United States General Accounting Office

GAO

Report to the Chairman, Committee on Finance, U.S. Senate

September 1995

BLOCK GRANTS

Issues in Designing Accountability Provisions

GAO/AIMD-95-226

GAO

United States
General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

B-265754

September 1, 1995

The Honorable Bob Packwood
Chairman, Committee on Finance
United States Senate

Dear Mr. Chairman:

The Congress has shown a strong interest in consolidating narrowly defined categorical grant programs for specific purposes into broader purpose block grants. The fiscal year 1996 budget resolution explicitly assumes enactment of a number of such consolidations. The Congress is also considering proposals to block grant Medicaid, Aid to Families with Dependent Children (AFDC), and other entitlement programs in order to both limit federal budgetary exposure and increase state flexibility. A total of 15 block grant programs with funding of $35 billion were in effect in fiscal year 1994, constituting a small portion of the total federal aid to states, $239 billion for about 593 programs. However, if Medicaid and AFDC are added, block grant spending could rise substantially—to as much as $138 billion or about 58 percent of total federal aid to states.

As demonstrated in the past, such basic changes in the grant structure can significantly alter federal and state and local government relationships. In contrast to categorical programs that are consolidated, block grants provide significant additional discretion for states and localities to define and implement federal programs in light of local needs and conditions. However, unlike prior block grant initiatives, some of the health and welfare programs presently under consideration are entitlement programs with open-ended funding. Accordingly, they would pose much larger implementation challenges and implications for intergovernmental relations.

In response to your request that we synthesize our past work on block grant and accountability issues, this report summarizes information on how accountability for financial management and program performance can be designed to fit a block grant approach and the potential consequences flowing from such provisions. To provide an overview and summary of our evaluations of past block grant programs, we reviewed nearly two decades of reports, evaluations, testimony, and other GAO correspondence on accountability issues related to intergovernmental programs. In addition, we consulted with experts on block grants, performance budgeting, and financial accountability.

Results in Brief

Building accountability into the newly proposed block grants is an important, but difficult, task requiring trade-offs between federal and state control over program finances, activities, and administration. More prescriptive federal requirements can limit the states' ability to implement block grants in an integrated and efficient fashion. But fewer federal financial and programmatic accountability provisions can limit federal goals and lead to reduced funding and/or recategorization. Accountability provisions will need to strike a balance between the potentially conflicting objectives of increasing state and local flexibility while attaining certain national objectives—a balance that inevitably involves philosophical questions about the proper roles and relationships among the levels of government in our federal system.

Well designed accountability provisions help clarify the financial and programmatic relationship between the federal government and the states and could be important in sustaining the block grant approach as these programs mature. There is general agreement that financial accountability provisions implemented through single audits can provide a foundation for assuring that states apply appropriate financial management and internal controls. There is less consensus on whether and how to promote accountability for block grant implementation and results. For those national goals and standards that are established, however, policymakers have options for building in adequate, but less burdensome, provisions. These options include (1) relying on state processes both to manage block grant funds and to monitor and assess compliance, (2) assessing the nature of requirements imposed on states, including the applicability of cross-cutting requirements[1] for national policy for block-granted programs, and (3) emphasizing results-based evaluation rather than examining specific program or administrative activities.

Whatever approach to program accountability the Congress chooses, the need for comparable data across the states is a critical issue. Comparable data make it possible to assess progress in meeting national objectives. Also, the lessons learned from state experiences are transferable only when conclusions can be drawn about the relative efficiency and effectiveness of different state strategies. Developing and implementing guidelines for comparable data will not be easy, especially under a results-oriented approach where states have discretion about the means they will use to achieve program objectives. In particular, the broad range of objectives identified for some block grants—coupled with state

[1]Cross-cutting requirements are grant conditions that generally apply to all or most federal assistance programs and recipients. Unless block grant statutes specify otherwise, these requirements and their regulatory prescriptions would apply.

discretion—will complicate the task of developing and implementing suitable performance measures and assessing state performance. Regarding the identification of suitable measures and data collection strategies, it will be important to have a partnership between the states and the federal government. Moreover, assessments of state progress will need to recognize that outcomes are often affected by factors beyond state administrators' control.

