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Federal Aid to State and Local Governments: Select Issues Raised by a Federal Government Shutdown

April 7, 2014

Congressional Research Service
https://crsreports.congress.gov
R43467

CRS REPORT
Prepared for Members and
Committees of Congress

Summary

At the end of the day on September 30, 2013, appropriations provided under the Consolidated and Further Continuing Appropriations Act, 2013 (P.L. 113-6) expired. Beginning on October 1, 2013, the first day of FY2014, this resulted in a partial federal government shutdown due to a lapse in appropriations. On October 17, 2013, the Continuing Appropriations Act (P.L. 113-46) was signed into law and provided funding through January 15, 2014. Funding for the remainder of the fiscal year was provided when the Consolidated Appropriations Act (P.L. 113-76) was signed into law on January 17, 2014. During the October 2013 lapse in appropriations, federal agencies were directed to implement contingency plans that were designed to guide federal agency operations during the partial government shutdown.

Notably, federal agency operations include administration of over 1,714 congressionally authorized federal grant programs administered by 26 federal agencies. Federal outlays for grants to state and local governments were $514.6 billion in FY2011 and an estimated $504.4 billion in FY2012. The largest outlays for grants to state and local governments are for health programs with an estimated outlay of $275 billion in FY2012, and education, training, employment, and social services with an estimated outlay of $115 billion for the same year.

State and local governments rely upon federal aid to fund projects and provide services that benefit communities and individuals. Interruptions in these activities can have a negative effect on the beneficiaries of federal aid. These activities rely upon the following grant administration activities:

- Executing grant award agreements;
- Processing payments to grantees; and
- Investigating waste, fraud, and abuse allegations.

A federal government shutdown may cause a minor disruption or may result in the cessation of these activities depending on the following factors:

- The timing and length of the federal government shutdown;
- Choices made by federal, state, and local officials; and
- Congressional action since the last federal government shutdown.

Federal, state, and local officials make choices involving:

- Covering gaps in federal funding with uncertainty of reimbursement;
- Furloughing grants administration personnel; and
- Including grants administration personnel in contingency planning.

The administrative, political, and economic environment will vary in every potential and actual federal government shutdown. Predicting the effect of a federal government shutdown on federal grant recipients and beneficiaries relies upon evaluation of these factors at the time of the lapse in federal funding and consideration of Congressional action since the last shutdown. This report will evaluate these factors and present a selection of legislative options to mitigate the effect of a future federal government shutdown.

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Introduction

State and local governments rely on grants from the federal government to assist in funding a wide variety of activities that benefit individuals and communities. The FY2015 budget proposed by the Obama Administration would provide $641.8 billion in outlays for federal aid to state and local governments.[1] The proposed funding levels provide a general idea of the scope and scale of federal funding for state and local activities and are comprised of both mandatory and discretionary funds. Outlays for discretionary spending generally rely upon appropriations acts, while mandatory spending is spending that is controlled by laws other than appropriations acts.[2] Because government shutdowns are the result of a lapse in appropriations, discretionary outlays are often the form of federal aid to state and local government most affected by a lapse in appropriations. However, in certain circumstances, mandatory spending may also be affected.

State and local activities that rely upon federal outlays encompass a wide variety of activities. These activities generally fall into program areas such as energy, natural resources and environment, agriculture, commerce and housing credit, transportation, community and regional development, education, training, employment and social services, health, income security, social security, administration of justice, and general government.[3]

During a federal government shutdown, outlays for state and local programs may be delayed. Delayed federal outlays to state and local governments may create state and local cash flow challenges which may force states to make difficult decisions such as whether to use state funds to cover the lapse in federal funding without a guarantee of reimbursement, or whether to halt program operations. Should states choose to use state funds to replace federal funding, states must then decide whether to fully fund the program at normal operating levels, or whether to scale back program activities which may result in delayed or temporarily suspended assistance to individuals and communities and furloughs of state employees involved in administering programs that receive some or all of the program funding from the federal government. While the length of the government shutdown affects the extent of the delay, the administration of individual federal grant programs also plays a critical role in the impact of the federal government shutdown on state and local governments and individuals and communities.

State and local governments make choices about how to administer federally funded programs provided at the state and local level. These choices include whether, and when, to request federal funds in advance of expenditures, how frequently to request reimbursement for expenditures authorized under a federal grant award, and whether to furlough state employees with federally funded salaries during a federal government shutdown. Analysis of the possible choices made by state and local governments administering federally funded programs may provide insight into which choices lessen the impact of a federal government shutdown.

The impact of the government shutdown may be exacerbated by certain characteristics of the state and local grant administration practices. Analysis of the possible actions of federal and state officials in the administration of federal grants during the shutdown may provide insight into the grant administration characteristics that mitigated the impact of the federal government shutdown in October 2013.

This report explores two grant administration issues to assist Congress in its oversight and law-making. First, the report provides an overview of the administration of federal grants and a

[1] U.S. Office of Management and Budget, *FY2015 Analytical Perspectives: Budget of the U.S. Government*, p. 244.

[2] Ibid., p. 137, 138.

[3] Ibid., p. 289-301.

discussion of the issues in federal aid to state and local governments raised by a lapse in federal funding. Second, the report provides potential legislative options to mitigate the effects of a lapse in federal funding and to encourage practices that reduce the impact of possible future government shutdowns on federal aid to state and local governments.

Overview of Federal Aid to State and Local Governments

The scope and scale of federal grant administration suggest the potential pervasiveness of the effects of a funding lapse on federally funded grant programs administered by state and local governments.

Many federal grant programs involve a direct payment to state governments, which are then responsible for program administration. Examples include grants that are "passed through" to local governments (such as block grant programs); grants, such as for highway construction, in which the financial impact of federal funds is spread out over all areas of the state; and grants or assistance programs such as Family Support Payments to states, which the state can administer but for which the ultimate beneficiaries are found throughout the states.[4]

Congressional authorization of federal assistance to state and local governments can be traced back to the Continental Congress and its approval of the granting of nationally owned land to states formed out of the Northwest Territory. Since that time, there has been dramatic growth in federal cash assistance programs, now commonly referred to as "federal grant programs" or "federal domestic assistance programs." These programs transfer money, property, services, or other items of value for which the principal purpose is to accomplish a goal authorized by Congress. **Figure 1** illustrates that federal outlays for grants to state and local governments has grown from $15.4 billion (in constant FY2009 dollars) in 1940 to $509.7 billion in FY2013.[5] Notably, federal grant outlays to state and local governments since the lapse in appropriations in FY1996 have increased by $194.2 billion, from $315.5 billion (in constant FY2009 dollars) to $509.7 billion in FY2013.[6] Therefore, state and local governments faced a more significant impact from the 2013 shutdown, and potential subsequent shutdowns, than from past federal government shutdowns.

