



**U.S. Department of Education  
Office of Inspector General**



# **American Recovery and Reinvestment Act of 2009**

## **State and Local Controls over ARRA Funds in California**

### **Audit Report**



**California State Capitol**

*Source: California Department of Water Resources*

**ED-OIG/A09J0006**

**January 2010**



UNITED STATES DEPARTMENT OF EDUCATION  
OFFICE OF INSPECTOR GENERAL

AUDIT SERVICES  
SACRAMENTO REGION

January 15, 2010

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Dear Ms. Bryant and Messrs. O'Connell and Sauer:

This **final audit report** presents the results of our review to determine whether State agencies charged with responsibility for overseeing education-related American Recovery and Reinvestment Act funds have designed systems of internal control that are sufficient to provide reasonable assurance of compliance with applicable laws, regulations, and guidance.

Statements that managerial practices need improvement, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General (OIG). Determinations of corrective action to be taken will be made by the appropriate Department of Education officials.

If you have any additional comments or information that you believe may have a bearing on the resolution of this audit, you should send them directly to the following Department of Education officials, who will consider them before taking final Departmental action on this audit:

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It is the policy of the U.S. Department of Education to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, receipt of your comments within **30 days** would be appreciated.

In accordance with the Freedom of Information Act (5 U.S.C. § 552), reports issued by the Office of Inspector General are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

Sincerely,

/s/

Raymond Hendren  
Regional Inspector General for Audit

## Abbreviations and Acronyms Used in this Report

ARRA	American Recovery and Reinvestment Act of 2009
CDE	California Department of Education
C.F.R.	Code of Federal Regulations
Department	U.S. Department of Education
GAO	Government Accountability Office
IDEA	Individuals with Disabilities Education Act
IG	Inspector General
LEA	Local educational agency
OIG	Office of Inspector General
OMB	Office of Management and Budget
OPR	Governor's Office of Planning and Research
SELPA	Special Education Local Plan Area
SERP	Supplemental Early Retirement Plan
SFSF	State Fiscal Stabilization Fund
USD	Unified School District

# State and Local Controls over ARRA Funds in California

Control Number ED-OIG/A09J0006

## PURPOSE

The American Recovery and Reinvestment Act of 2009 (ARRA) places a heavy emphasis on accountability and transparency and, in doing so, increases the responsibilities of the agencies that are impacted by the Act. Overall, the U.S. Department of Education (Department) is responsible for ensuring that education-related ARRA funds reach intended recipients and achieve intended results. This report provides the results of our review to determine whether agencies charged with responsibility for overseeing ARRA funds in California have designed systems of internal control that are sufficient to provide reasonable assurance of compliance with applicable laws, regulations, and guidance.

We focused our review on the design of State and local controls over cash management, subrecipient monitoring, data quality, and use of funds. The controls are a key aspect in the proper administration of ARRA funds for the State Fiscal Stabilization Fund (SFSF), Title I Part A of the Elementary and Secondary Education Act (Title I), Part B of the Individuals with Disabilities Education Act (IDEA), and Title I Part B of the Rehabilitation Act (Vocational Rehabilitation).

## RESULTS

The State and local agencies we reviewed in California had systems of internal control in place or were designing control systems to provide for the proper administration and use of education-related ARRA funds. These systems consisted of controls established prior to the passage of ARRA, modifications to existing controls in response to the Act, and/or planned controls not yet implemented at the time of our review. Based on our assessment of the designed systems of control planned for ARRA funds, we identified several areas in which controls need to be strengthened or established to provide reasonable assurance of compliance with applicable laws, regulations, and guidance. We concluded that the:

- California Department of Education (CDE) needs to ensure that local educational agencies (LEAs) receive Title I and SFSF funds when needed to pay program costs and timely remit interest earned on cash advances;
- CDE needs to improve existing monitoring procedures for Title I and IDEA under ARRA, and work with the Governor's Office of Planning and Research (OPR) to implement a monitoring protocol for SFSF, in order to ensure timely and adequate oversight of LEAs' administration and use of ARRA funds;
- CDE should take action to ensure that LEAs implement adequate controls to ensure appropriate use of ARRA funds based on issues identified at two of three LEAs reviewed; and
- CDE and OPR need to ensure that employees and subrecipients are informed of ARRA whistleblower protection and Office of Management and Budget (OMB) requirements for referrals to inspectors general.

We also found that California reported on recipients' and subrecipients' use of ARRA funds by the October 10, 2009, deadline. We did not review the procedures for or quality of the reporting.

However, we address as an Other Matter a concern that delays in implementing the reporting system may create challenges for ensuring the quality of LEAs' reported ARRA information.

We did not identify any reportable issues with respect to the education-related ARRA programs administered by the California Department of Rehabilitation (Vocational Rehabilitation), California Department of Corrections and Rehabilitation and the two State university systems (SFSF), or Chico Unified School District (Title I, IDEA, and SFSF).

A preliminary copy of this report was provided to CDE, OPR, and the California Department of Rehabilitation for comment. We discussed the results of our review and recommendations with officials from OPR on November 5, and CDE on November 20, 2009. CDE and OPR concurred with our findings and recommendations and provided updated information and technical corrections, which we have incorporated where appropriate. They did not provide formal written comments. The California Department of Rehabilitation did not provide comments.

