimated by the U.S. Census Bureau.

The remaining grants are project grants. They are awarded for specific projects of a fixed duration and include fellowships, scholarships, and research grants. As a whole, California received $1.4 billion in project grant assistance during fiscal year 2001–02.

FIGURE 1

**Four Departments Administer Most of the State's Federal Grant Awards*
Fiscal Year 2001–02**



Source: Federal Assistance Award Data System.

* Grant awards do not include unemployment compensation benefit payments. The federal government considers them to be direct assistance payments to individuals, rather than grants.

Federal grants generally require recipients to share program costs. There are two types of cost-sharing requirements: matching requirements and level of effort requirements. Under matching requirements, the grantee must contribute a specified amount or percentage to match federal receipts, and this match normally must be from nonfederal sources. The required nonfederal matching share is generally less than 50 percent of a grant's total costs. The State often uses money from its General Fund to meet these matching requirements. In some cases, however, it uses money from its special revenue funds; in other cases, it passes on the cost-sharing requirement to local subgrantees. The Rehabilitation Services-Vocational Rehabilitation Grants to States (Vocational Rehabilitation) program is an example of a grant with a matching requirement. Under this grant, the State must, using nonfederal funds, share 21.3 percent of the expenditures for vocational rehabilitation services and administration. In addition, if the construction of a community rehabilitation facility funded in part by the Vocational Rehabilitation program is approved, the State must use nonfederal sources to fund at least 50 percent of the costs.

Level of effort requirements are designed to prevent grantees from obtaining federal funds for a program and then reducing their own expenditures on that program. They include requirements that grantees maintain a set level of expenditures from nonfederal sources for specified activities from period to period, or that they use federal funds to supplement, but not supplant or replace, nonfederal funding of services. In addition to its matching requirement, the Vocational Rehabilitation program has a level of effort requirement. Under this requirement, the State must spend an amount from nonfederal sources that is at least equal to the amount of nonfederal funds it spent for the program two years earlier. If the State fails to maintain this expenditure level, the federal awarding agency will reduce the grant award by an amount equal to the decrease in nonfederal spending. In May 2003, we issued *Federal Funds: California's Share of Grant Funding Is Close to Its Share of the Population, but State Spending Cuts May Result in Reduced Federal Funds*, Report 2002-123.1, which includes an appendix noting the cost-sharing requirements for the 52 programs accounting for 95 percent of the State's federal cash receipts in fiscal year 2001–02.

In the State Administrative Manual, the Department of Finance (Finance) has delegated to state agencies much of its authority to require advance approval of federal grant applications. However, a department must request advance approval from Finance when applying for any new federal grant not included in an approved budget. A department also must request advance approval from Finance if the activities to be performed have been denied previously or if the grant involves "sensitive policy issues." The determination of a sensitive policy issue is left to the department's discretion. When requesting approval, a department must provide information specific to the grant, including a brief description, the application amount, and the budget impact. Depending on the timing of the grant application, the department must include and justify the request as part of its annual budget request. If the department does not anticipate the grant early enough to include it in the annual budget request, it must obtain Finance's advance approval of the application. In addition, if the unanticipated grant will augment or reduce available amounts for expenditure for the affected program, project, or function by more than $200,000 or 10 percent, the grant may fall under Control Section 28.00 of the annual budget. The requesting department then must submit additional materials to Finance, which will notify the

Legislature. Finance cannot approve the grant applications that fall under Section 28.00 sooner than 30 days after notifying the chair of the Joint Legislative Budget Committee.

SCOPE AND METHODOLOGY

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits determine whether California is maximizing the amount of federal funds it is entitled to receive for appropriation through the Budget Act. Specifically, we were asked to examine the policies, procedures, and practices state agencies use to identify and apply for federal funds. We also were asked to determine if the State is applying for and receiving the federal program funds for which it is eligible. In addition, we were asked to identify programmatic changes to state-administered programs that could result in the receipt of additional federal funds. Finally, the audit committee asked us to examine whether the State is collecting all applicable federal funds or is forgoing or forfeiting federal funds for which it is eligible.

To understand federal obligations for formula and project grants, we analyzed data from the Federal Assistance Award Data System (federal data system). This database, managed by the U.S. Census Bureau, documents 98 percent of federal grant awards flowing to the states and territories. Using this data, we accumulated obligations of grant awards for the four quarters making up state fiscal year 2001–02. We noted in our May 2003 report, *Federal Funds: California's Share of Grant Funding Is Close to Its Share of the Population, but State Spending Cuts May Result in Reduced Federal Awards*, Report 2002-123.1, that for fiscal year 2001–02 the number of large federal grants received by California was split almost evenly between those in which California received a share of the grant greater than its 12 percent population share and those in which California's share fell below its population share. According to our preliminary analysis in that report, of the 84 grants accounting for 90 percent of the total nationwide federal grant awards in fiscal year 2001–02, California's share of 46 grants exceeded its population share; 38 grants fell below.

Upon further analysis of the grants in the federal data system, we determined that California's share of the Head Start Administration grant was actually above its population share, and that the Unemployment Insurance grant was large enough to be added as another grant with a California share above

12 percent. Grant award information for five other grants required adjustments, although California's overall share of these grants still fell below its population share. In addition, after adjustments, the total federal award for another grant fell well below our initial criteria for review and we eliminated it from our analysis. After these revisions, of the 86[1] grants accounting for more than 90 percent of total nationwide federal grant awards in fiscal year 2001–02, California's share exceeded its 12 percent population share in 50 instances, providing $4.9 billion more than an allocation based on population share alone. California's share of the remaining 36 grants was $5.3 billion less than an allocation based on population share alone. Additionally, California's awards for all grants were $813 million less than an allocation based on population alone. This is somewhat better than our preliminary analysis, which indicated that California's share was $1.5 billion less than an allocation based on population alone.

We also used the federal data system to identify federal grants totaling between $10 million and $405 million in fiscal year 2001–02 for which California received nothing. Of the 50 grants we identified, California was ineligible for 21 because of geographic limitations, the specification of non-California grantees, or other limiting characteristics. For example, California received no funding for the Historically Black Colleges and Universities program because none of these colleges is located in the State. California also did not receive funding for the Appalachian States Research, Technical Assistance, and Demonstration Projects because of geographic restrictions. In addition, the State was precluded from some grants because the federal government limits eligibility to individuals, nonprofits, or other nonstate government entities. In other cases, we eliminated grants from consideration because state governments, although not explicitly excluded, received only a small portion of the funding, if any. For example, almost all of the Undersea Research Program was awarded to universities and other institutions of higher education; no state government received funding. Out of these 50 grants, we determined that the State could expect to receive funding for two grants with no California funding. We discuss these grants on page 22 of the Audit Results.

[1] The Workforce Investment Act (WIA) grant split into three separate WIA grants in federal fiscal year 2001. In our first report, we counted the predecessor WIA grant. For this report, we substituted the three successor WIA grants for the predecessor grant.

To determine factors affecting California's share of selected federal grants, we reviewed information from the Catalog of Federal Domestic Assistance, applicable federal laws, and U.S. agency publications. We compared these factors with statistics from federal agencies, including the U.S. Census Bureau, U.S. Department of Agriculture, and Bureau of Economic Analysis, as well as other sources. We compared California's share of the different federal grants and programs with California's share of the total U.S. population. We calculated the population share based on 2001 U.S. Census Bureau estimates for the United States, Puerto Rico, and other territories. When California's share of a federal grant was substantially lower than its population share, we determined whether the factors we had identified reasonably explained the difference. When additional information was needed, we contacted state and federal officials for further clarification.

We surveyed a sample of 33 state departments and agencies to determine the policies, procedures, and practices that state agencies use to identify and apply for federal funds, and to determine whether any limitations have caused the State to forgo this funding. We also asked them whether the State could change any programs in order to obtain additional federal funding. We interviewed officials from selected departments and obtained additional documentation where survey responses indicated substantial constraints for maximizing federal funding, or a loss of federal funding due to management practices. In addition, we contacted Finance about its role in the implementation of the State's hiring freeze and the proposed additional 10 percent reduction in departments' personnel budgets. Additionally, we examined the State's Single Audit, which presents audit findings related to the State's administration of federal funds, to determine whether agencies have had to return funds to the federal government because of noncompliance. Finally, we reviewed the Governor's Budget, Legislative Analyst's reports, and pending legislation to determine if there are other issues constraining the State's ability to obtain the maximum available funds. ■

AUDIT RESULTS

CALIFORNIA'S SHARE OF FEDERAL GRANTS FALLS SHORT OF ITS POPULATION SHARE, DUE IN PART TO THE STATE'S DEMOGRAPHICS AND FEDERAL GRANT FORMULAS

California's share of total federal grants awarded during fiscal year 2001–02 was 11.8 percent, or $42.7 billion. This share is slightly below California's 12 percent share of the nation's population (population share). We reviewed the 86 grants accounting for 90 percent of total nationwide federal grant awards in fiscal year 2001–02. California's share of 50 of these grants exceeded 12 percent, providing $4.9 billion more than an allocation based on population share alone. California's share of the remaining 36 grants was $5.3 billion less than an allocation based on population share alone. State agencies are doing a good job of identifying new or expanded grant funding, using the *Federal Register* to identify new funding possibilities and pursuing other sources of information, such as the Web sites of federal awarding agencies.

Grants for which California's share falls below its population share include ones in which demographics work against California, and formula grants that provide minimum funding levels to states or use out-of-date statistics. The Appendix presents details on the 36 grants for which California's funding is lower than its population share. Most of the federal formulas for the Highway Planning and Construction grant (highway grant) do not favor California, which paid an average of 10.1 percent of the total federal fuel taxes and fees during federal fiscal years 1998 through 2001 but received only an average of 9.3 percent of the highway grant. A minimum guarantee keeps the State's share from being even lower.

Of the 36 grants for which California's share fell below its total population share, 10 are due to California's low share of a particular demographic group. California received relatively little of the federal funds awarded to rural communities for water and waste disposal systems in fiscal year 2001–02 because its rural population is low in relation to the rest of the nation. In addition, California is the country's sixth youngest state, so it received less than its total population share of grants to serve the elderly.