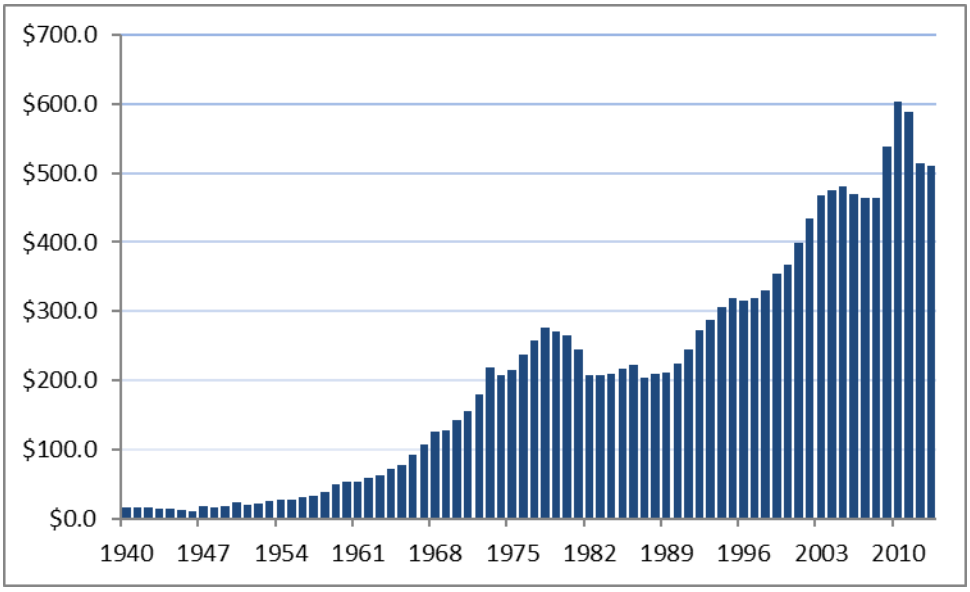
[4] U.S. Census, *Consolidated Federal Funds Report for Fiscal Year 2010*, September 2011, p. xv.

[5] U.S. Office of Management and Budget, *Table 12.1 Summary Comparison of Total Outlays For Grants To State and Local Governments: 1940–2017*, (Washington: GPO, 2013), at http://www.whitehouse.gov/omb/budget/Historicals.

[6] Ibid.

Figure 1. Total Grant Outlays to State and Local Governments: 1940-2013

(billions of dollars, in constant FY2009 dollars)

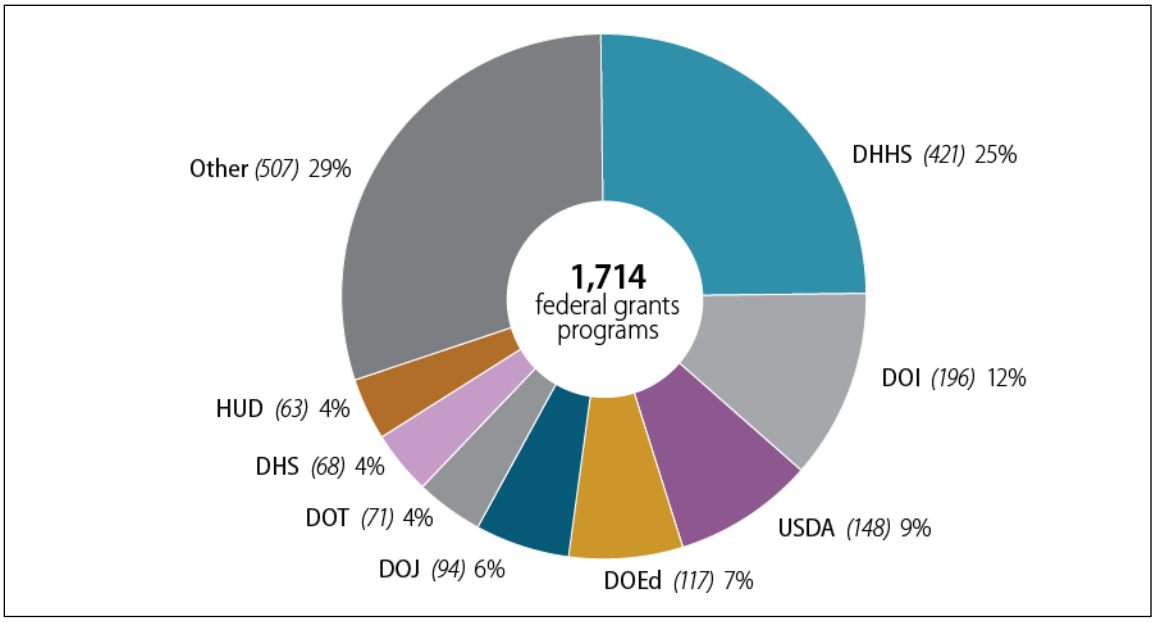


Source: U.S. Office of Management and Budget, *Table 12.1 Summary Comparison of Total Outlays For Grants To State and Local Governments: 1940 – 2017*, (Washington: GPO, 2013).

As shown in **Figure 2**, there are currently 1,714 congressionally authorized federal grant programs, which can be further broken out as formula (225) and project (1,489) grant programs administered by 26 federal agencies.[7] Eight federal agencies administer 67% (1,143) of these programs.

[7] Catalog of Federal Domestic Assistance, September 19, 2012, at http://www.cfda.gov.

Figure 2. Federal Administering Agency Distribution of Formula and Project Grants



Source: Congressional Research Service, with data obtained from the Catalog of Federal Domestic Assistance, February 23, 2014.

There is wide variation across and within federal agencies in the administration of federal grant programs. This variation in federal grant administration makes it difficult to anticipate or evaluate the impact of a federal government shutdown due to a lapse in appropriations. However, an understanding of the characteristics of federal grants may inform the grants administration issues that arise from a federal government shutdown.

