U.S. Department of Education
Office of Inspector General

American Recovery and Reinvestment Act of 2009

Systems of Internal Control Over Selected ARRA Funds in the State of Illinois

Audit Report

Illinois State Capitol Building

ED-OIG/A05J0012 **February 2010**

Acronyms/Abbreviations Used in this Report

ARRA	American Recovery and Reinvestment Act of 2009
C.F.R.	Code of Federal Regulations
CPS	Chicago Public Schools
DHS	Illinois Department of Human Services
DRS	Division of Rehabilitation Services
Department	U.S. Department of Education
EDGAR	Education Department General Administrative Regulations
East St. Louis	East Saint Louis School District 189
Hinsdale	Community Consolidated School District 181
Governor’s Office	State of Illinois Governor’s Office of Management and Budget
GSA	General State Aid
IDEA	Part B of the Individuals with Disabilities Education Act, as amended
ISBE	Illinois State Board of Education
LADSE	LaGrange Area Department of Special Education
LEA	Local Educational Agency
OIG	Office of Inspector General
SEA	State Educational Agency
SFSF	State Fiscal Stabilization Fund
Title I	Title I, Part A of the Elementary and Secondary Education Act of 1965, as amended

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

AUDIT SERVICES
Chicago/Kansas City/Dallas Audit Region

February 23, 2010

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Dear Mr. Vaught, Mr. Koch, and Ms. Saddler:

This **final audit report** presents the results of our review of the systems of internal control over selected American Recovery and Reinvestment Act of 2009 funds in the State of Illinois.

Statements that managerial practices need improvements, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determinations of corrective action to be taken will be made by the appropriate U.S. 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 U.S. 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/

Gary D. Whitman
Regional Inspector General for Audit

Systems of Internal Control Over Selected ARRA Funds in the State of Illinois

Control Number ED-OIG/A05J0012

PURPOSE

The American Recovery and Reinvestment Act of 2009 (ARRA) places a heavy emphasis on accountability and transparency. Federal agencies and others who are impacted by ARRA have the responsibility to ensure that ARRA funds reach intended recipients and achieve intended results. This includes effectively implementing and controlling funds at the Federal, State, and local levels; ensuring that recipients understand requirements and have proper controls in place over the administration and reporting of ARRA funds; and promptly identifying and mitigating instances of fraud, waste, and abuse of the funds. Proper systems of internal control are essential for ensuring ARRA funds are administered properly and used in ways that comply with the requirements of ARRA.

The purpose of our audit was to determine whether the Illinois State Board of Education (ISBE), other State of Illinois agencies, and selected local educational agencies (LEAs) charged with responsibility for overseeing ARRA funds had designed systems of internal control that are sufficient to provide reasonable assurance of compliance with applicable laws, regulations, and guidance. Our audit covered ISBE's and other State of Illinois agencies' designs for systems of internal control over the administration and use of ARRA funds as of October 1, 2009.

We assessed the design of State-level internal control that ISBE, the Illinois Department of Human Services (DHS) Division of Rehabilitation Services (DRS), and the State of Illinois Governor's Office of Management and Budget (Governor's Office) planned to use in administering funds received under ARRA. We assessed the design of internal control over the administration of ARRA funds only for the Title I, Part A of the Elementary and Secondary Education Act of 1965, as amended (Title I); Part B of the Individuals with Disabilities Education Act, as amended (IDEA); the Vocational Rehabilitation Act; and the State Fiscal Stabilization Fund (SFSF) programs. We assessed the design of State-level internal control related to data quality, cash management, and subrecipient monitoring. In addition, we assessed the design of control for the three areas listed above and use of funds at three LEAs: Chicago Public Schools (CPS), Community Consolidated School District 181 (Hinsdale), and East Saint Louis School District 189 (East St. Louis).

In December 2009, the Governor's Office and ISBE finalized a memorandum of agreement that stated that ISBE shall, on behalf of the Governor's Office, monitor the expenditures of SFSF and collect data on ARRA expenditures when LEAs are the subrecipients. ISBE is working on a proposal to award a contract to audit ARRA SFSF expenditures by LEAs for compliance with Federal requirements. Because the interagency agreement had not been completed and the monitoring contract had not been awarded at the time of our audit, we were unable to assess the design of internal control over all of Illinois' SFSF funds.

RESULTS

The State of Illinois has been proactive in its efforts to ensure the proper administration of ARRA funds. As an example, the Governor's Office established two groups to address the use of ARRA funds in the State. The first group that the Governor's Office established is an Executive Committee composed of the State Deputy Chief of Staff for Economic Recovery, Chief Internal Auditor, Budget Director, and Chief Information Officer. This Executive Committee is charged with identifying common risks at all State agencies that administer ARRA funds. The second group that the Governor's Office established was a Recovery Act Working Group. The Recovery Act Working Group includes staff from all the State agencies responsible for administering ARRA funds and is responsible for implementing the ARRA programs, communicating requirements, and disseminating guidance.

The Governor's Office also created the Illinois Recovery Web site to provide information to the public, and ISBE formed a Project Management Office to oversee ARRA funds. The Project Management Office is composed of ISBE's Chief Financial Officer and staff hired specifically to assist in oversight of areas such as data and reporting related to ARRA funds. ISBE also has presented webinars and workshops and distributed weekly messages from the State Superintendent to provide information to LEAs regarding ARRA funds and related requirements. Finally, ISBE plans to hire additional personnel in its External Assurance Division. The additional personnel will be conducting subrecipient monitoring of LEAs receiving ARRA funds.

