
Los Angeles Unified School District's Procedures for Calculating and Remitting Interest Earned on Federal Cash Advances

FINAL REPORT



**ED-OIG/A09H0019
December 2008**

Our mission is to promote the efficiency, effectiveness, and integrity of the Department's programs and operations.



U.S Department of Education
Office of Inspector General
Sacramento, CA

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UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

Audit Services
Sacramento Region

December 2, 2008

Mr. Jack O'Connell
State Superintendent of Public Instruction
California Department of Education
1430 N Street
Sacramento, CA 95814

Dear Mr. O'Connell:

Enclosed is our final audit report, Control Number ED-OIG/A09H0019, entitled *Los Angeles Unified School District's Procedures for Calculating and Remitting Interest Earned on Federal Cash Advances*. This report incorporates the comments you provided in response to the draft report. 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 Education Department official, who will consider them before taking final Departmental action on this audit:

Thomas Skelly
Acting Chief Financial Officer
Office of the Chief Financial Officer
U.S. Department of Education
400 Maryland Avenue, SW
Washington, D.C. 20202

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/
Gloria Pilotti
Regional Inspector General
for Audit

Enclosure

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EXECUTIVE SUMMARY

Over the 12-year period (fiscal year (FY) 1995 through FY2006), Los Angeles Unified School District (LAUSD) received more than \$8 billion in Federal revenues and earned millions of dollars of interest on Federal cash advances. LAUSD retained the interest earnings instead of remitting the earnings to the U.S. Department of Education (ED) and other Federal agencies as required by Federal regulations. LAUSD's noncompliance was repeatedly reported in its single audit reports. On March 9, 2007, LAUSD began remitting the earned interest to the California Department of Education (CDE) for submission to ED and other Federal agencies. At the time of our review, LAUSD had remitted about \$25 million to CDE for interest earned on Federal cash advances from FY1995 through FY2007. Based on the results of our review, we estimated that the remitted amount may not have included about \$6.3 million of interest earned on Federal cash advances during that period.¹

The purpose of our audit was to determine whether LAUSD 1) used a methodology for calculating the interest earned on Federal cash advances that was compliant with Federal requirements, and 2) has policies and procedures in place to ensure that future interest earned on Federal cash advances is accurately computed and remitted on a quarterly basis to CDE. To evaluate LAUSD procedures, we reviewed LAUSD's calculation and remittance of earned interest on Federal cash advances for FY2004 through FY2007.

LAUSD does not have procedures that identify the actual amount of interest earned on Federal cash advances. While LAUSD had developed a methodology for estimating the amount, the reliability of the estimate was not readily determinable due to the design and application of the methodology. Thus, LAUSD's methodology may overstate or understate the interest earned on Federal cash advances. We recommend that CDE work with the Los Angeles County Office of Education (LACOE) and LAUSD to develop a method for LAUSD to identify actual interest earned on Federal cash balances. We also recommend that, in the interim, LAUSD take the following steps to improve the reliability of its current estimation methodology: 1) perform a subsequent adjustment when the prior quarter earnings rate is used in calculations, and 2) improve the internal controls over performance of the calculations.

LAUSD did not remit the entire amount of estimated interest earned for FY2004 through FY2007 that was due to ED and other Federal agencies. As we describe in the following paragraphs, LAUSD improperly reduced the amount due by about \$1.48 million and did not demonstrate that another \$817,784 of interest identified as due was actually remitted to CDE or other grantors.

¹ The \$6.3 million is the sum of amounts presented in the Executive Summary for additional amounts that may be due to Federal agencies for interest earned during FY1995 through FY2007 (\$1.48 million + \$2.58 million + \$817,784 + \$1.42 million).

LAUSD improperly reduced the amount of earned interest to be remitted to CDE and other grantors to compensate LAUSD for the temporary use of other cash resources to operate Federal programs. Our review identified about \$1.48 million of earned interest that was excluded from LAUSD's estimates for FY2004 through FY2007 due to the improper reduction. We recommend that LAUSD exclude from its procedures the reduction of earned interest for the temporary use of other cash resources to operate Federal programs. We also recommend that LAUSD remit to CDE the \$1.48 million identified by our audit that was improperly excluded from analysts' calculations of earned interest due and identify and remit all other earned interest improperly excluded for FY1995 through FY2007 and later. If the periods reviewed are representative of the prior years, we estimate that about \$2.58 million may have been improperly excluded from amounts due to CDE and other grantors for interest earned during FY1995 through FY2003 to compensate for the temporary use of other cash resources to operate Federal programs.

LAUSD's current internal controls may not be adequate to ensure that amounts it identified as due to CDE and other grantor agencies are promptly remitted. Our review identified about \$817,784 of earned interest for FY2004 through FY2007 that LAUSD's accounting analysts identified in their worksheets as due to CDE or other grantors, but was not included in provided remittance documentation. We recommend that LAUSD remit the \$817,784 or provide documentation confirming the prior remittance of the amount. We also recommend that LAUSD reconcile its documentation for FY1995 through FY2003 and for fiscal years after FY2007 to identify any other amounts due in the analysts' worksheets that were not remitted and remit those amounts to CDE or other grantors. If the periods reviewed are representative of the prior years (FY1995 through FY2003), there could be about \$1.42 million of additional earned interest that was identified by the analysts, but not remitted to CDE or other grantors. Finally, we recommend that CDE review LAUSD's internal controls for ensuring prompt remittance of all interest earned to grantor agencies and monitor LAUSD, on an on-going basis, to ensure that LAUSD continues to remit interest earnings to CDE on a quarterly basis.

In response to the draft report, CDE provided us with LAUSD's written comments on the reported findings and recommendations and stated that the comments and positions set forth in the letter are solely those of LAUSD. LAUSD partially concurred with our findings and concurred or partially concurred with our recommendations, except for those recommendations that provided for the remittance of additional amounts of interest for periods earlier than the five-year limitation period specified in the General Education Provision Act (GEPA).

CDE did not provide its own comments on the findings and recommendations except to state that it would continue to work with LAUSD and ED in resolving the issues delineated in the audit report. LAUSD's comments are summarized at the end of each finding and the entire text of the CDE and LAUSD letters are included in an attachment to the report.

BACKGROUND

ED makes Federal funds available to state educational agencies for administration of Federal education programs at local educational agencies (LEAs). State educational agencies are responsible for providing the Federal funds to the LEAs (subgrantees).

ED General Administrative Regulations, at 34 C.F.R. § 80.21, prescribe the basic standards and methods that ED must follow when making payments to grantees and that grantees must follow when making payments to subgrantees. Paragraphs (c) and (d) of 34 C.F.R. § 80.21 state that grantees and subgrantees are to be paid in advance, provided they maintain or demonstrate the willingness and ability to maintain procedures to minimize the time elapsing between the transfer and disbursement of funds by the grantee or subgrantee. When the grantee or subgrantee cannot meet the timing requirement, reimbursement of incurred expenditures is the preferred method of payment. Paragraph (i) requires grantees and subgrantees to remit to ED, at least quarterly, interest earned on advances when the interest exceeds \$100 per year.

CDE generally uses the advance method for providing Federal funds to LEAs. LEAs hold the advanced funds in investment accounts with their respective County Treasurer's Office until the amounts are used for Federal program expenditures. California State law requires that County Offices of Education provide fiscal oversight of the LEAs within their respective counties.

LAUSD is the nation's second largest school district with over 700,000 students and total revenues exceeding \$10 billion in FY 2006, of which about \$1 billion was revenue from the Federal Government. As shown in Table 1, over the 12-year period from July 1, 1994 through June 30, 2006, LAUSD received more than \$8 billion in Federal revenues.

Table 1: LAUSD Revenues for FY 1995-2006 (a) (in thousands)			
Fiscal Year (July through June)	Total Revenues	Federal Revenues	Federal Percentage
2006	\$10,167,841	\$1,150,060	11%
2005	8,566,578	1,071,628	13%
2004	7,498,310	984,482	13%
2003	9,939,832	814,681	8%
2002	7,390,773	686,278	9%
2001	7,208,339	598,540	8%
2000	6,425,483	590,308	9%
1999	5,497,979	504,998	9%
1998	5,392,988	454,281	8%
1997	4,462,704	426,404	10%
1996	3,951,167	404,939	10%
1995	3,775,930	471,216	12%
Totals	\$80,277,924	\$8,157,815	10%
(a) Source: LAUSD's Comprehensive Annual Financial Reports (CAFR). The report for FY2007 was not available at the time of our review.			

Over the years, LAUSD earned millions of dollars of interest on Federal cash advances and retained those earnings instead of remitting the interest earnings to ED and other Federal agencies as required by Federal regulations. This condition was repeatedly reported as a compliance finding by Independent Public Accountants (IPAs) that conducted single audits of LAUSD.

- Single audit reports for FY1995 and FY1996. In the FY1995 single audit report, the IPA included a finding that LAUSD was holding interest earned on excess Federal funds. In its response, LAUSD stated it would develop procedures to monitor cash received and expended for each Federal grant and develop a process for allocating interest earned to the appropriate funding agency.² In the FY1996 single audit report, the IPA reported LAUSD had implemented the corrective action. However, as noted in the next paragraph, the finding was again reported in the FY1997 single audit.
- Single audit report for FY1997. The IPA included a finding that LAUSD had not reported interest earned on Federal funds to the funding agency. The IPA recommended that LAUSD report the interest earned and either request permission to reprogram the interest as an increase of total program funding, or request instructions for remitting the interest. The IPA also reported that, for FY1997 and the prior two years, LAUSD had calculated the interest earned on Federal cash advances and established a liability to the Federal Government.
- Single audit reports for FY1998 through FY2006. The IPAs repeatedly reported that LAUSD was not in compliance with 34 C.F.R. § 80.21(i) in findings in the single audit reports for FY1998 through FY2002 and FY2004 through FY2006. In the FY2003 single audit report, the IPA did not report this finding, but did include the finding in the status of the prior year's finding section of the single audit report.

