
The Arizona Department of Education's Implementation of the Single Audit Act Amendments of 1996

MANAGEMENT INFORMATION REPORT



ED-OIG/A02-90001
FEBRUARY 2000

Our mission is to promote the efficient
and effective use of taxpayer dollars
in support of American education.



U.S. Department of Education
Office of Inspector General
New York, New York

NOTICE

Statements that financial and/or managerial practices need improvement or recommendations that costs questioned be refunded or unsupported costs be adequately supported, and recommendations for the better use of funds, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determinations on these matters will be made by the appropriate Education Department officials.



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

MEMORANDUM

DATE: FEB 15 2000

TO: Thomas P. Skelly
Chief Financial Officer, Acting
Office of the Chief Financial Officer

FROM: Lorraine Lewis *Lorraine Lewis*

SUBJECT: MANAGEMENT INFORMATION REPORT: "The Arizona Department of Education's Implementation of the Single Audit Act Amendments of 1996"
Audit Control Number: ED-OIG/A02-90001

Attached is our subject management information report that covers the results of our survey of the Arizona Department of Education's implementation of the Single Audit Act Amendments of 1996 during the period July 1, 1996 to June 30, 1997.

In accordance with the Department's Audit Resolution Directive, you have been designated as the primary action official for this report. The Assistant Secretaries of the Office of Elementary and Secondary Education, Office of Special Education and Rehabilitation Services, and Office of Vocational and Adult Education are collateral officials. Please coordinate with them regarding any actions in connection with the recommendations.

Pursuant to the Freedom of Information Act (Public Law 90-23), reports issued by the Office of Inspector General are available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act. Copies of this report have been provided to the offices shown on the distribution list enclosed in the report.

If you have any questions, please call Bernard E. Tadley, Area Manager, at (215) 656-6279.

Please refer to the above audit control number in all correspondence relating to this report.

Attachment

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202-1510

Our mission is to ensure equal access to education and to promote educational excellence throughout the Nation.



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

MEMORANDUM

DATE: FEB 15 2000

TO: Michael Cohen
Assistant Secretary
Office of Elementary and Secondary Education

FROM: Lorraine Lewis *Lorraine Lewis*

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UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

MEMORANDUM

DATE: FEB 15 2000

TO: Judith E. Heumann
Assistant Secretary
Office of Special Education and Rehabilitative Services

FROM: Lorraine Lewis *Lorraine Lewis*

SUBJECT: MANAGEMENT INFORMATION REPORT: "The Arizona Department of Education's Implementation of the Single Audit Act Amendments of 1996"
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UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

MEMORANDUM

DATE: FEB 15 2000

TO: Patricia W. McNeil
Assistant Secretary
Office of Vocational and Adult Education

FROM: Lorraine Lewis *Lorraine Lewis*

SUBJECT: MANAGEMENT INFORMATION REPORT: "The Arizona Department of Education's Implementation of the Single Audit Act Amendments of 1996"
Audit Control Number: ED-OIG/A02-90001

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The Arizona Department of Education’s Implementation of the Single Audit Act Amendments of 1996

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SUMMARY

The Single Audit Act Amendments of 1996 were enacted on July 5, 1996 and apply to non-Federal entities with respect to fiscal years beginning after June 30, 1996. In response to the Single Audit Act Amendments of 1996, the Office of Management and Budget issued a revised Circular A-133 retitled "Audits of States, Local Governments, and Non-Profit Organizations," which established uniform audit requirements for non-Federal entities that administer Federal awards and implemented the Single Audit Act Amendments of 1996.

This Management Information Report presents the areas of concern identified in our survey of the Arizona Department of Education's implementation of the Single Audit Act Amendments of 1996. The objectives of the survey were to:

- Determine if the Arizona Department of Education is using single audits to manage U.S. Department of Education (ED) programs.
- Evaluate the impact of the new provisions of the Single Audit Act Amendments of 1996 (primarily the change in the dollar threshold for determining if an entity is subject to a single audit, and the use of a risk-based approach in identifying major programs) on the Arizona Department of Education's use of single audits.

In general, we concluded that the Arizona Department of Education uses single audits of local education agencies (LEAs) to correct deficiencies identified. In addition, Arizona Department of Education officials state that they rely heavily on single audit findings for monitoring LEAs. However, the Arizona Department of Education does not make other use of the audits, such as analyses of findings statewide to identify possible patterns of noncompliance. While not required under the Single Audit Act Amendments of 1996, the use of single audits to identify possible patterns of noncompliance could ultimately lead to improved program performance. We also concluded that the new provisions in the Single Audit Act Amendments of 1996 had little or no impact on the Arizona Department of Education's use of single audits.

