

**STATUS REPORT**

**GRANTS, SUBSIDIES, AND  
PURCHASES OF SERVICE**

**Chapter 42, Hawaii Revised Statutes**

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**A Report to the Legislature of the State of Hawaii**

**Submitted by the  
Legislative Auditor of the State of Hawaii**

**Report No. 83-4**

**January 1983**

## FOREWORD

In the 1981 regular session, the Legislature enacted Act 207 which established qualifying standards for private organizations applying for public funds and prescribed procedures for the review of applications and the expenditure of funds.

The Act directs our office to monitor and evaluate the implementation of Act 207 and to submit status reports.

Because the full scope of the Act did not go into effect until January 1, 1982 and the agencies involved have had only one cycle of experience in implementing major parts of the law, this report is preliminary in nature. However, where our assessment identifies deficiencies which might carry over into the next budgetary cycle, we have pointed these out in the report so that early corrective action can be taken.

A second status report is required by law to be submitted to the 1984 legislative session. We expect that report to be a more definitive and complete evaluation.

We acknowledge with thanks the cooperation extended to us by the many public officials and members of private organizations who were contacted during the course of the evaluation.

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## Chapter 1

### INTRODUCTION AND BACKGROUND

Act 207, Session Laws of Hawaii 1981 (codified as Chapter 42, Hawaii Revised Statutes) establishes qualifying standards for private organizations applying for public funds and prescribes procedures for the review of applications and the expenditure of funds. Section 2 of Act 207 directs the Office of the Legislative Auditor to monitor and evaluate the implementation of the act and to submit status reports to the 1983 and 1984 legislative sessions.

This introductory chapter provides background information on the constitutional origins of the act, reviews the statutory requirements and summarizes the objectives and scope of this report.

#### Constitutional Origins

In the 1970s, a phenomenal growth developed in State purchases of service from private organizations and in legislative appropriations for a variety of programs and activities deemed to be for a public purpose. Purchases of service were arranged by executive agencies and were fueled in large part by the availability of federal funds, particularly for social services. On the other hand, those organizations which were not funded by executive agencies turned for support to the Legislature, which found itself hard pressed to evaluate the many requests or to satisfy all of them.

By 1978, the year that Hawaii's third constitutional convention met, the recurring and rising tide of private requests for public support prompted legislative leaders to present the problem to the convention's Taxation and Finance Committee. The committee's solution was to propose an amendment to the Constitution's long standing "public purpose" section, which prohibits the appropriation of public funds except for a public purpose. The amendment was in the form of an additional clause which stated: "No grant of public money or property shall be made except pursuant to standards provided by law."<sup>1</sup> It was subsequently adopted by the convention and ratified by the people in the November 1978 general election.

1. Article VII, Section 4, Hawaii State Constitution.

In its commentary on the amendment, the Taxation and Finance Committee observed:

“In effect, the additional language will require the legislature to establish standards for the appropriation of funds to private organizations conducting programs which the legislature has determined to be in the public interest. No such standards exist at the present time even though the legislature appropriates several millions of dollars each biennium to private organizations. The requirement that the legislature set standards would be useful to the legislature itself as well as provide the public with an understanding as to what guidelines govern, and which types of organizations qualify for, the appropriation of grants and subsidies.”<sup>2</sup>

### **Statutory Requirements**

After three sessions of extensive public hearings, the Legislature enacted Act 207 in 1981 to implement the constitutional requirement. Amendments were made in 1982, but these were clarifying amendments rather than alteration of the basic substance of the law. In this section, we summarize the current statutory requirements.

**Scope and responsibility.** The standards, conditions and procedures established by law apply to the executive and judicial branches of State government. Through their rule making and review authority, primary responsibility to ensure that the statutory requirements are complied with rests with the Director of Finance, in the case of the executive branch, and with the Administrative Director of the Courts, in the case of the judiciary. The law also requires each county to establish standards for the grant of public money or property.

**Types of requests and appropriations.** The law identifies and defines three different types of requests and appropriations: grant, subsidy and purchase of service. A “grant” is an appropriation of public funds to a recipient for a specified public purpose. A “subsidy” is an appropriation of public funds made to alter the price of the cost of a particular good or service of a recipient for the purpose of encouraging or discouraging the output or supply of these items. A “purchase of service” is the exchange by an

2. Committee on Taxation and Finance, 1978 Constitutional Convention, Standing Committee Report No. 66, September 1, 1978, pp. 14–15.

agency of goods and services to be delivered by a provider to the general public or specified members of the general public for cash payments substantially equal in value to such goods and services.

**Qualifying standards.** An applicant for a grant, subsidy or purchase of service agreement must meet all of the following standards: (1) be a profit organization incorporated in Hawaii or a nonprofit organization exempt from the federal income tax; (2) in the case of a nonprofit organization, have a governing board whose members have no material conflict of interest and serve without compensation; (3) have bylaws or policies describing how it conducts business, including, for nonprofit organizations, policies concerning nepotism and management of potential conflict of interest situations; (4) have at least one year's experience with the project or in the program area for which funds are being requested; and (5) meet any applicable government requirements for licensing and accreditation.

**Procedures for review of applications.** Generally, the law provides for the review of requests for funding to be part of the budget review process of the executive branch and the judiciary. Specifically, requests are submitted to the Director of Finance or the Administrative Director of the Courts, and the appropriate agency in each branch reviews and analyzes each request in terms of the objectives to be achieved, alternatives, costs, benefits and effectiveness. The agency must prepare a statement of findings and recommendations for each request, and those requests recommended for approval are to be included in the agency budget submitted to the Governor and the Chief Justice.

The Governor and the Chief Justice then review the findings and recommendations of the agencies and incorporate into the budgets of their respective branches all requests recommended for funding by the Legislature. Those requests not recommended for funding are to be summarized in a separate report to the Legislature, together with the statements of findings and recommendations. A copy of the statement must be provided to the private organization applying for funds.

If an organization has not submitted an application to the executive branch or the judiciary but submits it directly to the Legislature, the chairperson of the appropriate legislative standing committee is required to refer the application to the appropriate agency for review, and the agency, in turn, is required to submit a statement of its findings and recommendations to the committee within 15 days.