In its responses to the findings, LAUSD stated it had communicated with ED officials regarding the interest earned on Federal cash advances that was being held by LAUSD.

- Single audit report for FY1998. LAUSD reported that its Chief Financial Officer had written a letter to the ED Director of Compensatory Education Programs, dated February 20, 1998, reporting the interest earned and requesting permission for LAUSD to retain the interest as additional program funds.
- Single audit report for FY1999. LAUSD reported that a letter was sent to ED on April 23, 1999 as a follow up to its earlier letter.
- Single audit report for FY2004. LAUSD reported that another letter was sent to ED on December 8, 2003, and that no response was received from ED on that letter.³

² In the FY1995 report, the IPA incorrectly referred to the interest earned on Federal cash advances as program income. The regulation at 34 C.F.R. § 80.25 states that program income is to be deducted from total allowable program costs to determine the net allowable costs, but explicitly states interest earned on grant funds is not program income. Thus, the IPA improperly recommended that the District credit all interest earned to each Federally funded program.

³ LAUSD provided a copy of its letter of December 8, 2003, but was unable to locate the earlier letters.

- Single audit report for FY2006. LAUSD reported that it had informal discussions with ED regarding the use of interest earned on Federal cash advances. LAUSD stated that it would decide in Fall 2006 whether to submit a plan for use of the interest earnings or to remit the amounts to ED.

In March 2007, LAUSD began remitting the interest earned on Federal cash advances to CDE for transfer to ED and other Federal agencies. Documentation provided by LAUSD and CDE confirmed the remittance of about \$25 million for interest earned on Federal cash advances during FY1995 through FY2007.

AUDIT RESULTS

LAUSD did not identify the actual amount of interest earned on Federal cash balances. While LAUSD developed a methodology for estimating the amount, the reliability of the estimate was not readily determinable due to the design and application of the methodology. In addition, when determining the amount of earned interest to be remitted to CDE and other grantor agencies, LAUSD improperly reduced the amount to compensate for the temporary use of other cash resources to operate Federal programs. Also, LAUSD's current internal controls may not be adequate to ensure that amounts identified as due to the Federal Government are promptly remitted to CDE and other grantors.

FINDING NO. 1 - LAUSD Estimated Interest Earned on Federal Cash Advances

LAUSD does not have procedures to identify the actual amount of interest earned on Federal cash advances. ED General Administrative Regulations at 34 § C.F.R. 80.20 (b) establish the standards for financial management systems at LEAs receiving Federal education grants and subgrants. The standard on internal control addresses effective control and accountability of cash and other assets.

3) *Internal control.* Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and **other assets**. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes. [**Bold** emphasis added.]

Other assets would include the interest earned on cash advances from Federal grants and subgrants. Thus, LEAs should have financial procedures for identifying the interest earned on Federal cash balances. The procedures should have a level of precision that ensures only an amount up to \$100 per year is retained for administrative expenses. Paragraph (i) of 34 C.F.R. § 80.21 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.

Reports on Interest Earnings Available to LAUSD

Cash received by LAUSD from Federal, state, and other sources is deposited in the School Fund managed by the Los Angeles County Treasurer. The School Fund is a pooled investment fund that includes cash received by various educational organizations, such as school districts, community college districts, and charter schools. Each month, the Los Angeles County Treasurer's Office provides LACOE with a statement showing the interest earned that month on cash held in the School Fund.

LACOE allocates the amount of earned interest reported by the Treasurer's Office to educational organizations on a quarterly basis using financial records that LACOE maintains for each organization's funds and subfunds. For example, LACOE maintains financial records on LAUSD's General Fund, Adult Education Fund, and other funds and subfunds that account for receipts from various Federal, state and local sources, including ED programs. LACOE uses the financial records to determine the average daily cash balance for each fund/subfund and uses the average balances to allocate the earned interest reported by the Treasurer's Office for the quarter to the funds/subfunds. LACOE provides educational organizations with quarterly reports showing the average daily cash balance for each of the organization's funds/subfunds and the amount of interest allocated to each fund/subfund for the fiscal quarter.

LAUSD can not identify the interest earned on Federal cash balances from the LACOE reports because LAUSD funds/subfunds contain amounts received from Federal, state, and other sources. Thus, to identify the amount, LAUSD developed a methodology for estimating the interest earned on Federal cash balances.

LAUSD's Methodology for Estimating Interest Earned on Federal Cash Balances

LAUSD used a methodology that estimated the earned interest on Federal cash balances by revenue code. LAUSD's financial accounting system uses revenue codes to trace receipts and expenditures by funding source. A revenue code may be used to account for cash receipts and expenditures for one or more Federal grants. Accounting analysts in LAUSD's Accounting and Disbursement Division are responsible for applying LAUSD's methodology through the use of a series of electronic files containing detailed and summary worksheets. Each analyst is assigned responsibility for preparing the worksheets for groups of revenue codes.

- Detailed Worksheet. The analyst prepares a detailed month-by-month worksheet for each assigned revenue code that covers a fiscal year. The worksheet begins with the amount of available cash for the revenue code. The analyst obtains the total cash receipts and expenditures by month for the revenue code from LAUSD's accounting system and enters the amounts on the electronic worksheet. The receipts are added to the month's beginning balance to obtain the available cash for the revenue code during the month. Then, the expenditures are subtracted from the available cash to derive the ending balance for the month and subsequent month's beginning balance. The month's ending balance is multiplied by one-twelfth of the School Fund interest earnings rate (School Rate)⁴ to compute an estimate of the interest earned for the month on Federal cash balances for each revenue code. When the ending balance for the month is negative (expenditures exceed available cash for the revenue code), the calculation results in a negative amount of interest for the month.
- Summary Worksheet. The analyst prepares a summary worksheet to calculate the amount of the earned interest that is to be remitted to CDE or other grantor agencies for each assigned revenue code for the fiscal quarter and, in total, for the fiscal year. This worksheet is discussed in Finding No. 2.

⁴ LAUSD obtains the annualized School Rate for each fiscal quarter from LACOE.

The reliability of LAUSD's estimated amounts of monthly earned interest could not be readily determined due to the design and application of the methodology.

- The methodology was designed to only provide calculations of the estimated earned interest for revenue codes from Federal sources. The calculations for all revenue codes in the General Fund or other funds would be needed to compare the total estimated earned interest derived using LAUSD's methodology to the total actual interest earnings that LACOE reported to LAUSD.
- The methodology was designed to use information from LAUSD's financial accounting system when the actual interest earnings were determined by LACOE using information from LACOE's financial records. Using information from a source other than the source used to calculate the actual interest earned by LAUSD increases the risk that LAUSD's methodology may not produce reliable estimates.
- The methodology was designed to calculate the estimated earned interest using the month-end cash balance rather than the average daily balance. As noted earlier, LACOE allocates the interest earnings to LAUSD and the other educational organizations using average daily balances. The daily cash balances for a revenue code would vary depending on the timing of receipts and expenditures.
- The application of the methodology utilizes numerous worksheets and calculations prepared by various LAUSD analysts. For example, LAUSD provided us with detailed and summary worksheets for FY2007 covering 190 revenue codes. If monthly interest calculations were performed for all 190 revenue codes each month, the detailed worksheets for just this one year would contain 2,280 separate calculations (190 revenue codes times 12 months). Performing that number of calculations would mean that 2,280 separate times the receipts and expenditures would be entered in the worksheets, month-end balances calculated, applicable School Rates identified, and the School Rate applied to the month-end balance. While the analysts used electronic worksheets, the worksheet formats varied among the analysts and were manually prepared using data obtained from LAUSD's accounting system. Due to the number of individual worksheets, calculations, and data elements and the variance in analysts' worksheets and their manual preparation, there is risk that the methodology may not be applied consistently, that the data used in the calculations may not be accurate, or the calculations may be incorrect. Our limited review⁵ of the worksheets identified instances where analysts did not prepare summary worksheets, did not consistently apply the methodology, used an interest rate other than the applicable School Rate, or used an incorrect formula in the worksheets.
- When the School Rate for the 4th quarter is not available at the time its analysts' perform the calculations, LAUSD's methodology provided for the analysts to use the School Rate for the prior fiscal quarter in the calculations of the estimated interest earned for the months in the 4th quarter. The methodology did not provide for the subsequent

⁵ Due to the number of calculations and variability in the provided documentations, we limited our review to the summary worksheets for FY2004 through FY2007. Our reviews of the detailed worksheets were limited to gaining an understanding of LAUSD's methodology and investigating anomalies in the summary worksheets.

adjustment of the calculations when the School Rate for the 4th quarter became available.⁶ LACOE's list of School Rates for FY1998 through FY2007 showed that the 4th quarter rates were higher than the 3rd quarter rates in 7 of the last 10 fiscal years. Thus, when the analysts used the prior quarter School Rate for 4th quarter calculations, the methodology understated the estimated interest earned on Federal cash balance in seven of the fiscal years and overstated the amount in the other three fiscal years.

Due to the above factors, LAUSD's methodology may overstate or understate the interest earned on Federal cash advances.

We have not recommended that LAUSD revise its current methodology to address the above factors, because the application of the methodology to all revenue codes and the calculation of average daily balances for each month for all revenue codes would require a substantial increase in the significant amount of staff resources already committed to the application of LAUSD's methodology. As we present in the next section, an alternative to LAUSD's current methodology may be available that would likely reduce the staff resources needed and identify the actual interest earned on Federal cash advances. However, until an alternative is implemented, LAUSD should take the following interim steps to improve the reliability of estimates.

