



EXECUTIVE CHAMBERS

HONOLULU

DAVID Y. IGE
GOVERNOR

October 29, 2018

The Honorable Ronald D. Kouchi,
President and Members of the Senate
Twenty-Ninth State Legislature
State Capitol, Room 409
Honolulu, Hawaii 96813

The Honorable Scott Saiki,
Speaker and Members of the House
of Representatives
Twenty-Ninth State Legislature
State Capitol, Room 431
Honolulu, Hawaii 96813

Dear President Kouchi, Speaker Saiki, and Members of the Legislature:

For your information and consideration, I am transmitting a copy of the Federal Funding Policy Study, pursuant to Act 178, SLH 2017. In accordance with Section 93-16, Hawaii Revised Statutes, I am also informing you that the report may be reviewed electronically at <http://budget.hawaii.gov/budget/reports-to-the-legislature/>.

Sincerely,

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DAVID. Y. IGE
Governor, State of Hawai'i

Enclosure



FEDERAL FUNDING POLICY STUDY
RECOMENDATIONS
TO THE GOVERNOR
PURSUANT TO ACT 178, SLH 2017



Department of Budget and Finance

October 22, 2018

Introduction

Act 178, SLH 2017 – RELATING TO THE FEDERAL FUNDING POLICY STUDY. Act 178, SLH 2017, requires the Department of Budget and Finance (B&F) and the Governor to develop a federal funding policy that can reduce the dependence of State government on federal funds to pay for government programs.

Act 178, SLH 2017, outlines three steps that must be taken to complete the Federal Funding Policy:

1. The Office of Federal Awards Management (OFAM) must develop data on federal fund use (Submitted on January 11, 2018);
2. By October 1, 2018: Based on data developed by OFAM, the B&F (B&F) must make recommendations to the Governor for the topic areas identified in Act 178 (17);
3. By January 1, 2019: After review of the policy recommendations made by B&F, the Governor must submit a report to the Legislature on whether the policy recommendations are accepted, rejected, or modified.

This report has been prepared to meet the requirements of Step 2 wherein B&F is asked to make recommendations to the Governor regarding the use of federal funds for State programs and projects that include the following topic areas:

1. Parameters regarding the application for and acceptance of federal funds available on a formula or competitive basis;
2. Principles guiding the extent of dependence of State executive departments on federal funds;
3. Conditions for using federal funds as a means of financing for the salaries of State employees;
4. Circumstances under which the State government should continue programs or projects with State funds after federal funds are no longer available for those programs and projects; and
5. Measures and recommendations to protect the State government and residents of the State from adverse effects of a slowed or reduced rate of federal funding for State programs and projects.

Current Policy

The current policy for federal funds is to maximize the receipt of federal funds and preserve program and funding flexibility so the Governor and Legislature can respond to changes in State and federal resources and priorities. Information on the state's policy regarding federal funds can be found at: www.federalawards.hawaii.gov.

Recommendation

The intent of Act 178, SLH 2017, is for the Governor to develop a federal funding policy "that reduces the dependence of State government on federal funds." In FY 19, federal funds account for \$3.6 billion, or 22%, of the State's operating and capital improvement program budget.

While we understand the reasons why the Legislature would like to reduce the dependence of State government on federal funds, as a practical matter it is difficult to recommend a policy which discourages with use of federal funds since most federal funds are for social, health, or educational programs. Any loss of these federal funds would increase the need for State funds, restrict eligibility for programs or eliminate programs all-together. Further, as the expenditure of federal funds impacts the State's revenues and economy, the impact of federal fund reductions could reach far beyond the State's programs and their constituencies.

There are suggested actions, however, which could help improve the State's management of federal funds, which we note in the forthcoming sections.

Topic Area #1

Parameters regarding the application for and acceptance of federal funds available on a formula or competitive basis.

Current Policy:

Departments are encouraged to apply for federal awards on a formula or competitive basis. Current policies require that all anticipated federal recurring awards and competitive awards that departments intend to apply for be included in the Executive budget. In this way, the Governor can be assured that all anticipated federal awards are budgeted and accounted for.

Recommendation:

The Governor should direct the Office of Federal Awards Management (OFAM) to identify federal awards that include requirements such as State matching funds or the adoption of policies that may excessively limit the State's flexibility to carry out the objectives of the award. This information would be provided by report to the Governor each year.

Topic Area #2

Principles guiding the extent of dependence of State executive departments on federal funds.

Current Policy:

Departments are encouraged to maximize the receipt of federal awards. However, departments are cautioned in the budget preparation instructions and budget execution policies every fiscal year that they should not assume that State funding will automatically replace federal funding in situations where federal funding is disrupted or discontinued.

Recommendation:

The Governor should direct B&F to continue to highlight the administration's position on federal funding throughout the budget process.

Topic Area #3

Conditions for using federal funds as a means of financing for the salaries of State employees.

Current Policy:

Departments are provided flexibility in the use of federal funds to pay for the salaries of employees. However, the use of discretionary federal funds for position salaries has been discouraged since FY 18.

Recommendation:

The Governor should direct the B&F to:

1. Inventory current department practices regarding the use of federal funds to pay for employee salaries and provide comment on the following:
 - The desirability of allowing departments flexibility in hiring positions that will be fully or partially federally funded.
 - The desirability of allowing split funded positions, where a percentage of an employee's salary is paid with federal funds and a percentage is paid with non-federal funds.
2. Determine the number of civil service positions currently funded by federal funds.
3. Propose methods and/or procedures that can be used to ensure that programs are accurately charging fringe benefit costs to federal awards.

Topic Area #4

Circumstances under which the State government should continue programs or projects with State funds after federal funds are no longer available for those programs and projects;

Current Policy:

The assumption built into the budgeting process is that if no extraordinary measures are taken, a federally funded State program that has a reduction in federal funds or loses federal funding entirely would reduce its program expenses to meet available revenue or would discontinue. If a reduction in federal funds occurs or is anticipated or if a federal funding source is suddenly eliminated, the current procedure is for the impacted department to confer with the Governor and B&F to determine what measures should be taken, if any, to continue the operation of the program until the next fiscal year and beyond, as may be appropriate.

In challenging times, the Governor may not be able to provide funds to keep a program in operation until the next Legislative Session or may have to prioritize competing requests. If the program is deemed critical, a budget request for non-federal funds may be submitted as part of the Governor's budget request during the next legislative session. Ultimately, it is up to the Legislature to decide if State funds should replace federal funds.

Recommendation:

The Governor should establish a formal process to review departmental requests for non-federal funding necessary due to a reduction in federal funds or a potential elimination of federal funding. The process would allow such requests to be validated and prioritized and could be established by Executive or Finance Memorandum.

The process would specify the information that would need to be submitted and the criteria for program review and should generally coincide with the budget review process, if timing is appropriate. Other requests could be handled outside the budget process, if necessary, on a case-by-case basis.

Topic Area #5

Measures and recommendations to protect the State government and residents of the State from adverse effects of a slowed or reduced rate of federal funding for State programs and projects.

Current Policy:

The Governor's budget policies and discretionary powers provide flexibility to deal with changes in federal fund levels. Significant changes, however, require legislative action.

Recommendation:

To protect the State government and residents of Hawaii from a reduction in federal funding levels, the Governor should take the following actions:

- Maintain budgetary policies to be able to reduce spending in response to changes in federal funds
- Be cautious in starting new programs or expanding programs that are dependent on federal funds.
- Continue to work with the Legislature if potentially significant changes in federal funding levels appear imminent.