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Report to Congressional Requesters

September 2009

VOCATIONAL REHABILITATION FUNDING FORMULA

Options for Improving Equity in State Grants and Considerations for Performance Incentives

GAO-09-798

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GAO Accountability • Integrity • Reliability

Highlights

Highlights of GAO-09-798, a report to congressional requesters

Why GAO Did This Study

State vocational rehabilitation (VR) agencies play a crucial role in helping individuals with disabilities obtain employment. In fiscal year 2008, the Department of Education (Education) distributed over $2.8 billion in grants to state agencies, using a funding formula that was last revised in 1978. Questions have been raised about whether this formula is outdated, allocates funds equitably, and adequately accounts for state agencies' performance.

GAO was asked to: (1) examine the extent to which the current formula meets generally accepted equity standards, (2) present options for revising the formula, and (3) identify issues to consider with incorporating performance incentives into the formula.

To address these objectives, GAO relied upon two equity standards commonly used to design and evaluate funding formulas: beneficiary equity, which stipulates that funds should be distributed so that each state can provide the same level of services to each person in need; and taxpayer equity, which stipulates that states should contribute about the same proportion of their resources to a given program. GAO analyzed data from Education, Department of the Treasury, Census Bureau, and other agencies; surveyed state VR agencies; interviewed agency officials and disability experts; and reviewed literature on performance incentives.

GAO makes no recommendations in this report.

View GAO-09-798 or key components.
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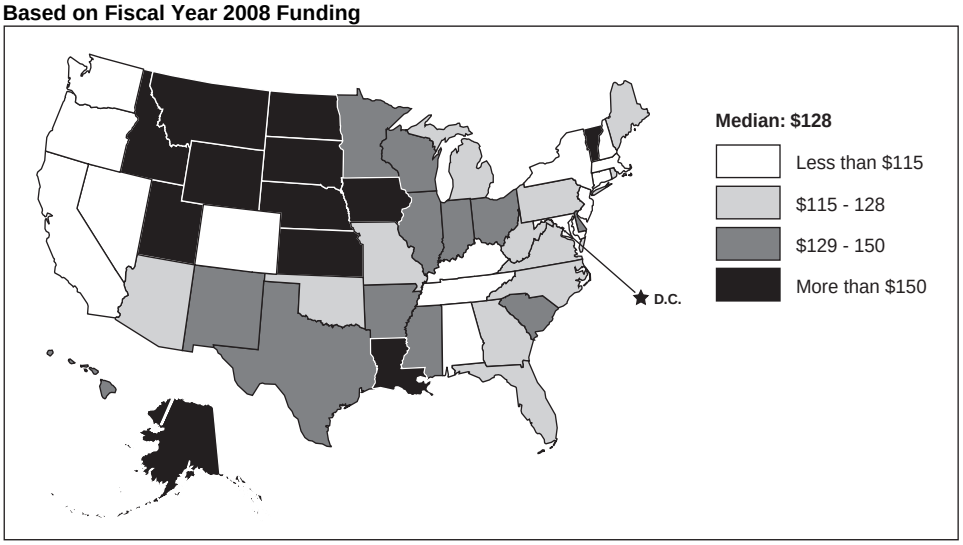
What GAO Found

The VR funding formula falls short of meeting equity standards because it uses imprecise measures of state needs and resources. The formula does not account for differences among states in the proportion of people with a disability or the costs of providing services. As a result, the amount of services that states can purchase per person with a disability varies, from $83 to $277 (see figure). In addition, the formula uses only per capita income to measure a state's ability to contribute to the program, excluding other taxable resources.

GAO presents three options for revising the formula to illustrate a range of possibilities: the first distributes funds based on states' disability populations, the second also accounts for costs of providing services, and the third further accounts for state resources beyond per capita income. Because any formula change would redistribute funds among states, potentially disrupting services to individuals, GAO also presents options for establishing a transition period.

Including performance incentives in the funding formula has potential for improving performance but can also pose challenges. These include: effectively balancing the VR program's multiple goals, rewarding agencies for meeting individuals' specific needs, and basing awards on an agency's performance rather than influences outside its control. GAO identified ways to mitigate these risks, such as using multiple performance measures to address different goals, and adjusting the performance level required for an agency to receive an incentive award. However, these approaches would still require careful consideration of several issues, such as how to account for clients' varying disability levels and needs and provide appropriate incentives for achieving desired outcomes.

Estimated State VR Allotments per Working-Aged Person with a Disability, Cost-Adjusted, Based on Fiscal Year 2008 Funding



Source: GAO analysis of data from Education, Census Bureau, Bureau of Labor Statistics, Department of Housing and Urban Development, and responses to GAO survey; Map, Map Resources (presentation).

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Abbreviations

ACS	American Community Survey
BLS	Bureau of Labor Statistics
CMS	Centers for Medicare and Medicaid Services
CPI-U	Consumer Price Index for All Urban Consumers
CSAVR	Council of State Administrators of Vocational Rehabilitation
CSE	Child Support Enforcement
Education	Department of Education
ERIC	Education Resources Information Center
FMR	Fair Market Rents
HUD	Department of Housing and Urban Development
JTPA	Job Training Partnership Act
NAICS	North American Industry Classification System
OES	Occupational Employment Statistics
QCEW	Quarterly Census of Employment and Wages
SOC	Standard Occupational Classification
SSA	Social Security Administration
SSDI	Social Security Disability Insurance
SSI	Supplemental Security Income
Treasury	Department of the Treasury
TTR	Total Taxable Resources
VR	Vocational Rehabilitation
WIA	Workforce Investment Act

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United States Government Accountability Office
Washington, DC 20548

September 30, 2009

The Honorable George Miller
Chairman
The Honorable John P. Kline
Ranking Member
Committee on Education and Labor
House of Representatives

The Honorable Howard P. "Buck" McKeon
House of Representatives

State vocational rehabilitation (VR) agencies, under the auspices of the Department of Education (Education), play a crucial role in helping individuals with disabilities prepare for and obtain employment.[1] In fiscal year 2008, Education distributed over $2.8 billion in grants to state VR agencies, using a funding formula that was last updated in 1978.[2] Questions have been raised about whether this funding formula is outdated and allocates funds equitably. In addition, growing interest in program accountability has prompted some to ask whether the formula should incorporate performance measures to reward high performance. As currently constructed, the VR formula distributes funds according to the size of a state's population, its per capita income, and the amount of VR funds the state received in 1978. States must match their federal grant allocations by contributing about $1 to their VR programs for each $4 they receive.

[1]In this report, unless otherwise noted, the term states or state VR agencies refers to VR agencies in the 50 states, the District of Columbia, and the territories of American Samoa, Guam, Northern Mariana Islands, Puerto Rico, and the U.S. Virgin Islands.

[2]An additional $35 million in VR funds was set aside for American Indian Vocational Rehabilitation services in fiscal year 2008. This report does not discuss the American Indian set-aside funds, since they are not distributed through the funding formula.

There are two standards concerning the concept of equity that have commonly been used to design and evaluate funding formulas.[3] The first—known as beneficiary equity—stipulates that funds should be distributed to states according to the needs of their respective populations so that each state, with their federal allocation, can provide the same level of services to each person in need. The second standard—known as taxpayer equity—applies to programs, such as VR, in which states contribute funds. This standard also seeks to provide individuals in need with the same level of services, but in addition, considers a state's ability to finance a program from its own resources. It stipulates that states should be able to provide comparable services to individuals, with each state contributing about the same proportion of their resources to the program. To achieve this standard, taxpayer equity formulas may allocate more funds to states with fewer taxable resources, set the contribution they are required to make at a lower level, or do both, so that poorer states do not contribute a larger share of their resources than wealthier states. To meet the taxpayer equity standard, a formula requires a reliable measure of a state's ability to finance a program from its own resources. To meet both equity standards, a formula should use reliable and appropriate measures of the need population in each state and the cost of providing services in each state.

In this context, you asked us to (1) examine the extent to which the current formula meets generally accepted equity standards, (2) present options for revising the formula to better meet these standards, and (3) identify issues to consider with incorporating performance incentives into the formula.

To determine the extent to which the VR funding formula meets equity standards and to develop options for revising the formula, we examined data from a number of sources, namely Education's data on state VR grants, Census Bureau data on state disability populations, Department of the Treasury (Treasury) data on state taxable resources, Bureau of Labor Statistics (BLS) data on wages, and Department of Housing and Urban

[3]These equity standards are not statutory requirements for the VR program, but are commonly used as standards in social science research to evaluate and design funding formulas. See, for example, GAO, *Maternal and Child Health: Block Grant Funds Should Be Distributed More Equitably*, GAO/HRD-92-5 (Washington, D.C.: Apr. 2, 1992); RAND Corporation, *Review and Evaluation of the Substance Abuse and Mental Health Services Block Grant Allotment Formula*, MR-533-HHS/DPRC, 1997; National Research Council, *Statistical Issues in Allocating Funds by Formula*, Panel on Formula Allocations, Thomas A. Louis, Thomas B. Jabine, and Marisa A. Gerstein, ed., Committee on National Statistics, (Washington, D.C., 2003).

Development (HUD) data on rents. In addition, we interviewed experts in the disability field and had key portions of our analyses formally reviewed by three disability experts. We also surveyed all 80 VR agencies in the states, territories, and District of Columbia to obtain their perspectives on the current formula, options for changing it, and views on the use of performance incentives in the VR program.[4] We received responses from 74 (93 percent) of the agencies. We also conducted in-depth interviews with state VR officials at 11 agencies in 9 states, as well as with members of advisory councils to the VR agencies in 5 of these states. To further consider potential benefits and challenges of using performance incentives in the VR funding formula, we reviewed academic literature on the subject and spoke with officials in three federal programs that currently provide incentive awards. We conducted this performance audit from September 2008 to September 2009, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. See appendix I for a detailed discussion of our scope and methodology.

Background

The Rehabilitation Act, as amended, sets out a formula for distributing VR grants to states and territories.[5] Through this formula, a portion of the funds appropriated for the VR program are distributed to states based upon the grant allotment they received for fiscal year 1978. States' 1978 allotments served to ensure that no state experienced a funding decrease when the formula was revised through a 1978 amendment to the Rehabilitation Act.[6] Of the remainder of the funds, one-half is distributed based upon states' general population and a factor that compares their per capita income to the national per capita income, and the other one-half,

[4]Some states have two VR agencies – one that serves individuals who are blind, and another that serves individuals with other types of disabilities. Other states have one VR agency that serves people with all types of disabilities.

[5]The Rehabilitation Act was most recently reauthorized as part of the Workforce Investment Act (Pub. L. No. 105-220). The funding formula we describe is used to distribute federal funds to states. In states with two VR agencies, the division of a state's allotment between the blind and general VR agency is determined by the state.

[6]Prior to 1978, funds were allotted based upon states' populations and the square of the allotment percentage. See footnote 7 and appendix II for an explanation of the allotment percentage.

according to their population and the square of the per capita income factor. The larger a state's population, the more funds it will receive. Conversely, the higher a state's per capita income compared to the national level, the lower its allotment will be. The squaring of per capita income increases its influence on a state's allotment. However, the formula mitigates the effect of per capita income for states with very high or very low per capita income levels by setting upper and lower limits.[7] Ultimately, the final allotment for a state cannot be less than 1/3 of 1 percent of the total amount appropriated, or $3 million dollars, whichever is greater.[8] In fiscal year 2008, the minimum allotment was $9.5 million, and 6 states were allotted this amount.[9] See appendix II for further information on the funding formula.

The Act requires states to share in funding the costs of the VR program. Specifically, the Act sets the federal share for the funding of a state's VR program at 78.7 percent. As a result, in order to receive their full federal allotment, each state must contribute at least 21.3 percent of the funds for their VR programs.[10] In cases where states do not meet this matching

[7]The allotment percentage, which is determined by comparing a state's per capita income to the national per capita income, cannot be less than 33 1/3 percent or greater than 75 percent. Default levels for the allotment percentage are set at 75 percent for the District of Columbia and U.S. territories. In fiscal year 2008, the limits on the allotment percentage affected only one state, Connecticut, whose allotment percentage was increased to 33 1/3 percent. See appendix II for a further explanation.

[8]If a state's allotment falls below this level, it is increased to this amount and the final allotments for all of the other states are decreased in proportion to their share of the total appropriation. The minimum allotment provision does not apply to U.S. territories, but it does apply to the District of Columbia.

[9]The six states were Alaska, Delaware, North Dakota, South Dakota, Vermont, and Wyoming.

[10]The Rehabilitation Act also includes a maintenance-of-effort requirement to encourage states to maintain their level of contribution to the VR program over time. If a state's expenditures from nonfederal sources in the prior fiscal year is less than its expenditures from nonfederal sources for the fiscal year two years prior to the previous fiscal year, Education can reduce the state's current year allotment by the difference between the two years' expenditures. For example, if a state's nonfederal expenditures in fiscal year 2007 were less than its nonfederal expenditures in fiscal year 2005, Education could reduce its fiscal year 2008 allotment by the difference between the 2005 and 2007 nonfederal expenditures. Funds incurred from maintenance-of-effort penalties are redistributed to all other states. In fiscal year 2008, 1 state and 1 territory incurred maintenance-of-effort penalties totaling $364,421, or 0.01 percent of total federal VR funds. However, the Act specifies that under exceptional or uncontrollable circumstances affecting the state, the maintenance-of-effort requirement may be waived. Education officials informed us that such circumstances may include a serious economic downturn or natural disaster.

requirement, the unmatched federal funds are redistributed to other states near the end of the fiscal year.[11] The Act also calls for annual funding increases to the VR program, overall, to be minimally pegged to the increase in the Consumer Price Index for All Urban Consumers (CPI-U). However, funding changes for an individual state may differ from the change to the CPI-U in any given year because state allocations are, ultimately, determined by the funding formula. In redistributing the funds, Education currently gives priority to those states that did not receive an inflation-adjusted increase over their prior year's allotment.

Under the VR program, state VR agencies are to provide vocational rehabilitation services for individuals with disabilities—consistent with the individual's strengths, resources, priorities, abilities, interests, and informed choice—so that they may prepare for and engage in gainful employment. To do so, state agencies provide a variety of services to individuals such as job placement assistance, medical treatment, postsecondary education, occupational training, and assistive technologies. Individuals may be eligible for VR services if they have a physical or mental impairment that constitutes or results in a substantial impediment to employment, and if they need VR services to prepare for, secure, retain, or regain employment. According to the Rehabilitation Act, if state VR agencies determine that they will not have enough funding to serve all eligible individuals who apply for services, they may state the order in which they will select individuals for services. Agencies using such an "order of selection" process must develop criteria for ensuring that individuals with the most significant disabilities will be selected first for services.

The current VR funding formula does not include factors for rewarding agency performance; however, pursuant to the Rehabilitation Act, Education evaluates state VR agencies' performance using a set of

[11]The redistribution process takes place through a memorandum that Education sends to each VR agency near the end of each fiscal year, asking them whether they will relinquish any funds or request additional ones. Education then redistributes the funds that states relinquished to other states who requested additional funds. In fiscal year 2008, 4 states and 1 territory relinquished $17.8 million in funding, or 0.6 percent of total federal VR funds. The required 21.3 percent state contribution also applies to any additional funds that states receive through the redistribution process.

performance indicators.[12] These indicators are designed to assess how well the agencies are helping individuals obtain, maintain, or regain high-quality employment and, also, how well they are ensuring that individuals from minority backgrounds have equal access to VR services. The Rehabilitation Act gives Education the authority to reduce or suspend payments to a state agency whose performance falls below a certain level and fails to enter into a program improvement plan or to substantially comply with the terms and conditions of such a plan.

The Current Formula Falls Short of Meeting Equity Standards for Beneficiaries and Taxpayers

The Formula Does Not Account for Varying Disability Rates and Service Costs

The VR funding formula does not achieve equity for beneficiaries—the individuals likely to be served by the VR program—for two reasons. First, it does not recognize differences among states in the size of their populations potentially needing VR services. Second, it does not account for state differences in the costs of providing those services.

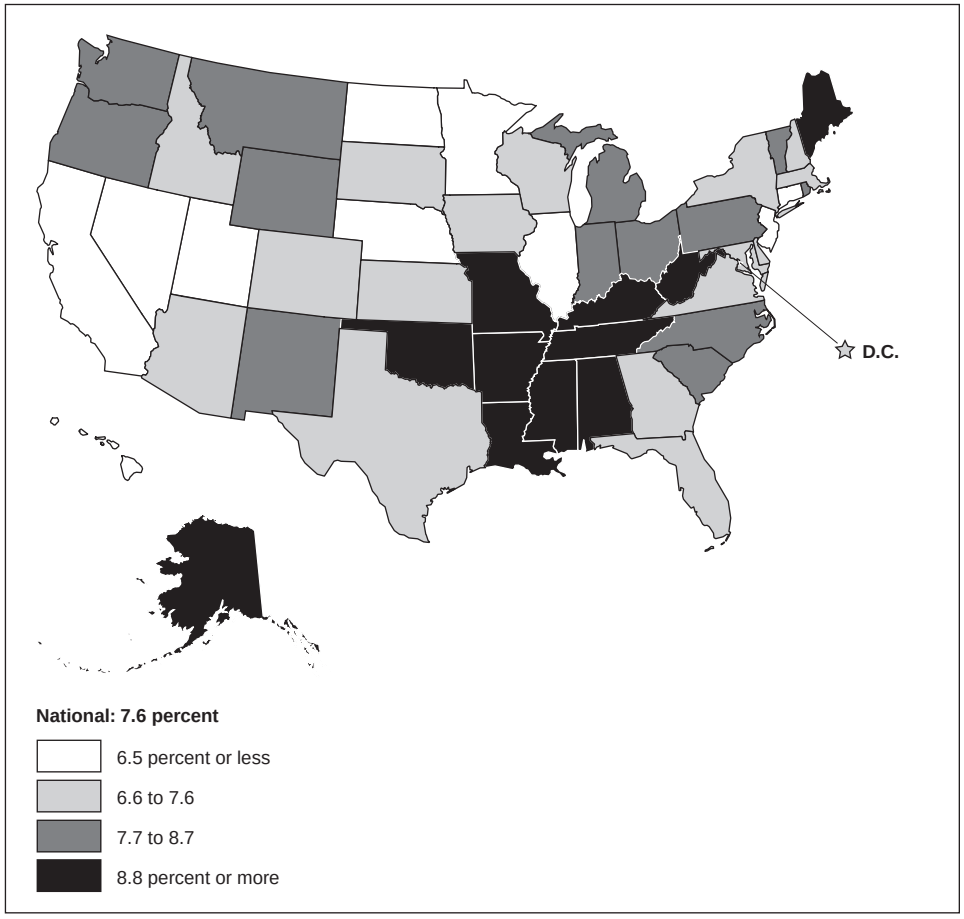
By targeting funds based on a state's general population, the formula assumes that the proportion of people needing services is largely the same from state to state. In fact, as shown in figure 1, the proportion of the general population that is working-aged and has a disability varies across states, from 5.6 percent (in New Jersey) to 12.8 percent (in West Virginia)

[12]The performance indicators are established in 34 C.F.R. § 361.84. For additional background on Education's oversight of state VR agency performance, see GAO, *Vocational Rehabilitation: Better Measures and Monitoring Could Improve the Performance of the VR Program*, GAO-05-865 (Washington, D.C.: Sept. 23, 2005).

in 2007.[13] See appendix III for information on disability rates in each state. In effect, the formula treats alike any two states with similar population sizes, irrespective of the size of their working-aged disability population. For example, New Mexico has a slightly greater population than West Virginia (2.0 million and 1.8 million, respectively), and, therefore, would receive more funding under the current formula (all other things being equal) than West Virginia. However, working-aged people with disabilities comprise nearly 13 percent of West Virginia's population, compared to 8.7 percent in New Mexico. By not factoring in state disability populations, the formula does not account for West Virginia having over 60,000 more working-aged people with disabilities than New Mexico.