- LAUSD could improve the reliability of its estimates by adjusting the calculations for the months of April, May, and June after receipt of the School Rate for the 4th quarter, or delay performance of the calculations until the 4th quarter rate is available.
- Also, LAUSD could take additional steps to improve the internal control over application of its methodology. LAUSD issued Policy Bulletin ADD-007-004 in March 2007 updating its procedures, which included a standard detailed worksheet for calculating the monthly interest for revenue codes. LAUSD should further enhance its procedures for applying the methodology by providing a standard summary worksheet and making the use of standard detailed and summary worksheets mandatory for analysts. LAUSD could also explore methods to incorporate internal controls within the design of the worksheets to ensure the accuracy of formulas and information entered into the worksheets. Taking these additional steps would improve the consistency and accuracy of interest calculations across all spreadsheets prepared by different analysts.

The above interim steps could improve the reliability of LAUSD's estimate of the interest earned on Federal cash balances without a significant increase in use of its staff resources.

LACOE Could Include in Its Reports the Interest Earned on Federal Cash Balances

LACOE advised us that its current financial report system allows educational organizations, such as LAUSD, to use subfunds within their General Fund and other funds to separately identify the cash balance for Federal programs as long as all the Federal programs are grouped into the same

⁶ Our review of analysts' worksheets for FY2004 through FY2007 found that the actual School Rate for the 4th quarter was only used in estimated interest calculations for April, May, and June 2006 and then only by six of the eight analysts who performed the calculations for FY2006.

subfund(s) with no other non-federal programs maintained in the same subfund. This accounting structure enables the interest allocation process in the current financial system to report quarterly on the actual interest earned, in total, on Federal cash held in those subfunds for the individual Federal programs. However, none of the educational agencies are currently maintaining such a structure in the financial system. Any structural change requires all the agencies to perform systematic tasks, such as a one-time crosswalk of all the existing balances from the current subfund to the new one. This change would only be effective if LAUSD and other educational agencies are allowed to remit interest earned on Federal cash balances in the subfund rather than on a grant-by-grant basis.

Federal regulations applicable to ED programs do not require states or LEAs to return interest earned on Federal cash balances on a grant-by-grant basis. Also, ED only identifies the grantee remitting the amount (e.g., CDE) and does not record the individual program information since the interest remittances are deposited in the U.S. Treasury as miscellaneous receipts.

If the subfunds were set up by Federal agency source, the LACOE reports could contain the information needed by LAUSD to meet ED requirements for reporting and remitting the actual interest earned on Federal cash balances. This change would substantially reduce the staff resources currently expended by LAUSD to estimate earned interest on a grant-by-grant basis while providing for the remittance of the actual interest earned on Federal cash balances.

Recommendations

We recommend that the Chief Financial Officer require CDE to—

- 1.1 Work with LACOE and LAUSD to develop a methodology for LAUSD to identify actual interest earned on Federal cash balances.
- 1.2 Instruct LAUSD to take the interim step to provide a more reliable estimate by revising its current methodology to either include a subsequent adjustment of the calculations when the School Rate for the 3rd quarter rate is used for months in the 4th quarter (April, May and June) or delay performance of the calculations until the 4th quarter rate is available.
- 1.3 Instruct LAUSD to recalculate the estimated interest earned on Federal cash balances for the 4th quarter of FY1995 through FY2007 and later using the actual School Rates for the 4th quarter, and remit any additional amounts due to CDE and other grantors, as permitted under Federal law.
- 1.4 Instruct LAUSD to take the interim step to enhance the procedures for applying its current methodology by providing a standard summary worksheet for use by its analysts, making the use of the standard worksheets mandatory, and incorporating internal controls into the design of the worksheets to ensure the accuracy of formulas and information entered into the worksheets.
- 1.5 Instruct LAUSD to implement appropriate reviews to ensure analysts are applying the new procedures consistently and accurately.

LAUSD Comments

In its comments on the draft report, LAUSD agreed that its methodology for determining remittance obligations was based on monthly estimates of interest earned on Federal cash advances. However, LAUSD disagreed with the OIG's finding that its methodology did not produce a reliable determination of the actual interest earned. LAUSD cited its recalculation of interest earned in FY2007 on Federal cash advances for the Elementary and Secondary Education Act (ESEA), Title I, Part D Program to demonstrate the difference between using month-end balances versus average daily balances in its calculations. LAUSD stated that the difference between the two calculations was less than one percent.

LAUSD stated that it is not aware of any applicable statute, regulation, or ED guidance that provided clear notice that the District's methodology for estimating interest was improper. LAUSD stated that neither 34 C.F.R. § 80.20(b), which states that Federal grantees must maintain "[e]ffective control and accountability" over grant assets, nor 34 C.F.R. § 80.21(i), which permits grantees to retain only up to \$100 per year in earned interest, expressly requires any particular interest calculation methodology. LAUSD stated that, absent clear notice, it was unjust to penalize the District for its methodology especially since LAUSD repeatedly sought guidance from ED regarding policies and practices for remitting interest on Federal cash advances.

LAUSD expressed eagerness to work expeditiously with LACOE and CDE to develop an alternative methodology for calculating interest earned on Federal cash balances, so long as the resulting procedure is not significantly more burdensome to the District than its current approach. LAUSD is willing to consider adoption of OIG's proposed alternative methodology; however, implementation would require support from LACOE and concurrence from CDE that grant-by-grant reporting of interest remittances is no longer required. LAUSD stated that it has had preliminary discussions with CDE and has begun reviewing its current methodology to determine ways in which it might be streamlined.

LAUSD explained how it had already revised its interest calculation methodology in accordance with Recommendation 1.2. LAUSD stated that it continues to estimate interest for the 4th quarter using the 3rd quarter School Rate, but requires analysts to make a subsequent adjustment to the calculations when the actual 4th quarter rate becomes available in the following fiscal year. LAUSD provided inter-office correspondence, dated October 31, 2006, which advised staff to recalculate interest for the 4th Quarter of FY2006 using the actual rate for the quarter.

LAUSD advised that it was in the process of verifying that remitted interest for FY2006 and FY2007 was calculated using the actual School Rates for the 4th quarter. For periods prior to FY2006, LAUSD contends that the District should not have to calculate and remit additional interest. LAUSD stated that the statute of limitations provision of the GEPA applies to FY2003 and earlier. LAUSD cited a House Committee Report, which stated that the statute of limitations was enacted to encourage more prompt audits and remove the threat of repayment of expenditures made many years before an audit. LAUSD stated that, under the statute of limitations, its monetary liability would at most extend no further back than five years from the present (i.e., FY2004). LAUSD asserted that its earlier voluntary remittances of interest for periods prior to FY2004 do not constitute a waiver of the statute of limitation provision and that the earlier remittances were intended to demonstrate LAUSD's good-faith commitment to work

with ED and CDE to resolve the matter. LAUSD stated that significant staff resources would be required to perform recalculations for the remaining two fiscal years—FY2004 and FY2005 and that such calculations would likely yield small sums of additional interest.

LAUSD stated that it would develop a standard template for both detail and summary worksheets to ensure accuracy of formulas and information entered into the worksheets and require staff to use the template. LAUSD expects to have the standard templates developed by October 1, 2008 for use in performing recalculations for FY2009.

LAUSD stated a procedure was already in place for Senior Accounting Analysts to review each worksheet and ensure that analysts are applying procedures consistently and accurately. LAUSD stated that, through training and appropriate monitoring, it would ensure that this procedure is followed rigorously and that the Senior Accounting Analysts perform careful and thorough reviews.

OIG Response

We did not change our finding or recommendations. In its comments, LAUSD inaccurately portrayed our conclusion regarding the reliability of its methodology. We concluded reliability could not be readily determined due to the factors listed in the finding regarding the design and application of the methodology. The recalculation for the ESEA, Title I, Part D Program provided an isolated example of only one of the factors listed in our finding. In addition, the pattern of receipts and disbursements for the ESEA, Title I, Part D Program may not be representative of the pattern for other programs since CDE does not have a standard method for determining the amount and timing of Federal cash disbursements to LEAs. Additionally, LAUSD may disburse cash at different times within the month for other programs.

The regulations cited in the finding clearly state the requirement to remit interest earned and, as LAUSD acknowledged, its methodology produces an estimate of the earned amount, not the amount actually earned. The cited regulations clearly state that LEAs need to have effective accountability for assets and LEAs must return all interest in excess of \$100. As we noted in the Background section of the report, LAUSD's letters to ED were requests for permission to retain the interest or use the amounts for program purposes, not for information on the methodology for determining the amount of interest earned on Federal cash advances.

We have not modified our recommendation in response to LAUSD's argument that GEPA's statute of limitations provision prevents ED from recovering interest retained by LAUSD for any period more than five years prior to an administrative determination by the Department. During audit resolution, ED will determine the proper application of GEPA requirements to the recovery of interest unlawfully and intentionally retained by LAUSD. As we noted in the Background Section of the report, LAUSD was aware of the requirement to remit the interest earned on Federal cash advances at the time its FY1995 single audit report was issued and its FY1997 single audit report disclosed that LAUSD had begun calculating the interest earned and had established a liability to the Federal Government. LAUSD, however, did not remit any amounts until March 2007. We noted that the first remittance occurred immediately after LAUSD was notified of the initiation of the OIG's earlier review of LAUSD's controls

in accounting for Federal funds.⁷ The statute of limitations provision of GEPA does not directly address this situation. The five-year provision addresses the liability of a recipient of Federal education program funds to “return funds which were **expended** in a manner not authorized by law....” [Emphasis added.] The earned interest amounts were neither program funds received by LAUSD nor expenditures of LAUSD. We had identified the potential GEPA issue in a footnote to our draft report. Since that issue is now included in LAUSD comments and our response, we have removed the footnote from the final report.