Federal policymakers will also need to be aware of existing state spending and programmatic commitments in areas that are block-granted. Evaluation studies have shown that the smaller the share of federal funds in block grant programs—and the broader the national objectives—the more difficult it is to assess performance and evaluate the impact of federal resources. Categorical and some block grants currently include maintenance-of-effort provisions requiring states to continue their spending for federally aided areas to prevent this kind of fiscal substitution. Although such requirements help to ensure that block grant funds are used in the program area intended, they can also encumber state resources in federally funded areas and reduce states' fiscal flexibility, particularly during times of fiscal stress. Similarly, they can reduce a state's programmatic flexibility to shift money among programs so that resources are used as effectively as possible. Maintenance of effort can also penalize states that take the initiative to start programs before the federal government—they essentially become locked into this spending even when federal funds become available. Carefully designed maintenance-of-effort provisions can help to overcome some of the technical difficulties. Yet, the decision to require maintenance of effort presents difficult trade-offs among competing concerns.

Background

Of the three kinds of grants-in-aid—categorical, block, and general-purpose fiscal assistance—block grants lie in the grey, middle area. Categorical programs feature narrowly prescribed, federally determined program objectives, processes, and administration. At the opposite end of the spectrum—general-purpose fiscal assistance—recipients are free to spend grant funds in the manner they choose with few, if any, federally imposed programmatic or administrative requirements. Although existing block grants differ with respect to specificity of objectives and administrative requirements, most share the following characteristics:

- federal aid is authorized for a wide range of activities within a broadly defined functional area;
- recipients have substantial discretion to identify problems, design programs, and allocate resources;
- administrative, fiscal reporting, planning, and other federally imposed requirements are limited to those necessary to ensure that national goals are being accomplished; and
- federal aid is distributed on the basis of a statutory formula with few, if any, matching requirements and, historically, spending has been capped.

A decision on whether to block grant programs raises important questions involving the appropriate balance of power and responsibilities in our federal system. Thus, the question of whether and what kind of accountability to require is a policy decision for the Congress to make. In previous reports, we have stated that states have become more capable of responding to public service demands and initiating innovations in the past two decades. At the same time, we have also noted that the new block grant proposals include programs that are much broader than block grants of the past and would present a challenge for states to both implement and finance.[2]

Accountability is an important yet elusive concept whose meanings and characteristics differ depending upon the context. For categorical grant programs, accountability is promoted through rules and regulations that hold state and local officials responsible for federally established programmatic objectives, implementation strategies, and administrative processes that are largely prescribed by federal agencies.

Under block grants, the principal locus of accountability shifts from the federal government to the states, consistent with the fact that grant purposes are broadened and authority is delegated. Under block grants, state and local elected officials bear the primary responsibility for monitoring and overseeing the planning, management, and implementation of activities that formerly were the purview of federal agencies. Nonetheless, because federal funds are involved, some residual accountability for national objectives is invariably provided, albeit in different doses and through different means.

[2]Block Grant: Characteristics, Experience, and Lessons Learned, (GAO/HEHS-95-74, February 9, 1995).

Accountability Will Likely Play a Critical Role in Block Grant Implementation

For block grants, accountability plays a critical role in balancing the potentially conflicting objectives of increasing state and local flexibility while attaining certain national objectives. Accordingly, the resolution of these issues invariably reflects a political decision properly decided through the democratic process.

The recent history of block grants suggests that the balance struck between federal objectives and state discretion has often been unstable. The failure to reach an acceptable accommodation of these competing concerns can undermine continued support for block grant programs. As a result, the balance is often adjusted and reformulated as implementation proceeds.

In building accountability into block grant programs, problems can arise from either too many accountability provisions or too few. The presence of too many requirements and conditions can inhibit states from realizing the kinds of efficiencies and service delivery improvements promised by the block grant mechanism. Overly prescriptive federal requirements can limit states' abilities to integrate related federal and state programs in new and more efficient ways. Moreover, they may limit states' interest in taking ownership and responsibility for program management and results—a key attribute that the 1981 block grants initially succeeded in instilling at the state level. Prompted by their newly won flexibility, state legislators and governors exercised a level of involvement and oversight for block grant programs typically not found for categorical programs.