[13]These disability rates are calculated as the civilian working-aged population of people with disabilities (ages 16-64) divided by the total state population. Our measure of the disability population is derived from five disability questions asked in the 2007 American Community Survey (ACS), conducted by the Census Bureau. We did not include data from a sixth disability question about whether a person has difficulty working at a job or business because of a physical, mental, or emotional condition lasting six months or more because this question was no longer included in the ACS, starting in 2008. We were not able to calculate the disability rates of U.S. territories. Data are available from the ACS on the population of people with disabilities in Puerto Rico, but are not available for other territories. For further information on our analysis of states' disability populations, see appendix I.

Figure 1: Percentage of Each State's Total Population that Is Working-Aged and Has a Disability, 2007



Source: GAO analysis of Census Bureau's ACS data; Map, Map Resources (presentation).

Education officials and one expert we spoke with speculated that the formula's use of per capita income might serve to target funds to states with higher rates of disability since people with disabilities have, on average, lower incomes. We found some correlation between states' disability rates and their per capita income.[14] As such, per capita income is, at best, an imprecise measure of states' disability rates.

[14]We calculated the correlation to be 0.53 between states' disability rates and their per capita income, where 1 would be a perfect correlation between two variables and 0 would indicate a lack of correlation.

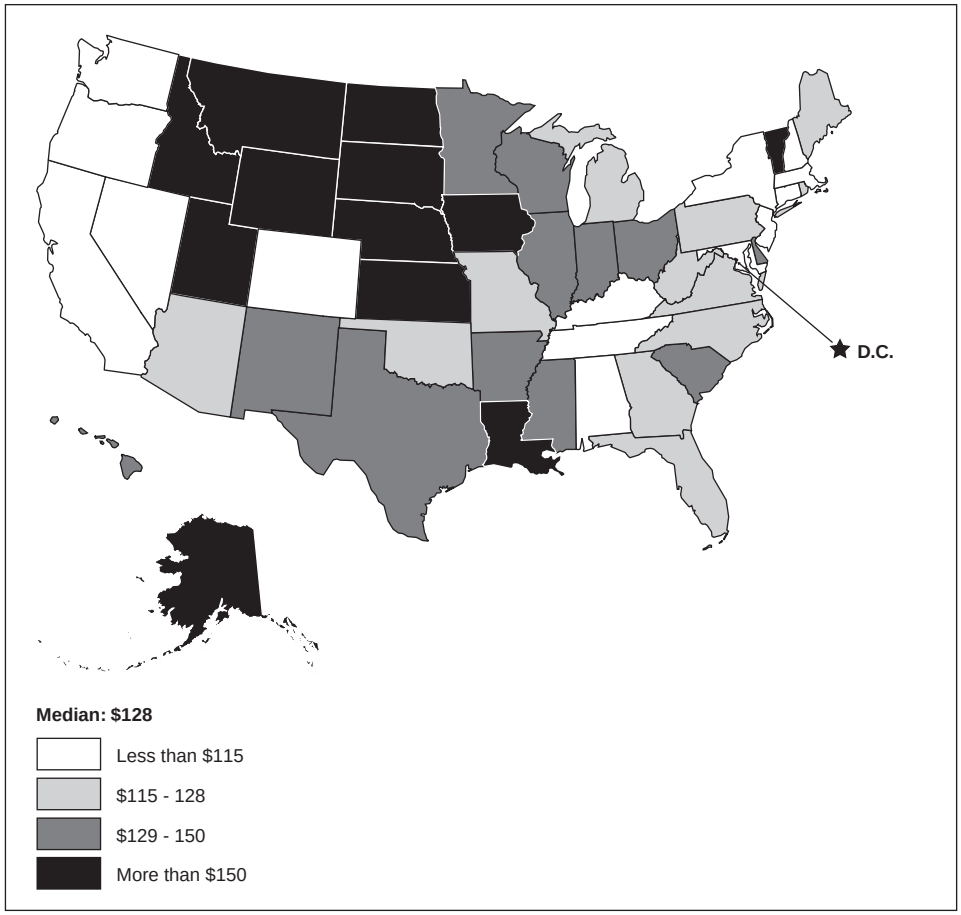
The funding formula also fails to account for differences among states in the cost of providing VR services. Focusing on average wages and rents in each state, we estimated that the cost is 13 percent below the national average in Idaho, for example, while it is 13 percent above average in Massachusetts.[15] This means that Massachusetts would need to pay $1.13 for the same set of services that Idaho could purchase for $0.87. By not taking into account cost differences, VR allocations purchase fewer services in states that have higher costs. See appendix IV for a table of our estimates of state cost differences. Also, see appendix I for information on how we estimated state service costs.

Not accounting for state differences in both disability populations and cost of services results in a substantial variation in the amount of services that states are able to purchase per person with a disability, from a low of $83 in Connecticut, to a high of over three times as much—$277 in North Dakota. Figure 2 shows estimated state VR allotments, per working-aged person with a disability, based on fiscal year 2008 funding, adjusted for differences in costs of wages and rents between states.[16] See appendix V for a state-by-state listing of VR grant allocations and cost-adjusted allotments per person with a disability.

[15]We estimated the relative cost of providing services by estimating the costs of two inputs to providing VR services, labor and office space. Specifically, we used data on state average wages in the education, healthcare, and social assistance sector from BLS' Quarterly Census of Employment and Wages, as well as data on fair market rents from HUD. To determine how much to weight wages and rents in our cost estimates, we used data obtained from our survey and Education's data on expenditures. Although our cost index provides a reasonable approximation of basic cost differences among states, we were unable to develop a more precise estimate reflecting all possible inputs due to the lack of readily available data. For further information about our data sources and methodology, see appendix I.

[16]Grant allotments used in this analysis are the initial allotments distributed to states using the funding formula. The allotments do not include any adjustments that occur due to states' inability to match federal funds or the application of maintenance-of-effort penalties.

Figure 2: Estimated State VR Allotments per Working-Aged Person with a Disability, Cost-Adjusted, Based on Fiscal Year 2008 Funding



Source: GAO analysis of data from Education, Census Bureau, BLS, HUD, and responses to GAO survey; Map, Map Resources (presentation).

The Formula Does Not Capture Certain Taxable Resources

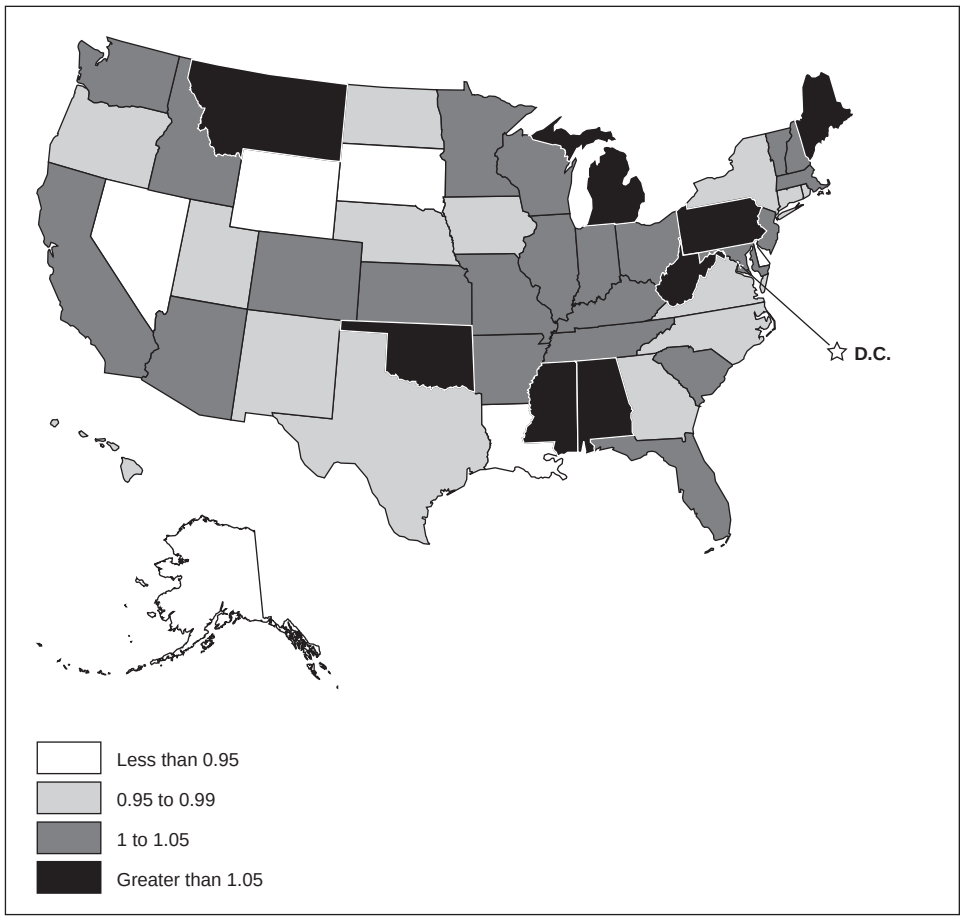
While proper measures of need and cost are important for both beneficiary and taxpayer equity, the VR funding formula lacks equity for state taxpayers, in particular, because its measure of a state's ability to contribute to the VR program is limited to per capita income and does not include all potentially taxable resources. Per capita income is based on the personal income in a state, including income received by state residents in the form of wages, rents, and interest income. However, using only this measure excludes certain categories of corporate income that are not received as income by state residents. For example, the formula does not factor in corporate income that is retained by corporations for investment

purposes, which could theoretically be subject to state taxation through corporate income taxes. The formula also excludes business income received by out-of-state residents, such as dividends, that are potentially taxable by the state. Although states may differ in their decisions about whether to tax these resources, the measure used in a funding formula to compare states' ability to finance a program should capture all possible revenue resources and should not be affected by an individual state's fiscal decisions. Treasury's Total Taxable Resources provides more comprehensive data on the amount of resources that are potentially taxable in each state. Comparing states' per capita income with their total taxable resources shows that, for most states, the two measures are similar. However, the formula's use of per capita income particularly understates the taxable resources in certain states and overstates it in others (see figure 3). For example, the ratio of per capita income to total taxable resources per capita is 0.80 in Alaska, which suggests that the use of per capita income in the formula understates Alaska's taxable resources by 20 percent.[17] The formula's use of per capita income especially understates the taxable resources in energy-exporting states, such as Alaska and Wyoming, and in states with numerous corporate headquarters, such as Delaware. The lack of precision in using per capita income is accentuated by the squaring of the per capita income factor in the formula.[18] See appendix VI for a comparison of per capita income and total taxable resources in each state. Also, see appendix I for a more detailed explanation of our analyses of per capita income and total taxable resources data and appendix II for a detailed explanation of the current formula.

[17]Specifically, we present ratios of a per capita income index to an index of total taxable resources per capita. The indexes were created by dividing a state's per capita income and total taxable resource per capita by the U.S. averages for each.

[18]Squaring of the per capita income factor (i.e., multiplying the per capita income factor by itself) increases the influence of per capita income in the formula.

Figure 3: Ratio of Per Capita Income to Total Taxable Resources Per Capita



Source: GAO analysis of Department of Commerce data on per capita income and Treasury data on total taxable resources, 2004 to 2006; Map, Map Resources (presentation).

Note: These are ratios of a per capita income index to an index of total taxable resources per capita. The indexes were created by dividing the per capita income and total taxable resource per capita levels by the U.S. averages for each.

Over One-Quarter of Funds are Distributed Based on States' 1978 Allotments

In fiscal year 2008, 27 percent of federal VR funds were distributed to states based upon the amount of funds they received for fiscal year 1978. This provision of the formula served a purpose when the formula was last revised, in 1978, to ensure that no state experienced a funding decrease. However, most disability experts we spoke with considered this provision outdated and no longer an appropriate factor for distributing VR funds. The Congressional Research Service also reported that due to the 1978

allotment, VR funding allotments do not fully reflect population changes since the mid-1970s.[19]

Most State Agencies Indicated Satisfaction with the Formula, though Some Believe It Results in Inadequate Funding for their States

Most state agencies that responded to our survey indicated satisfaction with the current formula. Of respondents, 62 percent (46 of 74) expressed the view that the current formula is appropriate, while 31 percent (23 of 74) viewed it as inappropriate. When asked about specific parts of the formula, opinions varied. For example, 86 percent (64 of 74) considered the use of general population to be appropriate, while only 27 percent (20 of 74) considered the 1978 allotment provision to be appropriate. See appendix IX for responses to our survey questions. However, in their comments to the survey and in interviews, some state agency officials asserted that the formula does not provide them with adequate funds. For instance, VR officials we spoke with in Massachusetts and Maryland said that due to current funding allotments, their agencies are on an "order of selection," in which they give priority to individuals with significant disabilities and place other individuals on waiting lists.

When we compared allotments per person with a disability against order of selection status, we found that states that receive less funding per person with a disability were somewhat more likely to report being under an order of selection than those states that receive relatively more funding.[20] Specifically, we found in fiscal year 2008 that among states with lower than median allotments per person with a disability (adjusting for costs), 72 percent reported being under an order of selection, compared to 52 percent of states above the median. However, the data do not explain whether or the extent to which the VR funding formula is causing states to

[19]The Congressional Research Service found that states with the largest population growth since 1976 would have received larger funding allotments if the 1978 provision were not part of the VR funding formula, while states with lower rates of population growth since 1976 benefit from this provision. Congressional Research Service, *Vocational Rehabilitation Grants to States and Territories: Overview and Analysis of the Allotment Formula*, RL34017 (Washington, D.C., January 2008).

[20]In states with two VR agencies, we considered a state to be under an order of selection if either of its agencies reported being under an order of selection. In one state—Delaware—the state VR agency for the blind was under an order of selection, but not the general agency. In all other states that we considered to be under an order of selection, either only the general agency reported being under an order of selection, or both the general and blind agencies did so. We did not include U.S. territories in this analysis due to lack of data that would allow us to determine the size of their allotments per working-aged person with a disability.

be under an order of selection. For example, many states above the median allotment are also under orders of selection. Further, in interviews state VR officials indicated that factors other than allotment levels could also influence a state's decision to be under an order of selection, such as the level of state resources provided to the VR program, the effectiveness of the agency's management of program costs, and the agency's decisions about how to use existing funding.

Greater Equity in VR Funding Could Be Accomplished in Several Ways

Options for Introducing Greater Equity for Taxpayers or Beneficiaries

There are a number of ways to redesign the VR funding formula to achieve greater equity for beneficiaries, taxpayers, or to balance equity for both. We present three options, or prototypes, to illustrate the range of options. See appendix VII for a more detailed description of each formula option. For each of these options, we have retained the minimum allotment that the current formula provides to ensure that each state would receive at least a certain level of funds for its VR program.

- *A partial beneficiary equity formula:* This option bases allocations solely on the size of a state's population potentially needing VR services. To measure the need population, this option would use data on the states' civilian working-aged disability populations from the Census Bureau's ACS.

- *A full beneficiary equity formula:* This option also allocates funds based on states' working-aged disability populations using Census data, but also includes estimates of the cost of providing VR services in each state. These cost estimates reflect differences among states with respect to two basic costs (i.e., wages and rents), which underlay the provision of many VR services. We developed estimates of state costs using data on wages from BLS and on rents from HUD. This option does not reflect differences in other types of basic costs for which reliable data may not be readily available. See appendix I for further information on the development of our cost estimates.

- *A taxpayer equity formula:* This option also distributes funds based on states' working-aged disability populations and the cost of providing VR

services, but it adds a third factor to the formula—a measure of each state's ability to contribute to the VR program. More funds would be allocated to states with fewer taxable resources. To measure a state's ability to finance the VR program, we utilized data from Treasury on a state's total taxable resources, which includes per capita income as well as other sources of potentially taxable state income, such as corporate income produced within the state but not received by state residents.

For the taxpayer equity option, an issue to consider is whether the matching requirement would be the same across all states, as is the case with the current formula, or would vary based upon a state's ability to finance the VR program. To fully achieve taxpayer equity, the matching requirement would need to vary according to each state's financing ability. If the matching requirement were the same for all states, those with fewer resources would receive more federal funds but would also need to provide more state funds for the match. This could result in poorer states having to contribute a greater share of their resources to the VR program than wealthier states. See appendix VII for an explanation of how a variable matching requirement could be incorporated into the taxpayer equity option.

Table 1 shows the amount of funds redistributed among states, as well as the number of states gaining and losing funds, for each of the three formula options. For example, each of our three prototypes would redistribute approximately 4 to 6 percent of the VR funds, with about 20 states receiving more funds and at least 20 states receiving less in funds than they do under the current formula. Between 5 and 11 states would experience a change in funding levels of 20 percent or more. See appendix VIII for a state-by-state table of allocations under our three formula options.

Table 1: Redistribution of Funds under Three Formula Options[a]

	Partial beneficiary equity	Full beneficiary equity	Taxpayer equity
Amount of funds that would be redistributed, in millions	$103.9	$153.4	$138.3
Percentage of total allocation	3.8	5.6	5.0
Number of states receiving more funds	23	19	23
Number of states receiving less funds	22	26	22
Number of states with no change[b]	6	6	6
Number of states experiencing an increase in funds of 20 percent or more	2	4	4
Number of states experiencing a decrease in funds of 20 percent or more	3	7	7

Source: GAO analysis of data from Education on VR grants in fiscal year 2008, Census Bureau's 2006 and 2007 ACS, Treasury's data on total taxable resources, BLS' Quarterly Census of Employment and Wages, HUD's data on fair market rents, and responses to GAO survey.