FINDING NO. 2 - LAUSD Inappropriately Reduced the Estimated Interest Earned on Federal Cash Advances to Compensate for Temporary Use of Other Available Cash Resources

LAUSD understated the amount due to grantor agencies when it inappropriately reduced the estimated interest earned on Federal cash advances to compensate for the temporary use of other available cash resources for Federal programs. For purposes of the report, we refer to this process as “netting.”

To calculate the amount of earned interest to be remitted to CDE and other grantors for the fiscal year, the analyst prepares a summary worksheet for each assigned revenue code showing an amount for each fiscal quarter. To obtain the quarterly amounts, the analyst combines the related monthly estimated earned interest amounts shown on the detailed worksheets. As we noted in Finding No. 1, LAUSD’s methodology can result in a negative amount for interest earned for a month when expenditures exceed the available cash for a revenue code.

When a quarter has both positive and negative monthly amounts, the analyst nets the amounts to obtain the quarterly earned interest to be remitted for the revenue code (quarterly netting). Thus, netting at the quarterly level reduces the estimated earned interest to be remitted and can result in a negative amount for the quarter. Then, the analyst combines the quarterly amounts on the summary worksheet to derive the amount to be remitted for the fiscal year. When a fiscal year has both positive and negative quarterly amounts, the analyst again nets the amounts to obtain the earned interest to be remitted for the fiscal year for the revenue code (fiscal year netting). Thus, fiscal year netting can further reduce the estimated earned interest to be remitted to the grantor agency.

As we noted in Finding No. 1, 34 C.F.R. § 80.21(i) allows grantees or subgrantees to keep only up to \$100 per year of interest earned on Federal cash advances for administrative expenses. Federal laws and regulations do not contain provisions for compensating LEAs for the use of other available cash resources to operate ED programs. In fact, Office of Management and Budget (OMB) Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*, Attachment B which establishes the principles and standards for determining allowable costs for Federal awards, prohibits the use of Federal funds for such purposes. Attachment B, Paragraph 23.a states that costs incurred for “the use of a governmental unit’s own funds, however represented, are unallowable.”

⁷ ED-OIG issued a letter to LAUSD on February 8, 2007 announcing a review of LAUSD’s administration of the Federal education funds. The review comprised an assessment of LAUSD’s controls in accounting for Federal funds and administering programs authorized by the ESEA, as amended. Based on that assessment, the ED-OIG initiated the audit that resulted in this report.

The U.S. Department of the Treasury regulation at 31 C.F.R. § 205.14(a), which is applicable to ED programs⁸, allows states to collect interest from the Federal Government when funds are not delivered to the state in time to fund a Federal program. There is no similar provision for LEAs and the definition of a state used in the Treasury regulations specifically excludes local governments. Also, the Federal Government may deny a state's interest claim for interest if the state fails to request Federal funds timely. In the case of the example of netting shown in Table 2, the Elementary and Secondary Education Act (ESEA) funds for school year 2006-2007 were available to CDE on July 1, 2006. CDE did not make the initial advance to LAUSD until December 2006. Thus, CDE had not made the Federal funds available to LAUSD when needed for Federal program expenditures.

Impact of Quarterly Netting. The following example demonstrates the impact of netting when determining the amount to be remitted for a quarter.

Table 2: Impact of Fiscal Quarter Netting For Revenue Code R046-003F (a) October through December 2006		
Month	Estimated Interest Earned From Detailed Worksheet	Notes
October 2006	<\$ 87,830>	Expenditures exceeded available cash
November 2006	<\$212,229>	Expenditures exceeded available cash
December 2006	\$336,224	Available cash exceeded expenditures
LAUSD analyst’s calculation of interest earned for the quarter, with netting	\$36,165	
OIG calculation of interest earned for the quarter, without netting	\$336,224	
Additional interest due to CDE for the quarter	\$300,059	
(a) ESEA, Title I, Part A – Basic Grants to LEAs		

⁸ The regulation at 34 C.F.R. § 80.21 provides the basic standard and the methods under which a Federal agency will make payments to grantees, and grantees will make payments to subgrantees and contractors. The basic standard refers to the regulations at 31 C.F.R. Part 205, issued by the U.S. Department of the Treasury.

Our review of the detailed worksheets for R046-003F identified a total of five quarters (including the one above) in FY2004 through FY2007 where LAUSD's analyst netted interest earned for the quarter because of negative amounts for one or more of the months. The additional interest due to ED for FY2004 through FY2007 because of quarterly netting for Revenue Code R046-003F is as follows:

April – June 2004	\$ 85,241
January – March 2006	119,131
October – December 2006	300,059
January – March 2007	101,530
April – June 2007	<u>281,831</u>
Total Additional Interest Earned Due	\$887,792

The above example represents LAUSD's largest Federal grant and, thus, would not be representative of the impact that fiscal quarter netting had on other individual Federal programs. However, the cumulative effect on the other Federal programs over the four year period would likely be significant, as would the impact on the interest remitted for ESEA, Title I and other Federal programs in prior years (FY1995 through FY2003).

Impact of Fiscal Year Netting. The following examples shown in Table 3 demonstrate the impact of netting when determining the earned interest to be remitted for a fiscal year.

Table 3: Impact of Fiscal Year Netting for Selected Revenue Codes FY 2006		
Fiscal Quarter	Revenue Code	
	R344-634F (a)	Y349-636F (b)
	<i>Example 1</i>	<i>Example 2</i>
July-Sept 2005	\$19,980	\$4,126
Oct-Dec 2005	<\$4,700>	<\$10,866>
Jan-Mar 2006	\$796	<\$15,684>
Apr-June 2006	\$531	<\$15,921>
LAUSD analyst's calculation of interest with netting	\$16,607	None (c)
OIG calculation of interest without netting	\$21,307	\$4,126
Difference	\$4,700	\$4,126
(a) ESEA, Title I, Comprehensive School Reform Grant (b) 21 st Century Community Learning Centers Grant (c) When the sum for the four quarters is a negative amount, the LAUSD analyst records the interest to be remitted as zero for the revenue code.		

When the quarterly amounts include both positive and negative amounts, fiscal year netting results in an understatement of the amount of earned interest to be remitted as shown by the examples in Table 3. Fiscal year netting has no effect on the amount when quarterly amounts are either all positive or all negative.

Our review of LAUSD’s summary worksheets for all Federal revenue codes for FY2004 through FY2007 identified the following amounts, in total, that were not included in earned interest to be remitted to grantor agencies because of LAUSD’s use of fiscal year netting.

FY2004	\$ 39,966
FY2005	369,862
FY2006	146,422
FY2007	<u>40,580⁹</u>
Total	\$596,830

Our review identified a total of \$1,484,622 (\$887,792 + \$596,830) of interest earned during FY2004 through FY2007 that was excluded from amounts returned to grantors due to quarterly and fiscal year netting. If the impact of netting in FY2004 through FY2007 is representative of the impact in prior years, we estimated that the combination of quarterly and fiscal year netting on interest remitted for FY1995 through FY2003 was about \$2.58 million.¹⁰ Thus, the overall impact of the use of netting on amounts remitted to grantors could be about \$4.06 million.

The IPA reported a finding in LAUSD’s FY2005 single audit that netting was inappropriate and recommended that LAUSD discontinue the practice. LAUSD disagreed with the IPA’s recommendation. LAUSD stated that it “believes that the practice of netting the interest expense incurred by the grant against the subsequent interest earnings of the grant funds is appropriate and that the Federal Government does not want LAUSD to decrease its available regular program resources so as to benefit the Federal programs.” The IPA repeated the finding and recommendation in its report for the FY2006 single audit.¹¹

Recommendations

We recommend that the Chief Financial Officer require CDE to—

- 2.1 Instruct LAUSD to revise its procedures to exclude netting or any other method that reduces the interest due to grantor agencies for the temporary use of other available cash resources to operate Federal programs.

⁹ In March 2007, LAUSD began remitting the interest earned on Federal cash advances to CDE for transfer to ED and other Federal agencies. Since some of the interest remittances were for interest liabilities incurred during the first three quarters of FY2007, LAUSD did not net across all revenue codes for the full fiscal year. Thus, we calculated the effects of fiscal year netting only for the first 3 quarters of FY2007.

¹⁰ We calculated the estimate for the prior FYs by applying the percentage of additional earned interest identified by our audit for FY2004 through FY2007 to the earned interest that LAUSD remitted for the prior FYs.

Additional interest due from netting identified by our audit for FY2004-2007	\$1,484,622	X	\$16,039,512	=	\$2,576,853
Interest LAUSD remitted for FY2004-2007	\$9,240,968		Interest LAUSD remitted for FY1995-2003		Estimated additional interest due from netting FY1995-FY2003

¹¹ LAUSD’s 2007 CAFR, which contains the single audit findings, was not yet available at the time of our fieldwork.

- 2.2 Instruct LAUSD to remit to CDE and other grantor agencies, as permitted under Federal law, the \$1,484,622 (\$887,792 + \$596,830) that our audit identified as not included in its estimated interest earnings due to grantor agencies because of the use of netting in LAUSD's calculations.
- 2.3 Instruct LAUSD to identify other amounts of interest earned on Federal cash advances that were not remitted to CDE and other grantor agencies due to the use of netting in FY1995 through FY2007 and later, and remit the amounts to the agencies, as permitted under Federal law.¹² We estimated that about \$2.58 million may have not been remitted for FY1995 through FY2003 due to LAUSD's use of quarterly and fiscal year netting.
- 2.4 Promptly transmit to ED the interest amounts remitted by LAUSD under Recommendations 2.2 and 2.3.