The survey identified two areas of concern:

- I. The Arizona Department of Education Special Education and Vocational Education program offices do not have plans for expanded monitoring of LEAs no longer subject to a single audit.
 - We recommend that the ED Chief Financial Officer, with the assistance of ED program officials, ensure that the Arizona Department of Education provide appropriate oversight for subrecipients expending less than \$300,000 per year in Federal awards, in accordance with the Education Department General Administrative Regulations (34 C.F.R. Section 80.40(a)) and Circular A-133 (Subpart D, Section 400(d)(3)).

- II. Fifteen LEAs in Arizona with fiscal year 1997 Federal expenditures of less than \$300,000 included unallowable audit costs in their fiscal year 2000 indirect cost pools. An Arizona Department of Education Audit Services Unit representative concurred that these audit costs are unallowable under the Single Audit Act Amendments of 1996 and agreed to remove them from the fiscal year 2000 and 2001 indirect cost pools.
- We recommend that the ED Chief Financial Officer ensure the Arizona Department of Education's completion of the proposed corrective actions.

BACKGROUND

The Single Audit Act Amendments of 1996 were enacted on July 5, 1996 and apply to non-Federal entities with respect to fiscal years beginning after June 30, 1996. In response to the Single Audit Act Amendments of 1996, the Office of Management and Budget issued a revised Circular A-133 retitled "Audits of States, Local Governments, and Non-Profit Organizations," which established uniform audit requirements for non-Federal entities that administer Federal awards and implemented the Single Audit Act Amendments of 1996.¹ As a result of consolidating the audit requirements for state and local governments with those of other non-Federal entities, the revised Circular A-133 replaced Circular A-128 "Audits of State and Local Governments." One of the more significant revisions in the Single Audit Act Amendments of 1996 and Circular A-133 is that the dollar threshold for entities required to submit single audits was increased from \$25,000 to \$300,000 in annual expenditures of Federal awards. Another significant new provision is identifying major programs using risk-based program selection criteria; previously, major programs were identified based solely upon the amount of Federal awards expended by the entity.

In Arizona, the Arizona Department of Education and Auditor General share oversight responsibilities for single audits of local education agencies. The Arizona Department of Education Audit Services Unit tracks the receipt of LEA audit reports and the audit finding resolution process. The Arizona Department of Education program offices are responsible for monitoring LEAs, eliciting the appropriate corrective actions from auditees, and determining when LEAs have satisfactorily resolved audit findings. The Auditor General reviews LEA single audit contracts, single audit reports, audit work papers, and the State's Uniform System of Financial Records Compliance Questionnaire to determine if LEAs and their independent public accountants have complied with the Single Audit Act Amendments of 1996 and the State's Uniform System of Financial Records requirements.

¹ ED amended Title 34 Code of Federal Regulations Section 80.26, effective September 29, 1997, to codify the revised Circular A-133, so as to apply to audits of fiscal years beginning after June 30, 1996. The amended 34 C.F.R. Section 80.26(a) states, "Basic Rule. Grantees and subgrantees are responsible for obtaining audits in accordance with the Single Audit Act Amendments of 1996 (31 U.S.C. 7501-7507) and revised OMB Circular A-133, 'Audits of States, Local Governments, and Non-Profit Organizations.' The Audits shall be made by an independent auditor in accordance with generally accepted government auditing standards covering financial audits."

AREAS OF CONCERN

In the course of conducting our survey, we discovered two areas of concern, which are discussed below.

I. ARIZONA DEPARTMENT OF EDUCATION'S OVERSIGHT OF LEA PROGRAMS

The Single Audit Act Amendments of 1996 increased the threshold that triggers an audit requirement from \$25,000 to \$300,000 in annual Federal award expenditures.

The new threshold resulted in approximately 70 Arizona LEAs losing oversight formerly provided by single audits. This increased the number of LEAs in Arizona without single audit coverage to approximately 110 out of 234 LEAs.

According to Arizona Department of Education officials, they rely heavily on single audit findings for monitoring LEAs. In addition, the Arizona Department of Education's monitoring of LEAs includes site-visits, technical assistance, and self-assessments. Arizona Department of Education officials provided us with program monitoring instruments and reported that Vocational Education and Special Education programs are on a 5 and 6 year monitoring cycle, respectively. Arizona Department of Education officials intend these monitoring procedures to cover approximately 95 percent of Federal awards.