[a]The options presented in Table 1 are cumulative, i.e., the second option presented (full beneficiary equity) includes the first option (partial beneficiary equity). The third option (taxpayer equity) includes both of the other options.

[b]The same six states—Alaska, Delaware, North Dakota, South Dakota, Vermont, and Wyoming—experience no change in their allotment due to the fact that they receive the minimum allotment under the current formula and would continue to do so under each of our options.

In our survey of state VR agencies, many respondents expressed reservations about options for revising the current funding formula. Our survey presented state agencies with three general approaches to revising the formula, roughly based on our three formula options.[21] Most respondents expressed reservations about options that were generally based on partial beneficiary and taxpayer equity, and they were divided on the option generally based on full beneficiary equity. Specifically, 45 percent of respondents expressed support for an approach that would distribute funds so that all states would receive funding to be able to provide the same level of services to each individual potentially eligible for VR services, taking into account certain differences in the cost of providing services, while 47 percent expressed disapproval of this approach, and the remainder expressed no opinion or preference.

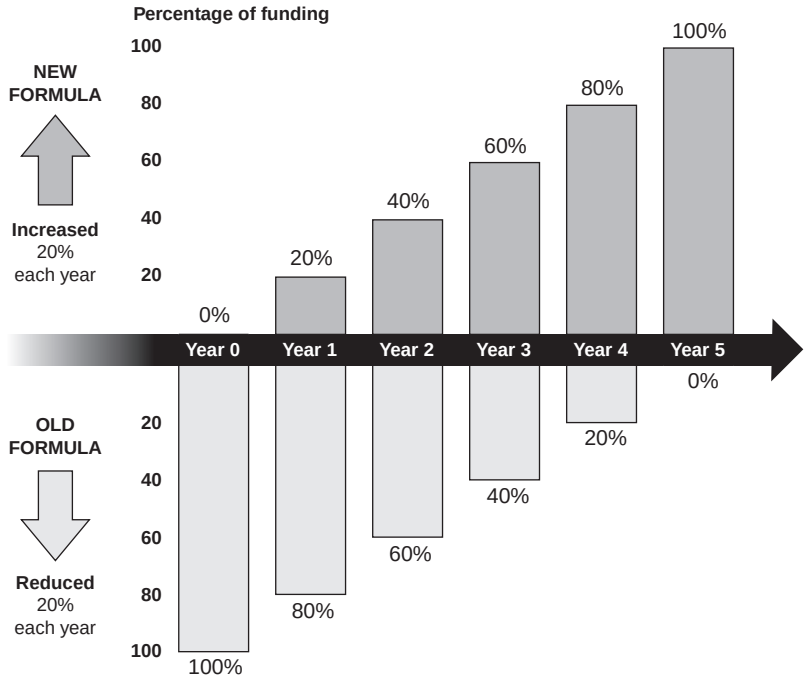
[21]State agencies were not provided with specific details of the options presented in this report because these were not finalized at the time of our survey. In asking state agencies to provide their views on three options, generally based upon the equity standards, we sought to minimize the effect of any perceptions that they might gain or lose funding as a result of a formula change; however, we do not know whether such perceptions ultimately influenced their responses.

Options for Phasing In Changes to Minimize Disruption to State Programs

When a new federal formula is implemented, Congress often provides a transition period so that grant recipients have time to adjust, especially those recipients whose grants will be reduced. An abrupt reduction in funding level could disrupt a state agency's ability to provide VR services. Transition periods allow for greater predictability and stability in state funding levels, which in turn, help avoid major disruptions to existing state services and allow states to develop long-range plans and program commitments.

One way to ease the change to a new formula is to phase it in gradually over a number of years. During the phase-in period, the state allocations would be a combination of the old and new formulas, with a gradual increase in the portion of funding distributed through the new formula, until the phase-in period is complete. By way of example, figure 4 depicts a 5-year transition period, under which the amount of money allocated under the old formula would be reduced by 20 percent each year, and the amount allocated under the new formula would be increased by 20 percent each year, until all of the allocations are made using the new formula. To further minimize the disruptive effects of a new formula, the phase-in period could be longer, although this would, of course, postpone full use of the new formula.

Figure 4: A 5-Year Phase-In Transition to a New Funding Formula



Source: GAO analysis.

Another approach to minimize disruption to state VR programs is to establish a hold harmless provision that limits the amount of funding that states could lose under a new formula. One example of this approach would be to hold states entirely harmless in the first year that the new formula is implemented, but would allow minimal decreases during the second and successive years, such as by 1 or 2 percent. Because state agencies could also have difficulties adjusting to large and sudden funding increases, limits could also be set on the increases that states would receive from one year to the next. This graduated approach would allow agencies to better plan for the additional funds and manage growth in their VR programs. It should be noted that use of a hold harmless provision would effectively reduce the amount of funds available for distribution through the new formula in the early years of a change because most of the funds would be allocated through the hold harmless provision. However, over time, as the total amount of funds appropriated for the VR

program increases, more of the funds would be allocated through the new formula.[22]

Incorporating Financial Performance Incentives in the VR Formula Poses Challenges

Some research and experiences suggest that providing financial incentive awards based on program performance has the potential to improve government programs, and a slight majority of VR agencies surveyed are open to using them in the VR program. Some federal programs currently provide incentive awards and officials we spoke with from three of these programs noted some benefits, such as motivating state and local agencies to improve performance. Of the state VR agency officials who responded to our survey, 59 percent were open to including some form of incentive awards in the VR program. Some state officials noted that doing so could reward high performing agencies, improve VR client success, or motivate agencies to focus on continuous improvement.

Nevertheless, there are challenges to incorporating incentive awards into the VR program, whether through its funding formula or outside it due, in part, to the multiple and potentially competing facets of the VR program's mission. According to the Rehabilitation Act, state VR programs should help clients achieve employment by providing individualized services, while also prioritizing service to those with the most significant disabilities when agencies cannot provide services to all eligible applicants. VR stakeholders we spoke with, including state agency officials, state advisory council officials, representatives from private sector VR companies, and disability researchers, identified three main challenges to incorporating incentive awards into the VR program. To some extent, these challenges are already present in the VR program's current performance measurement system and could be accentuated by linking program performance to incentive awards. These challenges are:

[22]The amount of time it would take for the new formula to fully be in place would depend on the level of the hold harmless provision. For example, if the hold harmless provision did not allow any state to experience a decrease from the prior year's allocation, we estimate that it would take 10 to 13 years before all states' allocations were determined by the new formula. However, if the hold harmless provision allowed states to experience a decrease of up to 10 percent from the prior year's allocation, we estimate that it would take 7 to 10 years for all states' allocations to be determined by the new formula. These estimates assume that the federal funds available to be distributed for the VR program would increase by 4 percent per year, and that states' relative levels of need population, costs, and taxable resources would remain the same over time.

- *Challenge of balancing potentially competing program goals:* Unless carefully designed, a financial performance incentive system could run the risk of encouraging state VR agencies to focus on achieving certain program goals, at the expense of others. For example, 89 percent of state VR officials who responded to our survey thought it likely that providing state agencies with additional funds based on performance would result in agencies focusing more heavily on clients who were expected to positively impact agency performance. In interviews, many VR stakeholders expressed particular concern that if incentive awards were focused on achieving employment outcomes for clients, they could induce state agencies to concentrate on serving those most likely to obtain employment, at the expense of those with greater barriers, such as those with the most significant disabilities. This would run counter to the VR program requirement that state agencies serve individuals with the most significant disabilities first when operating under an order of selection. Similar concerns have arisen in other employment programs that have used incentive awards. For example, we previously reported that local agency officials in the Department of Labor's Workforce Investment Act (WIA) Title IB programs may be reluctant to provide services to job seekers less likely to find and maintain a job.[23]

- *Challenge of rewarding agencies for providing appropriate individualized services to clients:* The VR program provides both long-term services, such as supporting youth with disabilities as they transition out of high school and pursue higher education, and short-term services, such as identifying job opportunities for people who already have skills and qualifications. Several VR stakeholders expressed concern that if incentive awards did not take into account some clients' specialized needs for higher-cost or longer-term services, they could cause agencies to focus on providing short-term services. Officials from one state advisory council cautioned that incentive awards might encourage VR counselors to focus on providing short-term services, even if it resulted in low-paying jobs, instead of placing VR clients in higher education programs that could ultimately yield long-term, higher paying career positions.

- *Challenge of basing incentive awards on an agency's performance, without accounting for factors outside its control:* A variety of factors outside an agency's control may influence performance outcomes, such as the state's economy and the characteristics and needs of the individuals

[23]GAO, *Workforce Investment Act: Improvements Needed in Performance Measures to Provide a More Accurate Picture of WIA's Effectiveness*, GAO-02-275 (Washington D.C.: Feb. 1, 2002).

who seek rehabilitation services. If an agency's performance cannot be distinguished from these factors, the provision or withholding of incentive awards would not necessarily reflect agency actions.[24] Of state VR agency officials who responded to our survey, 77 percent stated that isolating an agency's performance from factors outside its control would be a great or very great challenge to appropriately distributing incentive awards. For example, officials in one VR agency said that some parts of their state have 20 percent unemployment, which decreases their ability to place clients in jobs.[25] Another state agency official noted that his agency has had very high employment outcomes, in part because the state had one of the lowest unemployment rates in the country. He added that agencies in other states whose economies are weak have had poorer employment outcomes through no fault of their own. In addition, some state officials suggested that agencies operating under an order of selection would be at a competitive disadvantage compared to those that are not, because the caseload of the former would include a greater proportion of clients with the most significant disabilities and barriers to employment.

Our research into the types of incentive awards used by other federal programs, as well as the views of VR stakeholders, revealed several ways to mitigate such challenges, but none are without potential pitfalls. Specifically, research on designing incentive award systems suggests the following options:

- *Using multiple measures of success:* Using a range of performance measures to determine incentive awards could help motivate state

[24]Prior GAO reports have noted that Education's performance measures for the VR program do not account for factors such as the economic health and demographics of a state. GAO, *Vocational Rehabilitation: Improved Information and Practices May Enhance State Agency Earnings Outcomes for SSA Beneficiaries*, GAO-07-521 (Washington D.C.: May 23, 2007) and *Vocational Rehabilitation: Better Measures and Monitoring Could Improve the Performance of the VR Program*, GAO-05-865 (Washington D.C.: Sept. 23, 2005).

[25]A 2004 report commissioned by the Department of Education found that poor labor market conditions, particularly high unemployment rates, were reported as being among the most influential hindrances to a VR agency's performance. See RTI International, *Study of Variables Related to State Vocational Rehabilitation Agency Performance* (Revised Draft Final Report), (Research Triangle Park, N.C., October 2004).

agencies to focus attention on all aspects of the VR program's mission.[26] For example, the performance of state VR agencies might be measured in terms of both the proportion of people with the most significant disabilities who find employment, and the proportion of all clients who achieve this outcome. Another option that could encourage agencies to provide long-term services, when appropriate, is to establish intermediate measures of client achievement or the services provided that have increased a client's prospect for employment. Such an intermediate measure could be the number of VR clients who successfully complete training programs or college degrees. Nevertheless, there are challenges to developing appropriate measures. For example, although Education already uses a measure for the VR program focused on people with significant disabilities, it may be difficult to develop a measure specifically on people with the most significant disabilities because the Rehabilitation Act allows states to individually define the term, and our past work found that state agencies' definitions vary.[27] Although Education uses multiple measures to evaluate state VR agencies' performance, an issue to consider is whether or not the current measures would be appropriate to use for distributing incentive awards. Our prior work on the VR program found that the current measures do not consider agencies' success in assisting individuals who have not yet exited the program and do not specifically track outcomes for youth transitioning out of high school. As a result, we recommended that Education reevaluate its performance measures to determine whether they reflect the agency's goals and values.[28]

[26]According to our past work, one key attribute of a successful performance measure system is its coverage of all activities that an entity is expected to perform to support the intent of the program. GAO, *Tax Administration: IRS Needs to Further Refine Its Tax Filing Season Performance Measures*, GAO-03-143 (Washington D.C.: Nov. 22, 2002). Also, researchers of performance incentives have noted that the exclusion of measures for some key program goals can lead agencies to focus on goals that are measured, to the detriment of those that are not.

[27]Under the Rehabilitation Act, a significant disability is defined as one that seriously limits one or more functional capacities and can be expected to require multiple VR services over an extended period of time. In the VR program, "significant disability" is a separate and broader category than "most significant disability." For more information on our prior work related to the definition of most significant disability, see GAO-05-865.

[28]GAO-05-865. For example, GAO recommended that Education consider additional measures (e.g., to better reflect special needs populations, such as transitioning students) and accounting for factors outside of its control. Education generally agreed with our findings. Since then, Education has developed a draft strategic plan that proposes long-term performance goals, objectives, and measures for use in its performance monitoring activities. This draft plan includes measures of agency success in serving youth transitioning out of high school, individuals with significant disabilities, and individuals with significant disabilities who receive public financial support at the time of application to the VR program.

- *Adjusting performance standards to account for differences in local economies and program clients:* The level of performance required of each state VR agency to receive an incentive award could be adjusted to account for the challenges they face.[29] For instance, the performance standard required to receive an incentive award may be set lower for agencies in states with poor economies than for states with better economies.[30] These adjustments could be made using a mathematical model, negotiations between federal and state agencies, or a combination of the two approaches. For example, the Job Training Partnership Act program (JTPA) used mathematical models to quantify the relative effect of participants and economies on agency outcomes. Some researchers of the JTPA program found that this approach was perceived to "level the playing field" for agencies and had lessened the perverse incentives to focus more heavily on the most promising clients.[31] However, the research also suggests that it is difficult to identify and measure all the external

[29]For more detail about potential approaches to adjusting performance standards, see Pascal Courty, Carolyn Heinrich and Gerald Marschke, "Setting the Standard in Performance Measurement Systems," *International Public Management Journal* 8:3 (2005); Joe Siedlecki and Christopher T. King, "Approaches to Adjusting Workforce Development Performance Measures," Ray Marshall Center for the Study of Human Resources, Lyndon B. Johnson School of Public Affairs, *The University of Texas at Austin Occasional Brief Series* 1:2 (2005); and Carolyn J. Heinrich and Burt S. Barnow, "One Standard Fits All? The Pros and Cons of Performance Standard Adjustments," *La Follette School Working Paper*, 2008-023. These articles discuss adjusting performance standards based on mathematical models; negotiation among local, state and federal agencies; or approaches that use both.

[30]Incentive award decisions could also be based on the extent to which an agency improved over its past performance. While this approach allows agencies to be measured against their own progress rather than general standards applied to all states regardless of their circumstances, it can also pose challenges because the circumstances within a state may change from year to year. For example, if a state enters a recession, improving performance from previous years may not be feasible. In addition, setting performance goals in this way may create perverse incentives for officials to limit performance gains in a given year in order to decrease the performance level required in future years.

[31]The JTPA was the predecessor to the Department of Labor's WIA Title IB employment and training programs for adults, youth and dislocated workers which were authorized in 1998. For more information, see Heinrich and Barnow, 2008 and Pascal Courty, Do Han Kim, and Gerald Marschke, "Curbing Cream-Skimming: Evidence on Enrollment Incentives," Forschungsinstitut zur Zukunft der Arbeit Institute for the Study of Labor, Discussion Paper No. 3909, (December 2008). Courty, Kim, and Marschke found that the JTPA agencies responded to the adjustment model by increasing the proportion of clients in the program from demographic groups estimated to have more barriers to employment. However, they also found that JTPA program staff continued to select the individuals who were most likely to find employment from within these demographic groups. While this shows continued evidence of a perverse reaction to the performance award system, the authors described it as a much smaller problem than if these adjustments had not occurred.

factors that can undermine or lessen agency performance. If key factors are missing from mathematical models, the adjusted performance standards may lead to inaccurate estimates.[32] Taking a different approach, WIA Title IB employment and training programs set performance standards by negotiating with state agencies. Although advocates of this approach say that it increases agency involvement and may better capture qualitative factors that affect agency performance, we and others have criticized the WIA negotiation approach as unsystematic and inconsistent across states.[33] Specifically, we have suggested using an approach that combines negotiations with mathematical models. In a prior report, we recommended that Labor develop an adjustment model or other systematic method to account for different populations and local economies when negotiating performance levels.[34] Labor officials generally agreed with our recommendation and told us recently that they are starting to provide states with adjustment models to inform the negotiation process. Finally, some researchers and public officials identified concerns about adjusting performance standards, regardless of the method. For example, some researchers have expressed concern that adjusting performance standards may be unfair to clients because it allows agencies to settle for less desirable outcomes for harder-to-serve populations.

Beyond these risks, there are a number of considerations involved in deciding to incorporate incentive awards directly into the VR funding formula itself. First, it would be important to consider whether or not states should be required to match the additional funds allocated for performance, and if not, whether those funds could be treated as part of the state's matching contribution. Another consideration is that rewarding high performance through the funding formula would, in effect, penalize other states insofar as it reduces the total funding available for distribution to all agencies based on other formula factors. Some state VR agency officials we spoke with suggested that incentive awards should not result in any decrease to base funding allocations. HUD's Public Housing Capital

[32]For more information, see Arthur C. Brooks, "The Use and Misuse of Adjusted Performance Measures," *Journal of Policy Analysis and Management*, 19:2 (Spring 2000) and Heinrich and Barnow, 2008.

[33]GAO, *Workforce Investment Act: States and Local Areas Have Developed Strategies to Assess Performance, but Labor Could Do More to Help*, GAO-04-657 (Washington, D.C: June 1, 2004) and GAO-02-275.

[34]GAO-04-657.

Fund program, which provides incentive awards through its funding formula, includes provisions that minimize the impact of the awards on states' funding.[35] However, HUD officials we spoke with still expressed concern that this system penalizes housing authorities that may need additional funds if they are to improve their performance.

Alternatively, incentive awards could be distributed independently of the VR funding formula to avoid these inherent penalties. Options for distributing funds outside the main VR funding formula include providing incentive awards as grants, as occurs in the WIA Title IB programs, or through a separate incentive award formula, as occurs in the Child Support Enforcement program.[36] Of the state VR officials who responded to our survey, 51 percent supported providing incentive awards distributed independently of formula-determined funds, while only 22 percent supported providing the incentive awards through the formula.[37]

Finally, regardless of whether incentive awards are provided through the VR funding formula or independent of it, there are still other considerations involved in designing and carrying out an incentive award system. For instance, it is important that incentive awards are based on reliable data about agency performance. It is also important to consider the extent to which an incentive award system will allow for future modifications should there be changes in program priorities or available

[35]High performing local public housing authorities receive a 5 percent increase in their base formula allocation, with the stipulation that no public housing authority will lose more than 5 percent of its formula allocation due to the redistribution of funds for incentive awards.