LAUSD Comments

LAUSD agreed that it used a process called "netting" to reduce the remittances of interest earned on Federal cash advances. While LAUSD disagreed that "netting" was improper, it stated that staff were informed on July 29, 2008 to cease netting for FY2008. LAUSD stated that it is willing to make this policy revision permanent, provided that CDE eliminates, or substantially reduces, the time-lag between the date on which ED makes Federal funds available to CDE and the date on which CDE makes the initial advance to LAUSD.

LAUSD disagreed that it should be required to undertake any recalculations or additional remittances or that monetary liability should be imposed for its past practice of "netting." LAUSD stated it was not aware of any applicable statute, regulation, or ED guidance that expressly prohibits netting where local educational agencies are recipients of Federal grant funds that "pass through" from State agencies and reiterated that clear notice is required for valid imposition of conditions upon a school district's receipt of Federal funds.

LAUSD asserted that school districts should be allowed to use "netting" since current U.S. Department of Treasury regulations allow states to collect interest from the Federal Government when funds are not delivered in time to fund a Federal program. LAUSD cited opinions issued in the 1980s by the U.S. Department of Justice and the U.S. Comptroller General applying Federal statutory provisions applicable to States and their subgrantees. LAUSD also stated it was unfair to prohibit "netting" when the procedure was used primarily to mitigate the financial impact of delays in the receipt of Federal grant funds. LAUSD stated that the delays have no impact on the State of California's treasury and are beneficial to the Federal Government since it may use the cash for other purposes until the grant funds are drawn by the State. LAUSD reiterated its position that the statute of limitations provision in the GEPA would be applicable to the period prior to FY2004 and stated that remittance of additional funds would result in fewer resources being available to fund district programs.

¹² The \$887,792 in Recommendation 2.2 includes the impact of quarterly netting for only the ESEA, Title I – Basic Grants to LEAs for FY2004 through FY2007. Our review did not identify the impact of quarterly netting for other Federal program advances.

OIG Response

We did not change our finding or recommendations. The regulation at 34 C.F.R. § 80.21 clearly states the requirement to remit interest earned on Federal cash advances quarterly. Federal law and regulations applicable to the time periods covered by our recommendations do not contain provisions for compensating LEAs for the temporary use of cash from other available resources. In fact, as we noted in the report, other Federal requirements explicitly state that the Federal Government cannot be charged for a government unit's use of its own funds.

The U.S. Department of Justice decision and the U.S. Comptroller General opinions are not relevant to the interest remittance requirement for the periods covered by our recommendations. These decisions related to a provision of the Intergovernmental Cooperation Act of 1968 that was amended by the Cash Management Improvement Act (CMIA) of 1990.¹³ The current Treasury regulations reflect the amended provision. While the CMIA amended the provision on interest to provide for the payment of interest from states to the Federal Government and from the Federal Government to states, the amended provision does not provide for payment of interest by the Federal Government to local governments, such as school districts. Even if the provision were applicable to local governments, LAUSD could not charge interest to the Federal Government since, as we noted in the finding, Federal funds were available at the time to CDE for disbursement to California LEAs.

We understand LAUSD's desire to mitigate the financial impact of delays in its receipt of Federal grant funds. However, LAUSD has no recourse with the Federal Government since the Federal funds were available to CDE for disbursement to LEAs. As we noted earlier, ED will make a determination during audit resolution on the appropriate application of the statute of limitations provision in the GEPA.

FINDING NO. 3 – LAUSD Needs to Improve Internal Controls to Ensure Earned Interest Identified As Due to the Federal Government Is Promptly Remitted to CDE and Other Grantors

In March 2007, LAUSD issued Policy Bulletin ADD-007-004 updating its procedures to provide for prompt remittance of interest earned on Federal cash advances to the grantor agency. In the Bulletin, LAUSD included the procedures for interest calculation, interest remittance, and remittance verification, and the standard worksheet to be used by analysts to calculate the monthly interest for each revenue code. Based on our review of LAUSD's documentation for FY2004 through FY2007, LAUSD needs to take additional steps to ensure it has adequate internal controls to ensure that amounts due to the Federal Government are promptly remitted to CDE and other grantor agencies. Also, given that LAUSD had not previously remitted interest timely, CDE needs to monitor LAUSD, on an on-going basis, to ensure that LAUSD continues to

¹³ As explained in the General Accountability Office's *Principles of Federal Appropriation Law* (Redbook), prior to 1968, the prohibition on retention of interest earned on Federal cash advances applied to states as well as other grantees. The passage of the Intergovernmental Cooperation Act of 1968 created a major exception to the rule for states—states were no longer required to return interest earned on grant funds pending their disbursement for program purposes. That statutory exception did not prove satisfactory since grantor agencies complained of premature drawdown of grant advances while grantee states complained of slow Federal payment in reimbursement situations. The passage of the CMIA in 1990 amended the statute.

remit interest earnings to CDE on a quarterly basis. As we mentioned in Finding No. 1, 34 C.F.R. § 80.20(b) requires that financial management systems of grantees and subgrantees meet specific standards, including an internal control standard that addresses the effective control and accountability of cash and other assets. In Finding No. 1, we also mentioned that 34 C.F.R. § 80.21 requires grantees and subgrantees to promptly, but at least quarterly, remit interest earned on Federal cash advances to the grantor agency.

LAUSD began remitting interest to grantor agencies in March 2007, but may not have remitted all amounts its analysts identified in their worksheets as due for interest earned during FY1995 through FY2007. We compared amounts in LAUSD's remittance documentation for FY2004 through FY2007 to the amounts shown as due on the analysts' worksheets for those years. The comparison identified additional earned interest amounts due to grantor agencies. Table 4 shows the number of revenue codes and the \$817,784 of related amounts identified in the comparison that may not have been remitted to CDE and other grantor agencies.

Table 4: Results of OIG Comparison of Remittance Documentation to Analysts' Worksheets		
Fiscal Year	Number of Revenue Codes with Earned Interest Amounts Due	Total Earned Interest Due
2004	56	\$255,596
2005	14	\$305,829
2006	37	\$218,289
2007 (a)	14	\$38,070
Total		\$817,784
(a) Information for FY2007 represents amounts through the 3 rd quarter of the fiscal year. At the time of our review, the interest earned during the 4 th quarter had not yet been remitted to the grantor agency.		

The results of our comparison indicate LAUSD's internal controls may not be adequate for ensuring that all interest earned identified as due to the Federal Government is promptly remitted to CDE and other grantor agencies.

Our comparison covered remittance documentation and analysts' worksheets for FY2004 through FY2007 (3rd quarter). Amounts shown on analysts' worksheets for earlier years (FY1995 through FY2003) as due to grantor agencies may not have been included in LAUSD documentation of amounts remitted to CDE and other grantor agencies. If the periods reviewed were representative of the prior years (FY1995 through FY2003), there could be about 1.42 million¹⁴ of additional earned interest that was identified by the analysts, but not remitted to CDE and other grantor agencies.

¹⁴ The estimate for the prior FYs was calculated using the following formula:

Additional amounts due but not remitted identified by our audit FY2004-2007	\$817,784	X	\$16,039,512	=	\$1,419,423
Interest LAUSD remitted for FY2004-2007	\$9,240,968		Interest LAUSD remitted for FY1995-2003		Estimated additional interest due for FY1995-2003

Recommendations

We recommend that the Chief Financial Officer require CDE to—

- 3.1 Instruct LAUSD to remit the \$817,784 to CDE and other grantor agencies, as permitted under Federal law, for the amounts LAUSD identified as due for interest earned during FY2004 through FY2007 (3rd quarter), or if previously remitted, provide documentation confirming the remittance.
- 3.2 Instruct LAUSD to reconcile analysts' worksheets amounts with remittance documentation to identify earned interest for FY1995 through FY2003 that was not remitted to CDE or other grantor agencies and remit the identified interest to the agencies, as permitted under Federal law. We estimated that about \$1.42 million of additional earned interest may not have been remitted for FY1995 through FY2003.
- 3.3 Promptly transmit to ED the interest amounts remitted by LAUSD under Recommendations 3.1 and 3.2.
- 3.4 Obtain confirmation from LAUSD that it has remitted to CDE or other grantor agencies all amounts LAUSD identified as due for interest earned for the 4th quarter of FY2007 and later.
- 3.5 Evaluate LAUSD's internal controls for ensuring that all interest earned on Federal cash advances are remitted promptly to grantor agencies and require LAUSD to implement any needed additional controls.
- 3.6 Monitor LAUSD, on an on-going basis, to ensure that it continues to remit interest earnings to CDE on a quarterly basis.

LAUSD Comments

LAUSD stated that it will complete a review of its records to verify interest remittances for FY2004 through FY2007 and provide the necessary documentation to confirm the remittances. The target date for completion of the review was October 31, 2008. However, LAUSD asserted that, even if the review identifies interest that has not been remitted, it should not be required to remit the amounts. LAUSD stated that it already demonstrated a good-faith commitment to resolve the audit by voluntarily remitting interest for periods covered by the statute of limitations, and that the amounts previously remitted should more than suffice to remedy any possible omissions due to discrepancies in documentation for prior years. LAUSD also claimed that it was due, at least in part, to CDE's grant-by-grant reporting requirement that LAUSD developed such a staff-intensive interest remittance methodology which, by its nature, was more prone to inadvertent calculation errors.