On the other hand, insufficient federal accountability provisions can create other problems for consolidated programs. Continued congressional support for block-granted programs has historically rested on sufficient information and assurances that the funds are being well managed and used to support national objectives. The recent history of block grants suggests that the absence of such provisions can either undermine continued congressional funding or prompt recategorization and prescriptive regulations to ensure that national objectives are achieved. For instance, the block grants enacted as part of the Omnibus Budget Reconciliation Act of 1981 (OBRA), which lacked consistent national program reporting on state implementation, were subject to more than 50 congressional actions to tighten program requirements and accountability provisions.[3]

[3]Block Grants: Increases in Set-Asides and Cost Ceilings Since 1982 (GAO/HRD-92-58FS, July 27, 1992).

A balance will need to be struck to respond to these two conflicting objectives. It should include safeguards to ensure that states are applying proper financial controls. Also, the Congress will not only have to determine the level and extent of national programmatic objectives for the individual block grants, but also decide the most appropriate means to monitor and oversee state progress toward these objectives.

In considering ways to build financial and program accountability that could be built into the new block grants, the following observations based on our work may be useful.

Accountability for Financial Management

The Single Audit Act of 1984 provides an important tool for ensuring that states are promoting financial accountability for block grant programs. The act expanded the focus of federal oversight from a grant-by-grant examination to an overall financial audit of the state or local government or agency receiving federal funds with a specific focus on federal programs.

A single audit is expected to address the states' or state agencies' overall financial statements and compliance with major federal assistance program requirements. Moreover, as we have said repeatedly over the years, the single audit is a more efficient and less burdensome way to use auditing resources in satisfying federal accountability interests than the prior grant-by-grant auditing approach.

The Single Audit Act of 1984 helps ensure that state agencies responsible for block grant funds have sound financial management systems and internal controls. The act promotes sound financial management by requiring each state or agency to arrange for an annual[4] audit of its financial statements. This involves more than simply preparing schedules of financial data; it involves a disciplined process that promotes proper recording of financial transactions and maintaining accurate records of financial flows. The single audit also involves evaluating the adequacy of the internal financial and management controls used by the agency to prevent problems and ensure the integrity of public funds, including block grant funds.

Finally, the act, and its implementing guidance, requires that single audits test compliance with federal program requirements for "major federal

[4]In some circumstances, biennial audits are allowed, provided they cover both years of the biennial period.

assistance programs."[5] Auditors are required to test two types of grant requirements: (1) general requirements that are national policies prescribed by statute, executive order, or other authoritative sources that apply to federal assistance programs of two or more agencies and (2) specific requirements that apply only to individual programs.

The results of single audits can also contribute toward achievement of the objectives of the Chief Financial Officers (CFO) Act of 1990. The act, as amended, requires the 24 CFO executive branch agencies to prepare financial statements, beginning for fiscal year 1996, and to have those statements audited. It also requires GAO to conduct an audit of the annual consolidated financial statements for the entire executive branch beginning with fiscal year 1997. Since many federal funds often flow to their ultimate beneficiaries through multiple state and local entities, and because many of these amounts are subject to single audit, the results of these audits can provide information on the successful completion of the required federal agency and executive branch-wide consolidated financial statement audits.

The single audit process could be particularly advantageous for block grant programs. As the purposes of federal aid programs broaden and the federal financial role diminishes, federal funds become fungible.[6] This is especially true for block grants because the programs anticipate the integration of federal and state funding streams. Accordingly, the management and outcomes of federal assistance programs depend heavily on the overall controls states use to manage the combined effort. Thus, the block grant approach coincides with the act's shift away from individual grant auditing.

It is also likely that most block grants under consideration would continue to be considered major programs for Single Audit Act purposes. Accordingly, they are likely to be reviewed for their compliance features under this process. A single audit is not and should not be viewed as sufficient for evaluating state performance relative to block grant programmatic goals and objectives. However, a single audit is an important oversight tool that can be used to provide insights into the entity operating federal programs.

[5]A program is classified as a major program based upon the amount of expenditures. Presumably all the large block grants currently being proposed—notably, Medicaid and AFDC—would be classified as major.