[36]For more information on the process for distributing WIA performance incentive awards as grants, see Employment and Training Administration, Training and Employment Guidance Letter No. 9-07, *Revised Incentive and Sanction Policy for Workforce Investment Act Title IB Programs* (Washington D.C., Oct. 10, 2007). For more information on the process for distributing Child Support Enforcement Program performance incentive awards through a specific formula, see Congressional Research Service, *Child Support Enforcement Program Incentive Payments: Background and Policy Issues*, RL 34203 (Washington D.C., October 2007).

[37]Specifically, officials from 14 percent of the agencies that responded to our survey supported incentive awards, regardless of whether they were provided inside or outside the formula; 38 percent only supported incentive awards outside the formula; and 8 percent only supported incentive awards within the formula. Also, 41 percent did not support, or had no opinion regarding, using incentive awards either within or outside the funding formula. These numbers total to greater than 100 percent due to rounding.

data, or if perverse and unanticipated results ensue. Our earlier work discusses these and other, related considerations.[38]

Concluding Observations

Although the measures currently used to allocate VR funds may have been the best available when the formula was last revised in 1978, better data are now available for factoring in both the potential need for and ability to support a program. Improved information offers policymakers the opportunity to update the formula to more closely align funding with the need for services, as well as with each state's ability to contribute to the program. In deciding whether a revision to the formula is warranted, policymakers will likely want to consider how to strike a balance among all important factors—need, the cost of providing services, and the extent to which state resources are available. Certainly, revising the funding formula poses challenges because any formula change will result in funding decreases for some states, along with increases for others. However, there are ways to ease the transition to a new formula, so as to minimize disruption to VR programs and the people they serve. On the other hand, incorporating performance incentives into the formula might introduce more complexity and risk. While there are mechanisms to mitigate these challenges, the potential benefits for the VR program would need to be carefully weighed against the potential risks.

Agency Comments and Our Evaluation

We provided a draft of this report to Education for review and comment. Education provided technical comments and we modified the report, as appropriate, to address these comments.

We are sending copies of this report to the Secretary of Education, relevant congressional committees, and other interested parties. The report will also be available at no charge on GAO's Web site at http://www.gao.gov.

[38]GAO, *Grants Management: Enhancing Performance Accountability Provisions Could Lead to Better Results*, GAO-06-1046 (Washington D.C.: Sept. 29, 2006).

If you or your staffs have any questions about our report, please contact me at (202) 512-7215 or bertonid@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of the report. Key contributors to this report are listed in appendix X.

Daniel Bertoni
Director, Education, Workforce,
and Income Security Issues

Appendix I: Objectives, Scope, & Methodology

Our objectives were to: (1) assess the extent to which the funding formula meets generally accepted equity standards, (2) develop options for revising the formula to better meet these standards, and (3) identify issues to consider with incorporating performance incentives into the formula. We used two generally accepted formula design standards intended to achieve equity for beneficiaries and taxpayers.[1] To meet both equity standards, a formula should use reliable and appropriate measures of the need population in each state and the cost of providing services in each state. A taxpayer equity formula additionally requires a reliable measure of a state's ability to finance a program from its own resources. In the following sections, we describe how we measured the need population, cost of providing services, and financing capacity in each state, and how we analyzed the extent to which the current formula meets equity standards and developed various formula options.[2] To address all three objectives, we also surveyed the 80 vocational rehabilitation (VR) agencies in the states, territories, and District of Columbia and conducted in-depth interviews with 11 VR agencies in 9 states. Finally, for the third objective, we reviewed literature on performance incentives and obtained the opinions of officials at 3 federal government programs that use incentive awards, which we describe in more detail in the last section.

We conducted this performance audit from September 2008 to September 2009, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[1]As noted earlier, beneficiary equity stipulates that funds should be distributed to states according to the needs of their respective populations, so that each state, with its federal allocation, can provide the same level of services to each person in need. Taxpayer equity stipulates that funds are distributed so that states can provide individuals comparable services using both state and federal funds, while each state contributes about the same proportion of its resources to a given federal program.

[2]The following experts reviewed our analysis of need population and cost of providing services: Andrew Houtenville, Associate Professor of Economics and Research Director of the Institute on Disability, University of New Hampshire; Mitchell LaPlante, Associate Adjunct Professor of Social and Behavioral Sciences and Director of the Disability Statistics Center, University of California San Francisco; and David Stapleton, Senior Fellow and Director, Center for Studying Disability Policy, Mathematica Policy Research, Inc.

Measuring State Need Populations

Data that directly measure the number of people in a state who potentially need VR services do not exist. Although state VR agencies have data on the size of their own caseloads, these data are not appropriate for use in a funding formula for two reasons. First, caseloads may be influenced by state funding levels. For example, an agency's caseload may be relatively small because of limited funds, not because of limited demand for services. Second, data that can be controlled by state agency officials should not be used in a funding formula because they could introduce some "undesirable incentives" into the program. For instance, if a state's allotment were determined by the size of its caseload, a state agency might be rewarded for taking inappropriate actions, such as enrolling individuals into the VR program who do not require VR services or, in the case of an agency under an order of selection, enrolling individuals who do not meet its criteria for receiving priority for services.

There are, however, several national surveys that provide estimates of the number of people with disabilities by state. These surveys are conducted by statistical agencies such as the Census Bureau and Bureau of Labor Statistics (BLS). We reviewed several of these surveys: (1) the Census Bureau's American Community Survey (ACS), (2) the Decennial Census,[3] (3) the Current Population Survey's Basic Monthly Survey, (4) the Current Population Survey's Annual Social and Economic Supplement, and (5) the Center for Disease Control's Behavioral Risk Factor Surveillance System. We sought to identify data on the populations with all types of disabilities in each state.[4]

We ultimately selected the Census Bureau's ACS to use as a measure of state populations potentially in need of VR services for several reasons. First, the ACS provides data on states' disability populations on an annual basis. Second, the ACS has a large sample size (with about 3 million housing units surveyed across all 50 states, the District of Columbia, and Puerto Rico), which would allow for more accurate estimates of the need

[3]The Department of Transportation's New Freedom program, which provides funds to support public transportation services and alternatives beyond those required by the Americans with Disabilities Act, uses a formula that allocates funds based on a locality's population of people with disabilities. The Department of Transportation measures the disability populations of large urbanized areas, small urbanized areas, and rural and small urban areas with populations less than 50,000 using data from the 2000 Decennial Census.

[4]We did not separately identify data on blind populations in each state. In a state with two VR agencies, the state determines how to divide federal VR funds among the agency for the blind and the general VR agency.

population in each state. Third, the ACS surveys people in more types of group quarters than any of the other surveys, such as those living in college dormitories, group homes, prisons, and nursing care facilities. This is significant, since about 10 percent of VR clients exiting the program in 2006 and 2007 lived in group quarters such as group homes or rehabilitation facilities when they applied to receive VR services, according to Education's data. Fourth, the ACS asks six questions that are designed to capture a wide variety of disabilities (see table 2), and these questions are asked consistently across all states. One limitation of the ACS for purposes of allocating VR funds, however, is that the data are not available for U.S. territories, with the exception of Puerto Rico.

Table 2: Disability Questions from the American Community Survey, 2006 and 2007

Disability question
1. Does this person have any of the following long-lasting conditions: Blindness, deafness, or a severe vision or hearing impairment?
2. Does this person have any of the following long-lasting conditions: A condition that substantially limits one or more basic physical activities such as walking, climbing stairs, reaching, lifting, or carrying?
3. Because of a physical, mental, or emotional condition lasting 6 months or more, does this person have any difficulty in doing any of the following activities: Learning, remembering, or concentrating?
4. Because of a physical, mental, or emotional condition lasting 6 months or more, does this person have any difficulty in doing any of the following activities: Dressing, bathing, or getting around inside the home?
5. Because of a physical, mental, or emotional condition lasting 6 months or more, does this person have any difficulty in doing any of the following activities: Going outside the home alone to shop or visit a doctor's office?
6. Because of a physical, mental, or emotional condition lasting 6 months or more, does this person have any difficulty in doing any of the following activities: Working at a job or business?

Source: Census Bureau.

We analyzed the data produced by only 5 of the 6 disability questions from the 2006 and 2007 ACS. We did not use data from the sixth question regarding the difficulty of working (question 6 in table 2) because the Census Bureau had removed this question in 2008 at the recommendation of an inter-agency task force. The 2008 ACS data is expected to be released in the fall of 2009 and was not available to use for this study. Since this question will not be included on future surveys, we sought to produce an analysis that would more closely reflect future available data. However, because changes were also made to each of the five other ACS questions

for the 2008 survey, we cannot say whether our analysis of 2006 and 2007 data will be predictive of conditions in 2008 or thereafter.[5]

We measured each state's disability population by counting the number of civilians of working age (16 to 64) who responded "yes" to any of the five disability questions. By excluding the difficulty working question, our measure excluded 12.5 percent of the population who responded "yes" to the difficulty working question. The remaining 87.5 percent of those who responded "yes" to this question were people who also responded "yes" to one or more of the five other disability questions. As a result, they were included in our measure.

Table 3 provides a breakdown of the total U.S. population into the different components of our measure of the need population for the VR program. As shown in the table, our measure—the civilian working-aged population with a disability—comprises 7.6 percent of the total U.S. population.

Table 3: Breakdown of the Total U.S. Population into Components of our Measure of the Need Population for the VR program, 2007

	Population	Percentage of total population
Total U.S.	**301,621,159**	**100**
Civilian working-aged (16 to 64)	197,630,139	65.5
Civilian working-aged with a disability[a] (16 to 64)	22,886,919	7.6

Source: GAO analysis of data from the Census Bureau's ACS.

[a]For purposes of this study, the population of people with disabilities is based upon data from five disability questions asked in the 2007 ACS. We did not include data from a sixth question on difficulty working.

[5]Each of the other five disability questions in the ACS were changed, starting in 2008. For example, question 1 on blindness, deafness, or severe vision or hearing impairment was made into two separate questions—one specifically on deafness or serious difficulty hearing, and another one on blindness or serious difficulty seeing even when wearing glasses. Question 2 about difficulty with physical activities such as walking, climbing stairs, reaching, lifting, or carrying was changed to ask whether the person has a serious difficulty walking or climbing stairs. Question 3 about difficulty learning, remembering, or concentrating was changed to ask about difficulty concentrating, remembering, or making decisions. Question 4 about difficulty dressing, bathing, or getting around inside the home was changed to ask whether the person has difficulty dressing or bathing. Finally, Question 5 about difficulty going outside the home alone to shop or visit a doctor's office was changed to ask about difficulty doing errands alone, such as visiting a doctor's office or shopping.

We assessed the reliability and validity of ACS data by interviewing Census Bureau officials and disability experts, reviewing documentation and literature, and conducting comparisons with other disability data. Specifically, we compared the ACS data with data from the Social Security Administration (SSA) on recipients of two types of disability benefits, Social Security Disability Insurance (SSDI) and Supplemental Security Income (SSI) benefits. For individuals to receive SSDI or SSI benefits, SSA or a state agency must first determine that they have a disability that prevents them from working. We compared the proportion of state populations with disabilities, according to ACS data, with the proportion of their populations receiving SSA disability benefits and found a high correlation—0.872 for SSDI and 0.788 for SSI. This indicates that ACS data and the SSA data showed similar trends; states with higher rates of disability according to ACS data also tended to have higher proportions of their population receiving SSA disability benefits. We had our work on identifying a measure of need population reviewed by three disability experts, and they concurred that ACS data provide a reasonable measure of the size of a state's population potentially needing VR services.

Measuring State Cost Differences

It is difficult to estimate differences among states in the costs of providing VR services. Although one approach for estimating cost differences is to estimate the costs for the same basket of goods in different states, attempting to do this for VR services would be extremely costly and labor-intensive because of the wide array of services that VR agencies provide, including assessment, counseling, higher education, occupational training, medical diagnosis and treatment, and transportation. Another challenge is finding a reliable data source on cost. State agencies' data on expenditures, in part, reflect cost of services, but using these data in a formula runs the risk of allowing undesirable incentives to be introduced into the program. For example, a state agency that efficiently manages its program will be able to provide the same quality of services at a lower cost than an agency with less efficient management. In this case, if the formula provided higher allocations to states with higher reported costs, it could reward agencies that are more inefficient. In addition, expenditures data are of limited use in measuring state cost differences because they reflect many other factors besides costs. For example, the amount of funds that agencies spend per client reflects the level of funds they receive from state and federal sources, as well as the types of clients they serve and the types of services they provide. For example, some agencies may choose to provide more intensive, higher-cost services to a smaller number of clients, while other agencies may choose to serve a larger number of clients with lower-cost services.

To address these challenges, we developed and used measures for the costs of resources—or inputs—that go into providing services, which are beyond the direct control of state agencies. Specifically, we focused on two basic inputs—labor and office space—that are needed to provide the different types of VR services. Where wages or rents are higher because the general cost of living is high, state agencies must pay more for workers or office space to provide services. In the following subsections, we describe in detail how we developed a cost index to reflect differences in costs for these two types of inputs, labor and office space. There are many other resources used to provide VR services, such as equipment and supplies, but data are not readily available on them. Obtaining such data would be time-intensive and costly, requiring detailed surveys of the specific services that each VR agency provides and the particular resources that go into each service. As a result, our cost index may not capture differences in the cost of some key inputs. For example, due to lack of data, our index would not capture transportation costs, which could be higher in states that have geographically dispersed populations.

While our index has some limitations, we believe it is a reasonable proxy that can reflect general differences across states in the cost of providing VR services. Because any cost index will only be an approximation of true cost differences, the index we developed is based on what we believe are reasonable assumptions that avoid overstating or exaggerating cost differences among states. We believe our measure allows us to at least partially recognize real cost differences among the states, while avoiding inappropriate incentives. A similar cost of services index is used in the funding formulas for the Community Mental Health Services and the Substance Abuse Prevention and Treatment block grants.

In the following subsections, we describe: (1) our work to identify a data source for estimating wages in each state, (2) the data source we used to estimate rental costs in each state, (3) our methodology for estimating how much to weight wages and rents in the cost index, and (4) how we combined our weights with the data on wages and rents to develop a cost of services index for each state. Since the purpose of our cost index is to help distribute federal VR funds among states, we did not examine cost differences between agencies for the blind and general VR agencies. In states with two VR agencies, the state determines how to divide the federal grant allocation among the agencies.

Identifying a Proxy for Wages in the VR Program

A measure of state labor costs should reflect the wages of all types of workers potentially involved in the VR program, including those directly employed by state VR agencies, as well as those employed by public or private-sector organizations that VR agencies have contracted with to provide VR services. To obtain an understanding of the types of workers who may be involved in state VR programs, we first reviewed data from Education's Annual Vocational Rehabilitation Program/Cost Report (RSA-2), which provides information on state agencies' expenditures on various types of services, both those provided by state agency employees and those provided through contracts or purchases from other organizations.[6] The data indicate the proportion of expenditures state agencies spent on the following types of services in fiscal year 2007:

- 7 percent on postsecondary education
- 14 percent on occupational and vocational, job readiness, and all other training
- 13 percent on assessment, counseling, guidance, and placement
- 7 percent on diagnosis and treatment of physical and mental impairments
- 4 percent on rehabilitation technology
- 1 to 2 percent each on other types of services, such as income support, transportation, and personal assistance services

Once we obtained information on the types of services that the VR program provides, we reviewed sources of data from BLS on average annual wages in each state for various industries and occupations, as well as wage data from the Centers for Medicare and Medicaid Services (CMS) that are used to adjust payments to healthcare providers. Specifically, we examined BLS data from the Quarterly Census of Employment and Wages (QCEW) and Occupational Employment Statistics (OES). The QCEW data, which come from employer filings for unemployment insurance, cover nearly all civilian employment. It classifies wages and employment levels by industry, using the North American Industry Classification System

[6]The RSA-2 data showed that 46 percent of state agencies' expenditures were spent on services that were contracted out or purchased. The data did not, however, allow us to determine the extent to which each specific type of service was provided by state agency employees or was contracted out or purchased from other organizations.

(NAICS). We examined private sector wages, but also included public sector wages for state government employees. In addition, we also reviewed data on specific occupations related to the VR industry from the OES. The OES classifies occupations according to the Standard Occupational Classification (SOC) system. Finally, we examined wage indices used to allocate funds in the Medicare program for skilled nursing and inpatient rehabilitation facilities. The specific data series we reviewed are listed below:

- BLS, Quarterly Census of Employment and Wages
  - Vocational rehabilitation services industry, private sector (NAICS 6243)
  - Social assistance industries, private sector (NAICS 624)
  - Healthcare and social assistance industries, private sector (NAICS 62)
  - Education, healthcare, and social assistance industries, private sector (QCEW industry code 1025)
  - Service-providing industries, private sector (QCEW industry code 102)
  - State government sector (QCEW industry code 10, state government)

- BLS, Occupational Employment Statistics
  - Rehabilitation counselors (SOC 21-1015)
  - Substance abuse and behavioral disorder counselors (SOC 21-1011)
  - Educational, vocational, and school counselors (SOC 21-1012)
  - Community and social services occupations (SOC 21)

- Wage indices for Medicare's Prospective Payment System
  - Inpatient Rehabilitation Facilities
  - Skilled Nursing Facilities

We determined that the data for the most narrowly-defined industries and occupations— the QCEW data for the vocational rehabilitation services industry, and the OES data on rehabilitation counselors—were less suitable for use in a cost index after examining the data and speaking with officials from BLS. The QCEW data on the vocational rehabilitation industry showed some peculiar values. For example, the wages in Vermont were the highest in the nation in the vocational rehabilitation services industry, but they were not among the highest in other data series we examined. We contacted BLS officials to better understand these data. They informed us that Vermont's data for the vocational rehabilitation services industry come from a small number of employers, and as a result, could be affected by two factors: possible differences in the types of work

performed and in the number of hours worked per week. The average annual wage in the QCEW is calculated by including both employees who worked full-time and part-time. If the proportion of VR employees working part-time varies substantially across states, this could cause state annual wages to vary. At a broader industry level, this is less likely to be a problem because the data cover more employers and employees. With regard to the OES data on rehabilitation counselors, the data were incomplete. There were no published wages for Alaska and Utah.