Characteristics of Federal Grants

Characteristics of federal grants include the type of budget authority provided to fund the grant programs, the life cycle of a federal grant, and the method of disbursing federal grant funds to state and local governments.

The federal budget classifies grant programs based on discretionary and mandatory budget authority. Issues raised in the administration of federal grants during a lapse in appropriations are influenced by the type of budget authority for the grant programs.

Discretionary Budget Authority

Discretionary grant programs rely upon annual appropriations acts to control the amount of budget authority that is available for the grant program. The life cycle of federal aid to state and local governments begins once Congress appropriates funds for these programs through annual appropriations acts. A lapse in appropriations delays the administration of these programs to varying degrees depending on the grant award period, grant extensions that may be in place at the time of a lapse in appropriations, program elements such as the availability of contingency funds that can be reprogrammed, and the amount and type of state and local contributions provided to programs funded with federal discretionary grant funds.

Examples of grant programs providing outlays to state and local government through discretionary spending include, but are not limited to, the following.[8]

- **Department of Agriculture:** Special Supplement Nutrition Program for Women, Infants, and Children (WIC)
- **Department of Education:** Impact Aid; Accelerating Achievement and Ensuring Equity; Education Improvement Programs; State Fiscal Stabilization Fund (Recovery Act); Innovation and Instructional Teams; Special Education; Career, Technical, and Adult Education
- **Department of Health and Human Services:** Children and Families Services Program; Aging and Disability Services Programs; Health Resources and Services; Substance Abuse and Mental Health Services Administration; Low Income Home Energy Assistance; Payments to States for the Child Care and Development Block Grant
- **Department of Homeland Security:** State and Local Preparedness Programs; Hazard Mitigation Grant Program
- **Department of Housing and Urban Development:** Community Development Fund; Public Housing Operating Fund; Tenant Based Rental Assistance; Public Housing Capital Fund; Home Investment Partnership Program
- **Department of Justice:** State and Local Law Enforcement Assistance
- **Department of Labor:** Training and Employment Services; Unemployment Trust Fund
- **Department of Veterans Affairs:** Medical Services
- **Environmental Protection Agency:** State and Tribal Assistance Grants
- **Federal Aviation Administration:** Grants-in-Aid for Airports
- **Federal Highway Administration:** Emergency Relief Program; Federal-aid Highways
- **Federal Railroad Assistance:** Capital Assistance for High Speed Rail Corridors and Intercity Passenger Rail Service
- **Federal Transit Administration:** Capital Investment Grants; Public Transportation Emergency Relief Program; Transit Formula Grants

Mandatory Budget Authority

Mandatory budget authority for grant programs relies upon authorizing legislation to control the amount of budget authority available for the program, rather than annual appropriations acts. Spending for entitlement programs is also considered mandatory spending and includes domestic assistance programs such as Medicare, Medicaid, and the Supplemental Nutrition Assistance

[8] The grant programs provided as examples of discretionary spending were selected from the following publication based upon programs with FY2014 estimated outlays equal to or greater than $1 billion: U.S. Office of Management and Budget, *Analytical Perspectives: Budget of the U.S. Government*, *Table 17-1*, 113th Congress, 1st Session, H. Doc., 113-3 Vol. III, p. 289-301. The federal agencies are listed in alphabetical order and are not organized by either size of the agency or estimated outlays for the identified programs.

Program (SNAP). Other programs with mandatory spending provisions include, but are not limited to, the following.[9]

- **Department of Agriculture:** Funds for Strengthening Markets, Income, and Supply; Supplemental Nutrition Assistance Program (SNAP); Child Nutrition Programs
- **Department of Education:** American Jobs Act; Innovation and Instructional Teams; Rehabilitation Services and Disability Research
- **Department of Health and Human Services:** Social Services Block Grant; Affordable Insurance Exchange Grants; Grants to States for Medicaid; Children's Health Insurance Fund; Payments to States for Child Support Enforcement and Family Support Programs; Payments for Foster Care and Permanency; Child Care Entitlement to States; Temporary Assistance for Needy Families (TANF)
- **Department of Interior:** Mineral Leasing and Associated Payments
- **Department of Justice:** Community Oriented Policing Stabilization Fund
- **Department of Labor:** American Jobs Act and Community College to Career Fund; Universal Displaced Workers Program
- **Department of Transportation:** Immediate Transportation Investments
- **Federal Communications Commission:** Universal Service Fund

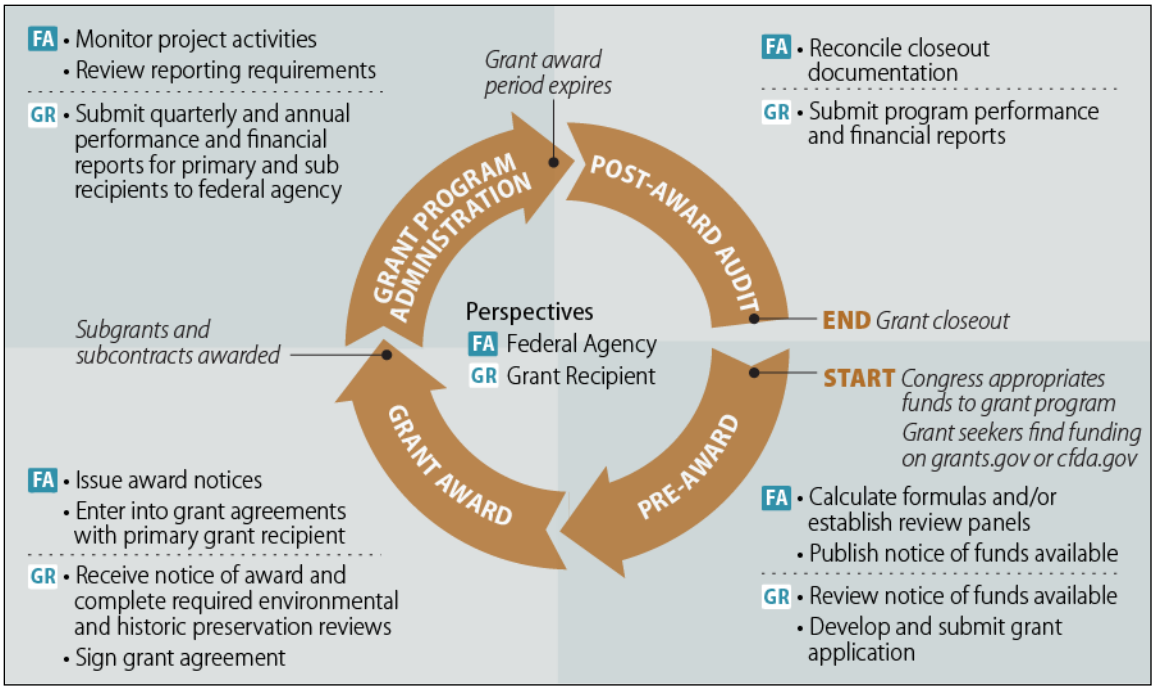
While programs funded though mandatory spending provisions do not rely upon annual appropriations acts, programs that are up for reauthorization at the time of a lapse in appropriations, such as the TANF program for which the authorization expired during the most recent shutdown, are affected by similar program administration issues affecting programs funded through discretionary spending. Additionally, while funding for obligations may be based on mandatory spending, funding for the program administration staff may be provided through annual appropriations. Therefore, mandatory budget authority does not necessarily insulate programs from the grants administration issues arising from a lapse in appropriations facing discretionary grant programs. These grant administration issues are discussed in more detail in the "Issues" section of this report.