**Appropriations.** Should the Legislature decide to appropriate funds for a request that has not been included in the budget of the executive branch or the judiciary, it may do so by separate bill, in which case the bill must specify whether a grant, subsidy, or purchase of service is being made, name the recipient in the case of a grant or subsidy, and define the public purpose to be served by the appropriation. Funds for purchases of services can be appropriated to the agencies without naming the specific providers.

**Conditions and contracts for receipt of funds.** Organizations authorized to receive funds must agree to comply with certain specified conditions. These conditions include: (1) have persons qualified to perform the activity being funded; (2) comply with non-discrimination laws; (3) refrain from using public funds for entertainment or perquisites; (4) comply with other requirements as may be prescribed to ensure adherence to applicable laws; and (5) allow the State to have access to their records for monitoring and evaluation purposes.

Appropriations cannot be released unless a contract is first entered into between the appropriate agency and the private organization. Each contract must specify that the State will not be held liable for any acts of the organization, and the organization must require signed waivers from participants in its program holding the State harmless from liability. All contracts are required to be reviewed by the Attorney General, on behalf of executive agencies, and the Administrative Director of the Courts, on behalf of the judiciary, for conformance with public purpose and legislative intent.

The release of funds is subject to the allotment system generally applicable to all legislative appropriations.

**Monitoring and evaluation.** Every grant, subsidy or purchase of service agreement is required to be monitored by the appropriate agency for compliance with statutory requirements, public purpose and legislative intent. An annual evaluation is also required of each grant, subsidy or purchase of service agreement to determine its continued eligibility and whether the intended results have been attained.

## **Objectives and Scope**

**Objectives.** The Office of the Legislative Auditor is required by law to monitor and evaluate Chapter 42, Hawaii Revised Statutes. The objectives of the evaluation are:

1. To assess whether the various agencies involved are in compliance with Chapter 42, HRS, in the handling of grants, subsidies and purchases of service.
2. To determine whether Chapter 42, HRS, is achieving the results intended.
3. If appropriate, to make recommendations for changes in the law or agency procedures.

Under the law, two status reports are required to be submitted to the Legislature. This is the first of the required status reports. The immediate objectives of this particular report are:

1. To inform the Legislature of progress in implementing Chapter 42, HRS.
2. To identify problems which have emerged and to suggest their remedy even as fuller implementation proceeds.

**Scope and emphasis.** While the statutory requirements apply to the executive branch as well as the judiciary, the emphasis of this status report is on activities in the executive branch as the branch of government with by far the greatest involvement with grants, subsidies and purchases of service. Our assessment of the judiciary is limited to a summary of its progress, and our review of the counties is intended only to determine whether standards have been established as required by law.

## **Organization of the Report**

This status report consists of three chapters. Chapter 1 is this introductory and background chapter. Chapter 2 assesses budgetary procedures and their application to the funding requests of private organizations. Chapter 3 assesses procedures for the expenditure of public funds by private organizations.



## Chapter 2

### ASSESSMENT OF THE APPLICATIONS AND REVIEW PROCESS

The full application of the law with respect to the handling of public funding requests by private organizations became effective in the executive branch in its preparation of the executive budget for the 1983–85 fiscal biennium. In this chapter, we assess the applications process to which private organizations were required to conform and the review of applications which government organizations were required to perform. We conclude the chapter by summarizing the progress of the judiciary and the counties.

#### Summary of Findings

We find that:

1. Initial implementation of the law was hampered by an inadequate timetable for applications and review, overly complicated application forms which are inappropriate for use by private organizations, and confusion and inconsistencies over what type of funds and services are covered by the law.
2. Because the Department of Budget and Finance (B&F) exempted most of the proposed funds for private organizations from the budgetary ceilings under which the departments prepared their budgets, there was no incentive for the departments to carefully review and analyze the requests of private organizations. The immediate result was that far higher levels of funding recommendations were transmitted by the departments to B&F than were ultimately accommodated in the executive budget. As a consequence, the Legislature can expect to be deluged by private organizations with requests which have not been critically analyzed, the very situation which the law was designed to correct.
3. Some of B&F's criteria for reviewing departmental recommendations and for developing final recommendations on behalf of the Governor to the Legislature are questionable. Moreover, the criteria were not communicated to the private organizations as part of the applications process or to the departments as part of their review process. As a result, the ultimate rules of the game were known only to B&F, and not until later, after B&F's review was concluded, were private organizations and the departments apprised of the criteria.

## The Applications Process

The more serious deficiencies in the applications process are the inadequate time allowed for private organizations to formulate and submit their funding requests and for responsible departments to review and analyze the applications, the overly cumbersome and inappropriate forms which private organizations are required to complete and submit, and the inconsistencies as to which potential private recipients of public funds are covered by the law.

**Lack of an adequate timetable.** The law requires that the Director of Finance define by rule “the timetable for the submission of requests.”<sup>1</sup> The rules, as adopted, however, provide only that the director will set a timetable; they do not indicate what the timetable will be.<sup>2</sup>

In the absence of a timetable established in the rules, public notice in newspaper announcements was provided which established the deadline for private organizations to submit their applications. From the first public notice on July 12, 1982, B&F allowed just three and a half weeks for private agencies to pick up application forms, learn the instructions, ask questions, and complete the application forms by the deadline for submission. The state agencies had even less time to analyze the applications and write up their findings and recommendations. Many of the requesting private organizations as well as the reviewing public agencies complained that there was just not enough time to do things correctly or well. Unless a definite timetable with more leeway is established, the agencies, private and public, are again likely to find themselves with inadequate time to prepare and review requests.

The Department of Budget and Finance should add to its rules a general timetable describing the State’s applications schedule. It should also specify a minimum number of days for different phases of the process. The rules could, for example, state that applicants will have 45 days to submit their applications from the time of first public notice, and that state agencies will have 45 days to complete their reviews. This would simply mean an earlier start to the budget preparation cycle as it applies to the submission and review of private organization funding requests. B&F should consult with the state and private agencies in developing an adequate timetable.