Funding formulas that do not allocate funds based on populations in need result in a lower percentage of grant funding for populous states such as California. Some grants are awarded based on old statistical data that no longer reflect the distribution of populations in need. For example, much of a grant for maternal and child health services is distributed according to states' 1983 share for earlier programs, for which California's share was 5.8 percent. If the entire grant were based on more current statistics, California's award for fiscal year 2001–02 would be $23.6 million higher. Other grants provide minimum funding to states without regard to need; the State Homeland Security grant, for example, distributes 40 percent of its funds to states on an equal basis, with the rest matching population share. For this grant, the average per resident share for California will be $4.75, far less than the $7.14 average per U.S. resident.

California's Proportionally Low Grant Awards Often Are Related to Unfavorable Demographics or to Measures Not Directly Tied to Existing Need

California's award fell below its population share for 36 of the 86 large grants.

Of the 86 grants accounting for 90 percent of total nationwide federal grant awards in fiscal year 2001–02, California's share was below 12 percent in 36 cases, amounting to $5.3 billion less than an allocation based on population share alone. These grants include the highway grant, for which some component formulas are unfavorable; grants where the demographics work against California, such as those for rural residents and the elderly; and grants that use out-of-date statistics or guarantee minimum state funding levels. The Appendix presents details on these 36 grants.

Although Formulas for the Highway Grant Are Unfavorable to California, the State Is Getting Its Guaranteed Share

As we discussed in our May 2003 report, *Federal Funds: California's Share of Grant Funding Is Close to Its Share of the Population, but State Spending Cuts May Result in Reduced Federal Funds*, Report 2002-123.1, most of the federal formulas for the highway grant do not favor California. For instance, in federal fiscal year 2001, California accounted for only 7 percent of the nation's interstate lane mileage and 8 percent of contributions to the federal Highway Account attributable to commercial vehicles, which combined determine 67 percent of the interstate maintenance formula. California accounted for 12 percent of the vehicle miles traveled on the interstate system, which

determines the remaining 33 percent of this formula. Another aspect of the highway grant, however, guarantees each state a minimum return of funds. The grant is funded through fuel taxes and fees, and each state is guaranteed a return of 90.5 percent of the taxes and fees it pays into the Federal Highway Account of the federal Highway Trust Fund. During federal fiscal years 1998 through 2001, California paid an average of 10.1 percent of the total federal fuel taxes and fees. Based on the minimum guarantee, California could expect to receive back about 9.1 percent of funding for the majority of the highway grant. Our preliminary analysis showed that California's share of awards in federal fiscal years 1998 through 2001 was 8.2 percent, significantly less than the expected 9.1 percent level, and was only 6.6 percent in state fiscal year 2001–02.

Upon further analysis, however, we determined that California's share of awards approximates its guaranteed share of the highway grant. The discrepancy in award levels relates to a change in the federal government's method of recording awards. According to the California Department of Transportation (Transportation), before federal fiscal year 2000, the federal government included transfers that states made from the Federal Highway Account to the Federal Mass Transit Account in its record of state awards for the highway grant. However, beginning in federal fiscal year 2000, these transfers no longer were included as highway grant awards. Based on an analysis of awards in the Federal Assistance Award Data System, we determined that the amounts were not recorded as Federal Transit Formula grant awards either. However, we were able to obtain documents from the Federal Transit Administration showing that the transfers were available to and designated by California for specific transit programs. If these transfers are added back to the highway grant, California's share of the grant for federal fiscal years 1998 through 2001 averages 9.3 percent, slightly above the State's guaranteed share. In addition, California's share for state fiscal year 2001–02 awards rises to 7.6 percent after the addition of transit grant transfers. Reported highway grant awards represent approved and obligated projects authorized under the federal funding available to a state, or its obligational authority. Thus, the 7.6 percent awards share for fiscal year 2001–02 indicates that California had not used all of its obligational authority within this period. Based on an analysis of obligations through the end of the federal fiscal year in September 2002, however, California's share of federal fiscal year 2002 awards approximates its guaranteed share after the addition of transit grant transfers.

California's share of the highway grant is slightly above the minimum guaranteed level of 9.1 percent.

California's Low Proportion of Rural Residents and Its Relatively Young Population Are Among Several Demographic Factors That Unfavorably Affect Its Share of Some Federal Grants

Unfavorable demographics often contribute to California's relatively low share of funding for grants. Of the 36 grants we reviewed in which California's share fell below its population share, 10 were due primarily to California's low share of a particular demographic group.

For example, California received $10.4 million of the funds awarded under the Water and Waste Disposal Systems for Rural Communities grant in fiscal year 2001–02. This represented only 1.8 percent of the $567 million awarded from this grant nationwide, well below California's 12 percent share of the U.S. population. Funds for this project grant are available for facilities to provide rural water supply and distribution, waste collection, pumping, treatment, or disposal. Awards are allocated to states based on their rural population, number of households in poverty, and unemployment level. The comparatively small proportion of rural residents in California explains the State's relatively low award share from this grant. According to the 2000 U.S. census, only 5.6 percent of California's residents live in rural areas. Moreover, California's rural residents account for only 3.2 percent of the country's total rural population. Because of the State's low share of the rural populace, it is reasonable to expect that California would receive a relatively low share of funding from this program.

California's relatively small populations of rural and elderly residents limit its share of some grants.

This program is only one example of grants for which California's relatively small rural population reduces its grant share. Other grants focused on rural areas include the Cooperative Extension Service grant and the Community Development Block Grants/State's Program. California received less than 4 percent of the total awards for both of these grants.

Similarly, California's relatively young population explains its low share of grants serving the elderly. For example, the State received $53 million, or only 9.3 percent, of the Special Programs for the Aging, Title III, Part C, Nutrition Services (Nutrition Services) grant and only $34 million, or 8.3 percent, of the grant for the Senior Community Service Employment Program (Senior Employment). Both grants award funding based on a state's proportion of older residents compared with their proportion in the country as a whole. Census data for 2000 indicate that California is the country's sixth youngest state, with a median age of 33.3 years. According to the

Administration on Aging, California residents age 60 years and older make up only 10.4 percent of all U.S. residents age 60 years and older, the target population for the Nutrition Services grant. Similarly, the U.S. Census Bureau reports that Californians age 55 and older make up only 10.3 percent of the nation's total population age 55 and older, the basis for the Senior Employment grant. Consequently, California's share of the Nutrition Services and Senior Employment grants are below 12 percent. As explained at page 17, a minimum guaranteed level of funding to states further reduces California's share of the Nutrition Services grant. Additionally, the Senior Employment grant's formula includes a provision based on per capita income that benefits states with low per capita income. California has an above-average per capita income that further decreases its share of this grant.

Because of the State's demographic composition, California's relative need for grants focused on rural or elderly populations may be less than that of other states. Conversely, these same demographics increase California's share of other grants. As we explained in our May 2003 report, the State receives a high share of the transit grant because of its high level of urbanization. Also, California's youthful population contributes to a relatively high share of funding under the State Children's Health Insurance Program.

Formula Grants That Use Out-of-Date Statistics or That Distribute Awards Equally Among the States Limit California's Share of Grant Funding

Funding formulas that do not allocate funds based on measures closely reflecting need can reduce California's share of grant funding. For example, some grants are awarded based on old statistical data that no longer reflect the distribution of populations in need. Grant formulas also may include provisions guaranteeing a minimum level of funding to states, without regard to populations in need.

In fiscal year 2001–02, California would have received about $66 million more for a child care grant if the entire award had been based on 2000 census data.

One example of a grant formula based on old data or past funding levels disadvantageous to California is the Child Care Mandatory and Matching Funds of the Child Care and Development Fund grant. In this case, California was awarded $275 million in fiscal year 2001–02, a grant share of only 10.5 percent. The "mandatory fund" portion of this grant is awarded based on a state's share of federal funding in the early 1990s from child care programs that have since been repealed. In fiscal year 2001–02,

the mandatory fund portion made up 44 percent of the total grant award, and California received only 6.9 percent of this portion. In contrast, the "matching fund" portion of this grant in fiscal year 2001–02 was based on a state's proportion of children under age 13, based on 2000 census data. These statistics yielded California 13 percent of the matching fund portion. If the entire grant were awarded based on the 2000 census statistics, California would have received $66 million more in fiscal year 2001–02.

The Maternal and Child Health Services Block Grant to the States also uses old data, and California is penalized significantly. In fiscal year 2001–02, the State received only $43.9 million for this grant, 7.5 percent of the total funding available. This grant enables states to maintain and strengthen health care for pregnant women, mothers, infants, and children who do not have access to adequate health care. Although the grant's formula is based on the proportion of a state's population of children living in poverty compared with the proportion in the entire nation, a large base portion of the grant is distributed according to the share states were allocated in 1983 for previous programs with a similar focus. Of the total $586 million from the fiscal year 2001–02 award, $422 million of the grant was based on the 1983 allocation. According to the U.S. Department of Health and Human Services, California's share of the base 1983 allocation is only 5.8 percent. In contrast, California's share of the other portion of the grant, which is based on 1990 data showing a state's proportion of the nation's children living in poverty, was 11.5 percent. California's grant award for fiscal year 2001–02 would have been $23.6 million higher if the entire grant were awarded based on these data.

California would have received about $23.6 million more for a maternal and child health grant in fiscal year 2001–02 had the awards been based on 1990 census data instead of 1983 awards for previous programs, and even more had they been based on 2000 census data.

The 2000 census data, which the U.S. Department of Health and Human Services will use to distribute the additional portion of the award starting in federal fiscal year 2004, indicates an even greater disparity. California's rate for children in poverty averaged 15.3 percent for 1998 through 2000, yet the base amount of this grant, which currently makes up 72 percent of the total grant, will continue to be distributed based on 1983 figures.