The Life Cycle of a Federal Grant

The life cycle of a federal grant traditionally includes four stages: pre-award, grant award, grant program administration, and post-award/audit. **Figure 3** illustrates the life cycle of a federal grant. A federal government shutdown affects each stage of the life cycle.

[9] The grant programs provided as examples of programs with mandatory spending were selected from the following publication based upon programs with FY2014 estimated outlays equal to or greater than $1 billion: U.S. Office of Management and Budget, *Analytical Perspectives: Budget of the U.S. Government, Table 17-1,* 113th Congress, 1st Session, H. Doc., 113-3 Vol. III, p. 289-301. The federal agencies are listed in alphabetical order and are not organized by either size of the agency or estimated outlays for the identified programs.

Figure 3. Life Cycle of a Federal Grant



Source: CRS analysis, February 23, 2014.

Pre-Award Stage

For discretionary grant programs, the pre-award phase begins once Congress appropriates funds through annual appropriations acts. For mandatory spending programs, the pre-award phase begins once the authorizing legislation is enacted or a program is reauthorized. Additionally, some mandatory spending programs also require congressional appropriations through annual appropriations acts before the pre-award phase can begin.[10]

Once the pre-award phase begins, the federal administering agency calculates the amounts for formula grant programs and establishes criteria for scoring competitive grant program applications. Competitive grant programs are also known as discretionary grant programs since federal agencies have some discretion in selecting the applications to be awarded funding. During the pre-award stage, federal administering agencies review and select grant recipient projects pursuant to the program's statutory and regulatory provisions.

Since a federal government shutdown results from a lapse in appropriations, a shutdown delays the pre-award stage, which likely ultimately delays the distribution of federal grants to state and local government. While some federal agencies may begin to establish preliminary scoring criteria, the agencies are unable to finalize the criteria and formula calculations until funds are appropriated to the grant programs.

[10] For example, Medicaid is funded through annual appropriations act even though it is mandatory spending program (entitlement program). For additional discussion of Medicaid financing, please see CRS Report R42640, *Medicaid Financing and Expenditures*, by Alison Mitchell, p. 3.

Grant Award Stage

The amount of funds allocated to a grant recipient is typically based on either statutory formula, agency discretion, or a combination of the two. In some cases, Congress establishes a formula for distributing funds that provides minimum allocations to specifically identified primary grant recipients. In other cases, the statutory eligibility may be broad and agencies may have discretion in narrowing down the recipients who will receive formula allocations.[11] Regardless of the method of distribution, a federal government shutdown could potentially delay the awarding of federal grants since appropriated funds would not be available to award. When a grant award is made, a federal agency incurs an obligation equal to the grant award amount. Office of Management and Budget (OMB) directed federal agencies to avoid incurring new obligations for grants during a lapse in appropriations except in limited circumstances.[12]

Grant Program Administration Stage

Once a federal grant has been awarded and a grant agreement has been signed by both parties, the federal agency begins administration of the grant. Grant administration activities may include reviewing activities conducted under the terms of the grant award, reviewing and approving changes in the scope of work to be done under the grant agreement, providing extensions to the grant award period, monitoring grant awards for waste, fraud, and abuse, and assessing compliance with program and financial reporting requirements. For grants projects that are in the grant program administration stage at the time of a federal government shutdown, generally grant activities can continue. However, because federal agency personnel who process grant administration requests, such as requests for payments or changes in the grant project, may be furloughed, activities that require approval from a federal agency official may be suspended.

Determining Eligible Activities

Each grant program has a range of eligible activities, including pre-award activities, that can be funded through federal grant awards. Congress may limit the grant project eligibility by narrowing the range of activities to address specific categories of projects. As discussed above, these types of grants are known as categorical grants. Congress may also choose to provide greater flexibility in the range of eligible grant activities by authorizing a block grant. Block grants allow recipients, predominantly states, to fund a broad range of activities within more general policy areas such as community development or law enforcement. Federal grant awards where there is a broad range of activities allowable under the grant agreement may be less affected by a federal government shutdown because there may be less need to obtain federal agency official approval to adjust the grant project activities.

Grant Post-Award/Audit Stage

There are several accountability provisions that are part of the grant administration process. Reporting requirements, both statutory and regulatory, require data collection and dissemination. Federal agencies administering the grant may be required to report data to agencies with oversight, such as OMB or the Government Accountability Office (GAO), or to report grant information to federal assistance databases such as the Catalog of Federal Domestic Assistance

[11] U.S. Government Accountability Office, *Federal Grants-In-Aid Programs*, October 1980, p. 1, at http://archive.gao.gov/otherpdf2/113648.pdf.

[12] Office of Management and Budget, Memorandum M-13-22, *Planning for Agency Operations During a Potential Lapse in Appropriations*, September 17, 2013, p. 6.

(CFDA) or USAspending.gov. Agencies may also be required to report grant performance to congressional committees. At the end of the grant award period, grant recipients are required to submit all financial documentation during the post-award stage. The federal agency then compiles the financial documentation and commences in closing out the federal grant.