As a result of guidance disseminated by the Office of Management and Budget and the U.S. Department of Education (Department), as well as observations we made during our audit, ISBE and the LEAs were able to make changes to their systems of internal control. For example, ISBE modified its computer systems to capture all required Title I, IDEA, and SFSF data for reporting purposes.

However, during our audit, we still identified areas in which ISBE and the LEAs could improve their systems of internal control.[1] ISBE's and the LEAs' systems of internal control could be improved so they provide reasonable assurance of recipient compliance with applicable laws, regulations, and guidance. We concluded that, as of October 1, 2009—

- ISBE could improve its cash management procedures to ensure compliance with Federal requirements, and
- ISBE could improve its subrecipient monitoring to ensure compliance with ARRA requirements.

We provided a preliminary version of this final audit report to the Governor's Office and ISBE for review and comment on November 24, 2009. The Governor's Office did not provide comments. ISBE provided comments on December 14, 2009. ISBE did not agree or disagree with our findings and recommendations but did describe corrective actions it was taking to resolve the findings, comply with the requirements of ARRA, or improve operations. Based on ISBE's comments, we did not modify our findings and recommendations. The comments are summarized at the end of each finding. The entire narrative of ISBE's comments is included as an Enclosure to this report.

[1] We did not identify issues at the DHS DRS or the Governor's Office.

FINDING NO. 1 – ISBE Could Improve its Cash Management Procedures to Ensure Compliance with Federal Requirements

ISBE did not have an adequate process in place for monitoring excess cash balances at LEAs for the three programs (Title I, IDEA, and SFSF) that we reviewed. ISBE planned to disburse ARRA Title I and IDEA funds via the advance payment method as it does non-ARRA Title I and IDEA funds. To receive ARRA Title I or IDEA funds, LEAs will be required to submit applications. Along with the applications, the LEAs will prepare and submit budgets that include detailed payment schedules. The LEAs will specify their anticipated monthly program needs, based on their budgets, via payment schedules. ISBE will make disbursements to LEAs based on the payment schedules. ISBE's Funding and Disbursements division will prepare a voucher based upon the payment schedule for each LEA. Vouchers will flow electronically to ISBE's Fiscal Division. The Fiscal Division will send the vouchers via tape to the Illinois Comptroller's Office to generate payments to LEAs.

For fiscal year 2009, ISBE distributed $1.039 billion in SFSF to replace General State Aid (GSA) to LEAs statewide. The method for allocating ARRA SFSF Education Stabilization funds to subrecipients was based on the State's GSA funding formula prescribed in Illinois statute. The GSA payment amount is formula-driven, with the average daily attendance figures being the basis for the calculation. Illinois used the SFSF funds to replace GSA. Therefore, as required by the Illinois School Code, Illinois distributed SFSF Education Stabilization funds using the advance method of payment on the 10th and 20th of the month.

Existing Monitoring Procedures Are Not Adequate

ISBE planned to monitor LEAs for ARRA excess cash balances using the same quarterly expenditure reporting process it uses for non-ARRA funds. The LEAs' quarterly expenditure reports identify whether an excess cash balance exists. An excess cash balance indicates that funds were being held as cash rather than used to pay expenses. ISBE determines excess cash on hand by taking the amount vouchered (disbursed to the LEA) per the expenditure report and then deducting the total amount that the LEA expended and obligated for the quarter. According to ISBE's policy, if there is an excess cash balance for the reporting period, the LEA's next scheduled payment(s) will be withheld (frozen). The existing policy is silent regarding any excess cash balance threshold that would trigger the freezing of funds.

ISBE's system of internal control is not adequate to ensure LEAs are complying with Federal cash management requirements. ISBE's system of internal control did not ensure that (1) excess cash balances within a quarter are detected, (2) excess cash balances are calculated correctly, and (3) interest on excess cash balances is identified and remitted in a timely manner.

Excess Cash Balances Can Exist within the Quarter and Not Be Detected

Although ISBE monitors for excess cash on a quarterly basis, LEAs still might have excess cash balances for the months within the quarterly reporting period. One LEA had as much as $3 million of excess cash on hand during one month and still received its next scheduled disbursement.[2]

[2] Cash on hand was reviewed for the Rockford School District's non-ARRA Title I, Low Income program for fiscal year 2008.

Interest Calculations Are Incorrect

ISBE determines the amount of interest LEAs must remit to the Department during desk and monitoring reviews for LEAs. Hinsdale and East St. Louis rely on ISBE to complete their interest calculations during those reviews. CPS completes its own interest calculations in addition to ISBE's calculation.

ISBE and CPS are not accurately identifying excess cash balances when they calculate the amount of interest LEAs must remit to the Department. When calculating the amount of interest to remit, both ISBE and CPS subtract monthly obligations from vouchered payments to identify excess cash balances. To determine excess cash, CPS subtracts obligations, such as purchase orders and subsequent salaries and benefits, as well as cash expenses, from receipts. However, ISBE and CPS should not use accrued expenditures for identifying excess cash balances when calculating the amount of interest due because accrued expenditures include amounts that have been recognized as expenses but for which the payments have not yet been made. Accrued expenditures might not affect a program's cash account (disbursements) for weeks or months. ISBE's and CPS' practice of subtracting obligations, and not just cash expenses, from the interest calculations results in a reduction of interest earnings reported or remitted to the Department. CPS informed us that ISBE directed it not to use the Treasury interest rate and instead use a 3-year average return on operating expenses as its rate for determining interest. Because Federal regulation requires grantees and subgrantees to "remit interest earned on advances," the actual rates earned on funds held in their respective investments should be used.