Similarly, California received only 7.6 percent of the Capitalization Grants for State Revolving Funds in fiscal year 2001–02. These grants are designed to provide funding to states so they can provide low-interest loans and other nongrant financing to local agencies for construction of wastewater treatment facilities. California's share reflects an allotment percentage established in legislation in 1987. In this case, however, the law does not

include a method for determining current need or a process for adjusting even a portion of the grant award. Because of the lack of award criteria, we could not determine whether California's need for this grant has increased relative to the rest of the United States in the past 15 years. A bill under consideration in Congress would require the program administrator, the U.S. Environmental Protection Agency, to determine the level of need nationwide for use in a funding formula. Nevertheless, the new criteria would apply only to funding in excess of the grant's current awards of $1.3 billion.

Some grants also include provisions guaranteeing a minimum level of funding to the states and territories, reducing the share of funding for California and other large states. For the grants we reviewed, the minimum level of funding tended to affect 10 percent to 25 percent of the total program amounts and is thus a secondary cause of California's low share for those grants. For example, each state is assured at least 0.5 percent of the Nutrition Services grant. This provision is another factor that reduces California's grant below its share of the population age 60 and older, the primary basis for awards under the grant, as we discussed on page 15. In some cases, we recognize that equal distribution of a small portion of a grant may be necessary to ensure a minimum level of administration and services in some states.

Because of guaranteed minimum levels of funding to all states, California's award for the State Homeland Security grant will be $4.75 per resident, well below the $7.14 average per U.S. resident.

For the greatly expanded State Homeland Security grant, however, minimum funding provisions appear to go beyond ensuring minimum services and have a much larger impact on California's share of funding. This program's appropriations, signed into law by the president in February and April 2003, will distribute $2.1 billion to enhance the capability of state and local emergency responders by allowing for the purchase of advanced equipment. It also seeks to address other homeland security needs, including the development and conduct of weapons exercises and training programs, the protection of critical infrastructure, and administrative costs. California will receive only 8 percent of this grant because 40 percent of it will be distributed equally among all states. The remaining 60 percent will be distributed based on a state's population share. As it stands, the award for California will amount to only $4.75 per resident, well below the $7.14 average per U.S. resident. In contrast, Delaware's award will amount to $23.75 per resident. If the entire grant were awarded based on population share, California's award would be $248 million in federal fiscal year 2003, $83.7 million more than actually allocated.

California Uses Reasonable Processes to Identify New or Expanded Grant Funding

State departments appear to use reasonable processes to identify new or expanded funding from federal grants. They generally identify new and augmented federal funding through public sources such as the *Federal Register*, informal networks such as national organizations, and direct contact with federal awarding agencies. In California, departments are responsible for identifying their own federal funding opportunities, and the role of their overseeing agencies in identifying new funding opportunities is generally minimal. There is no central department or agency responsible for helping departments identify new federal funding opportunities.

Departments use the Federal Register, Web sites of federal agencies, and participation in national organizations to identify federal funding opportunities.

Many departments responding to our survey, described in the Introduction, noted that they identify new funding opportunities through public resources such as the *Federal Register*. The *Federal Register* is a legal newspaper published daily by the National Archives and Records Administration. It contains federal agency regulations, proposed rules and notices, and executive orders and proclamations. It also contains grant-specific notices for a variety of individual grants. Departments also rely on the Web sites of federal awarding agencies. Staff members at several departments, including the Department of Child Support Services, the Department of Social Services (Social Services), and the Governor's Office of Criminal Justice Planning, noted that they frequently check the Web sites of federal awarding agencies in order to stay alert to new information relating to federal funding opportunities.

Several departments also noted membership in national organizations and participation in directors' conferences, which discuss opportunities to apply for new federal funding, as useful tools for identifying funding opportunities. For instance, the Department of Food and Agriculture seeks out information on potential funding opportunities through its participation in the National Association of State Departments of Agriculture. Many departments also stay abreast of new federal grants by staying in direct contact with federal awarding agencies. The California Student Aid Commission and the Department of Alcohol and Drug Programs stated that their regular contact with federal awarding agencies leads to information regarding new or expanded grant opportunities.

Although some states have central agencies responsible for identifying new federal funding opportunities, California does not have such an agency. The closest thing to a central agency in California is the state clearinghouse, which serves as California's federally required single point of state contact for federal grants. The clearinghouse collects and distributes information on federal grant applications that must be publicly noticed for comment. However, it does not provide information on federal grants; nor does it help state or local agencies identify or apply for new grants.

The central agencies for some other states help to identify funding opportunities. For example, the goal of Wisconsin's Federal-State Relations Office, under the Wisconsin Department of Administration, is to ensure that Wisconsin gets its fair share of federal dollars. To meet this goal, it analyzes federal issues and their impact and provides assistance in obtaining federal grants and procurement through education, outreach, training, and other activities. In Texas, the State Grants Team is part of the Texas Governor's Office of Budget, Planning, and Policy and is responsible for alerting entities throughout Texas about funding opportunities. The team regularly posts a "grant alert" on its Web site that consists of compilations of information about current funding solicitations offered by federal, state, and private grant funding resources. The New York State Assembly produces a monthly publication entitled *Grants Action News* that provides updates and information on available federal, state, and foundation grants.

Despite California's lack of a similar central agency, our review revealed that departments did not miss grant opportunities because of a lack of awareness. Thus, although the creation of a central agency might yield some benefits to California, they would likely be related to the identification of small grants or to a marginal reduction in the time that agencies spend identifying grants.

STATE AND LOCAL POLICIES HAVE LIMITED CALIFORNIA'S SHARE OF FEDERAL FUNDS IN A FEW CASES

State and local policies limit California's share of federal funds for three programs. For the Special Education–Grants to States (Special Education) grant, California's share is less than would be expected based on its number of children because of the local

California's federal funding for the In-Home Supportive Services program is low because of a state program that pays legally responsible relatives to be caregivers, a type of activity ineligible for federal reimbursement.

approach to deeming children eligible for special education services. California's federal funding for the In-Home Supportive Services program is also low because of a state program that pays legally responsible relatives to be caregivers, a type of activity that is ineligible for federal reimbursement. Another agency has proposed changing the Access for Infants and Mothers (AIM) and State Children's Health Insurance (Children's Insurance) programs to increase federal grant funding. In addition, the State has chosen not to apply for two small grants for which it is eligible. These policies have affected the State's ability to maximize the receipt of federal funds. However, we did not review the effects on stakeholders that a change in government policies for these programs would entail, effects that may outweigh funding considerations.

California's approach to special education appears to reduce its grant share of the related federal Special Education grant. This grant assists states in providing a free appropriate public education to all children with disabilities. According to a report by the U.S. Department of Education, during the 1999–2000 school year, California had 10.2 percent of the nation's children, ages 3 through 21, served under the federal Special Education program, although the State's share of the nation's children was 12.4 percent. This is reflective of the fact that only 6.8 percent of California's children participated in services covered by the Special Education grant, compared with an average of 8.3 percent of children nationally. California's participation rate is the third lowest in the United States. In contrast, participation rates for Massachusetts and New Jersey are 10.7 percent and 10.3 percent, respectively. According to the California Department of Education (Education), California's low share of children served under this program may be due to the assessment practices and rigorous screening of children being considered for special education services. According to Education, local school districts attempt to serve special needs children in the least restrictive environment possible, using early intervention and accommodation in the regular classroom as much as possible, rather than special education. This approach may serve these children's needs better, but it appears to entail lower levels of participation.

The State's Residual In-Home Supportive Services program, funded solely from state and county sources, has likely reduced the participation of some eligible recipients in the federally supported Personal Care Services program. Both programs provide various services to eligible aged, blind, and disabled

persons who are unable to remain safely at home without this type of assistance. The Residual In-Home Supportive Services program provides additional services and serves recipients who are not eligible for the federal program. In addition, the State's program allows legally responsible relatives to be caregivers to recipients. Legally responsible relatives include spouses and parents who have a legal obligation to meet the personal care needs of their family members. The federal program, in contrast, does not allow payments to such caregivers. According to the analysis of the fiscal year 2002–03 Budget Bill by the Legislative Analyst's Office, prohibiting legally responsible relatives from acting as paid caregivers would likely cause more of the State's recipients to become eligible for federal aid from the Personal Care Services program. The Legislative Analyst's Office estimated that if the State's eligibility policies mirrored the federal guidelines, federal medical reimbursement for in-home services could have risen, decreasing the State's costs by $30 million and local costs by $18 million. However, the Department of Finance (Finance) advises that any savings would be offset by increased state costs resulting from the movement of state recipients into more expensive long-term care facilities. Finance preliminarily estimates that to the extent that 17.6 percent of the affected recipients were to move into institutions, the entire savings resulting from mirroring federal guidelines would be offset by increased state costs. In addition, Finance indicates that disallowing in-home services provided by legally responsible relative caregivers would be a major policy change, and would have a significant adverse impact on a large portion of vulnerable clients currently receiving services under the state program.

A federal waiver allowing payments to relatives assisting aged, blind, or disabled persons could save the State millions of dollars.

Alternatively, the Department of Health Services (Health Services), in conjunction with Social Services may be able to apply for a waiver under the Medical Assistance program, called Medi-Cal in California. This recently developed waiver program, called Independence Plus, may allow states to claim federal reimbursement for a portion of the expenditures for caregiver services provided by family members. The departments estimate that the State may be able to save $133 million of costs currently borne by the State's Residual In-Home Supportive Services program if this waiver is pursued. They indicated that they are jointly exploring the feasibility of this waiver.

The State's Managed Risk Medical Insurance Board (board) estimates that a programmatic change to its AIM and Children's Insurance programs would save the State a net of $8 million annually through increased federal reimbursements and greater efficiencies. It has included a program change in the fiscal year 2003–04 Governor's Budget proposing that infants eligible for the AIM program who meet certain income restrictions be enrolled in the Children's Insurance program while their mothers continue to receive prenatal and postpartum care under the AIM program. Currently, the primary source of funding for the AIM program is the Proposition 99 Cigarette and Tobacco Surtax funds. Due to restrictions in Proposition 99, these funds may be used only for programs that do not receive funding from federal or private sources. By switching children to the Children's Insurance program, the State would be able to receive federal funds for up to 65 percent of the costs. This change, however, also would require a greater expenditure of the General Fund. The board estimates that these expenditures may rise by as much as $1.6 million a year.