However, through our conversations with Arizona Department of Education officials, we learned that there are no written comprehensive monitoring policies and procedures in place. In addition, we determined that the Arizona Department of Education Special Education and Vocational Education program offices do not have plans for expanded monitoring of LEAs no longer subject to a single audit. The loss of single audit oversight of LEAs decreases the probability of detecting fraud, waste, abuse, and mismanagement of Federal awards. Comprehensive monitoring policies and procedures are needed to ensure that Federal awards are administered in accordance with program requirements.

The Single Audit Act Amendments of 1996 [31 U.S.C. Section 7502(f)(2)(B)] state "each pass-through entity shall monitor the subrecipient's use of Federal awards through site-visits, limited scope audits, or other means." When issuing the final revision of Circular A-133, the Office of Management and Budget recommended that state education agencies and other pass-through entities should review and possibly expand their subrecipient monitoring to address the loss of single audit oversight resulting from the Single Audit Act Amendments of 1996. Specifically, a response in the Public Comments and Responses issued with the final revision of Circular A-133 (issued June 30, 1997) states:

In light of the increased threshold that triggers an audit requirement under the Circular to \$300,000 or more in Federal awards expended per year, pass-through entities will need to make appropriate changes in their agreements with subrecipients to reflect that Circular A-133 audits no longer will be required for non-Federal entities with total Federal awards expended of less than \$300,000 annually.

Since pass-through entities are held accountable for Federal awards administered by their subrecipients, they also need to review their overall subrecipient monitoring process and decide what, if any, additional monitoring procedures may be necessary to ensure subrecipient compliance.

In a December 1, 1999, letter regarding the issues covered in this report, the Arizona Department of Education informed us that the Title I program office is piloting a comprehensive monitoring program "to meet the additional oversight requirements resulting from the increase in dollar unit threshold for single audits."

Recommendation

We recommend that the ED Chief Financial Officer, with the assistance of ED program officials, ensure that the Arizona Department of Education provide appropriate oversight for subrecipients expending less than \$300,000 per year in Federal awards, in accordance with the Education Department General Administrative Regulations (34 C.F.R. Section 80.40(a)) and Circular A-133 (Subpart D, Section 400(d)(3)).

II. UNALLOWABLE AUDIT COSTS

We discovered 15 LEAs in Arizona with fiscal year 1997 Federal expenditures of less than \$300,000 that included unallowable audit costs in their fiscal year 2000 indirect cost pools. Circular A-133, Subpart B, Section 230 (b) states that a non-Federal entity expending less than \$300,000 per year from Federal awards shall not charge audit costs to a Federal award. A representative of the Arizona Department of Education Audit Services Unit explained that before Circular A-133 went into effect, ED approved their plan for including these audit expenses in the indirect cost rate calculation for all LEAs. However, the Arizona Department of Education Audit Services Unit representative concurred that these audit costs are unallowable under the Single Audit Act Amendments of 1996 and initiated corrective action. The corrective action included:

- For the 15 LEAs in question, recalculating their fiscal year 2000 indirect cost rates after excluding from their indirect cost pools the unallowable fiscal year 1997 audit costs, which total \$100,091.
- For LEAs with less than \$300,000 in Federal expenditures, excluding fiscal year 1998 audit costs from their indirect cost pools prior to calculating their fiscal year 2001 indirect cost rates.

The costs for fiscal year 1997 audits were included in the indirect cost pools the Arizona Department of Education used to calculate fiscal year 2000 indirect cost rates.² Upon being notified of the unallowable audit costs that the survey team identified, the Arizona Department of Education initiated the removal of the unallowable audit costs from the indirect cost pools. According to the Arizona Department of Education Audit Services Unit representative, the indirect cost rates were corrected prior to their application in fiscal year 2000. Upon completion, the corrective action results in no unallowable audit costs being charged to Federal awards.

Recommendation

We recommend that the ED Chief Financial Officer ensure the Arizona Department of Education's completion of the corrective action.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our survey reviewed the Arizona Department of Education's implementation of the Single Audit Act Amendments of 1996. The survey covered the significant revisions to the Single Audit Act, primarily the change in the dollar threshold for entities subject to a single audit, and the use of a risk-based approach in identifying major programs. The objectives of the survey were to:

- Determine if the Arizona Department of Education is using single audits to manage ED programs.
- Evaluate the impact of the new provisions of the Single Audit Act Amendments of 1996 on the Arizona Department of Education's use of single audits.

Our work consisted primarily of interviews with officials from the Arizona Department of Education, Arizona Auditor General, LEAs, and independent public accountants that perform single audits of LEAs, as well as reviews of documents provided by the officials. We conducted the survey's fieldwork in Arizona during the period March 9 through March 25, 1999. The period covered by the survey was July 1, 1996 through June 30, 1997, the Arizona Department of Education's fiscal year 1997. Our work was conducted in accordance with the Government Auditing Standards appropriate to the survey's scope. Management Information Reports are intended to provide information for use by decision-makers and are not audit or investigative reports.