[6]In the context of federal grants, the term fungibility refers to the tendency for federal funds to be commingled with state or local funds to the point where the use of federal funds is difficult to track.

Although we believe that the Single Audit Act of 1984 is a suitable means for promoting financial accountability for the block grants, several improvements are needed in the single audit process. First, criteria for determining which assistance programs will be subject to compliance checks are based solely on dollar amounts. While, this approach has the advantage of subjecting a high percentage of federal funds to audit, it does not necessarily focus audit resources on identified high-risk programs. We have made recommendations[7] to enhance the single audit process and to make it more useful for program oversight, including oversight of the block grants.

Second, the single audit cannot be viewed as a substitute for management oversight and program reviews by federal agencies, should such activities be deemed appropriate for particular block grants. The single audit assesses the financial integrity and internal control of the entities receiving block grant funds and implementing programs. The audit may not select particular programs for compliance reviews if they are not defined as major programs. But even when programs are included for compliance checks, the single audit is not intended to provide in-depth analysis of state administrative practices or programmatic accomplishments.

Accountability for Program Goals and Objectives

As noted earlier, block grants present a dilemma to federal policymakers for they must balance the objectives of enhancing state and local flexibility, while also maintaining a degree of federal control, consistent with the fact that federal dollars as well as national objectives are involved. There is no easy way to resolve this tension; rather, a continuum of trade-offs between federal objectives and state flexibility will be required. First, the Congress will need to consider which national objectives remain appropriate for block grant programs. Then, it will need to determine how these objectives should be defined and implemented.

Among the various kinds of national objectives that could be applied to block grants are the following:

- Program specific requirements: These are standards or goals pertaining to program services or implementation processes funded by the grant. In terms of these grant conditions, prior block grants have included both federal rules involving program inputs—that is, what grantees do with their funds—and rules involving program results—that is, what is accomplished with the funds.

[7] Single Audit: Refinements Can Improve Usefulness (GAO/AIMD-94-133, June 21, 1994).

- Cross-cutting requirements: These are grant conditions that generally apply to all or most federal assistance programs and recipients. OMB had identified nearly 60 such requirements ranging from the Davis-Bacon wage standards for federally-assisted construction projects to Hatch Act prohibitions on funded employees' political activities. Unless block grant statutes specify otherwise, these requirements and their regulatory prescriptions would be expected to apply.

Once the new block grant requirements and programmatic concerns are defined and specified, the Congress may wish to design approaches that satisfy federal interests in less burdensome ways, in keeping with the block grant philosophy of enhanced flexibility and reduced regulation. Our work and other examinations of past block grant efforts suggest the following two approaches the Congress could consider.

Reliance on State Processes

Relying on state processes and procedures to govern the administration and management of block grant funds, as was done under the OBRA 1981 block grants, is one approach available to the Congress. For categorical programs, OMB circulars and federal agency regulations and guidance prescribe procedures governing such issues as state procurement, recordkeeping, cost allocations, and other business-type functions. However, this kind of national administrative prescription is contrary to the block grant premise of instilling responsibility in the states. In addition, as we found in the 1980s, moving away from such prescriptions opens up opportunities for states to more fully integrate the management of the block grants with broader state administrative practices and procedures.

In 1981, state authority was also promoted by shifting the responsibility for monitoring and assessing compliance with federal requirements away from the federal government toward states and localities. Reviews of state plans and applications were significantly limited. States, moreover, were principally responsible for interpreting the block grant statutory prohibitions and requirements; federal regulations and guidance were kept to a minimum. Federal agencies were actually prohibited from imposing "burdensome" reporting requirements, allowing the states to interpret the compliance provisions in the statute.

In seeking to minimize block grant program requirements, the Congress will need to decide whether the broad scale delegation to the states that occurred under the 1981 block grants is appropriate for the block grants currently being proposed. The federal dollars involved are far larger than under past block grants; during fiscal year 1993, approximately 18 percent of total state spending was for Medicaid, with 11 percent from state-only sources. Moreover, the stakes involved stand to significantly affect vulnerable populations and involve a number of entitlement programs that comprise the "social safety net."