The remaining data series could serve as reasonable proxies for state wages in the VR program, but we selected the QCEW data for the education, healthcare, and social assistance industry sector for our proxy because it covers the wide array of services that the VR program provides. These include training, healthcare-related services, and social services. In addition, this industry had the smallest range for wage differences across states—the state with the lowest wage in this industry was 17 percent below the average, and the state with the highest wage was 25 percent above average. As a result, compared to the other industries, the education, healthcare, and social assistance industry would produce the more conservative results. Table 4 shows the median, minimum, and maximum values for each of the data series we examined for which data were available for all 50 states and the District of Columbia. To compare wages across states and across data series, we used wage indices. A value of 1 is equal to the national average. Values greater than 1 are above the national average, and values less than 1 are below the national average.

Table 4: Summary Statistics for Wage Indices from Data Series Reviewed

Data source	Industry/occupation	Minimum	Median	Maximum
QCEW	Vocational rehabilitation services industry (NAICS 6243)	0.66	0.94	1.47
	Social assistance industries (NAICS 624)	0.70	0.92	1.84
	Healthcare and social assistance industries (NAICS 62)	0.83	0.95	1.31
	Education, healthcare, and social assistance industries (QCEW 1025)	0.83	0.95	1.25
	Service-providing industries (QCEW 102)	0.67	0.87	1.63
	State government (QCEW 10, state government)	0.73	0.95	1.32
OES	Community and social services occupations (SOC 21)	0.72	0.95	1.19
Medicare	Inpatient rehabilitation facilities	0.74	0.93	1.25
	Skilled nursing facilities	0.74	0.93	1.27

Source: GAO analysis of BLS and CMS data.

Table 5 presents correlations of the various wage indices. It shows that the various wage data we reviewed are correlated with each other, which suggests that the different data series would generally produce similar results in funding allocations. The vocational rehabilitation services industry (NAICS 6243), in the first row, has the lowest level of correlation with the other indices. Its highest correlation coefficient is 0.63 with the social assistance industry (NAICS 624), while no two other wage indices have a correlation coefficient less than 0.65.

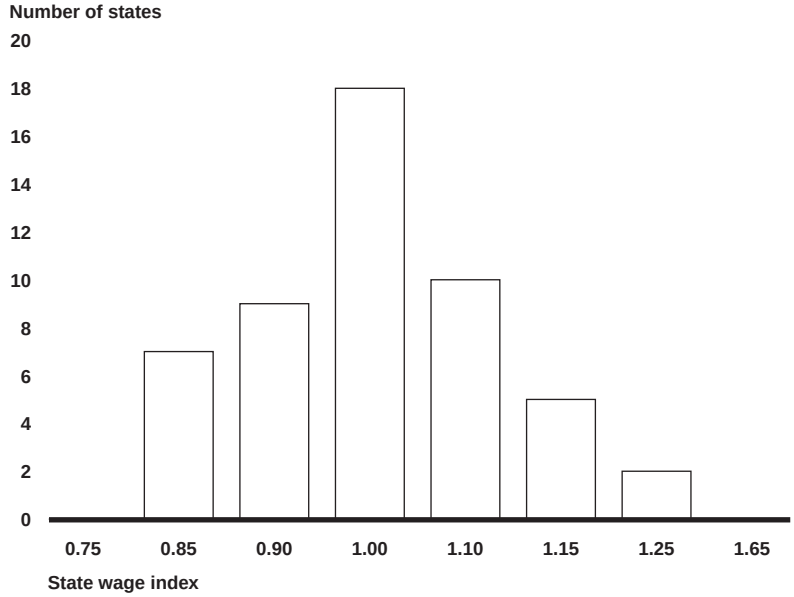
Table 5: Correlations between Wage Indices

	QCEW, Social assistance	QCEW, Healthcare and social assistance	QCEW, Education, healthcare, and social assistance	QCEW, Service-providing	QCEW, State government	OES, Community and social services occupations	Medicare, Inpatient rehabilitation facilities	Medicare, Skilled nursing facilities
QCEW								
Vocational rehabilitation services	0.63	0.51	0.52	0.61	0.49	0.50	0.49	0.48
Social assistance		0.80	0.78	0.84	0.69	0.69	0.66	0.65
Healthcare and social assistance			0.99	0.81	0.66	0.79	0.72	0.72
Education, healthcare and social assistance				0.83	0.67	0.79	0.72	0.72
Service-providing					0.72	0.74	0.68	0.66
State government						0.75	0.72	0.71
OES								
Community and social services							0.82	0.82
Medicare								
Inpatient rehabilitation facilities								1.00

Source: GAO analysis of BLS and CMS data.

The distribution of values for the education, healthcare, and social assistance wage index is shown in figure 5. Values for more than half of the states lie between 0.9 and 1.1, which suggests that most states have similar wages in this industry sector.

Figure 5: Distribution of Average State Wages in the Education, Healthcare, and Social Assistance Industry Sector, 2005 to 2007



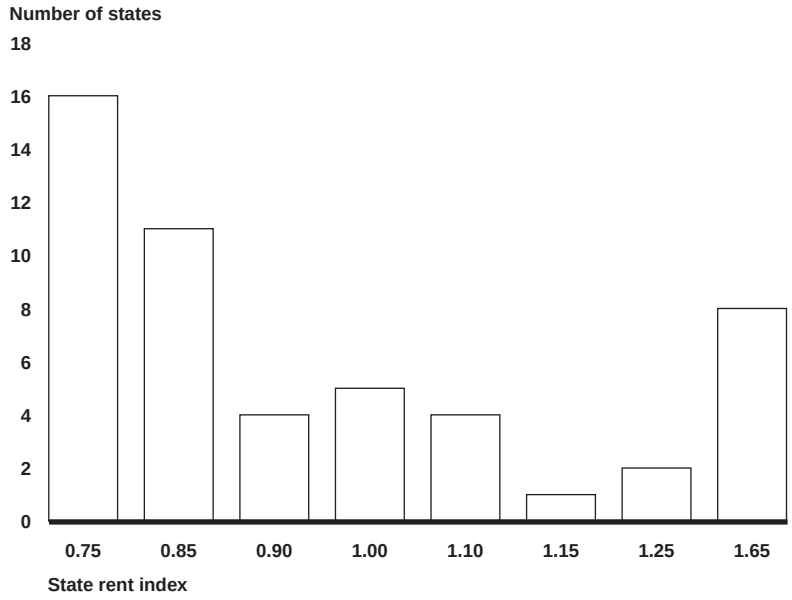
Source: GAO analysis of data from BLS' Quarterly Census of Employment and Wages.

Identifying a Proxy for Commercial Rents

State-by-state data on the cost of office space are not available. As a result, we used as a proxy residential rental rates. The Department of Housing and Urban Development (HUD) annually collects the rental cost of housing for 530 metropolitan areas and 2,045 non-metropolitan counties across the nation. These Fair Market Rents (FMR) data are used by several programs to set housing subsidies. The FMR data are also used in Medicare's physician fee schedule as a measure of office rents.

Since the FMR provides data on a local level, we aggregated the data to statewide averages and used an index to compare rental costs across states. The distribution of rents is shown in figure 6. Similar to figure 5, a value of 1 is equal to the national average. Values greater than 1 are above the national average, and values less than 1 are below the national average. Unlike the wage index, the rental cost index shows that over half of the states have a rental index of 0.85 or less, while 11 states have a rental index of 1.15 or higher. This suggests that rental costs vary substantially among states.

Figure 6: Distribution of Average State Rents, Fiscal Years 2007 to 2009



Source: GAO analysis of HUD data.

Weighting of Inputs

To determine how much to weight the wage and rental costs, we first surveyed state VR agencies to learn what proportion of their fiscal year 2007 and 2008 expenditures was spent on wages and rents. Because many agencies contract out or purchase services, our survey asked them first to report how much of their expenditures were for contractors or purchased services, and how much was spent in-house. Then we asked them to report how much of their in-house expenditures went to wages and rents. We used these responses to compute average proportions, which we then applied to categories of expenditures using RSA-2 data. In doing so, we assumed that the proportions of expenditures on wages and rents that state agencies reported for in-house expenditures was the same as the proportions for contracts and purchased services.[7] With regard to the RSA-2 data, we examined state VR agencies' spending in three broad categories: administration, individual services, and group services.

[7]We were not able to identify data that could be used to estimate the proportion of contract expenditures that went to wages and rents. Further, state agency officials who tested our survey informed us that they would not be able to estimate the amount of contract expenditures that went to wages and rents.

Table 6 shows the results of our analyses of the survey responses and the RSA-2 data, as well as how we combined these results to develop the weights for wages, rents, and other inputs in the cost index. In table 6, the first column shows the expenditure categories from the RSA-2 data. The second column shows the average proportion of expenditures that went to administration, individual, and group services, according to the RSA-2 data. The third through fifth columns show our survey results on the average proportion of expenditures that went to labor costs, rents, and other inputs. We assumed that for administration and individual services, expenditures went to labor, rents, and other inputs in the precise proportions that the survey results suggested. For example, we assumed that 69 percent of expenditures for administration and individual services were spent on wages, 5.6 percent on rents, and the remainder for "other," such as materials and supplies. However, group services can include activities such as construction of a community rehabilitation program. It is not clear what comprises these services. As a result, its input costs were assigned entirely to the "other" category. Finally, the last three columns multiply the prior columns, and the sum of the columns yields some preliminary weights.

Table 6: Combining Education's Expenditure Data and Survey Data to Estimate Weights for Inputs

		Input cost proportions (from survey)			Input cost weights		
VR expenditure categories	VR expenditure breakdown (from RSA-2 data)	Labor	Rents	Other	Labor	Rents	Other
Administrative	0.106	0.690	0.056	0.254	0.073	0.006	0.027
Individual services	0.862	0.690	0.056	0.254	0.595	0.048	0.219
Group services	0.032	0.000	0.000	1.000	0.000	0.000	0.032
Total	**1.000**				**0.668**	**0.054**	**0.278**

Source: GAO analysis of Education's RSA-2 data and GAO survey.

Once we obtained the results shown in table 6, we rounded the weights to the nearest 5 percent. Ultimately, we estimated the weights to be 0.65 for wages, 0.05 for rents, and 0.30 for all other inputs.

Constructing the Cost Index

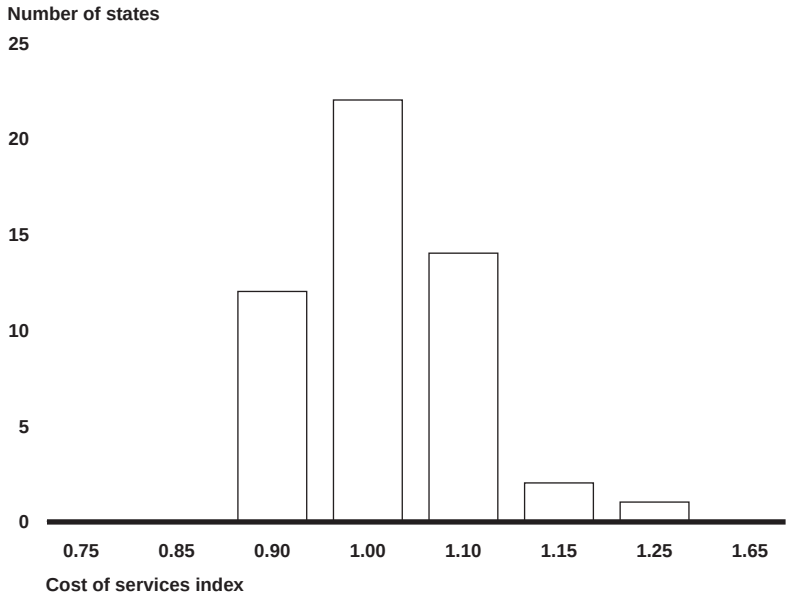
We then constructed the index, using the following formula:

Cost index = 0.65 Wages + 0.05 Rent + 0.30 Other

With this formula, we calculated a cost index for each state, using each state's average wage from 2005 to 2007 in the education, healthcare, and social assistance sector, according to QCEW data, and its average rental cost from fiscal years 2007 to 2009, according to the FMR data. The cost for "other" inputs besides wages and rents was assigned a weight of 0.30 and assumed to be constant for all states. We made this assumption to simplify the construction of the cost index because we were unable to readily or reliably capture differences in the costs of these inputs among states. As noted earlier, estimating these costs would be difficult because identifying the various materials and supplies used to provide the wide variety of VR services would be costly and labor-intensive. In addition, it is unlikely that there would be nationally available data on the costs of any materials or supplies we could identify. The assumption that the cost of "other" inputs is the same across states may be reasonable because some materials and supplies are likely to be purchased by state VR agencies from a national market and, therefore, the geographical variation in these costs would be limited.

Figure 7 shows the distribution of the cost index. If a state's cost index is 1, its costs are estimated to be the same as the national average. If a state's index is greater than 1, its costs are estimated to be above the national average. Finally, if a state's index is less than 1, its costs are estimated to be below the national average. Values for 36 of the states lie between 0.9 and 1.1. See appendix IV for a listing of the cost index for each state.

Figure 7: Distribution of the Cost of Services Index



Source: GAO analysis of data from Education, BLS, HUD, and responses to GAO survey.

We had our work on the cost of services index reviewed by three external experts in the disability field. They generally concurred with our methodology for developing the cost index using existing data. However, each noted that our index does not capture certain key inputs or costs underlying the provision of VR services, such as higher education, transportation, contracted services, and tax rates. We generally agree that it would be preferable to reflect all key cost differences that affect the provision of VR services; however, to do so requires reliable data from VR agencies (to determine average costs and develop weights for each input), and from independent sources (to estimate cost differences for those inputs among states). Either one or the other, or both, were not readily available. For example, with respect to transportation costs, data were not readily available from VR agencies that would allow us to develop average costs and weights, and we are not aware of independent data on

transportation cost differences among states.[8] Similarly, data were not readily available from VR agencies to identify the specific services that agencies contracted for and to determine the inputs that are used to provide those services. Finally, one of the experts noted that high tax rates in certain states may result in higher wages and rents, and suggested we incorporate states' tax rates into our cost index. We agree that tax rates may influence wages and rents; however, research suggests that many factors affect state differences in wages and rents, and determining the relative significance of state tax rates would be a highly complex analytical undertaking. In summary, although data were not readily available to reliably reflect cost differences for additional inputs suggested by our experts, these experts generally agreed that we appropriately accounted for cost differences in two basic inputs, i.e., wages and rents.

Measuring State Financing Capacity

A taxpayer equity standard stipulates that funds are distributed so that states can provide individuals comparable services using both state and federal funds, while each state contributes about the same proportion of their resources to a given federal program. This equity standard requires a formula to include an indicator of each state's ability to finance a given program from its own sources. In a funding formula, a good indicator of a state's financing ability would measure all types of taxable resources and would not be affected by an individual state's actual fiscal decisions.

We used Total Taxable Resources (TTR), as reported by Treasury, to measure state resources. The Treasury, as required by federal law, provides annual estimates of TTR in order to estimate states' financing ability. The estimates are used in formulas to allocate federal funds among

[8]Some of the experts also suggested that we include states' postsecondary education costs in our cost index. Although VR agencies track education expenditures that would allow us to develop weights, and data are available on states' postsecondary education costs (such as average tuition and fees), we did not include the data in our cost index for two main reasons. First, due to the availability of financial aid, we could not readily determine the extent to which these data would reflect actual costs incurred by state VR agencies. Second, costs of public higher education institutions are, in part, determined by states' funding decisions, and as a result, including these costs in our index may reward or penalize states based upon their fiscal decisions. Although we did not directly account for cost differences in higher education, the wage data we used for the education, healthcare, and social assistance industry may partly capture differences in education costs because it includes workers in education industries.

states for the Community Mental Health Services and the Substance Abuse Prevention and Treatment block grants. TTR is a more comprehensive measure of financing ability than per capita income because it includes personal income received by state residents, types of corporate income and capital gains that per capita excludes, as well as income produced within a state that is received by individuals who reside out-of-state.

Analysis of the Extent to which the Current Formula Meets Equity Standards

For our first objective, we reported state-level information on the proportion of the population of working age with a disability, allotments per person with a disability (adjusting for costs), and ratio of per capita income to total taxable resources. In addition, we analyzed the extent to which state per capita income is correlated with state disability rates in order to determine whether the current use of per capita income in the funding formula adequately accounts for a state's need population. Finally, we examined whether agencies in states with below median levels of funding per person with a disability were more often on an order of selection, compared to states above the median. For each of the above analyses, we examined only the 50 states and the District of Columbia. We did not analyze the U.S. territories because complete data were not available on the territories from the various data series we used. This section describes each of the analyses we conducted for our first objective.

Proportion of states' population that is civilian, of working age, and with a disability: To determine the proportion of each state's general population that is civilian, of working age, and has a disability, we analyzed 2007 ACS data to obtain the number of civilians in each state from age 16 to 64 who responded "yes" to at least one of five disability questions. As discussed above, we did not include individuals who responded "yes" to the question on difficulty working because this question was eliminated from the ACS, starting in 2008. We then divided the working-aged disability population numbers by the total population (all ages) for each state, which we also obtained from the 2007 ACS. These proportions are presented in appendix III.

Correlation between states' disability populations and their per capita income: To test whether the formula's use of per capita income is a reasonable proxy for states' disability rates, we analyzed the correlation between their disability rates and their "allotment percentage," which is the part of the formula that includes per capita income. As discussed above, we determined a state's disability rate as the proportion of a state's total population that is civilian, of working age, and has a disability. For

the per capita income factor, we calculated each state's "allotment percentage," which according to the formula, is one minus one-half of a state's per capita income level divided by the national per capita income level (see appendix II for a further explanation of the allotment percentage). We then obtained the correlation coefficient between states' disability rates and their allotment percentages.

Allotments per working-aged person with a disability (cost-adjusted): To determine for each state the allotment per working-aged person with a disability, as adjusted for the costs of providing services, we used Education data on the VR grant allotments that states received in fiscal year 2008, ACS data on state disability populations in 2007 (using the five disability questions, as described earlier), and the cost index, as described earlier. Specifically, we used the allotments that Education initially calculated for each state for fiscal year 2008.[9] To calculate the allotments per working-aged person with a disability while adjusting for costs, we divided each state's grant allotment by the product of the cost index and the state's 2007 working-aged disability populations. See appendix V for a state-by-state listing of allotments per working-aged person with a disability, as adjusted for costs of services.

We tested the reliability of Education's data on VR grant allotments by replicating Education's formula calculations and interviewing Education officials knowledgeable about the data. Our replications of the formula calculations produced results that were virtually identical to Education's. As a result, we determined that the data are sufficiently reliable for our purposes.

Order of Selection Status: We examined whether agencies in those states with below median allotments per working-aged person with a disability (adjusting for costs) more often reported being under an order of selection than those states whose allotments were above the median.[10] To obtain information on states' order of selection status, we used Education's RSA-

[9]The allotments data we used did not include any adjustments made to states' allotments at the end of the fiscal year, such as funds that state agencies returned because they could not fully match them or additional funds that agencies received through the reallotment process.