² OMB Circular A-87 "Cost Principles for State, Local, and Indian Tribal Governments" permits the use of fixed indirect cost rates. A fixed indirect cost rate is agreed to in advance, based upon an estimate of future costs, but is not retroactively adjusted. When the difference between the estimated and actual costs for the period is determined, an adjustment is made to the rate for future years to compensate for the difference between the costs used to establish the fixed rate and the actual costs incurred. Fixed cost rates are used exclusively by state and local governments due to their lasting relationship with, and continuous funding by, the Federal government. The Arizona Department of Education uses a fixed indirect cost rate. In developing their indirect cost rate for fiscal year 2000, the Arizona Department of Education used fiscal year 1997 costs as an estimate for fiscal year 2000 costs.

In a December 1, 1999, letter, which is attached, the Arizona Department of Education responded to summaries of our survey's areas of concern. We considered their comments in preparing this Management Information Report.

REPORT DISTRIBUTION LIST

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State of Arizona
Department of Education

Lisa Graham Keegan
Superintendent of
Public Instruction

Guido G. Piacesi
Regional Inspector General for Audit
75 Park Place, Room 1207
New York, NY 10007

December 1, 1999

Re: Comments on Management Information Report
Survey of implementation of single audit amendments

Dear Mr. Piacesi:

Enclosed are the Arizona Department of Education responses to the summaries *ADE Oversight of LEA Programs* and *Unallowable Audit Costs* in your Management Information Report.

If you have any questions, please contact me at (602) 542-5528.

Sincerely

A handwritten signature in black ink, appearing to read "Brian Jones", with a stylized flourish extending to the right.

Brian Jones
Director of Federal Programs

At the Arizona Department of Education (ADE), the responsibility for monitoring federal education programs are divided between Exceptional Student Services (ESS), Vocational/Technological Education (VTE) and Academic Student Support (Title I and umbrella programs). Following is a summary of the monitoring policy of each area.

Exceptional Student Services

ESS has a 6 year monitoring cycle that includes all of the LEAs and public agencies in the State. The monitoring focuses on programmatic compliance and does contain a "removal from census" procedure when we find schools that have not accurately implemented the major requirements of the law. It does not include a fiscal audit as our staff are program specialists not auditors. We have revised our monitoring process in light of IDEA '97 and we cover all program requirements in a process that takes 2-5 days in each LEA. We will revise our process if we are found to be out of compliance when our OSEP monitoring report arrives in January (or so).

Vocational/Technological Education

VTE is in the process of revising our monitoring instrument and cycle. We will be on a 5 year monitoring cycle and we will be focusing on programmatic compliance. Like ESS our staff are program specialists and not auditors and lack the knowledge and skill to do fiscal audits. If problems are identified through our programmatic monitoring, depending upon the level of problems, we will consider requesting a special audit. We have one district in that situation currently who will be experiencing such an audit.

Academic Student Support

To meet the additional oversight requirements resulting from the increase in dollar unit threshold for single audits pursuant to OMB Circular A-133, the Academic Support Division is piloting a comprehensive monitoring program. This program includes implementation of a self-assessment tool by Local Education Agencies (LEA's), on-site visits and third party financial audits of federal programs. These activities allow the ADE/ASD to meet statutory requirements to ensure sub-recipients are implementing programs pursuant to the law, that school plans are implemented as written, that students are achieving academically and that the SEA and LEA's work as partners in developing quality programs for students. A major component of the ADE/ASD Monitoring system is the provision of technical assistance.

The purpose of the IASA self-assessment instrument is to provide a tool for LEA's to use as a guide for development and implementation of their programs. This tool should be used to assess annually how well they are meeting the goals of their LEA Consolidated Plan. The tool is also designed to provide LEA's the ability to look at the integrity and quality of their IASA programs and to identify areas in which technical assistance may be needed. The results of these reviews may be used by the ADE/ASD to:

1. identify model programs
2. identify various levels of technical support needed
3. assist in meeting the needs of LEA's through the System of School Support and the provision of technical assistance.
4. Identify LEAs whose programs are not in compliance with federal or state law for follow-up monitoring.

The indirect cost rates for the LEAs with unallowable audit costs were corrected and notified of the changes before the incorrect rates were used. In the future the audit costs for audits not performed under OMB Circular A-133 will not be included in the indirect cost calculation for the LEA.