Interest Calculations Not Completed Timely

ISBE completes the LEAs' interest calculations to determine the amount of interest LEAs must remit to the Department for the Title I and IDEA programs annually. CPS also completes its interest calculations on an annual basis. However, LEAs are required by Federal regulation to remit interest at least quarterly. To be most effective, excess cash balances should be identified prior to each disbursement, and interest should be remitted at least quarterly.

The Department's guidance for funds made available under ARRA addresses the fiscal rules for these funds. The guidance states that the ARRA funds made available under the Title I; IDEA; SFSF; and Title I, Part B of the Rehabilitation Act of 1973 programs must follow the requirements set forth at 34 Code of Federal Regulations (C.F.R.) § 80.21(b) and 34 C.F.R. § 80.21(i).[3]

The Education Department General Administrative Regulations (EDGAR) at 34 C.F.R. § 80.21, prescribe the basic standard and the methods under which grantees will make payments to subgrantees. The basic standard is that the "[m]ethod and procedures for payment shall minimize the time elapsing between the transfer of funds and disbursement by the grantee or subgrantee . . . ." The regulations address two payment methods (advances and reimbursement):

> (c) Advances. Grantees and subgrantees shall be paid in advance, provided they maintain or demonstrate the willingness and ability to maintain procedures to minimize the time elapsing between the transfer of the funds and their disbursement by the grantee or subgrantee.

[3] All regulatory citations are as of January 1, 2008, unless otherwise noted.

In addition, 34 C.F.R. § 80.21(i) addresses requirements when interest is earned on Federal cash advances. The regulation states—

> . . . [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.

The fiscal year 2009 Treasury-State Agreement for Illinois at 8.6.1 states

> The State shall be liable for interest on Federal funds from the date Federal funds are credited to a State account until the date those funds are paid out for program purposes.

It is important that State Educational Agencies (SEAs) do not draw and disburse ARRA funds before LEAs actually need the funds. The U.S. Treasury incurs additional borrowing costs when an SEA draws and disburses Federal funds to LEAs in advance of their immediate cash needs. Because of the Federal deficit, the U.S. Treasury must borrow the cash needed to fund Federal programs and, as a result, incurs interest costs.

It also is important that Federal funds not be drawn prematurely because the funds might be more susceptible to misuse when held in local accounts for extended periods. Past U.S. Department of Education, Office of Inspector General (OIG) work has identified instances involving non-ARRA funds where the systems of internal control were weak, by-passed, or nonexistent.[4]

Recommendations

We recommend that the Assistant Secretary for Elementary and Secondary Education, in collaboration with the Assistant Secretary for Special Education and Rehabilitative Services, require ISBE to—

1.1 Strengthen procedures for monitoring excess cash balances at LEAs before approving cash disbursements. The procedures should be sufficient to minimize the time elapsing between the transfer by the State of Federal ARRA and non-ARRA funds and disbursement by the LEAs.

1.2 Revise its procedures to ensure that it and the LEAs are accurately identifying excess cash balances, calculating interest earned, and remitting interest in a timely manner.

ISBE Comments

ISBE stated that there are administrative difficulties in applying the Federal cash management requirements to its distribution of SFSF funds. ISBE distributed SFSF funds through its GSA system, which is not based on immediate need for cash, but uses a State statutory formula to distribute equal payments on a bi-monthly basis over an 11-month period. Nevertheless, ISBE agreed to take the corrective actions described below.

[4] *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).

For Recommendation 1.1, ISBE stated that it would resolve Finding No. 1 for SFSF funds by distributing additional SFSF Education Stabilization payments during the first quarter of the 2010 calendar year. In addition, ISBE will (1) inform all LEAs of the additional SFSF payments prior to their distribution; (2) request that the LEAs notify ISBE in advance of these payments if they believe they will be unable to fully expend them; (3) request that the LEAs notify ISBE of any changes to their scheduled payments; (4) inform the LEAs that an expenditure report that reflects all SFSF funds that were expended through March 31, 2010, must be submitted to ISBE; and (5) request that each LEA promptly return to ISBE any unanticipated excess cash that generates interest greater than $100.

In addition, ISBE stated that it would resolve Finding No. 1 and Recommendation 1.1 as it pertains to all other ARRA (except SFSF) and non-ARRA programs. ISBE will take the following corrective actions to monitor cash balances at LEAs before approving cash disbursements. ISBE will (1) voucher scheduled LEA payments at the beginning of the month instead of the end of the prior month to eliminate the risk that an LEA will receive funds earlier than intended; (2) change the LEA quarterly expenditure report due date from 30 days to 20 days from the end of the quarter; (3) change the LEA excess cash calculation by using a cash basis determination that does not include outstanding obligations; and (4) apply any unexpended funds (on a cash basis) from an LEA's prior year grant to its Federal project for the new fiscal year.

ISBE concurred that, due to a variety of factors, the LEA we identified did have excess cash on hand. However, ISBE stated that collecting expenditure data on a monthly basis to determine excess cash prior to distributing any additional funds for all its subrecipients' programs would impose a major burden on ISBE and more than 1,000 subrecipients.