[10]The state with the median allotment per working-aged person with a disability, adjusted for costs (Arizona) was excluded from the analysis so that our analysis was specifically of the 25 states (including the District of Columbia) above the median and the 25 states below it.

113 data, which are quarterly data that states submit on their caseloads. For states with two VR agencies, we considered a state to be under an order of selection if either of its agencies reported being under an order of selection. Table 7 shows the number of states that we considered under an order of selection, by type of VR agency.

Table 7: Number of States Considered to Be Under Order of Selection by Type of VR Agency

States with one VR agency (combined) under order of selection	16
States with two VR agencies, both general and blind agencies under order of selection	4
States with two VR agencies, only general agency under order of selection	10
States with two VR agencies, only blind agency under order of selection	1
Total states with an agency under order of selection	**31**

Source: GAO analysis of Education data.

We assessed the reliability of RSA-113 data by interviewing Education officials knowledgeable about the data and conducting edit checks. Education officials informed us that when a state agency reports being under an order of selection, the Department verifies that the state agency has documented in its state plan its intention to provide services on an "order of selection" basis. However, Education officials also informed us that the RSA-113 data on a state's order of selection status do not necessarily indicate whether state agencies are currently operating on this basis by actively limiting services to individuals. For example, they noted, and we subsequently confirmed through our own review of the data, that some states reported being under an order of selection, but reported having no individuals on a waiting list. As a result, we determined that the RSA-113 data on order of selection was sufficiently reliable to provide information on the number of states reporting they were on an order of selection, but we cannot say whether these states were actually operating under their order. Our analysis also did not allow us to conclude whether there is any causal link between states' funding levels and their order of selection status.

Comparison of per capita income and total taxable resources: We analyzed how per capita income compares with TTR in each state. To do this, we obtained data on per capita income from the Department of Commerce and TTR data from Treasury from 2004 to 2006, the latest years for which data from both sources were available. We took 3-year averages

(2004, 2005, and 2006) of the per capita income and total taxable resources levels for each state in order to limit the effects of any year-to-year fluctuations. We then calculated the total taxable resources per capita for each state by dividing the average total taxable resource amount by the state's average population from 2004 to 2006. Next, we created indices by dividing each state's per capita income and total taxable resources per capita by the U.S. averages of per capita income and total taxable resources per capita, respectively. To compare states' per capita income with their total taxable resources, we divided each state's per capita income index by its index of total taxable resources per person to obtain ratios. See appendix VI for a state-by-state listing of indices of per capita income and total taxable resources per capita, as well as their ratios.

Analysis of Formula Options

For our second objective, we developed three formula options based upon equity standards commonly used to design and evaluate funding formulas. See appendix VII for detailed descriptions of the formula options. We also estimated the grant allotments that each state would receive under each formula option, using data on states' disability populations from the ACS, our cost index, and TTR data from Treasury. See appendix VIII for a table of our estimates of the grant allotments. Specifically, we used for states' need populations, the average of their 2006 and 2007 populations of people of working age with a disability in order to limit the effects of any year-to-year fluctuations. As described above, we used the five disability questions from the ACS. As a measure of cost of services, we used the cost index that we developed, also described above. As a measure of state resources, we used the average of states' total taxable resources from 2004 to 2006.

Survey of State VR Agencies

We conducted a Web-based survey of VR agencies in states, territories, and the District of Columbia to gather information on agency officials' opinions regarding the current formula, potential modifications to the formula, and the incorporation of performance incentives into the formula. In addition, we used the survey to obtain data on agency expenditures that we needed to develop our cost index. The Web-based survey was conducted using a self-administered electronic questionnaire posted on the Web. This Web-based survey was compatible with computer software that makes Web sites accessible to people with visual impairments. We received completed surveys from 74 of 80 VR agencies, for a response rate of 93 percent.

We took steps in the development of the questionnaire, the data collection, and the data analysis to minimize nonsampling errors. The practical

difficulties of conducting any survey may introduce errors, commonly referred to as nonsampling errors. For example, difficulties in how a particular question is interpreted, in the sources of information that are available to respondents, or in how the data are entered into a database or were analyzed can all introduce unwanted variability into survey results. To minimize such nonsampling errors, a social science survey specialist designed the initial questionnaire, in collaboration with GAO staff who had subject matter expertise. The draft questionnaire was pretested with officials from 5 state VR agencies to ensure that the questions were relevant, clearly stated, and easy to comprehend. When the data were analyzed, an independent analyst checked all answers using a statistical program. Since the survey was a Web-based survey, respondents entered their answers directly into the electronic questionnaire, thereby eliminating the need to have the data keyed into a database and avoiding data entry errors. See appendix IX for selected responses to our survey.

Interviews with Experts and Agency Officials

To learn more about state agency officials' opinions on all three of our research objectives, we spoke with VR agency officials from 3 states when we designed our methodology and we followed our survey work by interviewing officials from 8 agencies in 6 states. In selecting these 8 agencies, we identified states with a diversity of characteristics in terms of their: (1) disability population rates; (2) per capita income levels; (3) geographic dispersion; and (4) order of selection status. In addition, we sought to interview both state agencies that serve individuals with a wide variety of disabilities and agencies that primarily serve blind individuals. In 5 states, we also spoke with representatives from the state rehabilitation councils, which are advisory councils for state VR agencies.

We also spoke with officials from: (1) Education's Rehabilitation Services Administration to obtain relevant programmatic data and perspectives on the VR program; (2) SSA regarding data on the population receiving Social Security disability benefits; (3) the Census Bureau regarding ACS disability data; (4) BLS regarding data on wages; and, (5) the Department of Transportation regarding the use of Census data on disability that was used in a formula to distribute funds for the Department's New Freedom program.

In addition, we conducted about a dozen interviews with researchers having expertise in disability data and the VR program and with advocacy groups. We also attended the fall 2008 conference of the Council of State Administrators of Vocational Rehabilitation (CSAVR) to learn more about matters of interest to VR stakeholders and to obtain the views of the

council's executive committee members. Also, we spoke with representatives from four private sector companies that provide vocational rehabilitation services, in order to learn about their experiences with performance incentives in the private sector. We chose these four companies based on the recommendations of a trade organization official familiar with the fields of disability insurance and private vocational rehabilitation.

Review of Literature on Performance Incentives

To identify issues to consider when incorporating performance incentives into the VR formula, we reviewed literature produced by academic experts, think tanks, and government agencies such as the Congressional Research Service. We also reviewed prior GAO studies dealing with performance accountability in government programs.[11] We identified relevant literature by reviewing research databases, such as EconLit and the Education Resources Information Center (ERIC). We were also referred to literature through citations in other literature and by the recommendations of GAO staff and the external experts we interviewed. In conducting our search and review, we endeavored to collect a diverse body of literature that offered different views about the use of incentive awards.

Aside from conducting a general review of literature on performance incentives, we also identified and reviewed literature specific to four federal programs in order to understand their experiences and identify issues related to providing incentive awards. These programs are the Workforce Investment Act (WIA), Child Support Enforcement (CSE), Public Housing Capital Fund, and the Job Training Partnership Act (JTPA) programs. The latter was discontinued and replaced by WIA Title IB programs, authorized in 1998. We also obtained the views of federal officials in the Departments of Labor, Health and Human Services, and HUD, which are responsible, respectively, for the WIA, CSE, and Capital Fund programs.

[11]GAO, *Grants Management: Enhancing Performance Accountability Provisions Could Lead to Better Results*, GAO-06-1046 (Washington D.C.: Sept. 26, 2006).

Appendix II: Description of the Current Vocational Rehabilitation (VR) Funding Formula

The current VR funding formula allocates federal funds to states annually, based on three factors: (1) the amount of federal funds they received for their VR program for fiscal year 1978, (2) their population size, and (3) their per capita income level, as compared with the national per capita income.

States' fiscal year 1978 allotments became part of the formula when it was revised through a 1978 amendment to the Rehabilitation Act.[1] This provision ensured that no state experienced a funding decrease with the formula change. As currently constructed, the formula first provides states with the amount of federal funds that they were allotted for their VR program in fiscal year 1978.

The remaining funds appropriated for the VR program are then distributed based on a state's population and its "allotment percentage." The allotment percentage is calculated using the ratio of a state's per capita income to the national per capita income, according to the following formula:

$$\text{Allotment percentage} = 1 - 0.50 \times \frac{\text{State per capita income}}{\text{U.S. per capita income}}$$

The allotment percentage is designed to be higher for poorer states. For example, a state that has a per capita income level equal to the national level will have an allotment percentage of 0.50. If a state's per capita income is lower than the national level, its allotment percentage will be above 0.50. If a state's per capita income is higher than the national level, its allotment percentage will be lower than 0.50. However, to mitigate the influence of per capita income for states with very high or very low per capita income levels, the Rehabilitation Act sets both a floor and a ceiling on the allotment percentage—it cannot be less than 33 1/3 percent or greater than 75 percent. Further, the allotment percentage is set at 75 percent for U.S. territories and the District of Columbia. Federal law requires the Department of Education (Education) to calculate the allotment percentages in even-numbered years, using the average of the three most recent years of available data on per capita income. Education

[1]Prior to 1978, funds were allotted based upon states' populations and the square of its allotment percentage.

obtains the data from the Department of Commerce's Bureau of Economic Analysis.

The portion of the formula used to distribute funds after each state is allocated its 1978 allotment allocates half of the remaining funds based upon a state's population and allotment percentage, and the other half based upon its population and the square of its allotment percentage. The squaring of the allotment percentage magnifies its effect. Education is required to determine state populations annually, using the most recently available data from the Department of Commerce. The following is the formula for calculating states' funding allotments:

$$\text{Allotment} = \text{FY1978 Allotment} + \frac{(\text{Population} \times \text{Allotment percentage}^2)}{\sum(\text{Population} \times \text{Allotment percentage}^2)} \times \frac{\text{Excess amount}}{2} + \frac{(\text{Population} \times \text{Allotment percentage})}{\sum(\text{Population} \times \text{Allotment percentage})} \times \frac{\text{Excess amount}}{2}$$

where:

$$\text{Excess amount} = \text{FY Appropriation} - \sum \text{FY1978 Allotments}$$

Finally, the Rehabilitation Act also stipulates a minimum level of funding for each state. Specifically, no state may receive less than $3 million or 1/3 of 1 percent of the total federal funds appropriated to the VR program that fiscal year, whichever is greater.[2] If a state's allotment is calculated to fall below this amount, its allotment is increased to that level, and the allotments of other states are decreased proportionately.

[2]This minimum allotment does not apply to the U.S. territories, but it does apply to the District of Columbia.

Appendix III: Percentage of Population that Is Civilian Working Age with a Disability, 2006 and 2007

Table 8 below shows the proportion of each state's total population that is civilian, of working age (16 to 64), and with a disability. See appendix I for further information on our data source and methodology for determining these proportions.

Table 8: Percentage of Population that Is Civilian Working Age with a Disability, 2006 and 2007

State	2006	2007
Alabama	10.8	11.1
Alaska	9.2	9.3
Arizona	6.7	6.8
Arkansas	11.3	11.1
California	6.4	6.5
Colorado	6.9	6.7
Connecticut	6.3	6.3
Delaware	7.5	7.2
District of Columbia	7.1	7.5
Florida	7.5	6.9
Georgia	7.7	7.5
Hawaii	5.8	6.1
Idaho	8.0	7.4
Illinois	6.2	6.1
Indiana	7.8	8.1
Iowa	7.0	7.3
Kansas	7.4	7.1
Kentucky	12.0	11.4
Louisiana	9.9	9.6
Maine	10.5	10.6
Maryland	6.4	6.6
Massachusetts	6.8	6.9
Michigan	8.5	8.5
Minnesota	6.1	6.3
Mississippi	11.1	10.9
Missouri	8.8	8.9
Montana	9.3	8.0
Nebraska	6.8	6.3
Nevada	6.3	6.4
New Hampshire	7.4	6.9

State	2006	2007
New Jersey	5.8	5.6
New Mexico	8.8	8.7
New York	6.7	7.0
North Carolina	8.7	8.7
North Dakota	6.8	6.0
Ohio	8.3	8.4
Oklahoma	10.4	10.1
Oregon	8.7	8.5
Pennsylvania	8.0	8.1
Rhode Island	7.9	8.1
South Carolina	9.1	8.7
South Dakota	6.4	7.5
Tennessee	10.2	10.0
Texas	7.7	7.4
Utah	6.3	6.1
Vermont	9.5	8.2
Virginia	7.2	6.8
Washington	8.6	8.5
West Virginia	12.7	12.8
Wisconsin	6.7	6.9
Wyoming	8.3	8.1
National	**7.7**	**7.6**

Source: GAO analysis of data from the Census Bureau's ACS.

Note: Our measure of state disability populations is derived from five disability questions asked in the 2006 and 2007 ACS. See table 2 in appendix I for the disability questions on the ACS. We did not include data from a sixth disability question—about whether a person has difficulty working at a job or business because of a physical, mental, or emotional condition lasting six months or more—because this question was no longer included in the ACS, starting in 2008.

Appendix IV: Estimates of Differences among States in the Cost of Providing Vocational Rehabilitation (VR) Services

Table 9 provides a cost index for each state, designed to estimate the differences among states in the cost of providing VR services. The index is a weighted average of the costs of two primary resources needed to provide VR services, labor and office space. See appendix I for further information on the development of our cost index. The average cost nationally is represented by an index of 1.00. A state with an index above 1.00 is estimated to have costs greater than average, while a state with an index below 1.00 is estimated to have costs less than average. For example, with a cost index of 0.95, Alabama is estimated to have costs 5 percent below the national average.

Table 9: Estimates of Differences among States in the Cost of Providing VR Services

State	Cost index
Alabama	0.95
Alaska	0.98
Arizona	1.04
Arkansas	0.88
California	1.12
Colorado	1.01
Connecticut	1.09
Delaware	1.07
District of Columbia	1.19
Florida	1.02
Georgia	1.01
Hawaii	1.03
Idaho	0.87
Illinois	1.01
Indiana	0.94
Iowa	0.88
Kansas	0.89
Kentucky	0.93
Louisiana	0.89
Maine	0.93
Maryland	1.06
Massachusetts	1.13
Michigan	0.98
Minnesota	0.99
Mississippi	0.90

State	Cost index
Missouri	0.95
Montana	0.87
Nebraska	0.93
Nevada	1.10
New Hampshire	1.04
New Jersey	1.09
New Mexico	0.89
New York	1.04
North Carolina	0.93
North Dakota	0.89
Ohio	0.94
Oklahoma	0.88
Oregon	0.98
Pennsylvania	1.00
Rhode Island	0.99
South Carolina	0.93
South Dakota	0.92
Tennessee	1.01
Texas	0.96
Utah	0.91
Vermont	0.92
Virginia	1.00
Washington	0.97
West Virginia	0.88
Wisconsin	0.97
Wyoming	0.89
National average	**1.00**

Source: GAO analysis of BLS' Quarterly Census of Employment and Wages, HUD data on fair market rents, Education data on VR expenditures, and responses to GAO survey.

Appendix V: Vocational Rehabilitation (VR) Grant Allotments by State and Cost-Adjusted Allotments per Working-Aged Person with a Disability, Fiscal Year 2008

Table 10 shows the amount of federal funds each state received for fiscal year 2008, and the amount of services each state would be able to purchase per working-aged person with a disability with those funds. The per person allotments were adjusted to take into account differences among states in the cost of wages and rents, using the cost index shown in appendix IV. See appendix I for more information about our data sources and methodologies.

Table 10: VR Grant Allotments and Cost-Adjusted Allotments per Working-Aged Person with a Disability

State	FY 2008 grant allotment[a]	Allotments per working-aged person with a disability (cost adjusted)[b]
Alabama	55,816,789	114
Alaska	9,463,837	153
Arizona	57,950,200	128
Arkansas	35,809,204	130
California	275,593,209	104
Colorado	36,013,729	109
Connecticut	19,947,115	83
Delaware	9,463,837	141
District of Columbia	12,618,252	240
Florida	152,844,034	119
Georgia	92,258,790	127
Hawaii	11,052,823	138
Idaho	15,867,655	165
Illinois	105,254,070	133
Indiana	66,660,094	139
Iowa	31,155,664	162
Kansas	26,929,144	154
Kentucky	51,743,094	114
Louisiana	56,383,213	154
Maine	15,030,202	116
Maryland	38,114,000	97
Massachusetts	45,530,340	90
Michigan	97,347,491	115
Minnesota	43,124,084	133
Mississippi	41,288,450	144
Missouri	62,037,506	125

State	FY 2008 grant allotment[a]	Allotments per working-aged person with a disability (cost adjusted)[b]
Montana	10,762,027	161
Nebraska	17,356,124	167
Nevada	17,931,565	99
New Hampshire	10,736,013	114
New Jersey	55,184,632	104
New Mexico	22,684,862	149
New York	147,351,564	105
North Carolina	92,812,979	126
North Dakota	9,463,837	277
Ohio	120,400,886	133
Oklahoma	40,628,883	126
Oregon	35,175,174	113
Pennsylvania	121,101,676	122
Rhode Island	10,051,281	118
South Carolina	50,734,708	143
South Dakota	9,463,837	174
Tennessee	65,575,720	106
Texas	217,749,584	129
Utah	28,030,439	191
Vermont	9,463,837	202
Virginia	62,084,119	118
Washington	51,125,448	97
West Virginia	25,312,666	125
Wisconsin	55,246,877	148
Wyoming	9,463,837	250

Source: GAO analysis of data from Education on VR grants in fiscal year 2008, Census Bureau's 2007 ACS, BLS' Quarterly Census of Employment and Wages, HUD's Fair Market Rents, and responses to GAO survey.

[a]Grant allotments listed are the initial allotments distributed to states using the funding formula. The allotments do not include any adjustments that occur due to states' inability to match federal funds or the application of maintenance of effort penalties.

[b]The denominator in these calculations is the state's civilian working-aged population with a disability, according to data from the 2007 ACS.

Appendix VI: Comparison of Per Capita Income and Total Taxable Resources (TTR), by State, 2004 to 2006

Table 11 illustrates the difference between each state's financial resources as measured by per capita income and TTR. The second column shows, for each state, its per capita income indexed to national per capita income, and the third column shows each state's TTR per capita indexed to national TTR per capita. These indices are based on averages of three years of data from 2004 to 2006. They were created by dividing each state's three-year average by the national average. States with income or TTR per capita levels that are higher than the national averages have indices that are greater than 1, and states with levels that are below the national averages have indices that are less than 1. For example, the TTR per capita index for Alabama is 0.79, meaning that the state's TTR per capita is 21 percent below the national average. The final column in the table shows the ratio of each state's per capita income index to its TTR per capita index. States in which the formula's use of per capita income understates its potentially taxable resources have ratios that are less than 1. States in which the use of per capita income overstates its potentially taxable resources have ratios above 1. For example, the ratio is 0.80 for Alaska, meaning that the formula's use of per capita income understates Alaska's taxable resources by 20 percent. See appendix I for further information regarding our analysis of per capita income and TTR.