The State has not applied for two small grants—the Abstinence Education and the Pacific Fisheries Data programs.

Finally, the State has turned down the opportunity to apply for two grants. Through our review of grants for which California received no funding in fiscal year 2001–02, we identified two grants in which the State could participate: Abstinence Education and the Pacific Fisheries Data program grants. For the first grant, Health Services says that it twice submitted a budget change proposal in which it sought to apply for funding for the grant, but the Legislature rejected the first request and Finance denied the second request. The Abstinence Education program enables states to provide abstinence education and, where appropriate, mentoring, counseling, and adult supervision to promote abstinence from sexual activity. The grant is awarded based on a state's relative share of children living in poverty, and it requires a 43 percent state match. Based on California's rate for children in poverty, which averaged 15.3 percent for 1998 through 2000, we estimate that the State could receive as much as $6.1 million in federal funding if it chose to participate in this program and would need to provide up to $4.6 million in state matching funds.

The Department of Fish and Game says it did not apply for the second grant, the Pacific Fisheries Data program, because it was focusing on other priority efforts, consistent with its goals, that already had resources available to effectively manage grants. It says that it did not have the additional resources needed to take

on new grant management responsibilities. This grant provides support to state fishery agencies to enhance their data collection and analysis systems to respond to fisheries management needs, and it provides up to 100 percent federal funding. It is a project rather than a formula grant, so it is difficult to estimate how much the State might receive. However, according to the Catalog of Federal Domestic Assistance, this program funded a total of $18.6 million in cooperative agreements in federal fiscal year 2002 and financial assistance to grantees ranged from $36,000 to $7.7 million, averaging $3.8 million.

CALIFORNIA IS NOT OBTAINING THE MAXIMUM FUNDING AVAILABLE FROM SOME FEDERAL GRANTS, BUT TO DO SO GENERALLY WOULD REQUIRE MORE STATE SPENDING

The State has lost some federal dollars because departments were unable to obtain the matching state dollars required by federal programs. For example, a Health Services program to recognize high quality skilled nursing facilities would have received more federal grant money had state matching funds been available. In addition, a reduction in state funding for several transportation-related funds may lead to the loss of federal funding for local projects. The use of state matching dollars to maximize federal funds must, however, be balanced against the State's other priorities.

In other cases, departments say they lack the staff to apply for and manage additional grants. For example, Health Services says it lacks the staff to research and apply for several waivers to federal requirements for its Medi-Cal program. Also, the Department of Housing and Community Development (Housing) states that California's rural counties lack the financial resources to create the necessary planning documents to receive a possible $2.3 million annually in federal funds under the McKinney-Vento Homeless Assistance Act.

The State Lost Some Available Federal Funding Because It Could Not Provide Required Matching Funds and May Lose More in the Future

Many of the federal programs under which the State receives funding require that it spend a certain amount of state funding, referred to as matching funds, in order to receive a set amount in federal grant dollars. As such, a department's inability to

obtain state matching funds for a federal program limits the amount of funds it receives from federal agencies. The limited availability of state matching funds has kept Health Services and may keep Transportation from maximizing federal funding.

At Health Services, the Quality Awards program, part of the Medi-Cal program, was established to recognize skilled nursing facilities that provide exemplary care to residents. In 2001, the U.S. Department of Health and Human Services agreed to match each dollar in state spending for this program according to the federal Medical Assistance Percentage (matching rate). In recent years, the matching rate has been close to 50 percent, meaning that state funding is matched dollar for dollar. For fiscal years 2001–02 and 2002–03, the federal government agreed to provide as much as $16 million for the program. In fact, however, Health Services received only $4 million in state funding for this program during fiscal year 2001–02, and it received no state funding for the program in fiscal year 2002–03 because of cuts in General Fund spending. Consequently, the State received $12 million less in federal funding than it would have if it had spent the originally planned state match.

The lack of matching funds led to the loss of $12 million for a Medi-Cal subprogram.

Transportation projects could risk losing federal funding because of a drop in available state matching funds. Our July 2003 report titled *California Department of Transportation: Low Cash Balances Threaten the Department's Ability to Promptly Deliver Planned Transportation Projects*, Report 2002-126, noted that the Legislature authorized loans totaling $1.3 billion from the Traffic Congestion Relief Fund (traffic fund) to the General Fund in fiscal years 2001–02 and 2002–03 as the State's fiscal crisis worsened. This reduced amounts in the traffic fund available for planned projects. The traffic fund then faced further budget uncertainties when the governor's December 2002 midyear spending reduction proposal called for (1) forgiving $500 million of the loans to the General Fund and (2) suspending the more than $1 billion transfer of state gasoline sales tax revenues from the General Fund to the Transportation Investment Fund, which in turn transfers money to the traffic fund and other transportation funds. A May 2003 revision to the Governor's Budget would decrease the suspension to $938 million, including up to $678 million for the traffic fund, and require the General Fund to repay these funds eventually. In July 2003, the Legislature enacted bills suspending $856 million in transfers to the Transportation Investment Fund and requiring the General Fund to repay this amount with interest by June 2009.

Decreased state funding for traffic fund projects may force implementing agencies to turn to other sources for funding or risk losing federal funds. Data from the California Transportation Commission's survey of implementing agencies revealed that at least $7.8 billion in other funds needed to complete their projects, including some federal funds, are in jeopardy if traffic fund dollars are not available. For example, the Los Angeles County Metropolitan Transportation Authority reported that if it could not replace traffic fund contributions, it risked losing $490 million in federal funds for one project. In April 2003, it requested that this project replace other projects already earmarked for funding by another state transportation fund in order to secure the federal funding.

Administrative Concerns May Lead Agencies to Avoid New Grant Opportunities

Some departments cite a general lack of staffing or other administrative issues as a factor limiting their participation in federal programs. For example, under the Medical Assistance program, each state can apply for waivers that remove certain federal requirements for specific components of the overall program. Health Services currently operates under several waivers covering services including clinic services and home and community-based services. According to Health Services, there are several other waivers that it could potentially implement, in addition to the one related to the Residual In-Home Supportive Services program discussed on page 21, if it were able to research, identify, and apply for them. Health Services says its current staff is not large enough to develop additional waiver opportunities, and because it has not been able to research this area it cannot estimate the amount of additional federal funds it might reap. According to data from the U.S. Department of Health and Human Services, in federal fiscal year 2002, California received only 2 percent of the federal expenditures paid under waivers for the entire Medical Assistance program. It is important to note, however, that an expansion of the State's Medi-Cal program related to new waivers likely would require an increase in state funding in order to meet the program's matching requirements.

Health Services says it did not apply for additional funding under the Housing Opportunities for Persons with AIDS program because of a lack of resources to apply for, implement, monitor, and evaluate the new program.

Health Services also believes that a lack of staff resources has kept its Acquired Immune Deficiency Syndrome (AIDS) division from applying for some federal grant dollars. Specifically, Health Services indicates that it did not apply for additional funding under the Housing Opportunities for Persons with AIDS

program because of a lack of resources to apply for, implement, monitor, and evaluate the new program. Health Services states that in each of the last four years it would have applied for the maximum annual grant amount of $1.3 million if it had the resources available to apply for and manage the grant. According to Health Services, the competitive nature of the grant and the annual change in the type of projects funded made it impractical to submit a budget change proposal to increase staff related to this grant. The uncertainty surrounding the long-term need for staff positions and the timing of the application process were additional factors contributing to the decision not to submit a budget change proposal.

The administrative burden of developing continuum of care plans may be keeping rural counties from applying for homeless assistance grants.

California's rural counties also may be forgoing a total of $2.3 million annually from three McKinney Continuum of Care Homeless Assistance programs under the McKinney-Vento Homeless Assistance Act because of concerns over the burden of creating the required planning documents. During fiscal year 2001–02, Housing said that 27 of the State's counties had not completed continuum of care plans, a requirement for receiving funds under the McKinney Continuum of Care Homeless Assistance programs. These plans demonstrate a broad participation of community stakeholders and identify the resources and gaps in a community's approach to providing a range of homeless services. For rural counties, the administrative burden of developing such plans may outweigh the potential increased federal funding. For example, Housing estimates that Inyo County would be eligible to receive only $31,996 more in annual funding for homeless aid if it developed a plan and won an award. Although efforts to complete a plan may be financially and administratively burdensome for rural counties, under U.S. Department of Housing and Urban Development (HUD) guidelines, the State could develop its own continuum of care plan for the "balance of the state"—those areas that have not created their own continuums. Housing believes, however, that it is infeasible to develop a balance of state plan due to the logistical obstacles involved in bringing together counties from different areas of the State. Instead, Housing is working with HUD to help counties collaborate to develop regional plans, including providing state and federal planning grants for multicounty plans. Housing may have identified another reason why it may not be in the State's best interests to pursue a continuum of care plan for the balance of the State. According to Housing, funding awarded to California as a whole is higher than its original allocations because other areas of the State are

effectively competing for nationwide unused funds. Thus, it believes that any application by the State for rural areas could decrease funding to the existing continuum of care jurisdictions.

THE STATE HAS LOST AND MAY CONTINUE TO LOSE SOME FEDERAL FUNDS BECAUSE OF AN INABILITY TO OBLIGATE FUNDS, FEDERAL SANCTIONS, AND BUDGET CONSTRAINTS

Over the last three fiscal years, agencies sometimes lost federal funds by failing to obligate funds within the grants' periods of availability. In addition, noncompliance with program guidelines in four instances resulted in funding losses of more than $758 million, mostly related to the lack of a statewide child support automation system. Finally, the statewide hiring freeze sometimes keeps agencies from spending available federal funding on grants staff, and a pending budget cut of 10 percent in personnel costs may further limit spending of federal funds.