**FINDING NO. 1 – CDE Needs to Ensure LEAs Receive Title I and SFSF Funds When Needed to Pay Program Costs and Timely Remit Interest Earned on Cash Advances**

We previously reported a number of cash management issues related to non-ARRA funds at CDE and LEAs within the State. In particular, we were concerned with CDE's inability to disburse Federal funds to LEAs when needed to pay program costs, its lack of controls to ensure that LEAs calculate interest earned on Federal cash advances, and LEAs' inability to accurately calculate and timely remit interest earnings.<sup>1</sup> Our ARRA work found that CDE made some progress in addressing these issues, and confirmed that the issues still existed with respect to CDE's disbursement of Title I and SFSF funds to LEAs under ARRA.<sup>2</sup>

The applicable cash management requirements are addressed in the *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments* (34 Code of Federal Regulations (C.F.R.) Part 80).

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<sup>1</sup> *Local Educational Agency Requirement to Remit Interest Earned on Federal Cash Advanced by State Educational Agencies* (Alert Memorandum, ED-OIG/L09I0013, July 14, 2009); *California Department of Education Advances of Federal Funding to Local Educational Agencies* (Audit Report, [ED-OIG/A09H0020](#), March 9, 2009); *Los Angeles Unified School District's Procedures for Calculating and Remitting Interest Earned on Federal Cash Advances* (Audit Report, [ED-OIG/A09H0019](#), December 2, 2008).

<sup>2</sup> The Government Accountability Office (GAO) also reported concerns about CDE and LEA cash management practices involving Title I funds under ARRA. The 10 LEAs that were contacted by GAO reported carrying significant Title I ARRA cash balances. Nine of the LEAs reported having processes in place to calculate and remit interest on unused Title I funds, although the processes varied from location to location. As of November 2009, CDE was planning to follow up with the one remaining LEA that the GAO report inferred did not have a process in place for calculating and remitting interest. *Recovery Act: Funds Continue to Provide Fiscal Relief to States and Localities, While Accountability and Reporting Challenges Need to Be Fully Addressed (Appendixes)*, GAO (GAO-09-1017SP, September 23, 2009).

- 34 C.F.R. § 80.21 prescribes the basic standard and the methods under which grantees will make payments to subgrantees. The basic standard is that the “[m]ethods and procedures for payment shall minimize the time elapsing between the transfer of funds and disbursement by the grantee or subgrantee . . . .” Grantees and subgrantees shall be paid in advance if they maintain or demonstrate the willingness and ability to maintain procedures to minimize the time between receipt and disbursement of the funds to pay program costs.
- 34 C.F.R. § 80.21(i) requires that “. . . [G]rantees and subgrantees shall promptly, but at least quarterly, remit interest earned on advances to the Federal agency. The grantee or subgrantee may keep interest amounts up to \$100 per year for administrative expenses.”

We did not identify issues related to minimizing time with respect to CDE’s method for disbursing IDEA funds to LEAs under ARRA. CDE initially disbursed 20 percent of IDEA funds to the 124 LEAs, which are known as Special Education Local Plan Areas (SELPA)s.<sup>3</sup> To receive additional funds, the SELPAs were to submit quarterly expenditure reports, which included interest earned on unspent IDEA funds.

**CDE’s Method for Disbursing Title I and SFSF Funds Did Not Ensure LEAs Received the Funds When Needed to Pay Program Costs**

Because of the State’s fiscal crisis and reductions in State funding for education, CDE disbursed most of the Title I and SFSF funds under ARRA without information about whether the LEAs needed the funds at the time of disbursement. Between late May and early July, the State drew down more than \$4 billion in ARRA funds for disbursement to LEAs and other subrecipients. The \$4 billion represented about 80 percent of the Title I and 86 percent of the SFSF funds the Department had awarded to California as of early August.

LEAs throughout the State may have received the ARRA funds too early under CDE’s disbursement method. Our work at three LEAs showed that, while they received most of their Title I and SFSF funds in June and early July, the LEAs had not spent any of the funds at the time of our visits in late July. The LEAs were still planning how they would use the funds. Planning considerations included the need to obtain approval from the LEA’s Board of Education, to work with the teacher’s union for new teacher positions, and/or to seek technical assistance from the Department on allowable uses of Title I funds under ARRA. One LEA planned to spend half of its SFSF funds during school year 2009-10 and the other half during the following year. This timeframe is more than a year after receiving the funds.

A general principle of ARRA is to expend the funding quickly consistent with prudent management to achieve the Act’s purposes. Although CDE distributed funds quickly, it was just as important for CDE not to draw and disburse ARRA funds before LEAs actually needed the funds. Our prior cash management report (A09H0020) described the additional borrowing costs

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<sup>3</sup> The SELPA is the LEA for IDEA funding purposes. A SELPA may be a single school district or composed of multiple districts. In a multi-district SELPA, the SELPA may provide special education services for member districts or disburse funds to districts to provide services.

that the U.S. Treasury would not need to incur if CDE had disbursed the funds when needed by LEAs to pay program costs.<sup>4</sup> Funds drawn too early may also be more susceptible to misuse when held in local accounts for extended periods. Past OIG work in other States had found instances involving non-ARRA funds where internal controls were weak, bypassed, or nonexistent, and LEA officials were able to commit improper and illegal acts that resulted in millions of dollars in misspent funds.<sup>5</sup>

### **CDE Needs to Strengthen Controls to Ensure that LEAs Remit Interest Earned on ARRA Cash Balances**

We previously reported that CDE relied on LEAs to self-report and remit interest earned on non-ARRA cash balances. Additionally, the nine LEAs included in that audit were either not performing the required calculations or incorrectly calculating interest earned on Federal advances. Our ARRA work found that similar conditions may exist at two of the three LEAs reviewed.