For Recommendation 1.2, ISBE stated that it intends to revise its cash management procedures to include: (1) requiring LEAs to hold all Federal funds in a separate, interest bearing, account; (2) instructing LEAs to remit interest earned on their Federal funds account to ISBE on a quarterly basis; and (3) having ISBE forward all interest received from LEAs to the awarding Federal agency. However, ISBE added that it would be a major burden for itself and more than 1,000 subrecipients to determine daily cash balances, calculate the interest earned on each daily balance, and report the results for up to 50 Federal programs.

OIG Response

ARRA places a heavy emphasis on accountability and transparency. ISBE's proposed steps appear to be appropriate; however, a more proactive monitoring approach is needed to ensure that LEAs do not have excess cash balances before ISBE makes additional disbursements. Although the corrective actions that ISBE is taking to address Recommendation 1.1 will help reduce the amount of excess cash on hand from month-to-month and reduce the time elapsing between the transfer and disbursement of Federal ARRA and non-ARRA funds, it will not prevent an LEA from receiving another disbursement while it still has excess cash on hand during a quarterly reporting period.

For Recommendation 1.2, ISBE stated that determining daily cash balances for each program to calculate the interest liability owed to the Department would be a major burden on ISBE and the subrecipients. However, ISBE may opt to have the subrecipients identify and remit only the actual interest earned from the applicable Federal funds. ISBE also may take advantage of flexibilities allowed by the Treasury regulations. According to 31 C.F.R. § 205.19(e), a State may use actual data, a clearance pattern,[5] or statistical sampling to calculate interest. A clearance pattern used to calculate interest must meet the standards of § 205.20. If a State uses statistical sampling to calculate interest, the State must sample transactions separately for each applicable Federal assistance program. Each sample must be representative of the pool of transactions and be of sufficient size to accurately represent the flow of Federal funds under the Federal assistance program, including seasonal or other periodic variations. ISBE should consider these flexibilities when it is revising its procedures to ensure that it and the LEAs are accurately identifying excess cash balances, calculating interest earned, and remitting interest in a timely manner.

FINDING NO. 2 – ISBE Could Improve Its Subrecipient Monitoring to Ensure Compliance with ARRA Requirements

ISBE could improve its subrecipient monitoring to provide reasonable assurance of LEA compliance with ARRA requirements. As part of our audit, we visited three LEAs (CPS, Hinsdale, and East St. Louis) to review their systems of internal control over data quality, cash management, subrecipient monitoring, and use of funds under ARRA Title I, IDEA, and SFSF. Two of the three LEAs were not tracking their SFSF expenditures, and one of the three LEAs had not established procedures to ensure that ARRA IDEA data will be complete, accurate, reliable, and in compliance with ARRA reporting requirements.

LEAs Are Not Tracking SFSF Funds

CPS and Hinsdale did not track or document SFSF expenditures for fiscal year 2009 as required by ARRA. CPS and Hinsdale tracked the SFSF revenue coming in but did not track the expenses as they were incurred. ISBE informed the LEAs that the SFSF would take the place of some of its GSA payments that the LEAs would normally receive. Because LEAs do not usually track or report spending for GSA payments, CPS and Hinsdale did not track or report their SFSF expenditures. ISBE has alerted the LEAs through webinars and Superintendent's notices that they must track and report expenditures for all ARRA funds, including SFSF.

LEA and Cooperative Uncertainty about Responsibility for Administering ARRA IDEA Funds

Hinsdale is part of a special education cooperative, the LaGrange Area Department of Special Education (LADSE), which provides special education services for Hinsdale and other LEAs' students. Regular IDEA funds usually are sent directly to the cooperative to pay for its services. For ARRA IDEA, the cooperative will transfer the funds to its member LEAs. The LEAs will use the ARRA IDEA funds to pay for their planned programs. Until September 30, 2009, neither Hinsdale nor LADSE clearly understood who was responsible for the administration of the ARRA IDEA funds. As a result, neither Hinsdale nor LADSE had developed a system of internal control that would provide reasonable assurance that reported ARRA IDEA data are complete, accurate, reliable, and in compliance with ARRA reporting requirements.

[5] States use clearance patterns to project when funds are paid out, given a known dollar amount and a known date of disbursement.

Section 1512(c) of Division A of ARRA,[6] requires each recipient that receives recovery funds from a Federal agency to submit a report to that agency that contains, among other items, the total amount of recovery funds received from the agency, the amount of recovery funds that were expended or obligated to projects or activities, a detailed list of all projects or activities for which recovery funds were expended or obligated, and an estimate of the number of jobs created and retained by the project and activity.

Recommendations

We recommend that the Assistant Secretary for Elementary and Secondary Education, in collaboration with the Assistant Secretary for Special Education and Rehabilitative Services, require ISBE to instruct CPS and Hinsdale to—

2.1 Track SFSF expenditures so that the detailed information can be accurately reported as required by ARRA.

2.2 Develop and implement procedures to collect, compile, and report on ARRA IDEA funds.

ISBE Comments

Regarding Recommendation 2.1, ISBE stated that it established separate ARRA revenue codes and amended its administrative rules to require LEAs to use those codes in accounting for expenditures of ARRA funds. ISBE stated that it continuously communicated to LEAs that they must separately track and account for ARRA funds. ISBE added that all LEAs submitted ARRA reports for the first reporting quarter. For one of the LEAs cited (in the preliminary version of this report) as not tracking SFSF expenditures, ISBE has received its Annual Financial Report which includes an audited schedule of receipt and expenditure of ARRA funds by program.