1. Section 42–4(c), HRS.
2. Section 6–3–5(e), Chapter 3 of Title 6, Administrative Rules.

Overly complicated and burdensome forms and instructions. By its rules, B&F adopted application forms and instructions which are regularly used by the state administration for preparation of its own budgets. They meet the requirements of the law, but they are unnecessarily complicated, are inappropriate for private organizations, and fail to fully meet the needs of the state agencies reviewing the requests.

The complete applications packet is an overwhelming array of 27 tables and charts and 25 single-spaced pages of instructions. Many of the forms are not applicable to most private organizations. The appropriate ones are not clearly marked and the instructions are not very helpful. They are filled with government budgeting concepts, abbreviations, computer codes, and bureaucratic language. They speak of “current approved program” and “program change request,” “PT” and “BJ” tables, “A” costs and “B” costs, “program ID” and “appropriation symbols”—terms foreign to most private organizations.<sup>3</sup> Most applicants were not sure how to complete the forms.

Moreover, when the private organizations started asking questions, the state agencies were ill-prepared to handle the questions. B&F had not planned any training sessions for departmental personnel or for members of the private agencies. It did, however, finally hold several ad hoc training sessions. Several other state agencies also held similar extemporaneous sessions. Unfortunately, these meetings tended to add to the confusion because state employees gave inconsistent answers to many of the questions. The end result was that applicants were forced to do the best they could on their own to complete forms in time to meet the deadline for submission, and many submitted wrong or incorrectly completed forms.

Some state employees felt that the application form should call for more information to help evaluators understand what applicants plan to do, how and where the applicants intend to perform their services, the target groups the applicants expect to serve, and what the applicants expect to accomplish. Several state agencies supplemented B&F application forms and instructions with questions of their own in an effort to satisfy their needs for information.

Forms and instructions should be simpler, redesigned to elicit pertinent and accurate information, and written in normal, nonbureaucratic language. B&F should redesign the forms and instructions. Before redesigning the forms, however, it would be beneficial

3. Department of Budget and Finance, Instructions for Preparing Program and Financial Plans and Program Budget Requests, June 1982.

for B&F to meet with representatives of the state and private agencies to determine what information should be in the forms and how it might best be presented. It might also be beneficial for B&F to review the judiciary's forms, which were tailored specifically for private organizations and the requirements of Chapter 42 and are simple and concise. B&F should also pretest the new or revised forms and instructions to ensure that users are able to understand and complete them without undue difficulty. B&F should also plan to train employees of the state and private agencies prior to the next round of applications to ensure that users know how to use the forms properly.

**Inconsistencies and improper exemptions.** The executive branch is doing a poor job of determining the specific programs which must follow the qualification and review requirements of Chapter 42. It has not applied the law consistently, especially with respect to programs using federal funds and programs involving private individuals.

*Federal funds and purchases of service.* Chapter 42 clearly applies to state programs using federal funds and purchases of service agreements. B&F's rules for Chapter 42, reiterating general state budgeting policies, says that the law applies to "all funds subject to appropriation by the Legislature including, but not limited to, general funds, federal funds, and special funds."<sup>4</sup> And yet, B&F and other state agencies tried to exempt from the law's application and review process some programs using federally funded purchases of service and did exempt other programs using purchases of service.

B&F, as the agency responsible for directing and coordinating administration of the law, is primarily responsible for this problem. During the phase when private agencies were preparing their applications, B&F was issuing erroneous and inconsistent directions for federally funded purchase of service programs.

For several weeks, B&F allowed the Mental Health Division of the Department of Health (DOH) to exempt its federal block grant funds for alcohol, drug, and mental health programs from the new review process, and the division told private agencies interested in these funds not to submit applications.<sup>5</sup>

4. Section 6-3-2, Administrative Rules.

5. Letter to Howard G. Medeiros, President, Hawaii Substance Abuse Association from Denis Mee-Lee, M.D., Chief, Mental Health Division, Department of Health, July 29, 1982.

B&F gave private agencies, through the Health and Community Services Council of Hawaii (HCSCH), the same erroneous directions which the HCSCH published in its newsletter:

“Latest word from B&F: purchase of service funds from block grants do *NOT* go through the Chapter 42 process, which is for General Revenues only. A formal opinion of the Attorney General is being written . . . . Other than the exception above, block grants funds and all other State-expended money, regardless of source, will go through this process.”<sup>6</sup>

During the same period, however, the Family Health Services Division of DOH and the Public Welfare Division of the Department of Social Services and Housing (DSSH) were telling private agencies wanting contracts from federal block grants to apply under the new procedures.

The private agencies were understandably confused by the mixed directions and upset. On advice from the department’s attorney, B&F subsequently changed its instructions; it said that organizations interested in federal block grant funds or purchases of service must apply under the applications process. According to B&F, all but two or three private agencies got the final word in time to submit applications for such funds.

*Improper exemptions from the law.* B&F allowed some significant exceptions to the law by the State Foundation on Culture and the Arts (SFCA) and the Division of Vocational Rehabilitation of DSSH.

The foundation exempts from the applications process those purchase of service contracts which have been built into its operating budget. Contractors for these funds must meet the qualification standards for recipients and providers but need not follow the applications process of Chapter 42. SFCA awards these funds according to its own procedures. The only funding requests which the foundation has put within the scope of the new applications process are those requests stemming from appropriations previously made by the Legislature as “grants-in-aid” to specific organizations.

Like the foundation, the Division of Vocational Rehabilitation also excludes from the applications process its current purchase of service program funded by its operating budget.

6. Health and Community Services Council of Hawaii Agenda, July 1982.

There is no basis for these exclusions.

*Private individuals under the law.* It is questionable whether Chapter 42 prohibits individuals from qualifying for public grants, subsidies, or purchase of service agreements, although clarifying amendments might be required.