Based on our review of existing controls, we concluded that San Diego USD and Tulelake Basin Joint USD may not be computing and remitting interest correctly. San Diego USD officials informed us that, although interest on Federal cash balances was earned in 2009, the LEA did not earn interest from 2006 through 2008 even though it received large sums of Federal funds each year. Tulelake Basin Joint USD was understating interest earnings by inappropriately reducing the estimated interest earned on Federal cash advances to compensate for the temporary use of other available cash resources for Federal programs (“netting”).

In response to a draft of our March 2009 audit report (A09H0020), CDE issued guidance to LEAs on calculating and remitting interest earned on Federal funds. However, we noted in the final report that the guidance did not identify appropriate methodologies for LEAs to use when calculating interest. As of August, CDE had begun a pilot program to implement procedures to monitor LEA compliance with the interest requirement for both ARRA and non-ARRA funds. In addition, CDE’s Audits and Investigations Division hired an analyst to work with the nine districts we reviewed to ensure that the interest-related deficiencies noted in our 2009 report are corrected. The Audits and Investigations Division also began coordinating with the School Fiscal Services Division to develop monitoring procedures to ensure that all LEAs remit interest earnings. Moreover, CDE implemented monitoring procedures for the nine districts previously mentioned. As of November 2009, CDE had drafted more detailed guidance to ensure that other LEAs calculate interest correctly and remit interest earnings at least quarterly. Completion of the guidance was delayed while CDE worked with the Department’s Risk Management Service on the appropriate methodology for calculating interest earnings.

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<sup>4</sup> Federal program funds drawn too early by CDE results in additional Federal borrowing costs because of the Federal deficit, which requires the U.S. Treasury to borrow the cash needed to fund Federal programs and, as a result, incur interest costs.

<sup>5</sup> *Fiscal Issues Reported in ED-OIG Work Related to LEAs and SEAs* (Management Information Report, [ED-OIG/X05J0005](#), July 21, 2009); *An OIG Perspective on Improving Accountability and Integrity in ESEA Programs* ([ED-OIG/S09H0007](#), October 16, 2007).



## Recommendations

We recommend that the Chief Financial Officer require CDE to—

- 1.1 Fully implement planned cash management procedures and consider the cash needs of LEAs before disbursing the remaining ARRA funds so that LEAs can minimize the time between receipt and disbursement of Federal funds in accordance with 34 C.F.R. § 80.21.
- 1.2 Ensure the guidance being developed on Federal interest requirements addresses appropriate methodologies for calculating interest earnings, as addressed in our previous audit report (A09H0020).

### **FINDING NO. 2 – CDE and OPR Need to Ensure that Timely and Adequate Subrecipient Monitoring Procedures Are Implemented for ARRA Subgrants to LEAs**

CDE needs to strengthen its Title I and IDEA program monitoring procedures to ensure LEAs comply with Federal fiscal requirements related to cash management and LEAs' use of and accounting for ARRA funds. At the time of our review, CDE had not modified existing Title I and IDEA program monitoring procedures to ensure timely and adequate oversight of LEAs' administration and use of ARRA funds for these programs. In addition, CDE and OPR had not established subrecipient monitoring procedures for SFSF funds disbursed to LEAs.

Federal regulations at 34 C.F.R. § 80.40 (a) prescribe the basic standards under which grantees will monitor program performance of subgrantees. The basic standards are that the “[g]rantees are responsible for managing the day-to-day operations of grant and sub-grant supported activities. Grantees must monitor grant and sub-grant supported activities to ensure compliance with applicable Federal requirements and that performance goals are being achieved. Grant monitoring must cover each program, function or activity.” On August 27, 2009, the Department issued guidance addressing State monitoring of subrecipients receiving SFSF funds under ARRA.

Although CDE informed us of plans to expand some existing processes to address ARRA monitoring, we concluded that more timely enhancements were needed. As of August, CDE had already disbursed significant amounts of Title I and SFSF funds to LEAs. Unless CDE takes prompt action to enhance subrecipient monitoring practices, and works with OPR to implement monitoring procedures for SFSF, the risk for LEA noncompliance with Federal grant requirements and potential misuse of ARRA funds could be significant.

### **CDE Needs to Improve Monitoring Practices to Ensure LEAs Administer and Use Title I and IDEA ARRA Funds Appropriately**

Existing Title I and IDEA program monitoring practices need strengthening to more effectively monitor LEA compliance with fiscal requirements related to cash management and LEAs' use of Federal funds. To ensure more timely oversight of Title I and IDEA funds under ARRA, CDE should resume Title I monitoring visits, improve the timeliness and effectiveness of its process for resolving LEA single audit findings, and implement other planned ARRA monitoring procedures.