Table 11: Comparison of Per Capita Income and TTR Per Capita for 2004 to 2006, by State

State	Index of per capita income	Index of TTR per capita	Ratio of per capita income index to TTR per capita index[a]
Alabama	0.84	0.79	1.07
Alaska	1.04	1.30	0.80
Arizona	0.88	0.87	1.00
Arkansas	0.78	0.74	1.04
California	1.08	1.07	1.01
Colorado	1.08	1.08	1.00
Connecticut	1.39	1.42	0.98
Delaware	1.06	1.59	0.67
District of Columbia	1.57	1.71	0.92
Florida	1.00	1.00	1.00
Georgia	0.89	0.91	0.98
Hawaii	1.00	1.01	0.99
Idaho	0.83	0.80	1.03
Illinois	1.05	1.05	1.01

State	Index of per capita income	Index of TTR per capita	Ratio of per capita income index to TTR per capita index[a]
Indiana	0.88	0.89	1.00
Iowa	0.91	0.93	0.97
Kansas	0.93	0.93	1.00
Kentucky	0.81	0.79	1.03
Louisiana	0.81	0.94	0.86
Maine	0.89	0.83	1.08
Maryland	1.20	1.17	1.03
Massachusetts	1.25	1.20	1.05
Michigan	0.93	0.85	1.09
Minnesota	1.07	1.07	1.01
Mississippi	0.73	0.68	1.08
Missouri	0.90	0.88	1.02
Montana	0.84	0.79	1.06
Nebraska	0.94	0.96	0.98
Nevada	1.06	1.18	0.90
New Hampshire	1.09	1.08	1.01
New Jersey	1.27	1.27	1.00
New Mexico	0.80	0.83	0.96
New York	1.17	1.19	0.99
North Carolina	0.89	0.94	0.95
North Dakota	0.89	0.90	0.98
Ohio	0.91	0.90	1.02
Oklahoma	0.87	0.82	1.06
Oregon	0.92	0.93	0.98
Pennsylvania	1.00	0.94	1.06
Rhode Island	1.03	1.05	0.98
South Carolina	0.82	0.79	1.04
South Dakota	0.91	0.97	0.94
Tennessee	0.88	0.87	1.02
Texas	0.95	0.98	0.97
Utah	0.79	0.83	0.96
Vermont	0.95	0.91	1.05
Virginia	1.09	1.14	0.96
Washington	1.05	1.05	1.00
West Virginia	0.76	0.72	1.06

State	Index of per capita income	Index of TTR per capita	Ratio of per capita income index to TTR per capita index[a]
Wisconsin	0.94	0.92	1.02
Wyoming	1.12	1.34	0.84

Source: GAO analysis based on data from the Department of Commerce and Treasury.

[a]Dividing a state's index in the second column by its index in the third column may not result in the ratio provided in the fourth column due to rounding.

Appendix VII: Description of Formula Options

This appendix provides detailed information on three formula options or prototypes for revising the VR funding formula: (1) a partial beneficiary equity formula that distributes funds based only on the size of a state's population potentially needing services, (2) a full beneficiary equity formula with the addition of a cost of services factor, and (3) a taxpayer equity formula with the addition of a measure of state resources.

The following is the Partial Beneficiary Equity Formula Option:

$$\text{State allocation} = \text{Appropriation} \times \left(\frac{\text{Need population}}{\sum \text{Need population}} \right)$$

where:

- $\sum$ Need population = sum of the need population across states, or the total need population nationally

This formula would allocate funds based on each state's share of the total need population nationally. It would only partially achieve beneficiary equity because it does not account for differences among states in the cost of providing services.

The following is the Full Beneficiary Equity Formula Option:

$$\text{State allocation} = \text{Appropriation} \times \left(\frac{\text{Cost adjusted need population}}{\sum \text{Cost adjusted need population}} \right)$$

where:

- Cost adjusted need population = Need population x Cost index
- $\sum$ Cost adjusted need population = Sum of the cost adjusted need population across states

This formula would achieve full beneficiary equity because it accounts for both states' need populations and costs of providing services. The cost index in the formula estimates each state's cost of providing services.

The final option is the Taxpayer Equity Formula Option:

$$\text{State allocation} = \text{Appropriation} \times \left(\frac{\text{Cost adjusted need population} \times \text{allotment percentage}}{\sum \text{Cost adjusted need population} \times \text{allotment percentage}} \right)$$

where:

- Cost adjusted need population = Need population x Cost index
- Allotment percentage = $1 - 0.20 \left(\frac{\text{TTR} / \text{Cost adjusted need population}}{\sum \text{TTR} / \sum \text{Need population}} \right)$

This formula would achieve taxpayer equity by basing allotments on a state's need population, adjusted for the cost of providing services, and its ability to fund program services. In this option, the formula includes an "allotment percentage" to account for a state's ability to contribute funding to the VR program. A state with fewer taxable resources compared to other states would have a larger allotment percentage and, therefore, a larger final allotment (all else being equal). "TTR" is used to indicate a measure of state's financing ability, since we regard Treasury's Total Taxable Resources (TTR) data to be a comprehensive measure of a state's taxable resources. The 0.20 in the allotment percentage equation indicates that, nationally, states' required contribution to the VR program is approximately 20 percent. If the matching requirement were to vary for each state, then an individual state's matching rate would simply be determined by its allotment percentage.

Appendix VIII: Funding Allocations under Three Vocational Rehabilitation Formula Options

Table 12 shows the allocations for each state and the percentage change from their fiscal year 2008 allocations under the three formula options (which are described in detail in appendix VII). For each of these options, we retained the minimum allotment that the current formula provides, 1/3 of 1 percent of the total federal funds appropriated to the VR program, or $9,463,837 for fiscal year 2008.

Table 12: Funding Allocations under Three VR Formula Options

		Funding allocations under each formula option			Percentage change from current formula allocations		
State	Current allocation[a] (2008)	Partial beneficiary equity	Full beneficiary equity	Taxpayer equity	Partial beneficiary equity	Full beneficiary equity	Taxpayer equity
Alabama	55,816,789	60,474,140	57,792,826	63,890,152	8.3	3.5	14.5
Alaska	9,463,837	9,463,837	9,463,837	9,463,837	0.0	0.0	0.0
Arizona	57,950,200	50,637,184	53,231,144	54,419,676	-12.6	-8.1	-6.1
Arkansas	35,809,204	37,745,777	33,384,156	36,944,930	5.4	-6.8	3.2
California	275,593,209	281,848,929	316,454,689	306,280,311	2.3	14.8	11.1
Colorado	36,013,729	39,237,548	39,789,523	38,041,490	9.0	10.5	5.6
Connecticut	19,947,115	26,435,688	29,061,990	24,834,700	32.5	45.7	24.5
Delaware	9,463,837	9,463,837	9,463,837	9,463,837	0.0	0.0	0.0
District of Columbia	12,618,252	9,463,837	9,463,837	9,463,837	-25.0	-25.0	-25.0
Florida	152,844,034	155,945,283	159,610,063	158,513,829	2.0	4.4	3.7
Georgia	92,258,790	85,813,700	87,120,651	89,613,060	-7.0	-5.6	-2.9
Hawaii	11,052,823	9,463,837	9,463,837	9,463,837	-14.4	-14.4	-14.4
Idaho	15,867,655	13,590,279	11,904,099	12,214,799	-14.4	-25.0	-23.0
Illinois	105,254,070	94,868,688	96,486,772	89,701,873	-9.9	-8.3	-14.8
Indiana	66,660,094	59,852,987	56,580,945	57,833,670	-10.2	-15.1	-13.2
Iowa	31,155,664	25,509,633	22,527,433	21,748,645	-18.1	-27.7	-30.2
Kansas	26,929,144	23,901,732	21,497,454	20,923,115	-11.2	-20.2	-22.3
Kentucky	51,743,094	59,192,108	55,614,304	61,905,089	14.4	7.5	19.6
Louisiana	56,383,213	49,964,835	44,807,381	46,381,939	-11.4	-20.5	-17.7
Maine	15,030,202	16,621,731	15,516,400	16,878,542	10.6	3.2	12.3
Maryland	38,114,000	43,538,487	46,623,678	43,151,763	14.2	22.3	13.2
Massachusetts	45,530,340	52,850,766	60,263,074	57,419,144	16.1	32.4	26.1
Michigan	97,347,491	102,640,869	101,655,273	107,105,165	5.4	4.4	10.0
Minnesota	43,124,084	38,337,539	38,187,943	35,046,524	-11.1	-11.5	-18.7
Mississippi	41,288,450	38,318,781	34,709,706	38,861,081	-7.2	-15.9	-5.9

State	Current allocation[a] (2008)	Funding allocations under each formula option			Percentage change from current formula allocations		
		Partial beneficiary equity	Full beneficiary equity	Taxpayer equity	Partial beneficiary equity	Full beneficiary equity	Taxpayer equity
Missouri	62,037,506	62,009,758	59,133,917	62,083,180	0.0	-4.7	0.1
Montana	10,762,027	9,819,094	9,463,837	9,463,837	-8.8	-12.1	-12.1
Nebraska	17,356,124	13,861,787	12,978,945	12,302,501	-20.1	-25.2	-29.1
Nevada	17,931,565	19,284,243	21,323,149	20,057,472	7.5	18.9	11.9
New Hampshire	10,736,013	11,253,039	11,765,675	11,439,120	4.8	9.6	6.6
New Jersey	55,184,632	59,366,303	65,132,995	55,977,949	7.6	18.0	1.4
New Mexico	22,684,862	20,433,059	18,374,225	19,274,803	-9.9	-19.0	-15.0
New York	147,351,564	158,395,726	165,414,325	153,342,264	7.5	12.3	4.1
North Carolina	92,812,979	93,532,116	87,623,917	90,647,005	0.8	-5.6	-2.3
North Dakota	9,463,837	9,463,837	9,463,837	9,463,837	0.0	0.0	0.0
Ohio	120,400,886	114,324,378	107,741,843	110,803,992	-5.1	-10.5	-8.0
Oklahoma	40,628,883	44,144,467	39,257,904	42,324,327	8.7	-3.4	4.2
Oregon	35,175,174	38,181,743	37,519,882	39,024,885	8.6	6.7	10.9
Pennsylvania	121,101,676	118,988,284	119,170,356	121,867,201	-1.8	-1.6	0.6
Rhode Island	10,051,281	10,186,243	10,174,087	10,128,252	1.3	1.2	0.8
South Carolina	50,734,708	46,262,110	43,300,526	46,345,994	-8.8	-14.7	-8.7
South Dakota	9,463,837	9,463,837	9,463,837	9,463,837	0.0	0.0	0.0
Tennessee	65,575,720	73,518,535	74,726,613	81,366,285	12.1	14.0	24.1
Texas	217,749,584	212,890,595	205,105,733	204,243,635	-2.2	-5.8	-6.2
Utah	28,030,439	19,126,893	17,574,143	17,143,931	-31.8	-37.3	-38.8
Vermont	9,463,837	9,463,837	9,463,837	9,463,837	0.0	0.0	0.0
Virginia	62,084,119	64,168,621	64,512,140	60,687,435	3.4	3.9	-2.2
Washington	51,125,448	65,447,069	63,657,218	64,260,364	28.0	24.5	25.7
West Virginia	25,312,666	27,640,419	24,406,947	27,506,549	9.2	-3.6	8.7
Wisconsin	55,246,877	45,317,537	44,300,827	43,478,226	-18.0	-19.8	-21.3
Wyoming	9,463,837	9,463,837	9,463,837	9,463,837	0.0	0.0	0.0
Total	**2,761,189,401**	**2,761,189,401**	**2,761,186,401**	**2,761,189,401**			

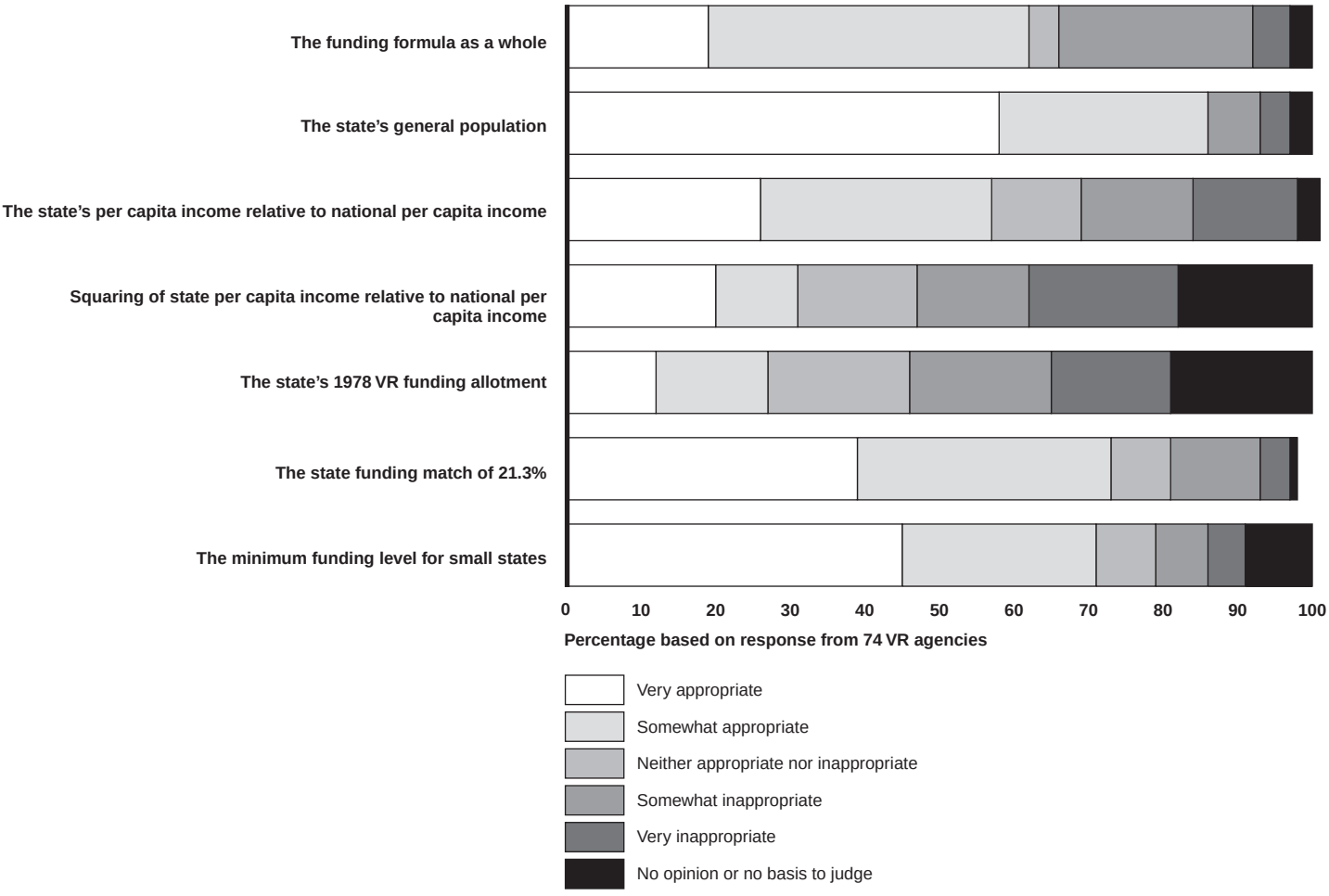
Source: GAO analysis of Education data on VR grants in fiscal year 2008, Census Bureau's 2006 and 2007 ACS, BLS' Quarterly Census of Employment and Wages, HUD data on fair market rents, Treasury data on total taxable resources, and responses to GAO survey.

[a]These funding allocations are based on the initial allocations distributed to states using the funding formula. The allocations do not include any adjustments that occur due to states' inability to match federal funds or the application of maintenance of effort penalties.

Appendix IX: Responses to Selected Questions from GAO Survey of State Vocational Rehabilitation (VR) Agencies

As part of our study, we distributed a Web-based survey to all 80 VR agencies in the states, territories, and District of Columbia to obtain agency officials' views regarding the current formula, potential modifications to the formula, and the possibility of incorporating performance incentives into the formula. In addition, we used the survey to obtain data on agency expenditures that were needed to develop our cost index. We received completed surveys from 74 of 80 VR agencies, for a response rate of 93 percent. The following figures show responses to all closed-ended questions, except for those questions concerning agency expenditures, which are discussed in appendix I. For more information about our methodology for designing and distributing the survey, see appendix I.

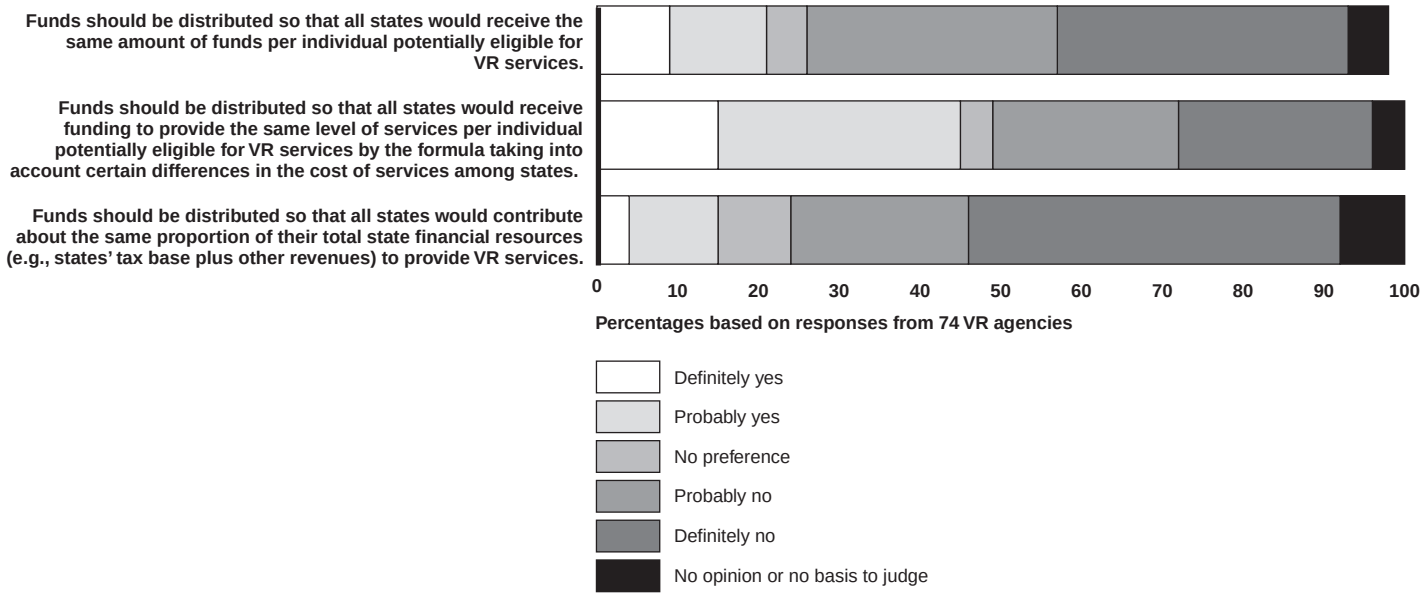
Figure 8: State Agency Officials' Opinions about the Appropriateness or Inappropriateness of Factors Currently Included in the Funding Formula



Source: GAO analysis of survey results, questions 2 and 3.