Regarding Recommendation 2.2, ISBE stated that it is using the same method for collecting ARRA IDEA data as is used for collecting non-ARRA expenditure data from cooperatives and their member LEAs.[7] ISBE requires the cooperatives to collect the same information from their LEAs as ISBE would collect from an LEA that is not a member of a cooperative. Discussions have occurred with the Department on the need for cooperatives to report LEAs as vendors for ARRA reporting purposes. ISBE stated that it is awaiting definitive guidance on this issue.

OIG Response

For Recommendation 2.1, it appears ISBE will rely on its current policies to address the matter. Although ISBE communicated to LEAs that they must separately track and account for ARRA funds, we found that, at the time of our site visits, CPS and Hinsdale were not tracking SFSF expenditures for fiscal year 2009. During our site visit, CPS stated that it was not tracking the expenditures for its SFSF funds because ISBE informed it to treat the funds as general state aid, which never required spending reports. CPS added that it was awaiting guidance from ISBE on how to report the data on its use of SFSF funds. During our site visit, Hinsdale was in the process of assigning payroll expenditures to the SFSF program, subsequent to the expense of those funds. In its

[6] All subsequent section references to ARRA in this report are to Division A.

[7] Certain areas in Illinois use special education cooperatives and joint agreements where individual LEAs are members of these intermediate units in which the units provide special education services to their member LEAs.

response, ISBE added that all LEAs submitted ARRA reports for the first reporting quarter. ISBE also received an Annual Financial Report from one of the LEAs we visited and cited as not tracking SFSF expenditures. The Annual Financial Report includes an audited receipt and expenditure schedule of ARRA funds. However, when ISBE responded to our report, it did not provide us documentation to support that the LEAs tracked their SFSF expenditures. Therefore, the determination of whether SFSF expenditures were properly tracked should be made during audit resolution.

For Recommendation 2.2, ISBE stated that it is utilizing the same method for collecting ARRA IDEA data that is used for collecting non-ARRA expenditure data from cooperatives and their member LEAs. However, ISBE should take a more proactive approach to ensure the procedures are understood and implemented by all parties. On September 30, 2009, we were able to confirm with ISBE that LADSE would be the administrative agent for Hinsdale's ARRA IDEA funds. Prior to that date, both Hinsdale and LASDE believed that Hinsdale would be responsible for the administration of the funds.

BACKGROUND

The Illinois Governor's Office was allocated more than $2.05 billion for SFSF. Illinois also was allocated nearly $927 million in ARRA Title I and IDEA and approximately $20 million for Vocational Rehabilitation. Title I, IDEA, and SFSF education funds are administered by ISBE and Vocational Rehabilitation funds are administered by the DHS DRS.

On April 1, 2009, the Department made available 50 percent of the funds for Illinois' Title I, IDEA, and Vocational Rehabilitation programs authorized through ARRA. As of September 30, 2009, ISBE has drawn down more than $4.6 million in ARRA funds while DHS DRS has not drawn down any ARRA funds.

Table 1. ISBE

	Allocation Amount	**Award Amount** [8]	**Drawdown Amount**
Title I	$420,263,561	$210,131,780	$523,189
IDEA	$506,479,753	$253,239,877	$4,091,868
TOTAL:	**$926,743,314**	**$463,371,657**	**$4,615,057**

Illinois' Application for Initial Funding under the SFSF Program was approved on April 17, 2009. As of September 30, 2009, over $1.228 billion in SFSF funds had been drawn down.

[8] First awards for award year 2009.

Table 2. Governor's Office			
	Allocation Amount	**Award Amount**[9]	**Drawdown Amount**
Education Stabilization	$1,681,130,685	$1,126,357,559	$1,038,987,579
Government Services	$374,041,302	$250,607,672	$189,058,500
Total SFSF	**$2,055,171,987**	**$1,376,965,231**	**$1,228,046,079**

SCOPE AND METHODOLOGY

Our audit covered ISBE's and other State of Illinois agencies' design for systems of internal control over the administration and use of ARRA funds as of October 1, 2009. We assessed the design of State-level internal control that ISBE, DHS, and the Governor's Office planned to use in administering funds received under ARRA for the Title I, IDEA, the Vocational Rehabilitation Act, and SFSF programs. We reviewed State-level control over data quality, cash management, and subrecipient monitoring. In addition, we assessed the design of control for the three areas listed above and the use of funds at three LEAs: CPS, Hinsdale, and East St. Louis.

Our review was limited to assessing the design of internal control. We did not evaluate or test the implementation of the controls. Also, during and subsequent to our fieldwork, ISBE, DHS, and the Governor's Office were continuing the process of designing and implementing internal control over the administration of ARRA funds. Thus, the plans and processes reviewed during our audit might be substantially modified or not implemented as designed. In addition, ISBE, DHS, CPS, Hinsdale, and East St. Louis had not used ARRA funds at the time of our audit for the Title I, IDEA, and Vocational Rehabilitation Act programs. Therefore, we were not able to test the use of funds and might not have been aware of unique factors related to the administration of ARRA funds during our assessment of the design of internal control. Because of the limited nature of our review and the other factors mentioned, there is more than a remote possibility that other opportunities for improvement in the State or local-level systems of internal control could exist but not be identified by our audit.