Failure to Obligate Funds Within the Period of Availability Resulted in the Loss of Some Funds

In addition to the $1.45 billion in lost funding under the Children's Insurance program, departments responding to our survey identified nearly $25 million[2] in lost federal funds between July 1, 1999, and December 31, 2002, resulting from a failure to obligate and/or liquidate funds within their grants' periods of availability. The period of availability is the specified time period during which a nonfederal entity may use funds from a federal award. The Children's Insurance program reversions related to the State's slow start-up of the federal program in fiscal years 1998–99 through 2000–01. The program now provides services at a level consistent with its annual funding allocation from the federal government; however, it appears that the program will continue to have sizable carry-over funds in future years. The amounts that reverted to the federal government for the other 60 grants identified by the departments we surveyed were small in relation to the total grant award, typically less than 2 percent.

[2] Additionally, the Department of Alcohol and Drug Programs is working with the U.S. Department of Education to adjust $2.6 million in expired funding.

Over a three-year period, the State lost $1.45 billion in Children's Insurance program funding because of a slow start-up of the program.

The most significant loss of federal funds relates to the Children's Insurance program grant, which is administered by the Managed Risk Medical Insurance Board (board). This grant helps states provide health care to low-income children who do not have health insurance. According to the board, over the last three years the State has forgone as much as $1.45 billion in available federal funding because of a slow start-up and limited state matching funds. California is not the only state that has lost available funding under this program. Only 14 states, including New York and Maryland, fully spent their federal fiscal year 2000 allotments by the end of federal fiscal year 2002, the final period of availability for that year. Unspent funds for that year amounted to $2.2 billion nationwide, with California's $744 million portion making up 34 percent of the total.

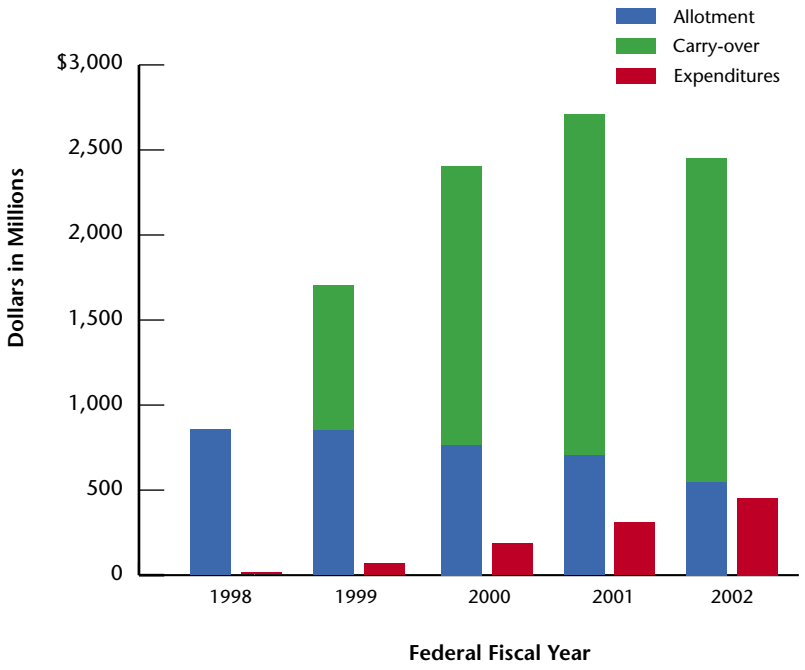
As a state initiating a new program, California's need to enroll clients led to a slow start-up of the Children's Insurance program and a resulting loss of federal funds, which primarily match a state's spending on insurance coverage for enrollees. According to a report by San Diego State University, administrative start-up costs made up a high proportion of total costs for states with new Children's Insurance programs, but the federal Children's Insurance program limits federal funding for these costs to 10 percent of total program costs. Thus, states with new programs had to bear most of the costs for outreach and other administrative expenditures during this phase. In contrast, states with existing programs, such as New York, were able to spend their entire grant awards and qualify for additional funding because their administrative costs were relatively low and their number of enrollees was large. Additionally, Health Services stated that California had delays in obtaining outreach contracts with 72 community-based organizations because of insufficient staff and lengthy contractor negotiations. Moreover, enrollment barriers such as linguistic diversity and families split between the Children's Insurance and Medi-Cal programs, further slowed enrollment of children into the program.

As shown in Figure 2, California has not had enough qualified program expenditures to use its total annual allocations each year, but expenditures have been rising steadily. Unspent annual allocations, which can be carried over for two years, less funds reverting after the two-year cutoff, have been substantial. This has led to a high balance of available funding. According to estimates by the board, reimbursable program expenditures will approximate its annual allocations in the next few years. Thus,

the board estimates that in the next few years carry-over funds, though still large, will continue to decline, and reversions to the federal government will stop after October 2003.

FIGURE 2

A Large Balance of Available Children's Insurance Funding Exists Despite Reversions of Funding



Source: Managed Risk Medical Insurance Board.

Limited state matching funds also have affected the Children's Insurance program. For example, the board said it has not implemented an approved federal waiver to include the parents of eligible children because it lacks the approximate one-third state funding share required to match the available federal funds. The board indicated that a lack of state funding also has resulted in the reduction of outreach activities for the Children's Insurance program. The State has tried to develop new sources of matching funds for the Children's Insurance program. In October 2001, the governor signed Assembly Bill 495 (Chapter 648, Statutes of 2001), which established a mechanism for collecting local funds and matching them with federal funds available under the program. A new fund established

by this bill accepts intergovernmental transfers from local governments as the nonfederal matching funds for programs at the county level. As of June 2003, however, the State Controller's Office indicates that this fund has received no revenues.

Of the other departments with reverted funds, Education reported the largest total. As of May 2003, it indicated that 29 grants had reverted more than $17.6 million over the past three fiscal years. This amounted to less than 0.5 percent of the $3.9 billion in total awards for these grants. Of the reverted funds, the largest amount, totaling more than $11 million, related to a program that is no longer active. As of July 31, 2002, the Comprehensive School Reform grant lost the second largest proportion, $2.6 million out of its $16.2 million award for fiscal year 1999–2000. Education said the reversion resulted from a lack of spending authority in the award's first year and the resulting inability of Education to award two years' worth of grant funds to subgrantees within the period of availability.

Program Noncompliance Resulted in Lost Federal Funds

Noncompliance with federal guidelines in four instances resulted in penalties, judgments, and ineligibility for federal reimbursements of more than $758 million over the past three fiscal years.

Since 1999, California has paid federal penalties for failing to implement a statewide child support automation system. Through July 2003, the total amount of federal penalties paid by the State amounted to nearly $562 million. Before federal fiscal year 2002, the penalty amounts owed reduced federal awards for the Child Support Enforcement program administered by the Department of Child Support Services (Child Support Services); since then Child Support Services has received its full award but paid the penalties from state funds. The estimated penalty payment for fiscal year 2003–04 is $207 million.

Since 1999, the State has been penalized $562 million for not having a statewide child support automation system, but it is working to develop one.

As a step toward eliminating the penalties, the Legislature enacted Chapter 479, Statutes of 1999, providing guidelines for procuring, developing, implementing, and maintaining a single, statewide system to support all 58 counties and comply with all federal certification requirements. In June 2003, Child Support Services and the Franchise Tax Board, which is managing the project, submitted a proposal to the Legislature to enter into a contract with an information technology company to begin the first phase of project development in July 2003,

with implementation in the 58 counties to be completed by September 2008. The total 10-year project cost is $1.3 billion, of which $801 million is for the contract. The federal government has conditionally approved the project, which is estimated to be eligible for 66 percent federal funding.

At Social Services, the U.S. Department of Agriculture (USDA) imposed sanctions because county error rates for the Food Stamp program exceeded the national standard. Under current USDA rules, states must maintain a quality control system to review a sample of their food stamp cases to determine the state's error rate. When a state's error rate exceeds the annual allowable error rate that the USDA establishes, the state is assessed a sanction based upon the difference between its error rate and the standard. For federal fiscal years 2001 and 2002, California's error rate for the Food Stamp program exceeded the federal standard by 8.7 percent and 6.6 percent, respectively. In February 2003, Social Services appealed the $114.3 million sanction for federal fiscal year 2001, stating that the USDA did not consider certain factors that would adjust the error rate and reduce the sanction to zero. The USDA responded to the appeal in May 2003, concluding that California had failed to state a claim upon which relief could be granted and was therefore not entitled to any penalty relief. In June 2003, Social Services received a nearly $62.6 million sanction for federal fiscal year 2002, which it has the option to settle or appeal. Social Services says it is working to improve its error rate by expanding its oversight of the Food Stamp program, requiring quarterly rather than monthly reports, and hiring contractors to evaluate targeted counties with high error rates to determine the causes and develop corrective action plans and goals. It says the State has made significant improvement in food stamp payment accuracy during the first five months of federal fiscal year 2003, decreasing the error rate by 6.8 percent compared to federal fiscal year 2002.

The State has lost more than $16 million annually because of the decertification of nine residential units at the Porterville Developmental Center.

At the Department of Developmental Services (Developmental Services), decertification of nine of the 22 residential units at the Porterville Developmental Center (Porterville) in September 2001 caused an annual loss of more than $16 million in federal funds. These units were decertified because they were not compatible with federal program requirements such as consumer freedom, access, and community integration. Medi-Cal generally reimburses developmental centers for about half of most costs, but the decertification made the nine units ineligible for federal funding. Developmental Services states that it is a recent trend by the federal

Centers for Medicare and Medicaid to deny certification to secure treatment programs similar to Porterville's and that certification may not be possible for these programs. Porterville will reapply for certification of some of the nine units when it completes some capital outlay projects to increase activity and programming space and expand housing on the campus, and obtains sufficient support from community members to allow for more community integration off the campus.

Similarly, the Department of Veterans Affairs estimates that it lost $3.5 million in federal funds when certification was withdrawn for the Veterans Home of California, Barstow (Barstow home) in July 2000. This decertification prevented the Barstow home from qualifying for federal payments for its daily care of residents and for Medicare and Medi-Cal reimbursements. Health Services recertified the Barstow home effective January 17, 2002, and the home resumed billing the federal government for services performed. In a subsequent action, the Department of Veterans Affairs decided in March 2003 to limit the services provided at the Barstow home as a result of continual problems with recruiting and retaining an adequate number of qualified licensed nurses.