Grant closeout is a process by which the federal agency reconciles all expenditures and disbursements and closes all cash management and program management accounts. Once the federal grant has been successfully closed out, the federal agency is able to conduct audits of the grant awards to measure efficiency and evaluate waste, fraud, and abuse in the use of federal grant funds. Under OMB guidance to federal agencies for agency operations during a lapse in appropriations, oversight activities such as audits and investigations will likely not occur.[13]

> In most cases, the absence of appropriations would prevent the continuation of such supervision or support. Routine ongoing activities, related to the agency's contract and grant administration, would not usually be authorized to continue when there has been a lapse in the appropriation that funds the contract and grant administration activities. In other words, during a funding lapse, the performance—by contracting officers, contracting officer technical representatives, contract administration personnel, and grants management specialists—of routine oversight, inspection, accounting, administration, payment processing, and other contracting or grant management activity would generally not continue.[14]

Once funding is restored, the federal agencies can begin conducting oversight again. However, activities normally conducted during the federal government shutdown would be delayed, which would create a backlog at the federal agency level. The backlog would likely cause delays in audits of grant funds and investigations into inappropriate use of those funds. Audits and investigations are used to identify activities that contribute to waste, fraud, and abuse. Delays in identifying these activities reduce the ability of a federal agency to resolve problematic activities and therefore increase the potential for waste, fraud, and abuse in the use of federal grant funds.

Awarding a Federal Grant: Elements of a Grant Agreement

Grant Award Period

The award period for federal grants varies from program to program, and even within the same program. Most federal grants have a twelve-month grant award period. However, some grants, such as the Department of Justice Community Oriented Policing grant program, can have multi-year award periods depending on availability of funding. Because of this variation in the award period, the impact of a federal government shutdown on grant programs and federal aid to state and local governments will vary across agencies and programs, and even within grant programs.

Administrative Requirement: Conditions of the Federal Grant Award

Grant recipients are required to comply with a variety of administrative requirements detailed in the grant agreement. A grant agreement is a legally binding contract between the federal agency and the primary grant recipient. Administrative requirements are often conditions of the grant award and are detailed in the grant agreement. These requirements may include conducting environmental impact assessments and maintaining accurate financial records.

[13] Ibid., p. 7.

[14] Ibid.

Federal agencies are also required to follow government-wide guidance, known as circulars, when entering into grant agreements. The circulars, which are issued by OMB, set standards for a range of grant management activities, including grant application forms, the timing of grant payments, and financial reporting.

However, as stated previously, OMB guidance to federal agencies for agency operation plans during a lapse in appropriations directs agencies to cease grant management activities including issuing new grant agreements, approving changes in the grant agreements, or investigating noncompliance with conditions of a federal grant award during the federal government shutdown.[15] Once funding is restored, grant management activities could commence again, but likely with a backlog.

Methods for Disbursing Federal Grant Funds

The authorizing legislation of a federal grant program generally establishes the distribution methodology. As discussed previously, the amount of federal grant funds awarded to a grant recipient may be determined by formula or awarded through a competitive process. Once the amount of the grant award is determined, the federal agency and the grant recipient, usually the state, enter into a grant agreement that establishes the terms and conditions of the grant award. These terms and conditions include financial management and reporting provisions such as the authorized level of funding and the process for, and timing of, payments from the U.S. Treasury. During a federal government shutdown due to a lapse in appropriation, the methods of disbursing federal grant funds may determine whether, and to what extent, there is a funding gap for state and local programs funded in whole or in part with federal funds.

For example, some grant programs, such as Medicaid, typically provide an advance payment in the first quarter of the federal fiscal year. Payments made to grant recipients in advance of expenditures are commonly known as "advance draw-downs." Therefore, during an October 1st federal government shutdown, states may already have federal funds available. However, if a federal government shutdown occurs on January 1st, the states may not have as much advance drawn-down funding available.[16] By comparison, some grant programs may not allow for advance draw-downs and instead allow funds to be drawn down from the Department of the Treasury only after the expenditures have been made by state and local grantees. This method of disbursing federal grant awards is commonly known as "reimbursement draw-downs."[17]

Payment Management Systems

Payment management systems are financial systems that enable grant recipients, generally the states, to draw funds from the U.S. Treasury pursuant to federal grant award authorizations. State-administered programs funded in whole or part with federal grant funds may initiate a request for federal funds to be disbursed through a process called a "draw-down." States may draw down grant funds for anticipated or actual expenditures made under the terms of the grant award or

[15] Ibid.

[16] For additional discussion of Medicaid financing, please see CRS Report R42640, *Medicaid Financing and Expenditures*, by Alison Mitchell, p. 8.

[17] For example, the Department of Homeland Security state and local preparedness grant programs typically disburse grant funds by reimbursing grantees after the grantee has expended funds and requested a draw-down of funds as reimbursement for that expenditure. For an example, see the U.S. Department of Homeland Security, *FY2013 Homeland Security Grant Program (HSGP) Funding Opportunity Announcement*, p. 58, available from the author to congressional clients upon request.

authorizing language of the federal grant program. These disbursements may be authorized in advance of actual program expenses or as reimbursement of expenditures made by the state. When there is a lapse in federal funding, the method by which federal grant funds are provided to the states can determine the severity of the consequences of a federal government shutdown.

If funds are accessible in advance of a government shutdown, the state may be able to continue program activities without interruption for a certain amount of time. The length of time a program can continue to operate normally will depend upon the amount of funds that were available at the time of the shutdown. For example, programs that allow for quarterly advance payments would be able to function longer than programs that only allow for weekly or monthly advance payments.

When funds are reimbursed, the federal agency will not process reimbursement requests during a federal government shutdown. In some cases, states rely upon reimbursement payments to fund program activities for the next time frame. For example, the state may cover program expenses for a month, then request reimbursement of those expenses at the end of the month in order to use that reimbursement payment to fund program activities for the next month.

If the federal government shutdown occurs during the time frame a state would normally request and receive reimbursement payment, the state would not be able to have the funds available to cover the next month or program activities until funding is restored. Therefore there would not be any funding available for a federally funded program during the duration of the shutdown and likely for a certain amount of time immediately after the shutdown, because there would be backlog in processing all of the reimbursement requests that came in during the government shutdown.