This issue was discussed in the 1982 legislative session. The Legislature considered, but did not pass, amendments which would either: (1) exempt certain individual, as opposed to organizational, providers of some professional or personal services;<sup>7</sup> or (2) clearly allow individuals to qualify under the law.<sup>8</sup>

The amendments addressed the concerns of several state agencies. The State Foundation on Culture and the Arts was especially interested in ensuring that individual artists as well as organizations would still be eligible for state grants, subsidies and purchases of service.<sup>9</sup> DOH wanted to continue using and paying individual care providers of psychological, medical, dental, laboratory, scientific and technical services without the constraints of Chapter 42.<sup>10</sup>

In the absence of legislative clarification, state agencies applied different interpretations. The State Foundation says that because of Chapter 42, individuals are not eligible for purchase of service agreements financed by the foundation's operating budget or "grants-in-aid" funds appropriated by the Legislature. DOH takes a different approach; it simply exempts all its individual providers from Chapter 42 and continues to pay them as it has in the past.

There is nothing in the history of the law to indicate that legislators intended to prevent individuals such as artists, health care professionals, or foster parents from receiving public funds, but because of the varying interpretations, the Legislature should consider clarifying amendments.

7. Senate Bill 2816, S.D. 2, Regular Session of 1982.

8. Senate Bill 2816, S.D. 1, 1982 Regular Session of 1982.

9. Testimony on Senate Bill 2816-82 to the Senate Committee on Government Operations and Intergovernmental Relations by the Department of Accounting and General Services, State Foundation on Culture and the Arts, State of Hawaii, February 24, 1982.

10. Letter to the Honorable Duke Kawasaki, Chairman, Committee on Government Operations and Intergovernmental Relations from George Yuen, Director of Health, February 23, 1982.

## Review by the Departments

B&F adopted evaluation and budgeting policies which discouraged rather than encouraged state agencies to carefully analyze private agencies' requests and consider them within the context of state plans, programs and budgets. More specifically, it set budgeting for private agencies apart from regular budgeting and established no limits on amounts which state agencies could recommend for private agencies. B&F also failed to set criteria related to state objectives and programs by which state agencies could evaluate requests. Consequently, the reviews of requests by state agencies were inconsistent and inadequate as each agency developed its own approach to evaluating and budgeting for private agencies.

**Separate and limitless budget for "grants-in-aid."** In 1982 B&F set new budget preparation policies for state agencies which significantly affected the State's review of requests from private agencies. In past years state agencies submitted to B&F departmental budgets without any specified funding ceiling. The budgets sometimes included funds planned for use through private agencies. Then, B&F usually trimmed the departmental budgets in developing its own budget recommendations to the Governor for his executive budget submission to the Legislature. This year, for the first time, B&F set general fund budget ceilings for the state agencies, allocating to each a general fund amount within which the agency was required to develop its operating budget, including changes in workload and programs. The B&F planned to make little or no adjustments to departmental plans for funds within these ceiling allocations. The establishment of budgetary ceilings was theoretically an advance over prior practices with the effect of reordering the relationship between B&F and the other executive agencies and inducing more realistic budgeting. For years, the Legislature had tried to bring about such a change. In 1972, a legislative joint special committee reported:

"In the conference committee report to the 1971 General Appropriations Act, the legislature expressed its concern that the absence of financial ceilings in budget-making and programming has resulted in agency recommendations which are unrealistic when viewed in the context and against the limitations of the total financial resources of the State. The problem of unrealistic planning, programming and budgeting on the part of the agencies will continue unless the administration process provides for informing the agencies of the tentative dollar allocations to major program areas even before the agencies begin to plan, program and budget. Only under realistic financial constraints

will there be induced in agencies, as part of the budget development process, the necessity to rank priorities and to analyze the tradeoff possibilities between programs. Your committee has thoroughly reviewed this matter and believes that the governor should assure that a process of tentative dollar allocations to agencies for all proposed expenditures, including capital investments, is provided for in instructions for the preparation of the budget and program and financial plans.<sup>11</sup>

However, the improved budgeting of private organization programs which could have come about with budgetary ceilings was negated when B&F kept out of the ceiling several items and placed no limits on the amounts state agencies could recommend for "grants-in-aid" funding.<sup>12</sup>

With these policies B&F perpetuated the differential treatment of funding requests from private agencies that the law was intended to change. If those requests recommended for funding had to be within an agency's budget ceiling they would, of course, have to be carefully considered because budgeting for these funds would have to be weighed against the resource requirements of a state agency's own programs and operations. It would have, as the 1972 legislative report observed, "induced in agencies, as part of the budget development process, the necessity to rank priorities and to analyze the tradeoff possibilities between programs." However, the lack of a ceiling for "grants-in-aid" practically invited the state agencies to recommend funding of any number of requests. There was little incentive for anyone to critically review all requests and selectively make recommendations for funding. There was no need to turn down any but the most extraordinary or unusual requests since there was no limit. Not surprisingly, the state agencies' recommendations for funding private agencies greatly exceeded past expenditures for grants, subsidies, and purchases of service by an estimated \$16-17 million, and it devolved once again to B&F to do the final budget cutting.

**Lack of meaningful criteria for evaluations.** B&F set no criteria, not by rule or administrative policy, for the state agencies to use in evaluating and ranking the requests and B&F did not develop criteria for its own review of the state agencies' recommendations and the requests, until after the state agencies had completed their review.

11. Special Committee Reports No. 9 and 10, Regular Session of 1972.

12. Memorandum to All Department Heads, from the Director of Finance, Department of Budget and Finance, June 29, 1982, pp. 1-2.

Early in the applications process, many state and private agencies asked B&F for the State's criteria for making the decisions, but B&F said it had no intention of setting specific criteria and that each state agency should set its own. As a result, some state agencies did, and others did not.

If the review process is to be meaningful and fair, it must be based upon definite and understandable criteria explaining what public objectives the State is seeking to accomplish through the programs of private agencies and what standards are used to determine which requests should be funded.