Under existing monitoring procedures, CDE conducts on-site monitoring for the Title I and IDEA programs at most once every 4 years.<sup>6</sup> In February 2009, however, CDE suspended all Title I monitoring visits for at least a year because of budget constraints. During the suspension period, CDE was working to resolve a backlog of prior year monitoring findings. At the time of our review, CDE was also developing a web-based system to collect Title I program compliance information from LEAs to facilitate desk reviews.

On-site program monitoring procedures have not addressed LEAs' administration and use of Title I and IDEA funds. Instead, CDE reviews LEA single audit reports to monitor compliance with applicable fiscal requirements. However, CDE's reliance on single audits will not identify or resolve problems with LEAs' administration of ARRA funds in a timely manner. LEA single audits are not due to CDE for more than 5 months after the State fiscal year ends on June 30. Since significant amounts of Title I and SFSF ARRA funds were disbursed to LEAs between May and July 2009 as reported in Finding No. 1, the single audits covering these funds would not be available to CDE for more than a year after disbursement. We also found that CDE had not ensured resolution of LEA single audit findings within the 6-month timeframe required by Federal regulation (34 C.F.R. § 80.26(b)(3)). To improve the timeliness of the single audit resolution process, CDE recently enhanced its database used to track LEA findings and began to code all repeat findings for easier followup.

As of August 2009, CDE was in the process of developing program monitoring enhancements to address cash management in general and ARRA, including Title I and IDEA. For Title I, CDE redirected staff to provide LEAs with technical assistance on cash management issues and to monitor LEA compliance with Federal interest requirements, including interest earned on unspent ARRA funds. CDE planned to request additional administrative funding to ensure that LEAs appropriately spend and account for ARRA funds. With the additional funding, CDE planned to conduct Title I monitoring visits focused on previously identified high-risk program monitoring findings. For IDEA, CDE planned to develop monitoring procedures addressing fiscal requirements under ARRA.

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<sup>6</sup> CDE visits Los Angeles USD, the largest LEA in the State, on an annual basis.

## **CDE and OPR Need to Implement Subrecipient Monitoring for LEAs that Receive SFSF Funds**

The Department awarded SFSF funds to the Governor's Office. OPR on behalf of the Governor's Office entered into an interagency agreement with CDE to allocate and distribute the funds to LEAs. The interagency agreement stated that CDE would work collaboratively with the Governor and other State agencies to ensure compliance with applicable Federal regulations, which would include the monitoring requirements at 34 C.F.R. § 80.40 (a). However, the agreement did not define oversight responsibilities, such as which State agency would be responsible for monitoring LEAs that receive SFSF funds.

At the time of our review, neither CDE nor OPR had implemented subrecipient monitoring procedures to ensure timely and adequate oversight of the administration and use of SFSF funds. Because SFSF was a new program under ARRA, CDE did not have a monitoring process in place and stated that it was working with OPR to address monitoring responsibilities. OPR told us that it viewed the monitoring of LEAs as CDE's responsibility. As articulated in the Department's August 27 guidance, entitled *States' Responsibility to Monitor Subrecipients Under the State Fiscal Stabilization Fund*, State educational agencies should establish a comprehensive monitoring protocol that includes a monitoring schedule, monitoring policies and procedures, data collection instruments (such as interview guides and review checklists), monitoring reports and feedback to subrecipients, and processes to verify corrective actions are implemented. In November 2009, CDE informed us that planned enhancements to program monitoring procedures previously mentioned for Title I and IDEA under ARRA will also address fiscal monitoring for SFSF.

OPR similarly executed interagency agreements with but had not established procedures for monitoring the use of SFSF funds by the California Department of Corrections and Rehabilitation and the two State university systems. However, we found that the entities used SFSF funds received solely to cover salary expenses shortly after receipt. Moreover, OPR had sufficient procedures to monitor the few salary transactions.

### **Recommendations**

We recommend that the Assistant Secretary for Elementary and Secondary Education and the Assistant Secretary for Special Education and Rehabilitative Services require CDE to—

- 2.1 Implement planned enhancements to existing Title I and IDEA program monitoring practices to provide timely oversight of LEA compliance with fiscal requirements related to cash management and the appropriate use of and accounting for ARRA funds.

We further recommend that the Assistant Secretary for Elementary and Secondary Education require CDE and OPR to—

- 2.2 Implement a comprehensive subrecipient monitoring protocol, consistent with Departmental guidance, to ensure timely and adequate oversight of LEAs' administration and use of SFSF funds.

### **FINDING NO. 3 – CDE Should Take Action to Ensure that LEAs Implement Adequate Controls to Ensure Appropriate Use of ARRA Funds**

Another principle of ARRA is to ensure accountability over the use of funds provided under the Act. Our limited review of LEA internal controls identified two issues that may put ARRA funds at risk for noncompliance with applicable OMB cost principles, ARRA guidance, and/or State requirements. Both issues were related to expenditures for personnel costs at two of the three LEAs reviewed.

Similar issues were likely more widespread across the State. In July 2009, the California State Controller's Office published a report, entitled *Annual Financial Report of California K-12 Schools*, which summarized the results of single audits for the period July 1, 2007, through June 30, 2008. According to the report, more than half of all Federal compliance findings were related to (1) allowable costs/adherence to OMB's cost principles, (2) allowed or unallowed activities, or (3) multi-funded positions not supported by required time distribution (time and effort) records.