LAUSD stated that it will have, by September 30, 2008, remitted to CDE and other grantor agencies all amounts it has identified as due for interest earned for the 4th quarter of FY2007 and for FY2008. LAUSD noted some delay in its remittances has occurred due to continued implementation issues with its new financial accounting system. LAUSD did not expect that such issues will affect interest remittances for FY2009 and subsequent years.

LAUSD stated that it will collaborate with CDE in the evaluation of its internal controls for ensuring that all interest earned on Federal cash advances is remitted promptly to grantor agencies and discuss with CDE how best to implement a collaborative monitoring process. LAUSD expressed willingness to implement additional controls provided such controls are not unduly burdensome to the District. LAUSD also stated, if CDE agrees to make the changes required to permit LAUSD to adopt the alternative interest calculation methodology proposed in Finding No. 1, LAUSD's procedures would be vastly simplified and, thus, much more easily monitored and reviewed.

OIG Response

We did not change our finding or recommendations. LAUSD is required to remit interest earned on Federal cash advances. LAUSD's previous remittances do not negate its liability for additional amounts that have been due to the Federal Government for periods of up to 13 years without penalty to LAUSD for late remittance. ED will make a determination during audit resolution on the applicability of the statute of limitations provision.

OBJECTIVES, SCOPE, AND METHODOLOGY

The purpose of the audit was to determine whether LAUSD 1) used a methodology for calculating the interest earned on Federal cash advances that was compliant with Federal requirements, and 2) has policies and procedures in place to ensure that future interest earned on Federal cash advances are accurately computed and remitted on a quarterly basis to CDE. To evaluate LAUSD procedures, we reviewed LAUSD's calculation and remittance of earned interest on Federal cash advances for FY2004 through FY2007.

Originally, we had planned to review LAUSD's calculations of interest earned on Federal cash advances during FY1995 through FY2007. LAUSD was experiencing delays in responding to our request due to problems experienced with implementation of a new financial accounting system. After reviewing the initial documentation provided by LAUSD and assessing the staff resources needed to review each fiscal year, we opted to focus our review on FY2004 through FY2007.

Prior to initiating the audit, our office completed a general assessment of LAUSD's controls over, and administration of, Federal education funds provided under the ESEA. We used information, documentation, and analyses previously obtained or conducted as part of the general assessment to accomplish the objectives of this audit. We also—

- Reviewed Federal laws and regulations related to cash management and financial administration of Federal grants.
- Reviewed cash management findings reported in the single audit portion of LAUSD's CAFRs from FY1995 through FY2006.
- Interviewed officials and staff at ED, CDE, LACOE, and LAUSD to gain an understanding of their cash management activities, Federal cash advance processes, and their related oversight responsibilities.
- Interviewed representatives from other Federal agencies including the Office of Management and Budget and the U.S. Treasury's Financial Management Service to gain an understanding of laws and regulations regarding interest earned on Federal cash advances.
- Interviewed the IPA that conducted all or a portion of the LAUSD's single audits for FY1998 through FY2007 and reviewed audit documentation supporting the cash management finding reported in the single audit portion of the CAFR for FY2006.

To determine whether LAUSD used a methodology for calculating the interest earned on Federal cash advances that was compliant with Federal requirements, we reviewed 34 electronic files provided by LAUSD that contained detailed and summary worksheets for FY2004 through FY2007. Since we concluded that LAUSD's methodology did not result in a reliable amount for the interest earned on Federal cash advances, we limited our review to confirming the accuracy of formulas and interest rates on the summary worksheets and consistency of analysts' adherence to LAUSD's calculation methodology. When we identified anomalies on the summary

worksheets, we expanded our review to the related detailed worksheets when necessary to resolve the anomaly. We did not confirm the accuracy of beginning cash balances and monthly receipts and expenditure amounts entered on the worksheets. We also did not confirm that LAUSD provided worksheets for all revenue codes for Federal programs.

To determine whether LAUSD has policies and procedures in place to ensure that future interest earned on Federal cash advances are accurately computed and remitted on a quarterly basis to CDE, we reviewed LAUSD's Cash Management Policy Bulletin, dated March 2007. We also reviewed copies of interest remittance documents supporting the submission of interest earned on Federal cash advances for FY2004 through FY2007. We compared amounts in the remittance documentation for FY2004 through FY2007 to the amounts due that were shown on the analysts' worksheets for those years.

We performed our onsite fieldwork at LAUSD's headquarters in Los Angeles, California. We held an exit briefing with LAUSD officials on March 19, 2008 and CDE officials on March 25, 2008. Our audit was performed in accordance with generally accepted government auditing standards appropriate to the scope of the review described above.

ATTACHMENT

CDE and LAUSD Comments on the Draft Report



CALIFORNIA
DEPARTMENT OF
EDUCATION

JACK O'CONNELL

STATE SUPERINTENDENT OF PUBLIC INSTRUCTION

August 15, 2008

Gloria L. Pilotti, Regional Inspector for Audit
U. S. Department of Education
Office of Inspector General
501 I Street, Suite 9-200
Sacramento, CA 95814-2559

Dear Ms. Pilotti:

Subject: Los Angeles Unified School District's Procedures for Calculating and Remitting Interest Earned on Federal Cash Advances, Control Number ED-OIG/A09H0019

In response to the U.S. Department of Education, Office of Inspector General's draft report entitled *Los Angeles Unified School District's Procedures for Calculating and Remitting Interest Earned on Federal Cash Advances*, the Los Angeles Unified School District (LAUSD) written comments on the reported findings and recommendations are contained in the attached LAUSD letter; the comments and positions set forth in the LAUSD letter are solely those of the LAUSD.

The California Department of Education (CDE) will continue to work with the LAUSD and the U.S. Department of Education in resolving the issues delineated in the audit report.

If you have any questions regarding the LAUSD's response to the draft report, please contact me at 916-323-1547, or by e-mail at kchan@cde.ca.gov.

Sincerely,

/s/

Kevin W. Chan, Director
Audits and Investigations Division

kwc:ab

Gloria L. Pilotti, Regional Inspector for Audit
August 15, 2008
Page 2

cc: Megan Reilly, Chief Financial Officer, Los Angeles Unified School District
John Walsh, Legal Counsel, Los Angeles Unified School District
Timothy Rosnick, Interim Controller, Los Angeles Unified School District

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DAVID L. BREWER III
SUPERINTENDENT OF SCHOOLS

August 11, 2008

Mr. Jack O'Connell
State Superintendent of Public Instruction
California Department of Education
1430 N Street
Sacramento, CA 95814

RE: ***Los Angeles Unified School District's Procedures for Calculating and Remitting Interest Earned on Federal Cash Advances, Control Number ED-OIG/ A09H0019***

Dear Superintendent O'Connell:

The Los Angeles Unified School District ("LAUSD") is pleased that the California Department of Education ("CDE") has extended this opportunity to submit a response to the Draft Audit Report, titled *Los Angeles Unified School District's Procedures for Calculating and Remitting Interest Earned on Federal Cash Advances*, recently issued by the U.S. Department of Education ("ED") Office of Inspector General ("OIG"). The District has always strived to administer its Federal grants within the purview of current Federal and State law, policies, and procedures. LAUSD is committed to working with CDE on an ongoing basis to resolve this audit review.

LAUSD is also appreciative of the hard work on the part of OIG in this audit review. The Draft Audit Report helps clarify ED's position on key aspects of the requirement set forth in ED's General Administrative Regulations that "grantees and subgrantees shall promptly, but at least quarterly, remit interest earned on advances to the Federal agency." 34 C.F.R. § 80.21(i). Since 1999, LAUSD has made repeated contact with ED to seek clarification with respect to matters that the Draft Audit Report addresses. Moreover, the District has frequently expressed its commitment to cooperate in good faith with this audit review. In March 2007, for instance, LAUSD began remitting interest for the period covered by this audit review to CDE for submission to ED and other Federal agencies. Without conceding any defenses that may be applicable here, LAUSD has voluntarily remitted to date about \$25 million for interest earned on Federal cash advances from FY1995 through FY2007, and will remit additional amounts going forward.

Set forth below are LAUSD's specific responses to each of the preliminary findings and recommendations identified in the Draft Audit Report. In addition, LAUSD asserts at the outset a general statute of limitations defense that, in our view, requires amendment of several of OIG's recommendations to: (a) reduce the additional funds that the District would be directed to remit by at least \$4 million and perhaps more; and (b) to relieve the District of the obligation to investigate further its interest remittance practices prior to FY2004.

I. OIG'S RECOMMENDATIONS SHOULD BE REVISED TO CONFORM TO THE APPLICABLE STATUTE OF LIMITATIONS

LAUSD respectfully requests that OIG revise its recommendations so they are consistent with the applicable statute of limitations set forth in 20 U.S.C. § 1234a(k). This provision mandates that recipients of ED program funds are *not* "liable to return funds which were expended in a manner not authorized by law more than 5 years before the recipient received written notice of a preliminary departmental decision." 20 U.S.C. § 1234a(k); *see also* 34 C.F.R. § 81.31(c); *State of Cal. Dep't of Educ. v. Bennett*, 851 F.2d 241, 242-43 (9th Cir. 1988) (reimbursement not required for funds expended five years before ED issued notice of the violation).