To assess the design of internal control, we:

- Reviewed prior single audits and applicable reports issued by the Government Accountability Office, and the OIG;
- Gained an understanding of the portions of the law, regulations, Department guidance, Office of Management and Budget Circulars, and contract and/or grant agreements relevant to the audit's objectives;
- Identified ARRA funds allocated to ISBE, DHS, and the Governor's Office for Title I, IDEA, Vocational Rehabilitation, and SFSF;
- Interviewed ISBE program officials for Title I, IDEA, and SFSF; and officials from the Funding & Disbursements Division, External Assurance Division, School Business Services, and Fiscal & Procurement Division;
- Interviewed DHS' program officials for Vocational Rehabilitation;
- Interviewed Illinois Office of Internal Audit officials regarding SFSF funds;

[9] First awards for award year 2009.

- Obtained and reviewed written policies and procedures related to data quality, cash management, and subrecipient monitoring for Title I, IDEA, Vocational Rehabilitation and SFSF;
- Obtained and reviewed ISBE's monitoring protocols for Title I, IDEA, and SFSF;
- Obtained and reviewed Illinois approved Part I SFSF application; and
- Interviewed school district officials and reviewed documentation related to Title I, IDEA, Vocational Rehabilitation and SFSF at the 3 selected LEAs (CPS, Hinsdale, and East St. Louis), as applicable.

With regard to IDEA funds, Hinsdale is part of a special education cooperative, LADSE, which provides special education services for Hinsdale and other LEAs' students. LADSE also calculates interest earned on excess cash balances for its member LEAs. We had been unable to confirm whether LADSE would be the administrative agent for the ARRA IDEA funds until September 30, 2009. Therefore, we were unable to conclude whether Hinsdale and LADSE had adequate procedures to minimize the time elapsing between the transfer of ARRA funds and disbursement by the LEAs and for LEAs to calculate and remit interest earned on ARRA funds.

We conducted our work for ISBE, DHS, the selected LEAs, and the Governor's Office[10] from May through September 2009.[11] We discussed the results of our audit and recommendations with ISBE, DHS, and the Illinois Office of Internal Audit on September 14, 2009.

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. Use of computer-processed data for this audit was limited to background information and expenditure reports provided by the LEAs that showed cash on hand. We did not assess the reliability of the computer-processed data because we used these data for informational purposes only.

[10] We conducted our work for ISBE, DHS, and the Governor's Office in Springfield, Illinois; for Chicago Public Schools in Chicago, Illinois; for East Saint Louis in East Saint Louis, Illinois; and for Community Consolidated School District 181 in Westmont, Illinois.
[11] We continued to receive and review additional information from ISBE and some LEAs through October 1, 2009.

Enclosure:
ISBE's Comments on Preliminary Version of Report

Illinois State Board of Education

100 North First Street • Springfield, Illinois 62777-0001
www.isbe.net

Jesse H. Ruiz
Chairman

Christopher A. Koch, Ed.D.
State Superintendent of Education

December 14, 2009

Mr. Gary D. Whitman
Regional Inspector General for Audit
U.S. Department of Education
Office of the Inspector General
Citigroup Center
500 W. Madison Street, Suite 1414
Chicago, IL 60661

Control Number ED-OIG/A05J001

Dear Mr. Whitman

On November 24, 2009, I received the Office of Inspector General's preliminary final Audit Report, titled *Systems of Internal Control Over Selected ARRA Funds in the State of Illinois*.

Enclosed is the Illinois State Board of Education's response to the findings and recommendations made by your audit team. ISBE has worked hard to comply with all requirements of the American Recovery and Reinvestment Act (ARRA). We recognize that audits are an important tool for ensuring compliance with regulations and appreciate this opportunity to review and improve operations.

If you require further information or clarification, please contact Lisa LaBonte, Chief Internal Auditor, at 217-782-2237 or by email at llabonte@isbe.net.
Sincerely,

/s/
Christopher A. Koch, Ed.D.
State Superintendent of Education

cc: David Vaught,
Director, Governor's Office of Management and Budget

Michelle R.B. Saddler,
Secretary, Illinois Department of Human Service

Enclosure

State of Illinois
State Board of Education

Response to: *Systems of Internal Control Over Selected ARRA Funds in the State of Illinois*
Control Number ED-OIG/A05J0012

ARRA - American Recovery and Reinvestment Act of 2009

General Comment: ISBE does not agree with the following statement from page two, paragraph three of the report: *For example, when we brought the matter to its attention, ISBE modified its computer systems to capture all required Title I, IDEA, and SFSF data for reporting purposes*.

ISBE was aware of the need to develop/modify computer systems to comply with the Section 1512 reporting requirement for ARRA. Discussions were held to determine how best to collect the proposed ARRA standard data elements described by the U.S. Office of Management and Budget in the April 1, 2009 Federal Register. Modifications began to occur as early as April 3, 2009 to account for ARRA grant programs and were communicated to all local education agencies (LEAs) via a May 1 webinar provided by ISBE. Separate ARRA revenue codes were created within agency internal systems and instructions for recording and expended ARRA funds at the LEA level were explained in the agency's May 1 and May 15 webinars. Further internal system modifications and detailed reporting instructions were developed after the U.S. Office of Management and Budget issued *Implementing Guidance for the Reports on Use of Funds Pursuant to the Recovery Act* on June 22, 2009.