Note: One agency did not respond to the question about the appropriateness or inappropriateness of the 21.3% state matching rate. For other questions, responses may not total 100% due to rounding.

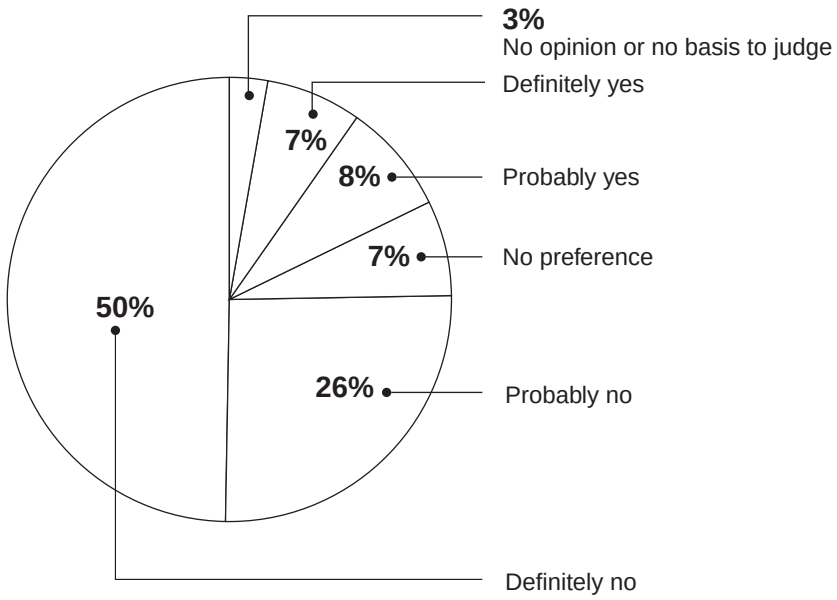
Figure 9: State VR Agency Officials' Opinions about Options for Modifying the Formula



Source: GAO analysis of survey results, question 5.

Note: Responses may not total 100 percent due to rounding.

Figure 10: State VR Agency Officials' Opinions about Whether the Matching Requirement Should Vary to Account for States' Total Financial Resources

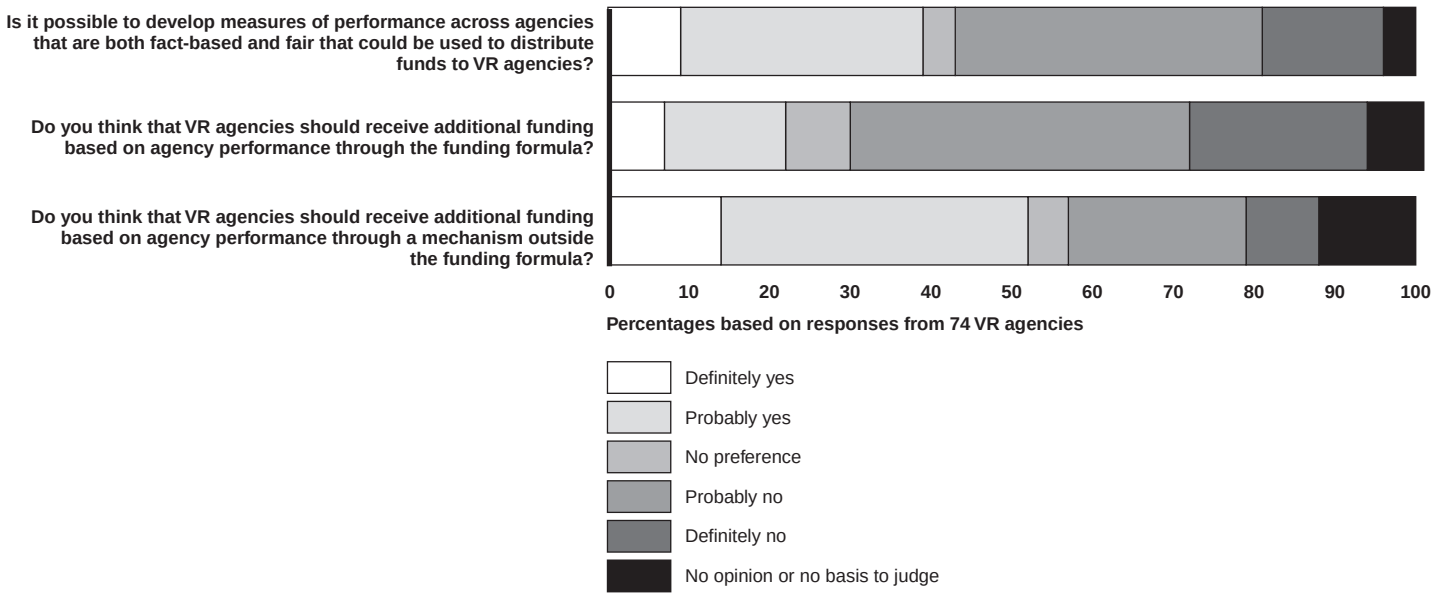


Percentage based on responses from 74 VR agencies

Source: GAO analysis of survey results, question 6.

Note: Responses total to greater than 100 percent due to rounding.

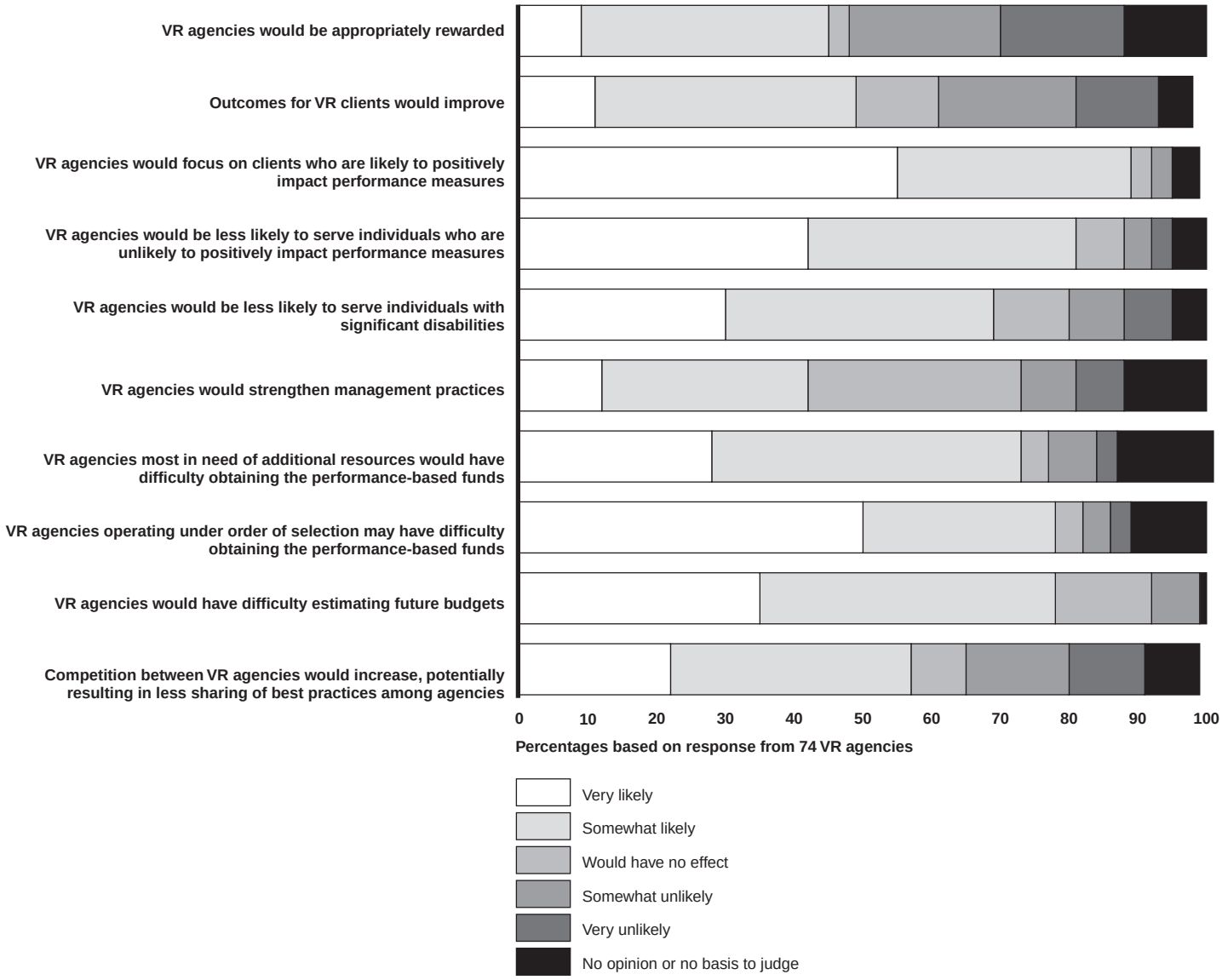
Figure 11: State VR Agency Officials' Opinions about Incorporating Performance Awards in the VR Program



Source: GAO analysis of survey results, questions 9, 11, and 12.

Note: Responses may not total 100 percent due to rounding.

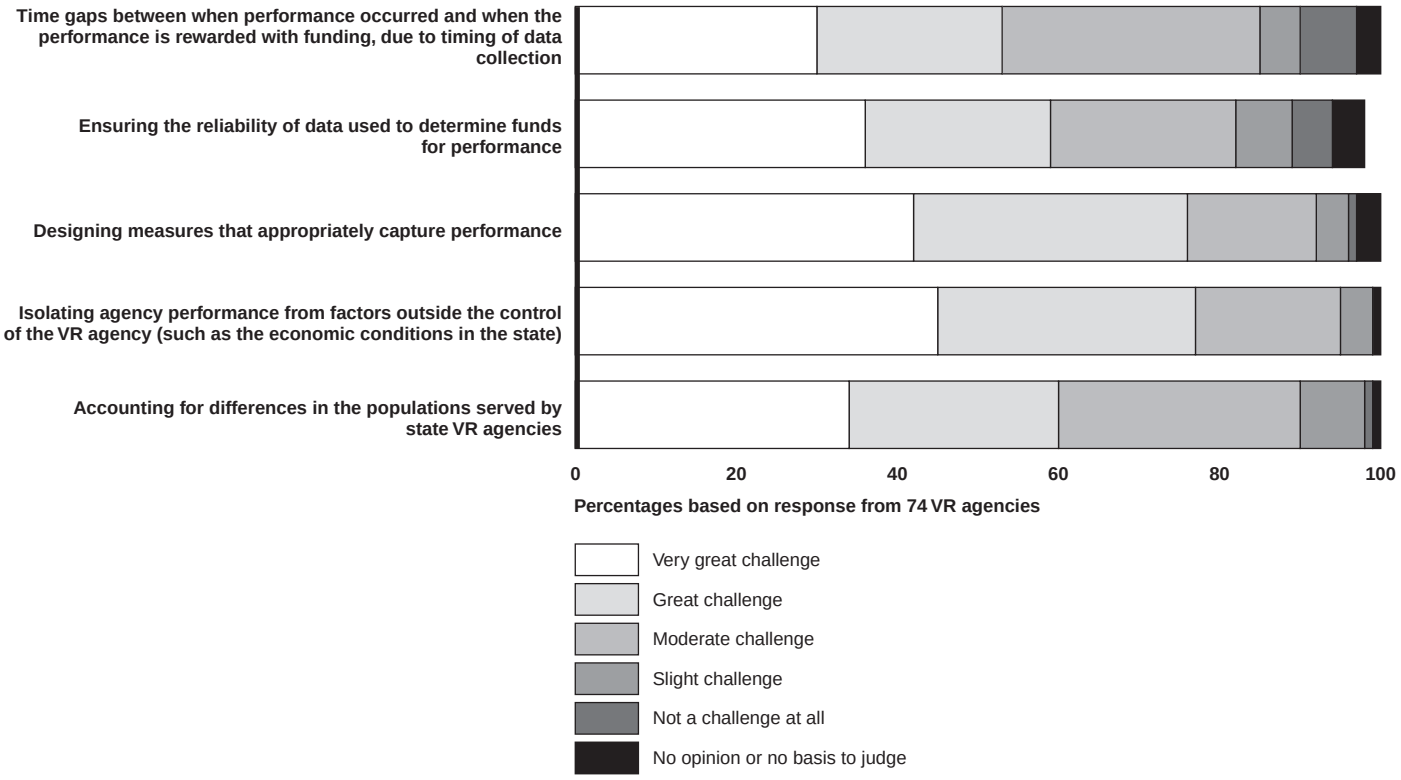
Figure 12: State VR Agency Officials' Opinions about Potential Results of Including Performance Awards in the VR Program



Source: GAO analysis of survey results, question 14.

Note: For three questions, 73 agencies provided responses. These questions asked about the following results: (1) "Outcomes for VR clients would improve;" (2) "VR agencies would focus on clients who are likely to positively impact performance measures;" and (3) "Competition between VR agencies would increase, potentially resulting in less sharing of best practices among agencies." For other questions, responses may not total 100 percent due to rounding.

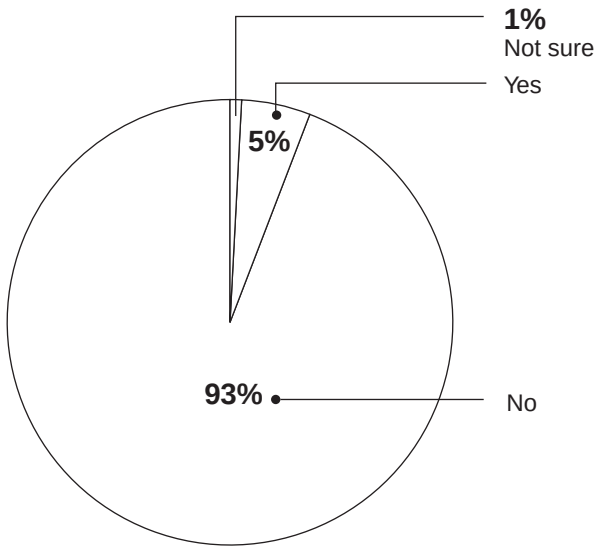
Figure 13: State VR Agency Officials' Opinions about Challenges of Incorporating Performance Awards into the VR Program



Source: GAO analysis of survey results, question 16.

Note: One agency did not provide a response regarding the extent to which data reliability would be a challenge. For other questions, responses may not total 100 percent due to rounding.

Figure 14: VR Agencies' Responses on Whether They Receive Funding from Their State based on Performance

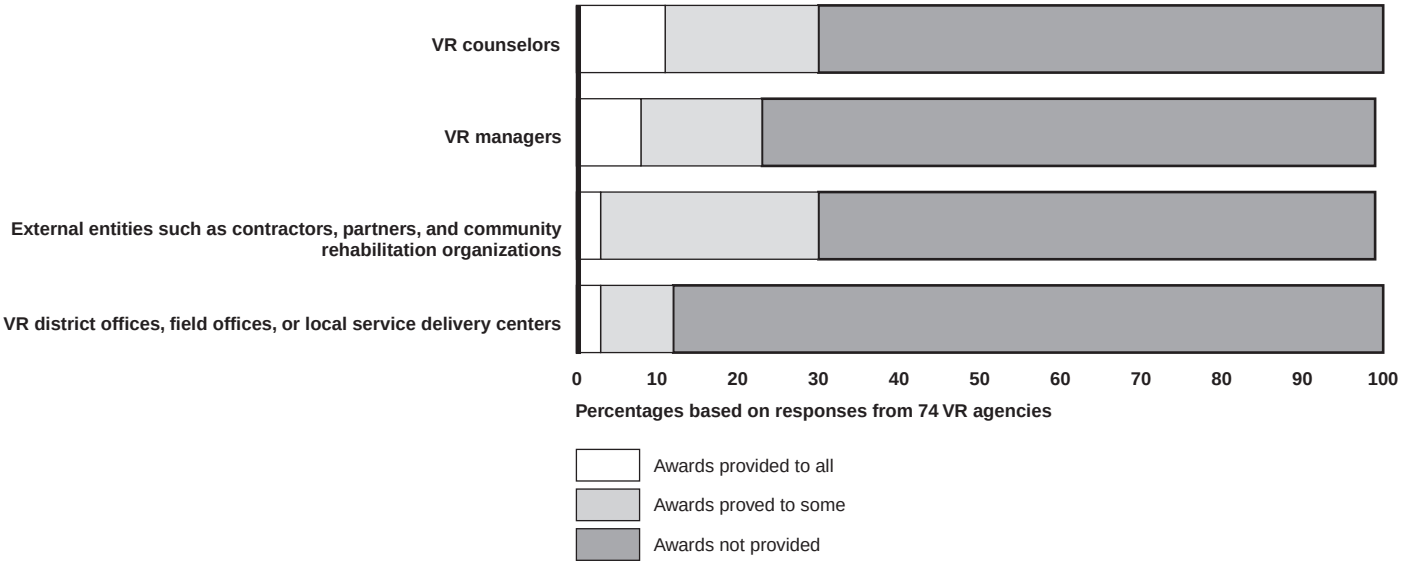


Percentage based on responses from 74 VR agencies

Source: GAO analysis of survey results, questions 2 and 3.

Note: Responses total to less than 100 percent due to rounding.

Figure 15: Current Use of Performance Awards by State VR Agencies



Source: GAO analysis of survey results, question 20.

Note: For two questions, 73 agencies provided responses. These questions asked whether agencies provided awards for (1) VR managers, and (2) external entities such as contractors, partners, and community rehabilitation organizations. For other questions, responses may not total 100 percent due to rounding.

Appendix X: GAO Contacts and Staff Acknowledgments

GAO Contact

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