Reexamining some of the more burdensome cross-cutting requirements also would provide states with additional flexibility. Cross-cutting requirements—also known as generally applicable requirements—could become some of the more burdensome federal mandates for new block grants because administrative guidance and regulations that have built up over the years to implement them do not discriminate between categorical and block grant programs. Our work has specifically identified one such cross-cutting requirement for potential elimination. We have stated that the Congress could repeal the Davis-Bacon Act cross-cutting requirement because of the act's administrative problems and associated increases in federal construction costs.[8]

Emphasis on Results

Another approach for balancing competing state and federal interests would be to promote accountability for results rather than accountability for implementation and administrative processes. Applying a results focus to the block grants would free state officials and program administrators to determine the most appropriate means for achieving federal block grant program goals and objectives, while also vesting them with responsibility for their choices. This approach presumes, of course, that the Congress has decided that imposing national block grant outcomes on the states is appropriate. Furthermore, this approach is fraught with technical problems and could engender conflict between the federal government and the states.

Under a results-oriented approach, states would be responsible for reporting on program outputs, outcomes, or other types of performance oriented measures. While outputs and outcomes are often correlated, they are not the same. Program output indicators generally involve measures of activities or services supported by the funds, such as the number of participants in job training programs or the number of children vaccinated. In contrast, program outcome indicators measure progress in terms of the end result intended by the program, such as increases in employment from

[8] Addressing the Deficit: Budgetary Implications of Selected GAO Work for Fiscal Year 1996 (GAO/OCG-95-2, March 15, 1995).

job training or reductions in the incidence of communicable childhood diseases.

The Government Performance and Results Act of 1993 (GPRA) could be used as a guide for a results-based approach. GPRA seeks to fundamentally change the focus of federal management and accountability from a preoccupation with inputs—what grantees do—to a greater focus on the outcomes—what has been achieved. GPRA requires federal agencies to develop outcome-oriented goals, systematically measure their performance, and report on their progress toward achieving goals.[9] While GPRA's implementation time frames do not match those for congressional consideration of the block grants, GPRA principles provide a logical starting point.

Under a results-oriented approach, federal policymakers would specify national goals and objectives in block grant statutes, enact a process for establishing them, or adopt some combination of the two. Ultimately, the decision whether to impose or call for such national objectives is a political decision that the Congress must make. The Congress may, in fact, decide to allow states to establish their own program objectives, thus limiting the federal role in monitoring block grants to collecting information on state program efforts and accomplishments as well as, perhaps, evaluating and disseminating information on "best state practices."

Outcome-Based Approach

An outcome-based approach to accountability has some advantages for block grants. Notably, unlike categorical grants, block grants provide states a broader scope of allowable activities to select from in attaining national outcomes. For example, if the desired outcome is to move welfare recipients into work, a categorical program providing resources for a single strategy forces grantees to select that nationally determined strategy—irrespective of local conditions and circumstances. This approach, in effect, suggests that "one size fits all." In contrast, a block grant gives states flexibility to mix services and activities best suited to achieving this outcome goal and to better integrate federal, state, and local efforts.

However, caution will be needed as well. While state efforts will certainly be closely tied to block grant results, outcomes will just as certainly be affected by factors outside the control of state administrators. Because of

[9]For a fuller description of the requirements of GPRA and the progress agencies are making in implementing the act, see Managing for Results: Status of the Government Performance and Results Act (GAO/T-GGD-95-193, June 27, 1995).

the role that these variables may play, evaluation will need to isolate the effect of outside factors on state programs. For example, the incidence of low birth weight infants depends not only on the efforts of a particular state and local agency to fill the gaps in prenatal care, but also on many other demographic and situational factors, such as regional employment trends and demographic patterns, that could easily confound an accurate assessment of state performance.

Just as some features of block grants facilitate a results-oriented approach, other features add complications. The broad range of objectives often identified for particular block grants coupled with broad state discretion in program implementation may make it difficult for the federal government to specify and select suitable results-oriented measures. For example, in areas such as community development that encompass a broad range of activities, it may be difficult to select a single, or even a small set of, preferred indicators against which to gauge performance. Alternatively, broader outcomes covering an entire function could be chosen, such as education achievement levels as measured through standardized testing. In either case, the states' flexibility to determine how best to use block grant funds can be compromised.