The Current Hiring Freeze Has and a Proposed 10 Percent Staff Reduction May Limit Agencies' Ability to Spend Federal Funds on Grants Staff

In order to address the State's significant decline in revenues, the governor has undertaken several initiatives to reduce spending on personnel. These include a hiring freeze in effect since October 2001 and a 10 percent reduction in staffing proposed in April 2003. The hiring freeze already has had a negative effect on some federal programs, and the 10 percent reduction may affect them as well.

As a result of a hiring freeze established to reduce state expenditures, managers of federal programs at two state departments say they have been unable to fill positions that receive some federal funds. On October 23, 2001, the governor issued an executive order prohibiting state agencies and departments from filling vacancies that would constitute a new hire to state government. This hiring freeze prohibited new hires regardless of the fund paying for the position. Although certain positions and appointments, such as public health and safety personnel, and personnel directly involved in producing state revenues, are excluded from the order, other positions are

subject to provisions of the hiring freeze. On July 1, 2003, the governor issued a similar executive order extending the freeze through June 30, 2005.

After the October 2001 executive order, Finance directed agencies, departments, and other state entities to enforce the hiring freeze. It also established a process for exempting some positions. The process includes explaining why a particular position should be exempted and what the effect of not granting an exemption would be. Departments and their oversight agencies must approve the exemptions and then forward them to Finance for approval. In response to our survey, staff at two departments said the hiring freeze and an inability to obtain exemptions had affected their federal programs negatively. In September 2002, the U.S. Centers for Disease Control and Prevention (CDC) wrote to Health Services noting nine vacant positions within the State's National Cancer Prevention and Control program and difficulties in filling vacancies due to the state-imposed hiring freeze as major weaknesses. It recommended that the program continue to push for exceptions to the hiring freeze and find the best and quickest way possible to fill the many vacancies. In a December 2002 letter of response to the CDC, Health Services indicated that it had filled some vacant positions, and in March 2003 Health Services sent exemption requests for five federally funded positions to Finance, four of which Finance denied. As of June 2003, Health Services says that the CDC plans to reduce the National Cancer Prevention and Control program grant for the 12 months ending June 30, 2004, to $8.4 million from the $10.6 million awarded for the nine months ending June 30, 2003. Health Services said an important element in the CDC's reduction was the department's inability to fill vacant federally funded positions. For this grant, the federal government requires the State to provide at least 25 percent in matching funds.

The federal government noted that vacant positions within a cancer prevention program and difficulties in filling positions due to the hiring freeze were major weaknesses.

Similarly, the USDA informed Education's Nutrition Services Division (division) in September 2002 that through a management evaluation it had identified corrective actions in several areas where a lack or shortage of staff contributed to findings. It was concerned about staffing shortages in a unit responsible for conducting reviews and providing technical assistance to sponsoring institutions participating in the child nutrition programs. It warned that the USDA may withhold some or all of the federal funds allocated to Education if it determines that Education is seriously deficient in the administration of any program for which state administrative

funds are provided. The USDA noted that a mix of federal funds and General Fund maintenance of effort appropriations support the vacant positions. In May 2003, the State Superintendent of Public Instruction wrote to the Governor's Office asking for approval of a blanket freeze exemption allowing Education to fill all division vacancies, reestablish 12 division positions eliminated during the fiscal year 2002–03 reduction of positions, and exempt the division from a proposed 10 percent reduction in staff.

Finance has approved some hiring freeze exemptions where departments presented a compelling need.

It appears that exemption requests for some federally funded positions have passed administrative hurdles at the departmental and agency levels and have been approved by Finance. Finance has not maintained statewide statistics to track the number of requests for or approvals of hiring freeze exemptions. However, it was able to provide examples of approved exemptions for positions that are fully federally funded where departments presented a compelling need. For example, Social Services requested an exemption to fill seven positions for clerical support in its disability unit. Finance reviewed the reason for the exemption, identifying federal approval for an increase in workload for the unit, and subsequently approved the exemption. Finance's Health and Human Services Unit also stated that from January through May 2003, it received requests to exempt 1,536 positions and approved 1,105 positions, many of which are partly supported by federal funds.

As noted earlier, the Superintendent of Public Instruction has requested an exemption for one division at Education from a proposed 10 percent reduction in personnel. On April 1, 2003, Finance and the Department of Personnel Administration informed departments that they had to prepare a reduction plan and associated layoff plan to reduce personnel budgets by at least 10 percent in additional ongoing costs. These cuts might be implemented in the event that proposed reductions contained in the fiscal year 2003–04 Governor's Budget are not realized in a timely manner. The proposed budget reduction would cut employee compensation costs by $855 million over the fiscal year, of which $470 million would relate to the General Fund.

Finance instructed departments to place a priority on eliminating positions that would produce immediate savings, such as vacant positions, temporary employees, and student assistants. All position reductions would be permanent, and therefore Finance told department directors to be prepared to address and

defend why they chose to cut particular positions and to explain the expected programmatic impact of eliminated positions. The reduction plan must contain a fund split that mirrors the split between the General Fund and all other funds combined in the fiscal year 2003–04 Governor's Budget.

For departments with significant federal funding, it may be difficult to meet the goal of reducing personnel budgets by 10 percent without jeopardizing federal funding or the administration of federal programs. Since this initiative is still being developed, however, it is unclear how or whether federal funds would be affected. Nevertheless, policy makers should consider carefully the potential loss of federal funding that would result from a reduction in federal program staff.

RECOMMENDATIONS

As federal grants are brought up for reauthorization, the Legislature, in conjunction with the California congressional delegation, may wish to petition Congress to revise grant formulas that use out-of-date statistics to determine the share of grants awarded to the states.

The Legislature may wish to ask departments to provide information related to the impact of federal program funding when it considers cuts in General Fund appropriations.

Finance should ensure that it considers the loss of federal funding before implementing personnel reductions related to departments' 10 percent reduction plans.

Health Services should continue to work with Social Services to determine the feasibility of pursuing an Independence Plus waiver that may allow the State to claim federal reimbursement for a portion of the expenditures for caregiver services provided by legally responsible family members to participants in the In-Home Supportive Services program.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

ELAINE M. HOWLE
State Auditor

Date: August 6, 2003

Staff: Nancy C. Woodward, CPA, Audit Principal
James R. Sandberg-Larsen, CPA
Michelle R. Ludwick
Cameron Swinko, CMA
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Paul P. Zahka

APPENDIX

Grants for Which California Received Less Than Its Population Share in State Fiscal Year 2001–02

In the Audit Results, we state that California received a less than 12 percent share for 36 of the 86 grants making up 90 percent of total federal grant funding in fiscal year 2001–02. (The State's share of the U.S. population (population share) is 12 percent.) The following tables present California's share of the total national grant during that period and the amount of California's actual award according to the Federal Assistance Award Data System. They also show the amount by which California's actual award fell below an allocation based solely on population share. The tables list the grants by the factors, established by law or regulation, that determine the funding level. In total, California's awards for these grants fell below an allocation based solely on population share by $5.3 billion.

Table A.1 presents 10 grants that award funds based on target populations for which California has a relatively low share, causing its award share to fall below an allocation based solely on population. For instance, rural population drives three of the 10 grants. California is a highly urbanized state, so it receives a relatively low share of these grants. California also has a low percentage of federal employees, elderly, and publicly owned housing.

TABLE A.1

Grants for Which California Has a Low Share of the Target Population
Fiscal Year 2001–02

Program Name	Type of Assistance	Award Determinant or Basis for Award	Why the Basis for the Award Is Unfavorable	Total Federal Awards (Dollars in Millions)	California Awards (Dollars in Millions)	California's Percent Share	Amount Under Population Share (Dollars in Millions)	Principal Grantees
Child Support Enforcement	Formula	State's volume of administrative expenses and paternity test costs reduced by the amount the state owes the federal government for assistance reimbursements from participants in the Temporary Assistance for Needy Families (TANF) and Foster Care programs	California has a high share of TANF and Foster Care collections due to the federal government, which partially offsets the federal contribution for administrative expenses and paternity test costs.	$2,473	$248	10.02%	$ (49)	Department of Child Support Services; 100%
Community Development Block Grants/State's Program	Formula	Poverty, housing overcrowding, and age of housing within a rural population	California's share of the rural population is low.	1,176	44	3.74	(97)	Department of Housing and Community Development; 100%
Cooperative Extension Service	Formula/ Project	Rural population, farm population, 1962 allotment	California's share of rural and farm populations is low.	403	11	2.73	(37)	State-run universities; 100%
Disaster Assistance	Project	Need for disaster or emergency assistance*	California had minimal federally declared disaster and emergency assistance events in fiscal year 2001–02.	2,159	2	0.12	(257)	Governor's Office of Emergency Services; 100%
Impact Aid	Formula	Military and federal employees who work on federal property not subject to local taxes	California has a low share of federal employees.	1,091	86	7.90	(45)	Local school districts; 99.7%
National Guard Military Operations and Maintenance Projects	Project	Awards granted to eligible applicants on a competitive basis	California has a relatively small National Guard in comparison to its population share.	618	43	6.96	(31)	Department of the Military; 100%
Public and Indian Housing	Project	Number of available publicly owned housing units; the cost of operating an average unit, plus average utility costs	California has a low share of publicly owned housing.	3,468	115	3.32	(301)	Special district governments; 100%

Program Name	Type of Assistance	Award Determinant or Basis for Award	Why the Basis for the Award Is Unfavorable	Total Federal Awards (Dollars in Millions)	California Awards (Dollars in Millions)	California's Percent Share	Amount Under Population Share (Dollars in Millions)	Principal Grantees
Senior Community Service Employment Program	Formula/ Project	Elderly population, per capita income, state minimum	California has a low elderly population compared with its population share and a per capita income above the national average.	$411	$34	8.33%	$(15)	Nonprofit corporations; 63.5%
Special Programs for the Aging, Title III, Part C, Nutrition Services	Formula	Elderly population, state minimum	California has a low elderly population compared with its population share.	565	53	9.34	(15)	Department of Aging; 100%
Water and Waste Disposal Systems for Rural Communities	Project	Rural population	California's share of the rural population is low.	567	10	1.83	(58)	City governments; 100%

* The Disaster Assistance grant was split into several smaller grants including Public Assistance and Crisis Counseling grants.