At the time of our review, OMB Circular A-87 *Cost Principles for State, Local, and Indian Tribal Governments* governed LEAs' use of Federal grant funds, including SFSF funds under ARRA. On December 24, 2009, the Department issued guidance for grantees and auditors related to SFSF funds in response to questions about recordkeeping, documentation, and reporting requirements. Recognizing that SFSF funds are essentially general aid and may support a broad array of activities, the guidance states that the specific cost principles in the OMB Circulars do not apply to SFSF funds. However, the guidance also states that expenditures attributed to SFSF must still be "reasonable and necessary" and consistent with applicable State and local requirements. Although there are no specific Federal time and effort requirements applicable to individuals whose salaries may be supported with SFSF funds, the guidance requires LEAs to still maintain documentation to support the time and effort of these individuals in the same manner as individuals performing similar duties who are paid with State or local funds. Because this guidance applies to SFSF funds only, all other Federal grant funds remain subject to the cost principles in the OMB Circulars.

#### **San Diego USD Planned to Use ARRA Funds for Supplemental Early Retirement Plan Costs Without Obtaining Prior Approval**

At the time of our review, San Diego USD planned to use \$31 million of its \$52 million SFSF allocation to pay for Supplemental Early Retirement Plan (SERP) costs. However, San Diego USD did not seek prior approval from the Department, as required by State requirements. Without this advance approval, SERP costs charged to the SFSF would be considered an unallowable use of funds.

In 2007, we reported the same issue at San Diego USD regarding the unapproved use of non-ARRA funds to pay SERP costs.<sup>7</sup> Our prior audit determined that payments to SERP

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<sup>7</sup> *San Diego Unified School District's Use of Federal Funds for Costs of Its Supplemental Early Retirement Plan* (Audit Report [ED-OIG/A09H0014](#), December 18, 2007).

participants are considered “abnormal or mass severance pay” and the costs of such payments are allowed only if approved by the cognizant Federal agency in advance of the payments. OMB Circular A-87, Attachment B, section 8.g.(3) addresses compensation for personal services and states that “[a]bnormal or mass severance pay will be considered on a case by case basis and is allowable only if approved by the cognizant Federal agency.” Although OMB Circular A-87 does not apply to SFSF, the *California School Accounting Manual* requires LEAs to obtain prior Federal approval for such costs.<sup>8</sup>

In 2009, the Department entered into a settlement agreement with San Diego USD and CDE. Under the terms and conditions of the agreement, San Diego USD was to comply with OMB Circular A-87 and the *California School Accounting Manual* beginning with the 2007-08 school year by obtaining approval from the cognizant Federal agency prior to charging abnormal or mass separation costs to Federal programs. Once we informed San Diego USD officials of the need for prior Departmental approval, they suspended the plan to use SFSF funds to cover SERP payments. The officials stated that they were unaware of the advance approval requirement despite our prior audit and would seek approval from the Department before using SFSF for this purpose.<sup>9</sup>

### **San Diego USD and Tulelake Basin Joint USD Did Not Document and Review Personnel Costs for Multi-Funded Employees**

Neither San Diego USD nor Tulelake Basin Joint USD had policies or procedures to require employees, who work on multiple activities, to prepare personnel activity reports or equivalent documentation to report actual employee time and effort funded by multiple Federal grants (multi-funded employees). Employees in the two LEAs charged their time and effort to Federal grants based on budget estimates rather than the actual time spent on these grant programs. This practice did not ensure that actual time and effort costs were charged to Federal grants. Absent adequate support for multi-funded employees’ time spent on different programs, Federal grants could be inappropriately charged for activities that do not benefit Federal education programs, or one Federal grant could be charged for activities benefiting another grant.

OMB Circular A-87, Attachment B, section 8.h., addresses support for wages and salaries. In particular, subsection (4) requires multi-funded salaried employees to prepare personnel activity reports or equivalent documentation to report actual activity. Subsection (5) requires employee certifications based on signed personnel activity reports at least monthly or comparisons of interim budget estimates to actual activity at least quarterly.

At San Diego USD, salaried employees working on multiple activities did not prepare personnel activity reports to document and report the actual time spent on Federal programs. Instead, San Diego USD used predetermined percentages (budget estimates) to allocate multi-funded salaried employees’ time to the programs they worked on. Employees were to report only the

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<sup>8</sup> California’s Education Code requires LEAs to follow the definitions, instructions, and procedures in the *California School Accounting Manual*, which provides State accounting policies and procedures.

<sup>9</sup> On August 4, 2009, we brought the matter of San Diego USD’s planned use of SFSF funds for SERP costs to the attention of the Department’s Office of the Chief Financial Officer.

overtime worked or leave hours taken during the month. Moreover, San Diego USD certified actual time and effort for multi-funded employees every 6 months rather than quarterly, as required by the Circular when budget estimates are used.

At Tulelake Basin Joint USD, the principal at the only school with multi-funded salaried employees used the scheduled times for intervention classes targeted for Title I students as a basis for charging seven employees' time and effort to the Title I grant. Instead of requiring the employees to complete personnel activity reports, Tulelake Basin Joint USD certified the employees' time and effort annually. Because of the small number of multi-funded employees in Tulelake Basin Joint USD, the effect of noncompliance with OMB cost principles may not be significant.