Performance Incentives

Some have suggested that the federal government incorporate monetary incentives to the states into the new block grants to achieve nationally desired results. Under such an approach, the incentives and penalties states face would act as a lever because they would be tied to progress on standards set for all states or standards predicated on individual states' past performance.

This kind of incentive structure is incorporated in the administration's "performance partnerships" and it is also central to Oregon's welfare proposal to pilot a reinvented form of intergovernmental relationships (known as the "Oregon Option"). The President's fiscal year 1996 budget introduced performance partnerships for a number of areas. Like block grants, performance partnerships would consolidate funding streams. However, the partnerships would provide for specific federal standards and goals expressed in output or outcome terms, and states or localities would be given incentives if they met or exceeded some of these federal objectives. For instance, the President's budget reported that under the performance partnership concept, the Environmental Protection Agency proposed to consolidate 12 media-specific grants (including, air, water, and hazardous waste), enabling states to target resources toward their most pressing priorities. Performance-based funding would be included in this program. Similarly, the Department of Housing and Urban Development's (HUD) proposed grant consolidations would distribute 10 percent of formula allocations based on performance.

Although offering the potential to improve states' performance for federally assisted programs, funding incentives warrant caution in their design and implementation. Given the difficulties performance measurement faces in the near term, significant intergovernmental conflict could arise from the application of outcome-based measures, particularly if, in evaluating progress, states were inadvertently held accountable for the impact of factors beyond their control. If performance-based measures were also tied to future federal funding in some way, such conflicts could be exacerbated. For example, it would make little sense to penalize a state that did not meet an immunization target if the major reason the state did not meet this target was a significant influx of unimmunized immigrants. Moreover, linking performance measures to funding could cause states to present only the most favorable performance information.

Data Collection and Capacity Issues

Whatever emphasis is selected, the Congress should consider carefully its current and future needs for uniform data and data collection procedures across the states. The 1981 block grants carried no uniform federal information and reporting requirements. After the block grants were enacted, states collected a wide range of program information, but the collection efforts were designed to meet the needs of the individual states. The Congress had limited information on program activities, services delivered, and clients served. As a result, it was difficult, in many cases, to aggregate state experiences and speak from a national perspective on the block grant activities or their effects. Similarly, without uniform information definitions and collection methodologies, it was difficult to compare state efforts or draw meaningful conclusions about the relative effectiveness of different strategies. In our recent report, Block Grants: Characteristics, Experience, and Lessons Learned (GAO/HEHS-95-74, February 9, 1995), we noted that problems in information and reporting under many block grants—including the Education block grant, the Community Services Block Grant (CSBG), and the Alcohol, Drug Abuse, and Mental Health Services Block Grant (ADMS)—have hampered Congress' ability to evaluate block grants.

Some have expressed concern that uniform national data might encourage the Congress to recentralize or recategorize block grants. This certainly could be one outcome, particularly if uniform data showed that states were falling short of national expectations in critical areas. However, the absence of uniform national data for the 1981 block grants did not prevent the Congress from adding new requirements and funding constraints to the block grant programs of the 1980s. In the absence of uniform information, policymakers are pressed to change to block grant programs based on examples and reports that may or may not represent broad-scale problems with program implementation. In 9 of the 11 block grants in existence from fiscal year 1983 through fiscal year 1991, the Congress added new cost ceilings and set-asides or changed existing ones 58 times as a result of congressional concern that states were not adequately meeting national needs. Reliable information that is comparable across states could enable federal policymakers to identify systemic problems.

Performance measures for block grants will need to be developed in partnership with the states. This will not be easy. Not only do federal and state interests differ, but it will take time to develop data collection systems and reporting capacities once the initial decisions are made. Even in the case of employment training programs, for example, in which there has been a congressional focus on program outcomes, we have found that most state agencies do not collect information on participant outcomes, nor do they conduct studies of program effectiveness.[10]

Federal agencies will need time to work with the states to establish reporting requirements, including the types and measurement methodologies for needed program information, and how and by whom such information will be collected and analyzed. For example, we recently testified[11] that HUD may face difficulties implementing its plans for consolidating housing and community development funds into larger programs that rely on performance measures to evaluate state and local efforts. Localities will need time to establish performance measures and work out program details. Community development researchers have had difficulty developing suitable performance measures because communities' needs differ and the results of some activities may not be quantifiable.