Table A.2 lists six grants with formulas that determine state shares using out-of-date information or guaranteed minimum state funding levels, resulting in awards falling below California's 12 percent share of the U.S. population. For example, the Rehabilitation Services–Vocational Rehabilitation Grants to States uses data from the late 1970s to determine portions of the states' awards, and the Maternal and Child Health Services Block Grant to the States allocates funds fixed at a 1983 allotment level. For more information on this issue, see page 16.

TABLE A.2

Allotments Based on Outdated Information or Which Guarantee Minimum State Funding Levels Fiscal Year 2001–02

Program Name	Type of Assistance	Award Determinant or Basis for Award	Why the Basis for the Award Is Unfavorable	Total Federal Awards (Dollars in Millions)	California Awards (Dollars in Millions)	California's Percent Share	Amount Under Population Share (Dollars in Millions)	Principal Grantees
Capitalization Grants for State Revolving Funds	Formula	Congressionally fixed percent share from federal fiscal year 1987. No explicit driver	We cannot determine the reason for California's low share because the basis for the award is not well defined.	$1,259	$ 95	7.56%	$ (56)	State Water Resources Control Board; 100%
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	Formula	The "mandatory fund" portion of this grant is awarded based on a state's share of federal funding in the early 1990s from child care programs that have since been repealed. The "matching fund" portion is based on a state's proportion of children under age 13.	California's population eligible for this grant has increased significantly since the early 1990s.	2,621	275	10.49	(40)	Department of Education; 99.5%
Class Size Reduction	Project	Highest percent share of Elementary and Secondary Education Act Title I or Eisenhower Professional Development State grant in 1998, state minimum	A grant provision that guarantees a minimum level of funding to the states and territories limits California's share of this grant.	1,618	175	10.81	(19)	Department of Education; 100%
Low-Income Home Energy Assistance	Formula	1984 allotment, home energy costs of low-income households	California's share of home energy expenditures has increased since the 1980s.	1,684	78	4.66	(124)	Department of Community Services and Development; 99.4%
Maternal and Child Health Services Block Grant to the States	Formula	1983 allotment to states for this program, proportion of low-income children	California's population of children in need has increased since 1983.	586	44	7.50	(26)	Department of Health Services; 100%
Rehabilitation Services–Vocational Rehabilitation Grants to States	Formula	Population, per capita income, 1978 state allotment, state minimum	California's share is based on outdated information from 1978. California's per capita income is slightly higher than the national average.	2,481	243	9.80	(55)	Department of Rehabilitation; 100%

Table A.3 presents two grants for which California is receiving a lower share of funds because the award drivers are predominately focused on areas that are unfavorable to the State. Formulas are weighted toward factors in which California is weak, such as diesel fuel usage. Please see page 12 for more information on the Highway Planning and Construction Grant.

TABLE A.3

Formulas Weighted in Areas Unfavorable to California
Fiscal Year 2001–02

Program Name	Type of Assistance	Award Determinant or Basis for Award	Why the Basis for the Award Is Unfavorable	Total Federal Awards (Dollars in Millions)	California Awards (Dollars in Millions)	California's Percent Share	Amount Under Population Share (Dollars in Millions)	Principal Grantees
Airport Improvement Program	Project	Base amount with a lower allocation per passenger as passenger count increases; base is reduced if airport imposes a passenger facility charge; state land area, population, nonprimary airports	California has mostly primary airports with high passenger counts. Some airports impose a passenger facility charge, thereby decreasing their share of passenger entitlements. Also, the State has low land area and nonprimary airports in comparison to its population share.	$ 2,575	$ 177	6.87%	$ (132)	City government; 44% County government; 39%
Highway Planning and Construction	Formula/ Project	Arterial miles, interstate miles, diesel fuel sales, driving miles; state minimum	California's proportion of most of the components of the formulas that drive the State's share are low.	36,567	2,771	7.58	(1,617)	Department of Transportation; 93.4%

Table A.4 lists four grants with low shares caused by State or local policies or procedures. For instance, California receives a lower share of funds for the Medical Assistance Program grant because of the low amount the State spends per enrollee. In addition, one reason California's share of the State Survey and Certification of Health Care Providers and Suppliers grant is low is that the federal government has not increased the State's award because the State's inspections of nursing homes take, on average, more than 15 percent longer than the national average threshold.

TABLE A.4

Low Share of Funding Attributable to State or Local Policies or Procedures
Fiscal Year 2001–02

Program Name	Type of Assistance	Award Determinant or Basis for Award	Why the Basis for the Award Is Unfavorable	Total Federal Awards (Dollars in Millions)	California Awards (Dollars in Millions)	California's Percent Share	Amount Under Population Share (Dollars in Millions)	Principal Grantees
Consolidated Knowledge Development and Application Program	Project	Awards granted to eligible applicants on a competitive basis	According to the department administering the State's award under this grant, it chose not to apply for additional small grant awards because of staffing constraints.	$ 486	$ 39	7.99%	$ (19)	Nonprofits; 44% City government; 14.4% County government; 14%
Medical Assistance Program	Formula	Spending on medical assistance for low-income individuals, state per capita income	California's spending per enrollee is less than that of any other state. The State receives the lowest matching percentage possible, 50 percent, because its per capita income is slightly above the national average.	147,102	15,625	10.62	(2,027)	Department of Health Services; 100%
Special Education-Grants to States	Formula	Number of children served under the Individuals with Disabilities Education Act	State and local policy emphasizes keeping special-needs children in the least restrictive environment, avoiding special education when possible.	6,296	650	10.32	(105)	Department of Education; 100%
State Survey and Certification of Health Care Providers and Suppliers	Formula	State budget requests; national average survey times for skilled nursing facilities	California's award was not increased in this year because the State exceeded by 15 percent or more the nationwide average time threshold for completing nursing home surveys.	444	41	9.23	(12)	Department of Health Services; 99.9%

Table A.5 presents five project grants that fell below the State's population share and are awarded only to nonstate applicants on a competitive basis. For example, the Indian Health Service—Health Management Development Program is available to federally recognized tribes and tribal organizations. The ability of eligible nonstate applicants to compete for these grants determines California's share of these awards.

TABLE A.5

Awards Granted to Eligible Nonstate Applicants on a Competitive Basis
Fiscal Year 2001–02

Program Name	Type of Assistance	Award Determinant or Basis for Award	Why the Basis for the Award Is Unfavorable	Total Federal Awards (Dollars in Millions)	California Awards (Dollars in Millions)	California's Percent Share	Amount Under Population Share (Dollars in Millions)	Principal Grantees
21st Century Community Learning Centers	Project	Awards are granted to eligible applicants on a competitive basis, state minimum.*	It appears that not all the State's local educational agencies applied for this grant.	$ 582	$ 56	9.68%	$(14)	Local school districts; 88.8%
Community Health Centers	Project	Awards are granted to eligible applicants on a competitive basis.	California appears to have a lower share of applicants applying for this grant.	919	67	7.28	(43)	Nonprofits; 75.8%
Heart and Vascular Diseases Research	Project	Awards are granted to eligible applicants on a competitive basis.	California appears to have a lower share of applicants applying for this grant.	1,211	122	10.06	(24)	State-run universities; 53.5% Other nonprofits; 19.2%
Indian Health Service—Health Management Development Program	Project	Awards are granted to federally recognized tribes and tribal organizations on a competitive basis.	California has a small percentage of eligible program participants.	497	14	2.74	(46)	Indian tribes; 63%; Nonprofits; 28%
Surveys, Studies, Investigations and Special Purpose Grants	Project	Awards are granted to eligible applicants on a competitive basis.	California has a small percentage of eligible program participants.	582	32	5.58	(37)	City governments; 40.6% Special district governments; 34.7%

*This grant began transitioning into a formula grant that is more favorable to California in federal fiscal year 2002.

Table A.6 lists the remaining nine grants whose share of awards fell below California's 12 percent population share. These grants did not meet our cutoff requirements for further investigation, except for the HOME Investment Partnerships Program.

TABLE A.6

Remaining Grants That Fell Below California's Population Share
Fiscal Year 2001–02

Program Name	Type of Assistance	Total Federal Awards (Dollars in Millions)	California Awards (Dollars in Millions)	California's Percent Share	Amount Under Population Share (Dollars in Millions)
Byrne Formula Grant Program	Formula	$ 492	$ 51	10.35%	$ (8)
Capitalization Grants for Drinking Water State Revolving Funds	Formula	733	87	11.86	(1)
Center for Research for Mothers and Children	Project	557	65	11.59	(2)
Drug Abuse Research Programs	Project	613	66	10.80	(7)
Employment Service	Formula	749	89	11.91	(1)
HOME Investment Partnerships Program*	Formula	1,476	164	11.08	(14)
Lung Diseases Research	Project	469	51	10.83	(6)
School Renovation Grants	Formula	1,170	139	11.92	(1)
Vocational Education-Basic Grants to States	Formula	1,077	121	11.22	(8)

* The HOME Investment Partnerships Program is awarded based on several factors including poor households living in rental units built before 1950. It also has a state minimum provision. During our investigation of this grant, we determined that the awards listed on the Federal Assistance Award Data System reflect funding for approved projects, rather than the overall grant allocation. California's share of allocations was around 13.5 percent in federal fiscal years 2001 and 2002.

Agency's comments provided as text only.

Department of Finance
Office of the Director
State Capitol, Room 1145
Sacramento, CA 95814-4998

July 25, 2003

Ms. Elaine M. Howle
State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, California 95814

Dear Ms. Howle:

Thank you for the opportunity to review and comment on the audit entitled "Federal Funds: The State of California Takes Advantage of Available Federal Grants, but Budget Constraints and Other Issues Keep It From Maximizing This Resource." This is the second of two reports assessing whether California is maximizing the amount of federal funds it is entitled to receive for appropriation through the Budget Act. The initial report described the types of federal funds available to California, assessed the degree to which funding mirrors California's share of national population, and concluded that California's overall share of federal grants is currently close to its population share, although proposed reductions in State funding may change that situation since the largest federal programs require State matches.