### **Recommendation**

- 3.1 We recommend that the Assistant Secretary for Elementary and Secondary Education and the Chief Financial Officer require CDE to ensure that all LEAs operating within the State implement appropriate policies and procedures to provide assurance that (1) ARRA funds are used to pay only allowable program costs, (2) ARRA expenditures are "reasonable and necessary" and consistent with State and local requirements, and (3) personnel costs charged to Federal grants conform to applicable compensation requirements in OMB Circular A-87, ARRA guidance, and/or State requirements.

### **FINDING NO. 4 – CDE and OPR Need to Ensure that Employees and Subrecipients Are Informed of ARRA Whistleblower Protection and OMB Requirements for Referrals to Inspectors General**

To ensure transparency and oversight of ARRA funds, the statute provides whistleblower protection, and OMB guidance includes a provision for referrals to the inspectors general (IGs). Our ARRA work in California found that State and local officials were unaware of these requirements. The lack of employee awareness about protection from retaliation and LEA awareness about the IG referral requirement could reduce the likelihood that concerns about possible misuse of ARRA funds will be raised, investigated, and rectified.

Section 1553 of Division A of ARRA provides whistleblower protection for State and local government and contractor employees, who report concerns about possible misuse of funds made available under the Act.<sup>10</sup> The statute prohibits reprisals against whistleblowers, requires a Federal investigation of all complaints, and requires recipients to notify employees of their rights under ARRA. In November 2009, OPR informed us that senior managers of all State departments and agencies were required to attend fraud training presented by California's ARRA Inspector General and local Federal IG offices. The training included a presentation on whistleblower protection under ARRA. Additionally, OPR included the Section 1553 requirements in updated interagency agreements executed with the University of California in

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<sup>10</sup> All subsequent section references to ARRA in this report are also to Division A.

September and California State University in October, and planned to include the requirements in a new interagency agreement with CDE.

Section 5.9 of OMB's updated implementing guidance for ARRA (dated April 3, 2009) directs Federal agencies to include in their grant agreements a requirement that each grantee and subgrantee shall promptly refer to the appropriate IG any credible evidence of a civil or criminal violation involving ARRA funds. Section 1514 of ARRA requires Federal IGs to review any concerns raised by the public about specific investments using funds made available under the Act. We confirmed that the Department's grant award to the Governor's Office for SFSF, and CDE for Title I and IDEA under ARRA, included the IG referral provision as a grant award term, consistent with the OMB guidance.

At the time of our review, officials at the three LEAs reviewed were not aware of the (1) whistleblower protection provided to non-Federal employees and the statutory requirement to notify employees of the protection afforded them when reporting misuse of ARRA funds, or (2) IG referral requirement. We found that CDE did not communicate the whistleblower protection and IG referral requirements to LEAs when first disbursing ARRA funds to LEAs. CDE did not include the referral requirement in LEAs' initial subgrant award for Title I and IDEA funds under ARRA because it was not aware of the requirement. Once we brought the matter to its attention in May 2009, CDE included the referral provision in SFSF award letters to LEAs and said the referral requirement would be included in future Title I and IDEA subgrant awards.

## **Recommendations**

We recommend that the Assistant Secretary for Elementary and Secondary Education and the Assistant Secretary for Special Education and Rehabilitative Services require CDE and OPR to ensure that—

- 4.1 Employees of State and local governments and contractors are notified of their rights protecting them from reprisals when reporting misuse of ARRA funds, in accordance with Section 1553 of the Act.
- 4.2 Recipients and subrecipients of ARRA funds are aware of the requirement to refer any credible potential violation of criminal or civil laws involving ARRA funds to the appropriate IG in accordance with grant award terms.

## OTHER MATTER

### **Delays in Implementing Reporting System May Create Challenges for Ensuring the Quality of LEAs' ARRA Information**

Section 1512 of ARRA requires recipients and subrecipients to report quarterly on the use of funds provided under the Act. The first quarterly report was due October 10, 2009. In California, LEAs reported their data to CDE, which provided the data to the statewide centralized reporting system for submission to the Federal ARRA reporting Web site (FederalReporting.gov). CDE met the reporting deadline despite delays in receiving Departmental guidance and difficulties in implementing its data collection system within compressed timelines. CDE received a 99 percent response rate from the State's more than 1,600 LEAs for the first quarterly report.

Even though CDE was able to report data for nearly all LEAs in the State, it recognized that delays in implementing its data collection system created challenges for ensuring the quality of the ARRA information reported. CDE cited the lack of specific guidance on reporting requirements and the ongoing State budget crisis as reasons for delays in developing its ARRA data collection system.

The compressed timeframe for developing, testing, and implementing CDE's system may have increased the risk of inaccurate and incomplete data. To help mitigate this risk, CDE told us during our review that it planned to preload LEA information where possible to reduce data entry errors, incorporate system checks for data input and completeness, and implement followup procedures when errors in LEA data were identified. In November 2009, CDE informed us that the new subrecipient monitoring procedures being developed for ARRA will also address the quality of LEAs' reported expenditures and estimates of the number of jobs saved and created.

We encourage CDE to take full advantage of the review period provided by FederalReporting.gov to correct and disclose data quality issues each quarter. We also encourage CDE to implement planned controls to CDE's data collection system, as well as assess and modify the controls as needed, to ensure LEA data are accurate and complete.