**Inconsistent and inadequate reviews.** The reviews of requests by the state agencies were inconsistent and inadequate.

*Eligibility review.* Before evaluating the substance of the proposals, the state agencies had to ensure that applicants complied with the basic eligibility standards set in the law. The state agencies as a whole were not inclined to deny requests on the basis of failure to meet the minimum eligibility requirements. In fact, at two of the agencies, we found applications missing required evidence of compliance—articles of incorporation, financial statements, and by-laws or policies on nepotism and conflict of interest. The state agencies denied only a handful of applicants on the grounds that they did not meet the basic eligibility standards. The agencies generally did take the reasonable step of giving the private organizations additional time to submit evidence of compliance since this was the first time the requirements were being imposed.

*Diverse and inadequate program reviews.* Instead of systematically analyzing the efficiency and effectiveness of requests in light of state objectives and considering whether contracting with a private agency is the most cost-effective means of obtaining services, as required by law, each state program developed its own approach to evaluating the requests and budgeting for those recommended for funding. And the result is a hodgepodge of budget recommendations, many bearing little relationship to state objectives, programs, or priorities. Some examples:

*Public Welfare Division.* The division reviewed requests very systematically and made several types of recommendations: to fund a request from within the division's budget ceiling allocation; to fund a request partly from the budget ceiling and partly from the "grants-in-aid" "account" above the ceiling; to fund a request totally from the "grants-in-aid" "account;" and to deny funding altogether.

The division based its decisions to fund certain types of services on its Title XX Social Services Block Grant Report of Intended Use which identifies priority services.<sup>13</sup> Staff also considered other characteristics of each project and organization such as geographic location of the service and accessibility to the target population, adequacy of staff qualifications, and so on.<sup>14</sup> Staff evaluation reports show that project proposals were carefully analyzed.

Nonetheless, it is clear that the division did not tie its final recommendations for funding from the “grants-in-aid” account closely to its block grant plan or the efficiency and effectiveness of private agencies. Some examples follow. In the case of one applicant, an evaluator noted numerous deficiencies: the service planned was not a priority service, the project appeared to be overstaffed with social workers, there were high fringe benefit costs, and the effectiveness of the project was doubtful. This project was nonetheless recommended for \$75,000 in public funds for each year of the biennium. Another program described as “Not a priority service for the department” was also recommended for funding. And for a third project, the evaluator frankly wrote “I don’t know what to recommend because I don’t know what the needs are,” and the division recommended funding. The division also recommended funding of a “case management” project although its block grant plan says that such services shall be provided by government personnel, not private agencies. Division staff acknowledged using less stringent guidelines for “grants-in-aid” recommendations. It denied only three of the 63 requests it reviewed.

*Mental Health Division.* The division took issue with B&F, Chapter 42, and the rules and regulations. During the applications phase, it tried, unsuccessfully, to exempt from the new review procedures, its program which uses federal funds for purchases of service. When it finally accepted applications for these and other funds it refused to evaluate most of them.

The division’s budget recommendations to B&F has three components. The first is a lump sum amount for continuing current purchase of service contracts within the division’s regular operating budget, i.e., within the program’s budget ceiling allocation.

13. This report outlines goals, objectives and priority social services and the criteria used to set the priorities, e.g., State mandated functions, services to vulnerable persons whose life or limb may be at risk, services to those with lower incomes. It also sets a budget for each type of program and specifies the amount for purchasing services and for direct provision of services by State employees. It is a plan used by the division to guide its current purchase of service program.

14. Department of Social Services and Housing, Public Welfare Division, *Checklist for Reviewing Requests for Grants, Subsidies, Purchase of Service—Biennium FY 1983–85*.

The second is another lump sum for “grants-in-aid” to fund some of the services currently financed as legislative “grants-in-aid,” outside of the executive budget. And the third consists of funds for specifically named private agencies.

It is the division’s position that all of these components, not only the first, should be part of the program’s regular budget. In other words, the division asked B&F to raise its budget ceiling allocation to accommodate all three categories. It argues that services funded in recent years as “grants-in-aid” outside of the executive budget are services which the division is mandated to perform and funds to support these services, therefore, should be a part of the division’s regular operating budget. It also says that funds for specifically named private agencies engaged in services which are outside the scope of the division’s regular responsibilities should also be added to the division’s operating budget because the Legislature continues to fund them and assign them to the division for administration. B&F initially disagreed but did not insist that the division revise its budget recommendations to conform to B&F’s guidelines.

The division also refused to evaluate requests and make recommendations on specific agencies for the two lump sum amounts. It deferred decisions on 30 proposals offering “mandated” services because it did not want to commit the division to funding those particular private agencies which applied under Chapter 42. Instead, it solicited new proposals for “mandated” services in December, required the private agencies to submit new and different applications, and planned to release its decision in February 1983.

From all this, two salient points are clear: (1) the division could have announced its “mandated” services during the State’s period of solicitation of requests and invited proposals for these at that time; and (2) the division improperly set aside many requests from private agencies entitled by law to a timely review and decision on their requests. The private agencies submitted their applications in good faith as prescribed by law, and the applications should have been reviewed. The Mental Health Division’s actions and omissions were contrary to law. For its part, B&F should have insisted that the division conform to the law, the rules and regulations, and its policies.

*State Foundation on Culture and the Arts.* The foundation did not accept requests for funds reserved within its budget ceiling for private agencies; it reviewed requests for “grants-in-aid” funds only, i.e., those requests related to appropriations previously made by the Legislature but which were not recommended through the executive budget. If

awards are subsequently made to private organizations from funds which the foundation has reserved in its budget and the recipients have not gone through the applications and review process required by law, the awards may be of doubtful legality.

The foundation is unique among state programs because making awards to private agencies is its business. Yet, it has no clear standards for deciding which projects should be funded. The foundation claims it used “review criteria” in evaluating requests but samples of foundation statements of findings and recommendations on the requests do not substantiate this claim. Many statements simply report the amount of funding the SFCA recommends and whether the amount is different from the amount requested. Some contain a one line description of the program and mention that the applicant was funded in the past. For example:

“The SFCA Board has recommended general fund amounts for . . . \$173,340 and \$185,473 respectively for each year of the biennium period. Increased programs costs noted in the PCR for additional personnel and operating expenses were not included.”