Advance Payments

Some federal grant programs allow grant recipients to draw down funds in advance of actual expenditures. The amount of the advance draw-down must not exceed the award amount and must be made within the program award period. Generally, advance draw-downs must be timed to minimize the time elapsing between the transfer of funds from the U.S. Treasury and the expenditure of funds by the grantee or subgrantee.[18] Program regulations will usually establish additional limitations on advance payments, such as how much in advance the draw-down can occur. In some cases, states may have discretion in determining whether to draw funds weekly, monthly, or quarterly in advance of expected expenses. Notably, the amount and timing of advance draw-downs varies program to program and state to state.

Reimbursement Payments

Federal grants may contain a reimbursement provision that allows the grant recipient to expend funds and then request reimbursement from the U.S. Treasury up to the amount authorized in the grant award. Grant recipients often have discretion in determining when to request reimbursement of expended grant funds, with some states opting to draw down funds more frequently than others. However, at the end of the grant award period, state cash management procedures usually require that the state draw down all reimbursement payments during the post-award period. State cash management procedures call this the "liquidation period" and require that the funds are requested immediately after the grant award period expires.

[18] For example, certain education grants allow both advance and reimbursement payments pursuant to 34 CFR, §80.21(c) and (d).

For grants in which the award period ended September 30, 2013, the liquidation period occurred during the federal government shutdown due to a lapse in appropriation. Like advance payment provisions, reimbursement statutory and regulatory provisions may vary program to program and the process for reimbursement requests may vary state to state.

Grant Administration Issues Affecting State and Local Governments During a Lapse in Federal Funding

There is some uncertainty regarding how a federal government shutdown would affect state and local governments. This uncertainty can be attributed to variations in statutory and regulatory provisions of individual programs, and in the administration of the grant programs. However, there are common grant administration themes that can contribute to an understanding of the impact of a federal government shutdown on federally funded programs administered by states. These include

- the timing and duration of the lapse in federal funding,
- uncertainty of reimbursement for grant program expenses covered by non-federal sources during the lapse, and
- federal agency and grant recipient discretion in administering the grant programs.

Lapse of Appropriations

A lapse in appropriations that results in a federal government shutdown can affect both mandatory and discretionary spending that funds programs at the state and local level. As discussed previously in the section "The Life Cycle of a Federal Grant," each stage of the grant life cycle is potentially affected by a federal government shutdown. The role of Congress, the federal agency administering the grant program, and state and local grantees varies depending on the stage of the grant life cycle that corresponds with the federal government shutdown.

It is difficult to determine the exact impact of a federal government shutdown on state and local governments because the impact will vary depending on the current stage of each individual grant award at the time of the shutdown and the duration of the shutdown. Additionally, the impact may vary within a grant program, and across programs and agencies, because grants are not necessarily awarded simultaneously. Therefore, some grant awards to state and local governments may be affected more than others if there is a lapse in federal funding.

Timing of the Lapse in Federal Funding during the Grant Lifecycle

Federal discretionary grants are awarded once appropriations acts authorize levels of funding for the grant program. When a federal agency makes a grant award, the grant recipient receives a letter of credit as authorization to expend a specified amount of money for a specified purpose during the grant award period. Some grant award periods coincide with the federal fiscal year.

Because the lapse in appropriations and subsequent partial federal government shutdown occurred on October 1, 2013, the beginning of the new fiscal year, many states were awaiting

letters of credit for federal grant award.[19] The letters of credit authorize draw-downs. Letters of credit are issued with the grant award and upon execution of the grant agreements. OMB instructed agencies to limit incurring new obligations during a lapse in funding except in limited circumstances.[20] Limited circumstances may include the following:

1. A statute expressly authorizing an agency to obligate funds in advance of appropriations.
2. The function addresses emergency circumstances, such that the suspension of the function would imminently threaten the safety of human life or the protection of property.
3. The function is necessary to the discharge of the President's constitutional duties and powers.
4. The agency must continue the function, in the absence of appropriations, because its continuation is "necessarily implied" from the continuation of other authorized activities.[21]

The federal agency administering the grant program has discretion in determining whether these circumstances allow the agency to incur the obligation.[22] Traditionally agency officials interpret grant management activities such as processing draw-down requests and conducting oversight activities such as audits and investigations as prohibited activities.[23] However, even in cases where the obligation is incurred, for example a grant agreement is processed during a federal government shutdown, the agency is prohibited from reimbursing the grant recipient until appropriations are enacted.[24]

Duration of the Lapse in Federal Funding

Though there are variations across states and federal grant programs, the longer the federal government is shut down, the greater the impact on the administration of grant programs at the federal and state level. OMB guidance indicated that grant management activities at the federal agency level generally would not continue during a lapse in appropriations.[25] These activities include routine oversight, inspection, accounting, administration, payment processing, and other grants management activities.[26] Assuming that there are active grant agreements in place at the time of the government shutdown, the grant agreements stipulate the conditions of a grant award. These conditions may include periodic review of performance or expenditures in order for the continued authorization of draw-downs.

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[19] For example, the State of Connecticut, Department of Public Health, identified six federal grant awards with outstanding letters of credit as of October 1, 2013. See http://www.ct.gov/opm/lib/opm/budget/2014_2015_biennial_budget/federal_shut_down/fedshutdowndph_1oct13.pdf.

[20] Office of Management and Budget, Memorandum M-13-22, *Planning for Agency Operations During a Potential Lapse in Appropriations*, September 17, 2013, p. 6.

[21] Ibid.

[22] Ibid.

[23] U.S. Department of Homeland Security, Federal Emergency Management Agency, *Memorandum: What Work Am I Allowed to Do During a Lapse in Annual Appropriations*, p. 3, available from author to congressional clients upon request.

[24] Office of Management and Budget, Memorandum M-13-22, *Planning for Agency Operations During a Potential Lapse in Appropriations*, September 17, 2013, p. 6.

[25] Ibid., p. 7.

[26] Ibid.

If federal grant program personnel are furloughed, then the reviews will not be completed and draw-down authorization may be disrupted.[27] Advance draw-downs may be used to cover the gap in federal funding due to the lapse in appropriations.[28] However, at some point the advance draw-downs run out and states will experience a funding gap for federally funded programs.

Variations in state predictions on how long federally-funded/state-administered programs can operate during a shutdown hinge, in part, on how much the state retained in advance draw-downs and whether there are other sources of program funding such as rebates that can be used to fund operations during the federal funding gap. Additionally, states that count on reimbursement draw-downs to fund program operations in months subsequent to a funding lapse or shutdown may be less able to cover program costs if there is a delay in reimbursement due to the furlough of federal grant program personnel to process reimbursement payments.