## BACKGROUND

California was scheduled to receive almost \$9 billion in education-related funding for State and local education programs under ARRA. Funds for SFSF, Title I, IDEA, and Vocational Rehabilitation represented more than \$8 billion of this total. As of September 17, 2009, the Department had awarded 92 percent of the State's SFSF allocation and 100 percent of the other ARRA programs we reviewed. Across five grants, the State had drawn down more than half of the ARRA funds awarded to date, as shown in Table 1.



<b>Table 1. ARRA Funding for Selected Programs in California, as of September 17, 2009</b> (dollar amounts in millions)				
<b>Program</b>	<b>Allocation</b>	<b>Awarded</b>	<b>Drawn Down</b>	<b>Percent of Award Drawn</b>
SFSF – Education Stabilization	\$4,875	\$4,388	\$3,020	62%
SFSF – Government Services	1,085	1,085	1,085	100%
<b>SFSF Subtotal</b>	<b>\$5,960</b>	<b>\$5,473</b>	<b>\$4,105</b>	<b>69%</b>
Title I	1,125	1,125	463	41%
IDEA	1,227	1,227	261	21%
Vocational Rehabilitation	56	56	3	6%
<b>Total</b>	<b>\$8,368</b>	<b>\$7,881</b>	<b>\$4,832</b>	<b>58%</b>

For the ARRA-funded programs reviewed, the Department awarded grants to three State agencies—OPR on behalf of the Governor’s Office (SFSF), CDE (Title I and IDEA), and California Department of Rehabilitation (Vocational Rehabilitation). The funds awarded to CDE and the Department of Rehabilitation supplemented existing programs. OPR took the following steps to receive funds and administer the new SFSF grant. To receive SFSF funds, the Governor signed an application on April 9, which was later amended on April 15. Because of State budget revisions, the Office of the Secretary of Education and the Department of Finance on behalf of the Governor’s Office later updated the application on May 15, and August 26. The Department approved the last updated application on September 15, 2009, and at the Governor’s request, made 90 percent of the State’s SFSF Education Stabilization funds available. Each application stated that all SFSF Government Services funds would be used for public safety.

To administer the SFSF grants, OPR entered into interagency agreements in May 2009 with four State-level entities—California Department of Corrections and Rehabilitation to expend SFSF Government Services funds, the two State university systems (University of California and California State University) to expend SFSF Education Stabilization funds, and CDE to allocate and distribute SFSF funds to LEAs.

About 220,000 students were enrolled at 10 campuses comprising the University of California system. The California State University system operates 23 campuses with an enrollment of nearly 450,000 students. CDE oversees the State’s elementary and secondary education system, which serves more than 7 million students in more than 9,000 schools. CDE passed through all SFSF Education Stabilization funds not allocated to the higher education institutions, and most Title I and IDEA funds, drawn down to date to more than 1,600 LEAs. At the time of our visits, the three LEAs we reviewed planned to use some or all ARRA funds as listed in Table 2.

<b>Table 2. Planned Use of ARRA Funds in Three LEAs</b>			
<b>LEA</b>	<b>Title I</b>	<b>IDEA</b>	<b>SFSF</b>
<b>San Diego USD</b>	Class size reduction	Professional development	SERP
<b>Chico USD</b>	New teaching positions	New teaching positions	Existing teaching positions
<b>Tulelake Basin Joint USD</b>	Professional development Part-time teacher	Summer school program Capital expenditures	Class size reduction

The California Department of Rehabilitation annually serves about 120,000 individuals with significant physical and mental disabilities throughout the State. Before drawing down any funds, the Department of Rehabilitation developed a comprehensive plan describing its objectives and 10 projects to be funded by Vocational Rehabilitation funds under ARRA. Between fiscal years 2009-10 and 2010-11, planned uses of funds include providing services to individuals on the waiting list, increasing services to eligible consumers through on-the-job training and internship opportunities, enhancing technology across the agency, and renovating its orientation center for the blind. ARRA funds will also be used for temporary positions to plan, monitor, implement, track, and report on the funded projects.

Several State-level entities are also responsible for overseeing ARRA funds coming into California. In March 2009, the Governor established the California Recovery Task Force to track the ARRA funds coming into the State, ensure the funding funneled through the State is spent efficiently and effectively, and manage the State's ARRA Web site. In April, the Governor appointed a new Inspector General to make sure ARRA funds are used as intended and to identify instances of fraud, waste, and abuse. At the request of the Task Force, the California Department of Finance's Office of State Audits and Evaluations reviewed selected State agencies' readiness for ARRA. For the State grants we reviewed, the readiness reviews concluded that (1) OPR and the Office of the Secretary of Education needed to clarify oversight responsibilities, (2) CDE had some necessary processes in place but as of July was waiting for additional guidance, and (3) the California Department of Rehabilitation's experience managing Federal grants will assist its preparation for receipt, expenditure, and oversight of ARRA funds.