OIG concedes the existence of this statute of limitations but declines to express a view with respect to its applicability to this audit review. *See* Draft Audit Report at 10 n.7. Yet, it is unquestionable that this statute of limitations is operative in these circumstances. By enacting 20 U.S.C. § 1234a(k), "Congress has clearly manifested its intention to raise a statutory barrier" to avoid open-ended investigations that would require ED grantees and subgrantees to worry constantly about the need to reach far back into the past to reconstruct prior practices and undertake forensic reviews of financial records. *Harrod v. Glickman*, 206 F.3d 783, 789 (8th Cir. 2000) (quoting *United States v. Wurts*, 303 U.S. 414, 416 (1938)). ED decision-makers, as well as OIG, have routinely acknowledged the applicability of this statute of limitations. *See, e.g.*, ED, Notice of Intent to Compromise Claim Against Louisiana State Dep't of Educ., 67 Fed. Reg. 64102, 64102 (Oct. 17, 2002); ED, Notice of Intent to Compromise Claim Against Puerto Rico Dep't of Educ., 67 Fed. Reg. 45103, 45104 (July 8, 2002); ED, Notice of Intent to Compromise Claim Against Minnesota State Vocational Educ. Program, 50 Fed. Reg. 4570, 4570 (Jan. 31, 1985); OIG, *Audit of Funds Not Recovered Due to the Statute of Limitations*, ED-OIG/A19-C0004 (Jan. 6, 2004).

Application of this statute of limitations here is consistent with the Congressional intent behind 20 U.S.C. §1234a(k), as reflected in the House Committee Report on the precursor to this provision:

The Committee has adopted this amendment because it believes that such a five year "statute of limitations" will lead to better administration of ESEA programs. It will encourage HEW [of which the Department of Education was then a part] to make audits more promptly than has been the case. It will also remove the threat presently hanging over the heads of school administrators that some day, some time, they may be forced to make repayments of expenditures made many years before.

H. Rep. No. 805, 93rd Cong., 2d Sess. (1974), *reprinted in* 1974 U.S. Code Cong. & Ad. News 4093, 4160. This Congressional intent would be undermined if ED were to require LAUSD to repay funds expended years ago for programs designed to improve achievement of school children in the District.

To date, the five-year statutory period has not yet been triggered because ED has not yet issued and LAUSD has not yet received a "written notice of a preliminary departmental decision." 20 U.S.C. § 1234a(k). Pursuant to ED regulations, the Draft Audit Report does not constitute the requisite notice. *See* 20 U.S.C. § 1234a(a); 34 C.F.R. § 81.34. Thus, LAUSD's monetary liability would at most extend no further back than five years from the present, *i.e.*, August, 2003. As a result, there is no basis for any

of OIG's preliminary recommendations that require recalculation or remittance of funds for periods prior to FY2004. Depending on when ED decides to issue the requisite written notice, the statute of limitations may also limit recovery for some or all of FY2004 and possibly periods thereafter.

To the extent that LAUSD has voluntarily remitted interest for periods prior to FY2004, these remittances do not constitute a waiver of the statute of limitations; rather, they were intended to demonstrate the District's good-faith commitment to work with ED and CDE to resolve the audit review.

II. LAUSD'S SPECIFIC RESPONSES TO OIG'S PRELIMINARY FINDINGS AND RECOMMENDATIONS

(A) LAUSD CONCURS IN PART WITH PRELIMINARY FINDING NO. 1

LAUSD agrees with OIG that the District has used a methodology for determining its remittance obligations that is based on monthly estimates of interest earned on Federal cash advances. But LAUSD respectfully disagrees with OIG's finding that this methodology does not produce a reliable determination of the interest LAUSD actually earned. Indeed, even OIG concedes that, in some fiscal years, LAUSD's methodology may have "overstate[d] . . . the interest earned on Federal cash advances." Draft Audit Report at 9.

For example, LAUSD identified such an overstatement in a sample analysis previously shared with OIG. LAUSD recalculated interest earned on Federal cash advances for its FY2007 Title I Part D grant, using OIG's proposed alternative methodology based on average daily balances. Under LAUSD's methodology, the interest earned totaled \$50,663.03, which was the amount the District remitted. Under OIG's alternative, the amount of earned interest was \$50,190. Thus, the District remitted *more* interest than would have been required under OIG's proposed alternative. Moreover, the difference between the two approaches is extremely small: less than 1%.

LAUSD further disagrees that its interest methodology is improper under existing law. OIG asserts a broad interpretation of two regulatory provisions: (a) 30 C.F.R. § 80.20(b), which states that Federal grantees must maintain "[e]ffective control and accountability" over grant assets, and (b) 30 C.F.R. § 80.21(i), which in pertinent part permits grantees to retain only up to \$100 per year in earned interest. See Draft Audit Report at 6. Although LAUSD appreciates OIG's effort to clarify ED's interpretation of these provisions, it should be noted that both provisions are phrased in general terms, and neither expressly requires any particular interest calculation methodology. Nor is LAUSD aware of any applicable statute, regulation, or ED guidance that provides clear notice that the District's methodology for estimating interest is improper. *Cf. Arlington Cent. Sch. Dist. Bd. of Educ. v. Murphy*, 548 U.S. 291 (2006) (requiring clear notice for valid imposition of conditions upon school district's receipt of federal funds).

Absent clear notice, it is unjust to penalize the District for the methodology it selected—especially since, as OIG notes, LAUSD repeatedly sought—without success—guidance from ED regarding its policies and practices for remitting interest on Federal cash advances. See Draft Audit Report at 4-5. Moreover, as OIG also notes, it would have been extremely difficult if not impossible for LAUSD to

have adopted OIG's preferred alternative methodology for interest calculations at any point from FY1995 through the present due to limitations inherent in the technical finance systems used by the County Treasurer's office, accounting procedures maintained by the Los Angeles County Office of Education ("LACOE"), and reporting requirements mandated by CDE, which are discussed further below. *Id.* at 6-10.

(B) LAUSD CONCURS IN PART WITH PRELIMINARY RECOMMENDATIONS 1.1 THROUGH 1.5

OIG recommends that ED's Chief Financial Office ("CFO") require CDE to take five corrective actions to address its first preliminary finding. Below LAUSD provides its response to each of OIG's preliminary recommendations.

1.1 Work with LACOE and LAUSD to develop a methodology for LAUSD to identify actual interest earned on Federal cash balances.

LAUSD partially concurs with Recommendation 1.1. Notwithstanding the concerns expressed above, LAUSD is eager to work expeditiously with LACOE and CDE to develop an alternative methodology for calculating interest earned on Federal cash balances, so long as the resulting procedure is not significantly more burdensome to the District than its current approach. LAUSD has already begun to review its current methodology to determine ways in which it might be streamlined.

LAUSD appreciates OIG's decision not to recommend that the District revise its current methodology to calculate actual interest earned on a daily basis for all revenue codes. Draft Audit Report at 9. As OIG notes, "calculation of average daily balances for each month for all revenue codes would require a substantial increase in the significant staff resources already committed to the application of LAUSD's methodology." *Id.* Instead, ED proposes an alternative approach that would permit LAUSD to take advantage of the subfund component of LACOE's current financial report system and group together cash balances for all Federal programs. According to OIG, this subfund approach would be satisfactory to ED because it would enable LAUSD to report quarterly on the actual interest earned, in total, on Federal cash held in those subfunds. *Id.* at 9-10.

LAUSD is willing to consider adoption of OIG's proposed alternative methodology because it would have the advantage of simplifying the District's procedures by significantly reducing the number of computations required. As a result, the District would likely be able to devote fewer staff resources to Federal grant administration. Moreover, this alternative should also diminish the need for the sort of heightened internal controls addressed by OIG in its third preliminary finding and related recommendations.

Yet, as OIG points out, there are two obstacles to implementation of its proposed alternative methodology. First, LAUSD needs support from LACOE in order to use LACOE's financial reporting system to undertake a "one-time crosswalk" to the new subfund methodology. *Id.* at 10.

Second, and perhaps more significantly, the subfund methodology would be more, not less, resource-intensive than LAUSD's current methodology (even if it were to be streamlined internally as

much as possible) if the District were required to continue remitting interest on a grant-by-grant basis. OIG points out that under Federal law LAUSD is allowed to remit the total amount of interest earned in a lump-sum payment rather than on a grant-by-grant basis. *Id.* Indeed, ED does not even record grant program information for interest remittances. *Id.* Nonetheless, CDE has directed local educational agencies to remit interest on a grant-by-grant basis. Before migrating to the new system, LAUSD would need concurrence from CDE that grant-by-grant reporting of interest remittances is no longer required. LAUSD has entered into preliminary discussions with CDE on this matter, but understands that CDE has not yet made a determination whether to continue to require grant-by-grant reporting.

1.2 Instruct LAUSD to take the interim step to provide a more reliable estimate by revising its current methodology to either include a subsequent adjustment of the calculations when the School Rate for the 3rd quarter rate is used for months in the 4th quarter (April, May and June) or delay performance of the calculations until the 4th quarter rate is available.

LAUSD concurs with Recommendation 1.2. It is LAUSD's understanding that this Recommendation is intended for the interim period while the District works with CDE to implement the alternative methodology proposed in Recommendation 1.1. One aspect of LAUSD's current methodology with which OIG takes issue is the District's practice of using the prior fiscal quarter School Rate in interest calculations for months in the 4th quarter of the fiscal year when the actual School Rate is not yet available. LAUSD notes that this approach does not necessarily produce outcomes favorable to the District. As OIG found, "the methodology understated the estimated interest earned on Federal cash balance[s] in seven of the fiscal years and overstated the amount in the other three years [that OIG analyzed]." Draft Audit Report at 9. Moreover, over time, the net fiscal impact of this practice is quite minor.

Nevertheless, LAUSD has already revised its interest calculation methodology in accordance with this Recommendation. While LAUSD continues to estimate interest for the 4th quarter using the 3rd quarter School Rate, it now requires analysts to make a subsequent adjustment to the calculations when the actual 4th quarter rate becomes available in the following fiscal year. Please see the attached memorandum, dated October 31, 2008, instructing staff to make this subsequent adjustment for FY2006 and thereafter.