And,

“The SFCA Board had recommended general fund amounts of \$51,600 and \$55,200 respectively for each year of the biennium period. There are no adjustments to their request. This organization has received grants-in-aid funds for many years and they provide important culture and arts activities needed by their community.”

The foundation, moreover, refused to rank the requests in order of preference for funding, as required by B&F, saying that it was not possible to rank culture and arts requests. The foundation’s review was superficial, and it ended up recommending the funding of all but four requests.

#### **Review by B&F**

The state agencies submitted to B&F their diverse, and sometimes questionable, budgets for funding private agencies. They recommended total funding of about \$30 million for each year of the 1983–85 fiscal biennium. B&F reviewed the departmental recommendations according to criteria it developed and deleted about \$9 million in the first year and \$8 million in the second year, nearly a third off the departments’ recommended funding levels. Table 2.1 provides a summary of private organization requests,

Table 2.1

Summary of Requests and Recommendations  
Fiscal Biennium 1983-85

Department	FY 1983-84			FY 1984-85		
	Private Organizations' Request	Departments' Recommendations	B&F's Recommendations	Private Organizations' Request	Departments' Recommendations	B&F's Recommendations
DOE						
Operating						
General Funds	\$ 421,376	\$ 421,376	\$ 0	\$ 464,472	\$ 464,472	\$ 0
DSSH						
Operating						
General Funds	6,792,125	5,267,450	4,715,176	6,710,361	5,389,069	4,819,516
Federal Funds	3,923,743	773,143	773,143	4,511,007	786,554	786,554
CIP	500,000	0	0	0	0	0
TOTAL	11,215,868	6,040,593	5,488,319	11,221,368	6,175,623	5,606,070
DAGS (SFCA)						
Operating						
General Funds	1,625,068	1,352,995	400,000	1,722,436	1,439,470	400,000
CIP	300,000	0	0	100,000	0	0
TOTAL	1,925,068	1,352,995	400,000	1,822,436	1,439,470	400,000
DPED						
Operating						
General Funds	4,050,000	2,670,979	2,670,979	4,090,000	3,420,258	3,420,258
DOH						
Operating						
General Funds	10,243,591	8,308,789	5,695,789	10,923,050	8,780,809	5,907,121
Federal Funds	927,576	777,211	777,211	956,502	791,188	791,188
CIP	1,634,000	1,584,000	0	0	0	0
TOTAL	12,805,167	10,670,000	6,473,000	11,879,552	9,571,997	6,698,309
DLNR						
Operating						
General Funds	646,271	545,120	445,120	615,465	726,278	476,278
CIP	2,405,000	0	0	1,438,000	1,300,000	1,000,000
TOTAL	3,051,271	545,120	445,120	2,053,465	2,026,278	1,476,278
GOV						
Operating						
General Funds	4,258,070	5,885,621	3,437,224	4,953,804	6,264,018	3,553,421
Federal Funds	2,316,248	1,878,473	1,878,473	2,453,917	1,878,473	1,878,473
TOTAL	6,574,318	7,764,094	5,315,697	7,407,721	8,142,491	5,431,894
GRAND TOTALS	\$40,043,068	\$29,465,157	\$20,793,115	\$38,939,014	\$31,240,589	\$23,032,809
Operating	35,204,068	27,881,157	20,793,115	37,401,014	29,940,589	22,032,809
General Funds	28,036,501	24,452,330	17,364,288	29,479,588	26,484,374	18,576,594
Federal Funds	7,167,567	3,428,827	3,428,827	7,921,426	3,456,215	3,456,215
CIP	4,839,000	1,584,000	0	2,538,000	1,300,000	1,000,000

Source: Department of Budget and Finance, December 27, 1982.

departmental recommendations, and B&F's adjustments. As a result of B&F's review, the Governor's executive budget request to the Legislature will recommend funding of about 140 requests with \$20,795,115 and \$23,032,809 from all sources of funding for FY 1983–84 and FY 1984–85, respectively.

**B&F's criteria.** B&F finally developed and used criteria for its review of the departmental recommendations and the requests themselves. B&F's criteria consists of eight priorities or categories of services ranked in order of preference for funding. A copy of the criteria is Exhibit 2.1.

In using the criteria, B&F first identified all requests, from all state agencies, falling within the first priority and recommended funding of these. Then it moved on to the second, third, fourth and finally, the fifth priority when its funding limits were reached. Requests not falling within any of these categories and requests for "grants-in-aid" for 100 percent state funding were denied recommendations for funding.

There are several problems with the criteria:

*First*, the key terms in the criteria—"mandated services," direct and non-direct health and social services, etc.—are not adequately defined to ensure fair application of the criteria.

*Second*, the criteria do not specify the types of services needed, the amount of services, or where they are needed.

*Third*, the criteria excludes any consideration of the efficiency and effectiveness of the proposed project in providing the kinds of services the State wishes to fund.

*Fourth*, B&F's decision to deny requests for projects requiring full state support is based on the department's own views, not on anything in Chapter 42. The law directs the State to review requests in terms of their efficiency and effectiveness in achieving state objectives. Projects entirely supported by state funds may meet these standards as well as projects with other sources of funds.

Underlying the entire issue of application of the criteria was B&F's delayed release of the criteria. It seems unfair that B&F announced the most important rules of the game after private agencies submitted their requests, after the departments completed their

Exhibit 2.1

Department of Budget and Finance's  
Priorities and Criteria for Purchases of Service, Grants-in-Aid, and Subsidies