According to work on the early implementation of GPRA, many federal agencies currently lack the ability to track progress, evaluate results, and

[10]Multiple Employment Training Programs: Most Federal Agencies Do Not Know If Their Programs Are Working Effectively (GAO/HEHS-94-88, March 2, 1994).

[11]Housing and Urban Development: HUD's Reinvention Blueprint Raises Budget Issues and Opportunities (GAO/T-RCED-95-196, July 13, 1995).

use performance data to improve their agencies' effectiveness.[12] Like executive branch agencies, states, will need to make significant investments in people, skills, and systems to effectively gather and use performance information.

In designing performance measurement systems for block grants, it will be important to take into account certain lessons from evaluation research. Most notably, performance measurement efforts and evaluation studies both involve cause and effect relationships. In the case of performance measurement, there is an assumption—perhaps implicit—that any results observed are a consequence of the programs and activities under scrutiny. However, as we have reported,[13] good evaluative information about these kinds of program effects is difficult to obtain. Each of the tasks involved—measuring outcomes, ensuring the consistency and quality of data collected, establishing the causal connection between outcomes and program activities, and separating out the influence of extraneous factors—raises formidable technical or logistical problems that are not easily resolved.

Implications of State Involvement and Spending on Block Grant Accountability

Federal officials need to be aware of existing fiscal and programmatic state and local commitments when designing federal block grant accountability provisions. Overall, evaluations and studies suggest that the broader the objectives and range of authorized activities and the fewer the requirements on grants, the greater the fungibility of funds. All grant programs potentially are susceptible to the problems of fungibility, but these issues loom larger in a block grant context for two reasons. First, under block grants the commingling of federal and state funds is allowed to help realize administrative cost savings, promote innovation, and improve service delivery.[14] Second, the federal government often assumes the role of a fiscal junior partner under block grants as state and local expenditures can easily overshadow the federal contribution within broadened categories of state and local spending.

[12]Managing For Results: Steps for Strengthening Federal Management (GAO/T-GGD/AIMD-95-158, May 9, 1995).

[13]Program Evaluation: Improving the Flow of Information to the Congress (GAO/PEMD-95-1, January 30, 1995).

[14]While there is agreement that administrative cost savings can follow from consolidations of federal grant programs—including those involved in block grants—measuring these savings is fraught with technical difficulties. We have reported on these problems in numerous reports and testimonies, many of which are summarized in Program Consolidation: Budgetary Implications and Other Issues (GAO/T-AIMD-95-45, May 23, 1995).

The fungibility of federal funds will vary by type of block grant. It is far easier to isolate the impact of federal funds for block grants where federal funding will comprise a major share of state spending or where the activities funded are relatively limited in purpose. The AFDC block grant, for example, may be more easily accounted for because federal block grant funds will continue to be a major, if not larger, share of total spending and because funding is provided for cash payments to eligible low income individuals. Proposed block grants for education or community and economic development, on the other hand, would be more difficult to track due to their broad, diffuse purposes and the relatively minor role played by federal funds.

Implications for Data Reporting

Fungibility clearly has implications for the kinds of information that can be expected on block grant results. Imposing data reporting requirements for the federal funds alone would force states to separately track and report on expenditures and accomplishments achieved with federal block grant funds. But this could provide only a bookkeeping perspective, having little or no relation to the actual impact of the funds.

We found this to be the case for reporting in the General Revenue Sharing (GRS) program. When we examined how GRS funds were used, we found that reports filed by grantees did not necessarily provide accurate information on how funds might have been used. This was because the flexibility inherent in revenue sharing permitted states and localities to use the federal funds to finance other programs, reduce taxes, or a combination. For reporting purposes, it became somewhat meaningless to earmark one revenue source for a specific set of expenditures and a second source for another where both revenues can be used interchangeably because funds can easily be displaced or substituted.