The California State Auditor conducts the State's single audit and has increased its oversight and accountability responsibilities under ARRA. In April 2009, the State Auditor identified California's implementation of ARRA as high risk based on past single audits, the vast amount of ARRA funds the State was expected to receive, extensive requirements placed on recipients of these funds, and the risk of losing ARRA funds if the State fails to comply with the requirements. In June, the State Auditor reported that CDE was not fully prepared to administer ARRA funding although progress had been made in correcting previously identified control weaknesses. Subsequent to our review, the State Auditor began issuing interim single audit reports concerning various State departments' administration of Federal programs to ensure proper accountability and transparency for ARRA expenditures. The State Auditor reported in November that the California Department of Corrections and Rehabilitation's use of SFSF funds to reimburse payroll costs was appropriate. In December, the State Auditor reported five findings involving internal control issues at the California Department of Rehabilitation that could affect its administration of Vocational Rehabilitation funds under ARRA.<sup>11</sup>

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<sup>11</sup> *California's System for Administering Federal Recovery Act Funds*, California State Auditor (2009-611, April 22, 2009); *High-Risk Update—California's System for Administering Federal Recovery Act Funds: State Departments Are Preparing to Administer Aspects of Recovery Act Funding, but Correction of Control Weaknesses and Prompt Federal and State Guidance Are Needed*, California State Auditor (2009-611.1, June 24, 2009); *Federal Compliance Interim Reporting (Recovery Act Programs) Fiscal Year 2008-09 Single Audit: Corrections and Rehabilitation*, California State Auditor (2009-002.1b, November 23, 2009); *Interim Reporting: Fiscal Year 2008-09 Single Audit*, California State Auditor (2009-002.2, December 21, 2009).

## SCOPE AND METHODOLOGY

Our review covered five education-related ARRA grants. For each grant, the following list identifies the original authorizing statute, abbreviated program name, and the Catalog of Federal Domestic Assistance number under ARRA:

- ARRA, Title XIV
  - SFSF Education Stabilization (84.394)
  - SFSF Government Services (84.397)
- Elementary and Secondary Education Act of 1965, as amended
  - Title I Part A Basic Grants to LEAs (84.389)
- IDEA, as amended
  - Part B section 611 Special Education—Grants to States (84.391)
- Rehabilitation Act of 1973, as amended
  - Title I Part B Vocational Rehabilitation State Grants (84.390)

To gain an understanding of the requirements applicable to the design and implementation of internal controls for Federal grant programs at State and local agencies receiving ARRA funds, we reviewed Federal laws, regulations, OMB Circulars, and ARRA-specific guidance issued by OMB and the Department. We assessed the designed systems of controls planned for ARRA funds. In particular, we assessed whether State and local internal controls were sufficient to provide reasonable assurance of compliance with Federal requirements in the following areas:

- **Cash Management.** We reviewed State and local entities' controls for receiving, managing, disbursing, and expending ARRA funds. We also determined whether the three LEAs reviewed had policies and procedures for correctly calculating and timely remitting interest earned on Federal cash balances.
- **Subrecipient Monitoring.** We inquired about plans at CDE and OPR to monitor the SFSF activities of subrecipients. We also gained an understanding of CDE's procedures for monitoring Title I and IDEA programs for LEA compliance with Federal fiscal requirements related to cash management and the use of funds under ARRA. We did not review subrecipient monitoring procedures at the California Department of Rehabilitation, which does not award Vocational Rehabilitation subgrants.
- **Use of and Accounting for Funds.** We assessed State and local entities' plans for expending ARRA funds. We also reviewed each entity's procedures for approving and accounting for ARRA expenditures, including the ability to separately account for ARRA funds and LEAs' procedures for contracting, recording personnel expenses, and purchasing.
- **Data Quality.** We inquired about State grantees' plans to collect and report the quarterly information required by Section 1512 of ARRA. We also reviewed related reporting guidance issued by CDE. In addition, we asked the State and local entities reviewed about their ability and willingness to report information required by the statute.

- **Whistleblower Protection and IG Referral.** We assessed each entity's understanding of the whistleblower protection requirements provided under ARRA, as well as the IG referral requirement articulated in OMB guidance.

At the State level, we performed work at OPR, CDE, and California Department of Rehabilitation, which are the State grantees to which the Department awarded ARRA funds for the programs reviewed. We also conducted work at the three State subrecipients of SFSF funds—that is, the University of California, California State University, and California Department of Corrections and Rehabilitation. At the local level, we judgmentally selected three LEAs that were to receive SFSF, Title I, and IDEA programs under ARRA. The three LEAs represented a mix of (1) total Title I and SFSF funds allocated relative to other LEAs in the State; (2) urban and rural locations; and (3) other risk factors, such as fiscal health and single audit findings. We selected and conducted fieldwork at San Diego USD (large LEA), Chico USD (medium LEA), and Tulelake Basin Joint USD (small LEA). Because Chico USD and Tulelake Basin Joint USD were each a member of a multi-district SELPA (LEA) for IDEA purposes, we also conducted work at their respective SELPAs—Butte County Office of Education and Modoc County Office of Education.

Our review was limited to assessing the design of existing and planned internal controls. At the State and local entities, we interviewed fiscal and program officials responsible for administering the ARRA programs reviewed, and reviewed available documentation. Because implementation of ARRA was in its early stages at the time of our fieldwork, we did not validate statements made by officials in regard to existing and planned controls over the proper administration and use of ARRA funds. We also considered the results and findings of prior single audits, OIG audits, other State reviews, and Departmental program monitoring visits. We did not test the controls. When we completed our fieldwork in August, the entities were still in the process of designing and implementing controls under ARRA. Thus, the system of controls we reviewed may have been substantially modified or not implemented as originally planned. Because of the limited nature of our review and the other factors mentioned above, there may be additional control weaknesses that were not identified by our review.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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