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- Priority 1: Services which are specifically mandated by State statutes or Federal law.
- Criteria: State or Federal laws which mandate the services which the departments have opted to purchase from private organizations rather than implement or expand State programs.
- Priority 2: Services which are required for clients for whom the State is mandated by State statute or Federal law to provide for.
- Criteria: State or Federal laws which mandate State responsibility for specific clients which the departments have opted to purchase from private organizations rather than implement or expand State programs.
- Priority 3: Grants-in-aid or subsidies for crisis intervention services.
- Criteria:
1. Services are non-duplicative of State programs.
  2. Services augment State programs.
  3. Organization not 100% State-funded.
  4. Services are not limited to any specific target group or geographical location.
- Priority 4: Grants-in-aid or subsidies for direct health and social services for the elderly and handicapped.
- Criteria:
1. Services are non-duplicative of State programs.
  2. Services augment State programs.
  3. Organization not 100% State-funded.
- Priority 5: Grants-in-aid and subsidies for direct health and social services for target groups other than the elderly or handicapped.
- Criteria:
1. Services are non-duplicative of State programs.
  2. Services augment State programs.
  3. Organization not 100% State-funded.
- Priority 6: Grants-in-aid and subsidies for non-direct health and social services.
- Criteria:
1. Services are non-duplicative of State programs.
  2. Services augment State programs.
  3. Organization not 100% State-funded.
- Priority 7: All other grants-in-aid and subsidies.
- Criteria:
1. Services are non-duplicative of State programs.
  2. Services augment State programs.
  3. Organization not 100% State-funded.
- Priority 8: 100% State-funded requests.

General criteria for recommendation:

1. Priority of departments to be given first consideration within each of the priorities.
  2. If no department priority, requests to be considered only if funds are available.
  3. All recommendations subject to availability of funds.
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Source: Department of Budget and Finance, December 9, 1982.

reviews, and even after B&F itself completed its reviews. The criteria should not have been restricted to application by B&F but should have had the effect, assuming the criteria's appropriateness, of influencing better proposals by the private organizations and better recommendations by the state agencies.

**Some results of B&F's review.** There are several questionable funding requests which were incorporated into the executive budget, and these relate to inconsistencies and questions of legality previously discussed in the context of the applications process and agency review. To illustrate, we follow up on the recommendations of the State Foundation on Culture and the Arts, the Public Welfare Division and the Mental Health Division.

*State Foundation on Culture and the Arts.* B&F made a significant exception for requests to the foundation. Although none of these requests met its criteria for funding (they did not fall under the first five priorities), B&F arbitrarily set aside a \$400,000 lump sum for the foundation. In effect, B&F is allowing the foundation to decide at a later time which requests would be recommended for funding, because the foundation had submitted its recommendations without ranking the requests and B&F said it was not able to determine who should receive the funds. The foundation, at the end of December, said it would decide how to apportion the funds later in January, and make known how it intends to use the funds.

*Public Welfare Division.* B&F adopted all of the Public Welfare Division's recommendations for funding requests, despite some problems in the division's evaluations and recommendations for funding requests outside of the ceiling. In doing so, B&F recommended funding of questionable projects—at the levels recommended by the Public Welfare Division—such as those previously identified in this chapter: the over-staffed and ineffective project, the projects which are not offering priority services and for which a need is uncertain, and the “case management” project which was to be conducted by state employees under the block grant plan. These kinds of projects apparently met B&F's criteria or were recommended for funding in spite of the criteria.

*Mental Health Division.* B&F, for the most part, accepted the division's recommendations, and in aggregate amounts, approved executive budget funding of 95 percent of the division's request for the biennium. B&F allocated to the division the two lump sum amounts the division requested—one for purchases of service in its

operating budget and the other for “grants-in-aid.” In doing so, it improperly allowed the division to defer decisions on 30 requests in violation of Chapter 42, which requires the State to make decisions and inform private agencies of the State’s findings and recommendations. As late as it is, we believe that decisions on these requests must be prepared and submitted to the Legislature. Otherwise, any subsequent awards made from such sums as the Legislature might appropriate could be legally questioned.

### **Judiciary and the Counties**

As a matter of convenience, we summarize in this chapter the progress of the judiciary and the counties in implementing Chapter 42.

The judiciary has promulgated rules and regulations, and it has developed forms for the applications process. The forms were specifically designed for private organizations, and they are concise and solicit the kinds of information Chapter 42 requires. We were informed that such purchases of service which the judiciary knows that it intends to enter into have been included in the judiciary budget submission to the Legislature. One possible problem that the judiciary foresees is that family court services, with its wide range of cases and clients, might have to use the services of a provider not foreseen at the time the budget was recommended to the Legislature. The Legislature might wish to clarify such situations.

As for the counties, which are required by Chapter 42 to adopt standards for the granting of public funds to private organizations, we found that each of the counties has enacted standards by ordinance.

## ***Recommendations***

*We recommend as follows:*

*1. With respect to the applications process, B&F add to its rules a timetable which allows adequate time for private organizations to submit applications and state agencies to review them; simplify and tailor the application forms specifically for private organizations; and require the State Foundation on Culture and the Arts and the Division of Vocational Rehabilitation of DSSH to implement the applications process for their budgeted purchases of service.*

*2. With respect to the agency review process, B&F include proposed funds for private organizations under departmental budget ceilings to induce the agencies to carefully review the requests, rank priorities and analyze tradeoff possibilities between programs. With respect to the Mental Health Division, B&F require the division to review and make decisions on the requests that were submitted by private organizations under Chapter 42 and communicate those decisions to the organizations and the Legislature.*

*3. With respect to funding criteria, B&F review the criteria it has developed, amend them as suggested in our report, and communicate the criteria to the state agencies and private organizations.*

*4. The Legislature consider whether legislation is needed to clarify how the law applies to individuals or unanticipated purchases of service by the family court.*

## Chapter 3

### ASSESSMENT OF EXPENDITURE CONTROLS FOR PRIVATE ORGANIZATIONS

While the State was busy processing applications and preparing its budget for the fiscal biennium 1983–85, it was also starting a new fiscal year and making arrangements to expend funds for private agencies appropriated earlier. The requirements of Chapter 42 relating to the expenditure of funds for private agencies went into effect in 1981. The statutory requirements pertain to: (1) contract conditions and contracting procedures; and (2) monitoring and evaluation of the programs of private organizations. In this chapter, we assess how well state agencies are meeting these requirements.

**Summary of findings.** The State is complying with some but not all of the statutory requirements governing the expenditure of public funds through private agencies. More specifically, we find that:

1. The contracts used by the state agencies differ from agency to agency and are not fully in conformance with statutory contract conditions or with the model contracts developed by the Department of Budget and Finance (B&F). In the execution of contracts, some state agencies have been late, thus delaying payments to the private organizations involved.