FINDING NO. 1 – ISBE Could Improve its Cash Management Procedures to Ensure Compliance with Federal Requirements

Finding Recap

ISBE did not have an adequate process in place for monitoring cash balances maintained by LEAs for the three programs (Title I, IDEA, and SFSF) that we reviewed. ISBE plans to disburse ARRA Title I and IDEA funds via the advance payment method as it does non-ARRA Title I and IDEA funds.

For fiscal year 2009, ISBE distributed $1.039 billion in SFSF to replace General State Aid (GSA) to LEAs statewide.… Illinois used the SFSF funds to replace GSA. Therefore, as required by Illinois' School Code, Illinois distributed the SFSF Education Stabilization funds using the advance method of payment on the 10th and 20th of the month

- **Existing Monitoring Procedures Are Not Adequate**
- **Positive Cash Balances Can Exist within the Quarter and Not Be Detected**
- **Interest Calculations Are Incorrect**
- **Interest Calculations Not Computed Timely**

Recommendation 1.1

Develop and implement procedures to monitor cash balances at LEAs before approving cash disbursements. The procedures should be sufficient to minimize the time elapsing between the transfer and disbursement of Federal ARRA and non-ARRA funds.

ISBE Response

State Fiscal Stabilization Fund (SFSF) dollars were distributed through General State Aid (GSA) which is the State's primary education funding formula for LEAs as required by ARRA. GSA is a reimbursement based claim program. Each LEA submits a claim for the prior school year and is reimbursed per statutory formula in twenty-two equal payments paid bi-monthly on the 10th and the 20th each month beginning in August through June as prescribed per State statute in Section 18-12 of the Illinois School Code [105 ILCS 5/18-12]. GSA is used primarily by LEAs for local expenses such as staff salaries, benefits and other operating costs.

ISBE required all LEAs to submit a SFSF application/assurance statement prior to the distribution of SFSF funds. These SFSF applications/assurance statements were due back to ISBE by April 17, 2009, before the first GSA payments were made with ARRA SFSF funds. Through this process, LEAs were informed of the unique accounting and reporting requirements that applied to these ARRA Federal funds although they were distributed as General State Aid (see items three and four on the SFSF application: http://www.isbe.net/funding/pdf/sfsf_gsa_assurances.pdf). When the SFSF program was initially announced, there was confusion as to how the SFSF funds would be treated since they were replacing state funds. The first indication that the Cash Management Improvement Act would apply to the SFSF funds was seen in the award letter accompanying the SFSF grant award notifications. ISBE continuously communicated to LEAs the importance of expending SFSF in a timely manner during conversations, conferences, and ARRA webinars. ARRA webinars were held on May 1, May 15 June 18, July 10, July 27, September 15, and November 20, 2009. (Link to ISBE's ARRA webinars page: http://www.isbe.state.il.us/arra/html/webinar.htm.) However, there are difficulties in applying the Cash Management Improvement Act to GSA payments, as their distribution is not based on immediate need for cash and the distribution schedule is established by statute. It is unclear whether ISBE has the authority to withhold GSA payments if the previously distributed Federal monies had not been spent by LEAs.

ISBE plans to distribute approximately three additional SFSF Education payments during the first quarter of the 2010 calendar year. ISBE will take corrective action to resolve Finding No. 1 for GSA SFSF funds by:

1. Sending notification to all LEAs prior to the distribution of SFSF that they should expect to receive SFSF payments on three specific disbursement dates;
2. Requesting that each LEA notify ISBE in advance of these payments if they believe they will be unable to fully expend the scheduled SFSF GSA payments;
3. Requesting that each LEA notify ISBE of any changes to their scheduled payments to ensure that all SFSF payments will be expended;
4. Stating that an expenditure report must be submitted to ISBE that reflects all SFSF were expended through March 31; and,
5. Any unanticipated excess cash that generates interest greater than $100 must be returned promptly to ISBE per 34 CFR 80.21(h)(2)(i).

All other ARRA funds such as for Title I and IDEA Part B are disbursed to LEAs based on monthly payment schedules submitted as part of their grant application. ISBE instructs LEAs to request funds on their payment schedules in the months in which cash outlays will occur (see page 10 of the State and Federal Grant Administration Policy http://www.isbe.net/funding/pdf/fiscal_procedure_handbk.pdf). In addition, all LEAs were reminded the importance of this requirement in the September 15 State Superintendent's Weekly Message (see page 3 at http://www.isbe.net/board/archivemessages/2009/message_091509.pdf).

ISBE's current process for monitoring cash balances prior to distributing funds for Federal programs is to collect quarterly expenditure reports from LEAs that are due 30 days following the end of the quarter. Prior to the distribution of additional funds, following receipt of a LEA's quarterly expenditure report, ISBE compares the amount of funds distributed to the LEA to the amount of expenditures reported by the LEA to determine if excess cash balances exist. If a determination is made that the LEA has excess cash, defined as any positive value, this amount is frozen from the LEA's next scheduled payment and is withheld until the LEA submits subsequent expenditure reports that results in the LEA not holding any excess cash. Note that obligations are currently not subtracted from a "cash on hand" balance to determine excess cash in this process. Salaries and benefits paid by the LEA are included in expenditures for calculating excess cash.