Delayed Grant Outlays to State and Local Governments

State and Local Cash Flow

During a funding lapse, program activities funded under existing grant awards may continue, but face limitations based upon state cash flow. States may continue normal activities until advance funding is depleted and then must decide whether to provide funding until additional advance or reimbursement payments are received. This decision may be based on the cash flow challenges of the state and the policy priorities of state elected officials.[29] While reimbursement for expenditures made pursuant to existing grant agreements and grant awards is likely, the state elected officials have the discretion to decide whether to cover the gap in federal funding or suspend program activities during the lapse in appropriations.[30]

Funding for program activities where the authorization to expend funds was not in place at the time of the lapse in appropriations is less certain. In cases where the grant agreement was not in place or where the mandatory budget authority for the grant program may have expired, there is limited authority for the federal agency to reimburse for expenses incurred outside of the grant award period. In some cases, federal agencies may authorize grant recipients to expend contingency funds to maintain program operations. In other cases, federal agencies may be able to reimburse states under the pre-award activities provisions in federal grant regulations or statutes. In still other cases, it may be necessary for Congress to enact specific provisions that would reimburse states for covering expenses that occurred before the grant agreement was officially in place if the delay in executing the grant agreement was attributed to a federal government

[27] Payment management systems are automated systems that may contain automatic "stop payment" triggers that must be resolved by an authorized federal grant management personnel in order for additional draw-downs to be allowed. For example, if the draw-down request appears to be a duplicate request or if there are insufficient funds available under the grant award to process the draw-down request.

[28] For example, see Texas Department of State Health Services, Press Release, *WIC Continues During Government Shutdown*, October 1, 2013, available from author to congressional clients upon request.

[29] National Association of State Budget Officers, *Federal Shutdown: Understanding the Impact and Challenges for States*, October 10, 2013, p.1.

[30] For example, Congress authorized federal agencies to reimburse states for grant expenditures covered by the state during the October 2013 shutdown when funding was restored. P.L. 113-46, 127 Stat. 561 states, "if a state (or another Federal grantee) used State funds (or the grantee's non-Federal funds) to continue carrying out a federal program or furloughed State employees (or the grantee's employees) whose compensation is advanced or reimbursed in whole or in part by the Federal Government ... the State (or other such grantee) shall be reimbursed for expenses that would have been paid by the Federal Government during such period had appropriations been available.

shutdown. The ability and willingness of federal and state agencies to exercise existing discretion in the administration of federally-funded/state-administered programs will also likely influence the impact of the lapse in appropriations on program beneficiaries.

Uncertainty of Reimbursement for State Expenditures

When there is a gap in federal funding for state administered programs, the states must decide whether to provide state funding to continue program operations, or whether to cease program activities during the lapse in federal appropriations. This decision may be based on several factors, including uncertainty of reimbursement and cash flow challenges.

State discretion in filling the funding gap resulting from a lapse in federal appropriations may also be influenced by political factors such as party affiliation of the governor and perceptions of the causes of the lapse in appropriations.[31]

Federal Administering Agency Discretion

While the authorizing legislation for a federal grant program may establish applicant eligibility and, to varying degrees, eligible activities, federal agencies exercise broad discretion in administering the grant program. Administering federal grant programs may include establishing procedures for applying, reviewing, scoring, and awarding federal grants. Once a federal grant is awarded, the administering agency has the authority to place conditions on the grant award, commonly known as conditioning a federal grant. Conditions of a grant award generally include compliance with financial and performance reporting requirements and audit requirements. When the grant recipient does not comply with the conditions of a grant award, the grant recipient may face a range of consequences, from additional monitoring to debarment or suspension from eligibility for current and future grant awards.

Federal agencies also establish program regulations which may determine the timing of advance payments and may set limits on the amount of authorized funds that can be drawn down in advance. Additionally, federal agencies may establish regulations pertaining to pre-award activities that may be reimbursed once a grant agreement is in place. While the ability of a federal agency to change the program regulations during a lapse in appropriation may be constrained, there may be flexibility in the existing regulations. Depending on the grant-specific authorizing legislation and regulations, this flexibility may allow federal agencies to adjust for unexpected grant administration issues, such as delayed reimbursement processing or delays in processing grant agreements, which occur during a federal government shutdown due to a lapse in appropriations.

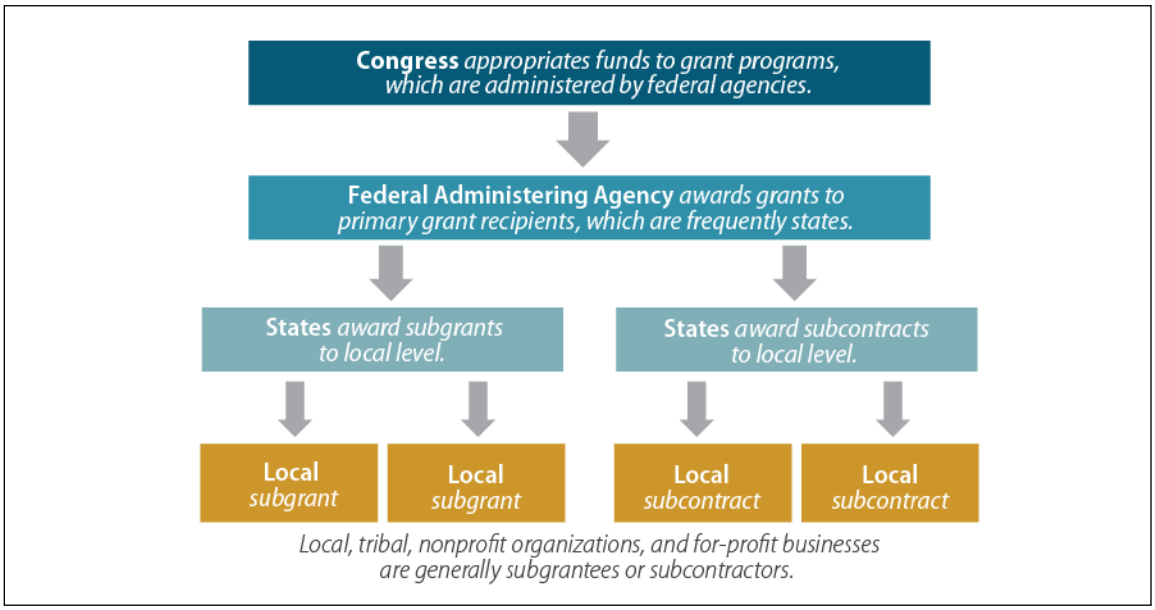
Grant Recipient Discretion

Generally, most federal grants are awarded to state governments, which then pass through grant funds to local entities either by formula or through a competitive process. This process is known as federal grant pass-through. Portions of federal grants may also be passed through when states award contracts to private sector entities. During a federal government shutdown, there may be a delay in awarding grants to state governments. Since state governments cannot pass through grant