2. The State has taken little action to establish a system for reasonable monitoring and evaluation of private agencies, as required by Chapter 42.

#### Contract Conditions and Procedures

As required by law, B&F developed model contract forms, one each for grants, subsidies, and purchases of service, outlining the rights and obligations of the State and the private agencies. However, there are some deviations from the law in these model contracts. More seriously, a number of the actual contracts entered into by the state agencies seem to be patterned after contracts previously executed and not after the specific conditions specified by Chapter 42.

Some deviations of B&F's model contracts from the law. The model contracts lack one of two required provisions on indemnification of the State.<sup>1</sup> They contain a clause holding the State harmless from liability for acts of the private agency, but they do not mention, as an essential condition, that the private agency must also agree to obtain signed waivers of liability from each program participant.

The model contracts also fail to state that violations of the terms of the contract as well as violations of Chapter 42, HRS, may, according to Section 42-10, HRS, result in the private agency being prohibited from applying for funds for a period of five years.

**Variations and nonconformance of state agency contracts.** In its instructions, B&F says that the state agencies may, with some restrictions, modify its model contracts. We find that state agencies are not following the model contracts very closely. They are using contracts which are not fully in compliance with the model contracts or the law, and which differ significantly from agency to agency.

**Deficiencies in agency contracts.** The state agencies are basically using their "old" contracts. Some have modified these contracts; others have not. The contracts executed by the state agencies in 1982 vary in degree of conformance to basic provisions of the model contracts and the law.

For example, some contracts of the Division of Vocational Rehabilitation are deficient in several respects. The law and the model contracts specify that private agencies shall not discriminate on the bases of race, color, national origin, religion, creed, sex, age, and physical handicap. The division's non-discrimination clause does not extend to age and creed and sometimes omits reference to sex. Furthermore, some contracts do not contain the statutory conditions not to use public funds for purposes of entertainment or perquisites; not to employ two or more members of a family or kin of the first or second degree without permission; and not to grant any salary or employee benefit increase without prior approval from the State.

1. Section 42-8(b), HRS reads: "Each contract shall specify that the State shall not be held liable for any claims or damages resulting from the acts of the recipient or provider. Each recipient or provider shall require signed waivers from the participants in the recipient's or provider's program holding the State harmless from liability."

The contracts of other agencies also have some omissions. The grant contracts of the State Foundation on Culture and the Arts (SFCA) are missing an indemnification clause holding the State harmless from liability and all foundation contracts are missing a non-discrimination provision for the physically handicapped. The contracts of the Public Welfare Division do not prohibit discrimination on the basis of religion or creed.

The model contracts developed by B&F come closer to compliance with the law than some agency contracts do. With the corrections to the model contracts that we have suggested, it may be simpler for all state agencies to use the appropriate model contracts word for word, and then add other provisions which the agencies might deem necessary to fit the situations of the particular programs being conducted by the private organizations.

**Delays in issuing contracts.** Contracts execution has been late, especially by state agencies heavily involved in contracts with private organizations. The law requires state agencies to “. . . execute each contract no later than sixty days from the effective date of the appropriation or as soon as practicable thereafter,” and if contracts are not executed within 60 days, the state agencies are required to inform the private agencies when they will be executed.

Despite the reasonable 60-day period, the SFCA and the Department of Health (DOH) still had many more contracts to execute at the end of August 1982. The foundation had executed about 25 percent of its contracts by then; it had about 100 more to prepare. DOH had executed about a third of its contracts; it, too, had about 100 to finalize. Because many of these contracts are stock contracts, with standard clauses, they should not have been difficult to prepare and execute in a timely fashion.

The delays in the execution of contracts resulted in delays in payments to the private agencies. None of the state agencies we monitored notified private organizations of late contracts, as required by law. But they did respond to inquiries about delays, when raised by the private organizations involved.

## Monitoring and Evaluation

Section 42–9, HRS, states: “Every grant, subsidy or purchase of service agreement shall be monitored by the appropriate agency to ensure compliance with this chapter and the public purpose and legislative intent of the grant, subsidy or purchase of service agreement,” and each shall also “. . .be evaluated annually to determine its continued eligibility and whether the grant, subsidy or purchase of service agreement attained the intended results in the manner contemplated.” These particular requirements became effective in June 1981.

While B&F adopted the required rules and regulations for monitoring and evaluation in July 1982—a year after the law went into effect—nothing much has been done to establish monitoring and evaluation on a systematic basis, except for those agencies, like the Public Welfare Division, which previously monitored private agencies as a matter of routine.

At the time that legislative hearings were conducted on the various measures related to transfers of funds to private organizations, some agencies complained that the proposed monitoring and evaluation requirements would create an onerous burden and that larger staffs would be required to carry out these tasks.

Our assessment is that the monitoring as well as evaluation requirements imposed by law and B&F rules are reasonable. Except in extraordinary cases, monitoring should involve little more than periodic checking to assure that the programs are on track and that public funds are being used for the purposes intended.

As for annual evaluations, they likewise can be conducted pretty much as a matter of program routine. The rules require private agencies to submit variance reports which show budgeted vs. actual expenditures, planned vs. actual performance and program size in the prior year, estimates of performance and program size in the current year, and explanations of significant differences. These reports are to be used by the agencies as the basis for preparing evaluation reports. Only in rare situations would in-depth evaluations, involving extensive field work, be required.

What is needed to place monitoring and evaluation on a systematic basis is for the state agencies to inform the private agencies of the kinds of data that need to be maintained and to establish schedules for monitoring and evaluation.

## ***Recommendations***

*We recommend as follows:*

*1. B&F enforce greater uniformity in contracts by requiring the agencies to follow the model contracts it has developed while allowing the agencies to include additional unique provisions which might be appropriate for their respective programs.*

*2. State agencies establish monitoring and evaluation of the programs of private organizations on a systematic basis by informing the organizations of the data they need to maintain and by developing schedules for monitoring and evaluation.*