With regards to the LEA that the Inspector General auditors identified as having excessive excess cash on hand, ISBE notes that the form the auditors reviewed was what is used by ISBE's Division of External Assurance for the purposes of computing imputed interest. This is not the mechanism used by the Division of Funding and Disbursements to determine if an LEA has excess cash that should be expended prior to the disbursement of additional funds. However, ISBE concurs that, due to a variety of factors which are addressed in our corrective action, this LEA did have excess cash. The LEA was cited for excess cash and returned imputed interest.

ISBE will take the following corrective action to resolve Finding No. 1 as it pertains to ARRA and all other Federal programs (except SFSF):

1. Beginning with the January 2010 payments scheduled for all LEAs, Funding and Disbursement Services staff will voucher at the beginning of the month an LEA payment is scheduled instead at the end of the month prior to eliminate an LEA from receiving funds earlier than intended.
2. Beginning with the quarterly expenditure report due for the period ending March 31, 2010, Funding and Disbursement Services will change the LEA expenditure report due date from 30 days to 20 days from the end of the quarter.
3. Beginning with the quarterly expenditure report due for the period ending March 31, 2010, Funding and Disbursement Services will change the LEA excess cash calculation by utilizing a cash basis determination and not include outstanding obligations.
4. At the beginning of a new grant cycle, Funding and Disbursement Services will apply any unexpended funds (on a cash basis) from the prior year's grant as identified by the LEA on their June 30 year-end expenditure report to the LEA's federal project for the new fiscal year. This will result in the LEA being required to expend the prior year's funds before any new disbursements are made to the LEA.

In considering discussions with the Inspector General auditors indicating that ISBE should collect expenditure data on a monthly basis to determine excess cash prior to distributing any additional funds, ISBE is concerned with the burden this would impose on more than 1,000 LEAs and subrecipients reporting on up to 50 Federal programs and on ISBE computer resources and staff.

Recommendation 1.2

Revise its procedures to ensure that it and the LEAs are accurately calculating cash on hand and remitting interest in a timely manner.

ISBE Response

Issues related to cash management of all Federal funds, not just ARRA funds, were discussed with the U.S. Department of Education ARRA Technical Assistant Team on November 10, 2009. Based on this discussion, ISBE intends to revise cash management procedures and request that the U.S. Department of Education provide an opinion on their adequacy and compliance of those procedures with grant administration requirements. These procedures will consist of:

1. Requiring LEAs to hold all Federal Funds in a separate, interest bearing, bank account. This requirement will be codified in administrative rule.
2. Instructing LEAs to remit interest earned on their Federal funds account to ISBE on a quarterly basis. The LEAs will be allowed to retain the first $100.00 in interest earned, annually.
3. ISBE will forward all interest received from LEAs to the awarding Federal agency.

It is ISBE's understanding that this process will comply with the requirements of 34 C.F.R. § 80.21(i). . . [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.

In considering discussions with the Inspector General auditors indicating that ISBE should require more than 1,000 LEAs and subrecipients to determine daily cash balances for up to 50 individual Federal programs, calculated imputed interest on each daily balance and report the results and the associated imputed interest, ISBE is concerned with the burden this would impose on LEAs and ISBE computer resources and staff.

FINDING NO. 2 – ISBE Could Improve Its Subrecipient Monitoring to Ensure Compliance with ARRA Requirements

Finding Recap

ISBE could improve its subrecipient monitoring to provide reasonable assurance of LEA compliance with ARRA requirements.

- **LEAs Are Not Tracking SFSF Funds**
- **LEA and Coop Uncertainty about Responsibility for Administering ARRA IDEA Fund**

Recommendation 2.1

Track SFSF expenditures so that the detailed information can be accurately reported as required by ARRA.

ISBE Response

ISBE established separate revenue codes for ARRA funds and amended its administrative rules to require LEAs to use these codes in accounting for expenditures of ARRA funds. ISBE continuously communicated to LEAs that they must separately track and account for ARRA funds. The need for tracking of the ARRA funds was tied to the ARRA 1512 reporting requirements.

All LEAs submitted ARRA reports for the first 1512 ARRA reporting quarter.

For one of the LEAs visited by the auditors and cited as not tracking SFSF expenditures, ISBE has received their Annual Financial Report which includes an audited schedule of receipt and expenditure of ARRA funds by program.

Recommendation 2.2
Develop and implement procedures to collect, compile, and report on ARRA IDEA funds.

ISBE Response
Certain areas in Illinois use special education cooperatives and joint agreements where individual LEAs are members of these intermediate units (IUs) and the IUs provide special education services to their member LEAs.

ISBE is utilizing the same method for collecting ARRA data as is used for collecting Federal program expenditure data from IUs and their member LEAs. This process requires the IUs to collect data from their member LEAs, accumulate the data, and report all of the information to ISBE. ISBE requires the IUs collect the same information from their LEAs as ISBE would collect from an LEA that is not a member of an IU.

Discussions have occurred with the U.S. Department of Education ARRA Technical Assistant Team on the need for IUs to report LEAs as vendors for ARRA reporting purposes. We are awaiting definitive guidance on this issue.

Anyone knowing of fraud, waste, or abuse involving U.S. Department of Education funds or programs should call, write, or e-mail the Office of Inspector General.

Call toll-free:
The Inspector General Hotline
1-800-MISUSED (1-800-647-8733)

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U.S. Department of Education
Office of Inspector General
400 Maryland Avenue, SW
Washington, DC 20202

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