The problem with interchangeable resources led us to conclude that, to be meaningful, data in broadly defined grant programs should be integrated and related to total expenditures for state and/or local activities by purpose or function. This logic applies to block grants. Assume, for example, that a community strongly supports the development of a recreation project and community officials elect to use block grant funds for this purpose. The community's accounting records and financial reports would reflect that the funds were used for the new project. However, the key question in this situation is what would have happened in the absence of the federal funds. If the funds for the new project would have been provided in the absence of the block grant, by reducing funding for other programs, increasing taxes, or using available surplus, then the net effects of the grant are not in the area of the project. In this case, the effect of the block grant would have been to negate the need to reduce other programs, halt a tax increase, or maintain the existing level of surpluses. Thus, instead of tracking the accomplishments of federal funds alone, it might be more realistic to assess the extent to which the entire federal-state effort promotes accountability for national goals of interest to the Congress.

Implications for Federally Imposed Prohibitions and Restrictions

The inherent difficulty of tracking the use of federal funds in a fungible fiscal environment, raises some basic questions about the enforceability of federal prohibitions or restrictions that might be applied to block grants. If state funds significantly outweigh federal funds, states can simply shift their own money to support a federally-eligible activity previously financed with state funds. This shift enables states to conform to the letter of the requirement, without fulfilling its spirit.

Implications for Maintenance-of-Effort Requirements

Maintenance-of-effort requirements are often found in categorical programs and some block grants to prevent states from substituting federal for state dollars. Maintenance of effort is potentially more sweeping than a matching requirement. For most close-ended grant programs, matching is minimal and can be met with existing state or local resources dedicated to the program. States and localities frequently provide far more funding to broad-based programs than federal matching provisions require. Maintenance of effort, on the other hand, requires states or localities to maintain their own previous or current level of nonfederal funding for the program.

Deciding whether to include a maintenance-of-effort requirement will be controversial. The benefits to the federal interest must be weighed against the encumbrance such requirements place on states' fiscal flexibility. Because the stakes are significant in either case, the Congress needs to carefully consider both sides of the equation.

Maintenance of effort can help ensure that federal block grant dollars are used for the broad program area intended by the Congress, whether it be spending on special education or spending for day care. Without such provisions, federal funds ostensibly provided for these broad areas could, in effect, be transformed into general fiscal relief for the states. States could use some or all of their federal block grants to replace their own money invested in the program area. To the extent that this occurs, the ultimate impact of these federal dollars would be to either increase state spending in other programs or reduce taxes.

Maintenance of effort does not overcome the fungibility dilemmas discussed above. These provisions would not permit easy tracking of the contributions of federal versus state dollars in a flexible block grant funding environment. Yet, they could ensure that federal block grant funds contribute to the broad program area addressed by the block grant.

Maintenance-of-effort requirements also have potentially significant effects on states' fiscal policy-making. They can encumber state resources in federally funded areas, even though state funds may far exceed federal block grants in magnitude. States, thus, are limited in their ability to shift their own funds across programs without risking the loss of federal dollars. This is particularly problematic for states facing cuts, as maintenance of effort has reportedly caused some to make disproportionate cuts in areas not receiving federal funds. Maintenance of effort can also penalize states that take the initiative to start programs before the federal government; they essentially become locked into this spending even when federal funds become available. States whose programs do not precede the federal government with their own programs implicitly get rewarded for their lack of initiative. As a result, the prospect of such requirements could defer program innovation until federal funds become available.

We have previously reported that most maintenance-of-effort requirements have not avoided widespread fiscal substitution by states or localities.[15] Typically, states were required to maintain their spending levels from several years before. Inflation alone gives states sufficient leeway to use federal funds to replace a significant amount of state funds.

Should the Congress wish to provide for a maintenance of effort, requiring states to do so based on a rolling average of the past 2 years of spending, for example, would help better protect against fiscal substitution. Permitting waivers for states experiencing fiscal stress or for those having innovative programs would be one way to at least partially address the states' concerns.

[15] Proposed Changes in Federal Matching and Maintenance of Effort Requirements (GAO/GGD-81-7, December 23, 1980).

We hope this information meets your needs. If you have any questions, please call me at (202) 512-9573 or Margaret T. Wrightson, Assistant Director, at (202) 512-3516.

Sincerely yours,

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