[31] For example, *Governing* commented on the October 2013 partial federal government shutdown by stating, "Noticeably silent were many Republican governors, who generally have not loudly criticized their House colleagues for their role in the shutdown that could have serious implications for states." *Governing*, "Shutdown Puts Republican Governors in Tricky Spot," October 3, 2013, at http://www.governing.com/blogs/fedwatch/gov-shutdown-republican-governors-tricky-spot.html.

funds until funds are awarded, local governments will also experience a delay in receiving federal grant funds. **Figure 4** illustrates the federal grant funding stream.

Figure 4. Federal Grant Funding Stream



Source: CRS Analysis, February 23, 2014.

The pass-through structure may be a result of the need to balance a federal interest in accountability and program effectiveness with a state need for autonomy and flexibility.[32] The pass-through structure may also exist because state governments may have more resources available to conduct oversight of federal funds than local or nonprofit organizations. States also retain discretion in determining the specific projects to be funded within the state if funds are passed through the state. This increases state autonomy to direct federal funding within the constraints of the federal grant authorization and federal agency grant guidance. The states, as primary grant recipients, are able to impose state priorities on federal grant funds and have discretion to determine whether to use state funds to cover a gap in federal funding due to a lapse in appropriation. Many state programs are federally funded but administered by the state. The state has the authority to administer the grant program within the statutory and regulatory constraints of the federal grant program.

State Employee Furloughs Due to a Lapse in Federal Funding

In cases where the state is the primary grant recipient and is tasked with administering a program that is partially or fully funded with federal grants, the state has the discretion to decide whether to cover any gaps in federal funding to maintain normal program operations, or whether to suspend program operations during the lapse in federal funding. In some cases, suspending program operations may include furloughing state employees.

Depending on the statutory and regulatory provisions of the federal grant program, the status of the federal grant award, and the provisions in the grant agreement, the state may have discretion in determining whether to provide back-pay to furloughed federal employees once federal funding is available. Specifically, if personnel expenses for October are a normal budget item for

[32] V.O. Key, *The Administration of Federal Grants to States* (Chicago: Public Administration Services, 1937), p. 4.

a program and federal funds were authorized either in an existing grant award or in a grant award entered into after appropriations are available for any subsequent grant award, the state may have discretion to provide back-pay to furloughed state employees in federally funded programs.

Potential Legislative Options

Several options exist to address federal grants administration issues that escalate the impact of a government shutdown due to delays in federal grant outlays to state and local governments.

Reimbursing States for Covering Grant Funding Gaps

When there is a gap in federal funding for state administered programs during a federal government shutdown, states must decide whether to fill the gap with state funding to continue program operations or whether to cease program activities until the federal funding is restored. Often this decision is influenced by the level of uncertainty the states face regarding the reimbursement of state funds by the federal government once funding is restored. Congress may consider enacting legislative language in advance of a federal government shutdown to address whether states would be reimbursed for expenses that would have normally been covered by federal grant outlays but that were delayed due to a government shutdown.[33]

Authorizing Advance Draw-Downs of Grant Funds

Some federal grant programs allow grant recipients to draw down funds in advance of actual expenditures. The impact of a federal government shutdown may be potentially mitigated in programs that allow such advance payments because recipients would have funds available to expend during the government shutdown. Amending the authorizing legislation for specific grant programs (with both discretionary and mandatory budget authority) to adjust advance draw-down provisions would potentially reduce the impact of a short-term federal government shutdown.

Funding for Grant Management Personnel in Mandatory Spending Programs

Grant programs funded through mandatory spending provisions are also affected by a lapse in funding, because often the federal agency personnel that administer the program are funded through annual appropriations acts. Some mandatory spending program activities rely upon the federal agency personnel to ensure normal program operations. Congress may consider authorizing federal agencies to use portions of the available funds in programs funded through mandatory spending to cover personnel expenses to reduce the impact on the beneficiaries of mandatory spending programs.

[33] However, this would not address the problem of federally funded parks shut down due to the lapse in appropriations, because the funding for these expenses is not normally covered by the state using federal grants, rather it is normal operating expenses of a federal agency. Therefore, when states supplant federal funds in order to reopen parks during a government shutdown, this would not be considered allowable grant expenditures.

Coordinating with Grants Administration Personnel for Contingency Planning

Programs funded by federal grants rely upon a number of administrative activities to operate. These activities are often conducted by state and federal employees and include executing grant award agreements and processing grantee payment requests. When employees involved in grant administration activities are furloughed, normal grant administration activities are affected. Federal agency employees that are directly involved in grants administration activities can provide insight into which activities may be critical during a federal government shutdown. Therefore, Congress may consider requiring OMB to include grants administration personnel in the development of agency contingency plans used during a federal government shutdown.

Conclusion

State and local governments rely upon federal aid to fund projects and provide services that benefit communities. During a federal government shutdown, delayed disbursement of federal funds may interrupt program activities. Federal, state, and local officials involved in grant administration must make choices about how to administer programs during a government shutdown. These choices include whether to cover gaps in federal funding and whether to furlough employees involved in grant administration activities or program activities. These choices are influenced by the likelihood of reimbursement if a grantee covers the funding gap, and by the extent of involvement of grant administration personnel in the agency contingency planning and the decision making.

Several factors influence these choices, including the timing and duration of a federal government shutdown, the financial capacity of a grantee, and the political environment in which these choices are made. Each of these factors will vary in every potential or actual federal government shutdown. Predicting the effect of a federal government shutdown on state and local governments relies upon evaluation of many factors at the time of the lapse in federal funding and consideration of any Congressional action since the last shutdown that addresses these factors.

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