I am pleased to note that this second report revises upward slightly the Bureau's estimate of California's share of federal grants and concludes, "State departments appear to use reasonable processes to identify new or expanded funding from federal grants." Overall, I agree with the report's findings and conclusions.

I note the following:

- In reviewing the report, Finance for the most part did not verify numeric data and understood that was not your office's expectation. Factual differences, where identified, have been largely resolved.
- Transportation:
  - The statement that "The State lost some available federal funding because it could not provide required matching funds and may lose more in the future" (page 29 of the draft) appears to be based largely on the concern that local governments may not be able to spend federal transportation allocations fully due to loans of $1.3 billion from the Traffic Congestion Relief Fund to the General Fund. At this

point, that risk seems low. The California Department of Transportation in the past has done an excellent job of managing federal dollars to ensure full utilization. The balance of dollars referred to in that section for other programs is very minor.

- The report states that the Traffic Congestion Relief Fund loans to the General Fund "reduced amounts in the traffic fund available for planned projects" (page 30 of the draft). My staff advises me, however, that the funds borrowed to date and proposed for 2003-04 take into account the cash needs of current and scheduled Traffic Congestion Relief Program project allocations and do not negatively impact those projects. While there has been some delay in allocations due to budget negotiations, the 2003 Budget Act is expected to include funding for all current and planned allocations for the prior and current fiscal years.

The report notes that budget constraints affect decisions about State participation in federally funded programs and recommends that the "Department of Finance should ensure that it considers the loss of federal funding before implementing personnel reductions related to departments' 10 percent reduction plans." In Budget Letter 03-21, Finance directs departments to identify impacts on federal funds as part of their 10 percent reduction plans. This information will be considered in Finance's review of the plans. However, please note that Budget Act requirements may limit Finance's flexibility in this regard.

If you have any questions or need any additional information regarding this response, then please contact Shelley Mateo, Program Budget Manager, at 445-3274.

STEVE PEACE
Director
By:

(Signed by: Kathryn Radtkey-Gaither)

KATHRYN RADTKEY-GAITHER
Assistant Director, Operations

Agency's comments provided as text only.

Business, Transportation and Housing Agency
980 9th Street, Suite 2450
Sacramento, CA 95814-2719

July 25, 2003

Elaine M. Howle
State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

Attached are the Department of Transportation's (DOT) and the Department of Housing and Community Development's (HCD) responses to your draft report, *Federal Funds: The State of California Takes Advantage of Available Federal Grants, but Budget Constraints and Other Issues Keep It From Maximizing This Resource* (#2003-123.2). I am pleased that your review disclosed no need for recommendations to either department. The DOT and the HCD work to the extent possible to maximize the amount of federal funding for their respective programs, but we agree with your finding that there are some constraints beyond their control. I am very proud of the fact that the departments work tirelessly to gain every additional dollar that is available, such as when the DOT pursues highway funding that is not used by other states.

I appreciate the opportunity to respond to your audit report. If you need additional information, please do not hesitate to contact me, or Michael Tritz, Chief of the Office of Internal Audits within the Business, Transportation and Housing Agency, at (916) 324-7517.

Sincerely,

(Signed by: Maria Contreras-Sweet)

MARIA CONTRERAS-SWEET
Secretary

Attachments

Department of Transportation
Office of the Director
1120 N Street
P.O. Box 942873
Sacramento, CA 94273-0001

July 23, 2003

Maria Contreras-Sweet, Secretary
Business, Transportation, and Housing Agency
980 – 9th Street, Suite 2450
Sacramento, CA 95814

Dear Secretary Contreras-Sweet:

I am pleased to provide the California Department of Transportation's (Department) response to the Bureau of State Audits' (BSA) report entitled, "Federal Funds: The State of California Takes Advantage of Federal Grants, but Budget Constraints and Other Issues Keep It From Maximizing This Resource." The draft audit report identified four issues related to Federal Funds maximization. However, only two of the four issues pertained to the Department as follows:

- California's Share of Federal Grants Falls Short of Its Population Percentage, Due in Part to the State's Demographics and Federal Grant Formulas.
- California Is Not Maximizing Some Federal Grants, But to Do So Would Require More State Spending.

The report noted that most of the federal formulas for the Highway Planning and Construction grant (highway grant) do not favor California, which paid an average of 10.1 percent of the total federal fuel taxes and fees during fiscal years 1998 through 2001 but received only an average of 9.3 percent of the highway grant. A minimum guarantee keeps the State's share from being lower.

The report also noted that transportation projects may lose federal funds because of a drop in available State matching funds. BSA's prior audit report dated July 3, 2003, titled, "California Department of Transportation: Low Cash Balances Threaten the Department's Ability to Promptly Deliver Planned Transportation Projects," acknowledged that the Legislature authorized loans totaling $1.3 billion from the Traffic Congestion Relief Fund to the General Fund in fiscal years 2001-02 and 2002-03 as the State's fiscal condition worsened. The report further states that decreased State funding for transportation projects will force implementing agencies to turn to other sources for funding or risk losing federal funds.

The report does not offer specific recommendations for the Department. However, the Department has a general response to the draft report.

Department Response:

Issue 1: California's Share of Federal Grants Falls Short of Its Population Percentage, Due in Part to the State's Demographics and Federal Grant Formulas

The Department agrees with BSA's assessment of the Highway Planning and Construction grant (highway grant) distribution of federal highway funding (i.e. Apportionment), and how that pertains to the Minimum Guarantee (MG) provision of the Transportation Equity Act for the 21st Century. The MG ensures each State receives 90.5 percent of its share of the total contributions into the Highway Account of the Federal Highway Trust Fund.

Issue 2: California Is Not Maximizing Some Federal Grants, But to Do So Would Require More State Spending.

Although most federal funds require non-federal matching funds, the Department and local transportation agencies are taking steps to prevent the loss of any federal funds. By transferring State and local funds among projects and re-prioritizing projects, the Department and the local agencies are able to provide sufficient matching funds to obtain all the federal funding available to California. In addition, by effective federal fund management and aggressive project delivery scheduling, the Department obtains federal funds not used by other states. In the past ten years, California has received over $350 million in additional Apportionment and Obligation Authority not used by other states.

It must be noted that the ongoing failure of the Legislature to pass a fiscal year 2003-04 budget could have a real and lasting negative impact on the State's ability to maximize the use of federal transportation funding. The United States Department of Transportation has informed the Department that increased transportation costs associated with the Legislature's delay must be borne entirely by California taxpayers. Unless the impasse is broken very quickly, this will begin to impact the overall program, and hurt the State's efforts to utilize existing federal funds, much less increase them.

If you have any questions, or require further information, please contact Gerald Long, External Audit Coordinator, at (916) 323-7122.

Sincerely,

(Signed by: Jeff Morales)

Jeff Morales
Director

Department of Housing and Community Development
Office of the Director
1800 Third Street, Room 450
Sacramento, CA 94252-2050

July 24, 2003

Ms. Elaine Howle, State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

The Department of Housing and Community Development (HCD) was pleased to assist the Bureau of State Audits in its audit on the State's efforts to maximize available federal grants.

Although no recommendations were made for further actions by HCD, we wish to assure you that the Department will continue its vigilance and work with the Business, Transportation and Housing Agency, the Governor's Office and the California Congressional Delegation to maximize the receipt of federal housing funds. We will also continue our work to promote federal housing program designs and policies that assist California in meeting its housing needs, especially the housing needs of lower income households.

The report also correctly noted that HCD is continuing its work with the U. S. Department of Housing and Urban Development and local jurisdictions to assist jurisdictions or regional consortia of jurisdictions in accessing McKinney Continuum of Care funds.

If you have any questions, please contact me or Judy Nevis, Chief Deputy Director, at 445-4775.

Sincerely,
(Signed by: Matthew O. Franklin)

Matthew O. Franklin
Director

Agency's comments provided as text only.

Health and Human Services Agency
1600 Ninth Street, Room 460
Sacramento, CA 95814

July 25, 2003

Ms. Elaine Howle
State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

Thank you for the opportunity to comment on the Bureau of State Audits' draft report entitled "Federal Funds: The State of California Takes Advantage of Federal Grants, but Budget Constraints and Other Issues Keep It From Maximizing This Resource." Enclosed is the Department of Health Services response to the review findings and recommendations.

We appreciate the cooperation and assistance provided by your staff. If you require further information concerning this review, please feel free to contact Diana M. Bontá, R.N., Dr. P.H., Director of the Department of Health Services, at (916) 440-7400.

Sincerely,

(Signed by: Grantland Johnson)

GRANTLAND JOHNSON

Enclosure

Department of Health Services
714 P Street
P.O. Box 942732
Sacramento, CA 94234-7320

July 24, 2003

Ms. Elaine M. Howle
State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

Thank you for the opportunity to comment on the draft of the audit entitled "Federal Funds: The State of California Takes Advantage of Federal Grants, but Budget Constraints and Other Issues Keep It From Maximizing This Resource." The Department of Health Services (DHS) is committed to identifying available sources of funds to implement programs or improve existing services to serve the people of California. DHS is pleased that the Bureau of State Audits recognizes this endeavor.

DHS agrees with the recommendation made in the draft report that DHS should continue to work with the Department of Social Services (DSS) to determine the feasibility of pursuing an Independence Plus waiver. Such a waiver may allow the state to claim federal reimbursement for a portion of the expenditures for caregiver services provided by family members to participants in the In-Home Supportive Services program. However, due to the state budget crisis and lack of available staff to develop an Independence Plus waiver, the effort towards this project has been suspended until staffing can be made available. If DHS obtains additional resources for this purpose, DHS will resume working with DSS to develop a waiver application. The application would be subject to Centers for Medicare and Medicaid Services (CMS) approval and CMS may require that any federal financial participation resulting from a waiver not supplant state funds.

We appreciate the cooperation and assistance provided by your staff. If you have additional questions or concerns, please contact Mr. Stan Rosenstein, Deputy Director, Medical Care Services at (916) 440-7800.

Sincerely,

(Signed by: Diana M. Bontá)

Diana M. Bontá
Director

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press