1.3 Instruct LAUSD to recalculate the estimated interest earned on Federal cash balances for the 4th quarter of FY1995 through FY2007 and later using the actual School Rates for the 4th quarter, and remit any additional amounts due to CDE and other grantors, as permitted under Federal law.

LAUSD partially concurs with Recommendation 1.3. Consistent with Recommendation 1.2, LAUSD is willing to develop and implement on a prospective basis an interest calculation methodology consistent with the Draft Audit Report. But the District contends that it should not have to remit additional interest for FY1995 through FY2007 beyond the \$25 million it has already voluntarily remitted. Significantly, LAUSD believes that the interest amounts that the District has already remitted for the period from FY2006 through FY2007 were calculated using the actual School Rates for the 4th quarter because, as previously stated in our response to Recommendation 1.2, the District adjusted its interest methodology in this respect, beginning with FY2006. LAUSD is in the process of verifying this

fact and will provide additional documentation once its review is complete. The target date for completion of this review is October 31, 2008.

For periods prior to FY2006, LAUSD contends that it should not be obligated to undertake further remittances. As stated above, due to the five-year statute of limitations provision set forth in 20 U.S.C. § 1234a(k), LAUSD has no obligation to undertake any recalculations or additional remittances for the period prior to FY2004. It would require significant staff resources to redo calculations for the remaining two fiscal years—FY2004 and FY2005. And such calculations would likely yield small sums of additional remittances. Remittances for these two years would also be inappropriate for the following previously stated reasons: (a) ED failed to provide sufficiently clear notice with respect to its preferred interest methodology; and (b) LAUSD tried unsuccessfully for years to obtain clarification from ED on its interest remittance practices.

1.4 Instruct LAUSD to take the interim step to enhance the procedures for applying its current methodology by providing a standard summary worksheet for use by its analysts, making the use of the standard worksheets mandatory, and incorporating internal controls into the design of the worksheets to ensure the accuracy of formulas and information entered into the worksheets.

LAUSD concurs with Recommendation 1.4. It is LAUSD's understanding that this Recommendation, similar to Recommendation 1.2, is intended to apply in the interim period while the District works with CDE to implement the alternative methodology proposed in Recommendation 1.1. To comply with this Recommendation, LAUSD will develop a standard template for both detail and summary worksheets to ensure accuracy of formulas and information entered into the worksheets. LAUSD will require staff to use this and only this template. We expect to have the standard templates developed by October 1, 2008, in time to use them for FY2009 calculations.

1.5 Instruct LAUSD to implement appropriate reviews to ensure analysts are applying the new procedures consistently and accurately.

LAUSD concurs with Recommendation 1.5. The District has in place a procedure for Senior Accounting Analysts to review each worksheet and ensure that analysts are applying procedures consistently and accurately. Through training and appropriate monitoring, we will ensure that this procedure is followed rigorously and that the Senior Accounting Analysts perform careful and thorough review.

(C) LAUSD CONCURS IN PART WITH PRELIMINARY FINDING NO. 2

LAUSD partially concurs with the OIG's second preliminary finding. LAUSD agrees with OIG's determination that the District has used a process called "netting," through which it has reduced its remittances of interest earned on Federal cash advances to compensate for its temporary use of other available cash resources in circumstances where CDE or ED was late in making Federal funds available. Yet LAUSD respectfully disagrees with OIG's conclusion that netting is improper.

LAUSD is not aware of any applicable statute, regulation, or ED guidance that expressly prohibits netting where, as here, local education agencies are recipients of Federal grants that “pass through” State agencies—i.e., the State receives grant funds from a federal agency and then re-distributes the funds to a local government entity or other sub-grantee. Under federal law, clear notice is required for valid imposition of conditions upon a school district’s receipt of federal funds. *Cf. Arlington Cent. Sch. Dist. Bd. of Educ. v. Murphy*, 548 U.S. 291 (2006).

In the absence of clear notice, LAUSD adopted netting as a good-faith effort to reconcile its legal obligations with the practical difficulties it has faced in Federal grants management. LAUSD relied on precedent that supports application of the same interest remittances rules for State “pass-through” grants as those that govern direct grants to States. Until the early 1990s, Federal law exempted States from the general rule that interest earned on Federal grant funds belongs to the Federal government. While this exemption did not cover direct Federal grants to local entities, the U.S. Department of Justice and Comptroller General endorsed its application to situations in which States acted as “pass-through” entities to local government entities or other sub-grantees. *See* U.S. Dep’t of Justice, Office of Legal Counsel, *Recovery of Interest on Advance Payments to State Grantees and Subgrantees*, 6 U.S. Op. Off. Legal Counsel 127 (1982); GAO, Office of General Counsel, *Principles of Federal Appropriations Law* (Redbook), vol. II, at 10-86 (3d ed. 2006).

This blanket exemption for States has been repealed, but U.S. Department of Treasury regulations applicable to ED programs allow States to engage in netting by collecting interest from the Federal Government when funds are not delivered in time to fund a Federal program. *See* 31 C.F.R. § 205.14(a); *see also* 31 U.S.C. § 6503(d)(1) (“If a State disburses its own funds for program purposes in accordance with Federal law, Federal regulation, or Federal-State agreement, the State shall be entitled to interest from the time the State’s funds are paid out to redeem checks or warrants, or make payments by other means, until the Federal funds are deposited to the State’s bank account.”). OIG acknowledges that CDE was authorized to engage in netting; but it fails to recognize that, under the same reasoning as the Department of Justice and the Comptroller General previously endorsed, it would be rational to conclude that netting should also apply to State “pass-through” grants to entities such as LAUSD.

Moreover, from an equitable standpoint, it is unfair to proscribe LAUSD from netting when it used this procedure primarily to mitigate delays in receipt of Federal grant funds. OIG found that CDE did not make Federal funds available to LAUSD on a timely basis when they were needed for Federal program expenditures. *See* Draft Audit Report at 12. For instance, OIG notes that for the 2006-2007 school year Elementary and Secondary Education Act funds were available to CDE on July 1, 2006, but CDE did not make the initial advance to LAUSD until December 2006. *Id.* The consequences of this delay were significant. Table 2 of the Draft Audit Report indicates that LAUSD expenditures exceeded available expenditures by at least \$300,059 (\$87,830 + \$212,229) in October and November 2006 alone. *Id.* The overall financial impact to the District of such delay from FY1995 through the present is of far greater magnitude.

In sum, when Federal funds are not made available on a timely basis, LAUSD suffers significantly because it must dip into other resources to fund Federal programs. By contrast, such delays have no impact on the State’s treasury and are, in fact, beneficial to the Federal government. Until the moment when grant funds are drawn down, the Federal government may use these moneys for other purposes.

And, as explained above, Federal law expressly permits the State to engage in netting. If LAUSD were ordered to remit additional funds, it would have fewer resources available to fund future programs simply because it took steps to ensure that such delays would not impede its continued operation of critical Federal programs. Thus, at the end of the day, District school children would be the primary victims of any corrective action required here.

(D) LAUSD CONCURS IN PART WITH PRELIMINARY RECOMMENDATIONS 2.1 THROUGH 2.4

OIG recommends that ED's CFO require CDE to take four corrective actions to address its second preliminary finding. Below LAUSD provides its response to each of OIG's preliminary recommendations.

2.1 Instruct LAUSD to revise its procedures to exclude netting or any other method that reduces the interest due to grantor agencies for the temporary use of other available cash resources to operate Federal programs.

LAUSD partially concurs with Recommendation 2.1. For the reasons stated above, LAUSD is unwilling to concede that its netting practices were improper. Nevertheless, in light of the Draft Audit Report's preliminary findings, LAUSD has revised its procedures to cease netting for FY2008 as well as the remainder of this audit review. Staff was informed of the change on July 29, 2008. LAUSD is willing to make this policy revision permanent, provided that CDE eliminates—or at least substantially reduces—the time-lag between the date on which ED makes Federal funds available to CDE and the date on which CDE makes the initial advance to LAUSD.

2.2 Instruct LAUSD to remit to CDE and other grantor agencies, as permitted under Federal law, the \$1,484,622 (\$887,792 + \$596,830) that our audit identified as not included in its estimated interest earnings due to grantor agencies because of the use of netting in LAUSD's calculations.

LAUSD disagrees with Recommendation 2.2. In the District's view, ED should not impose retrospective monetary liability for LAUSD's past practices of netting. As explained above, in the absence of clear guidance from ED, LAUSD adopted netting as a good-faith effort to reconcile legal precedents regarding State "pass-through" grants with the practical difficulties it has faced.

2.3 Instruct LAUSD to identify other amounts of interest earned on Federal cash advances that were not remitted to CDE and other grantor agencies due to the use of netting in FY1995 through FY2007 and later, and remit the amounts to the agencies, as permitted under Federal law. We estimated that about \$2.58 million may have not been remitted for FY1995 through FY2003 due to LAUSD's use of quarterly and fiscal year netting.

LAUSD does not concur with Recommendation 2.3. LAUSD should not be obligated to undertake any recalculations or additional remittances for the period prior to FY2004 due to the five-year statute of limitations set forth in 20 U.S.C. § 1234a(k), for the reasons explained above in Section I of this response. Accordingly, LAUSD should not be required to remit the \$2.58 million that OIG

estimates may have not been remitted for FY1995 through FY2003, or any other amount for this period, due to LAUSD's use of quarterly and fiscal year netting. Nor should LAUSD be required to undertake further investigations to identify other amounts it may not have remitted for FY1995 through FY2003.

Even for periods for which the statute of limitations does not apply, LAUSD disagrees, for the reasons stated in its response to Recommendation 2.2, with OIG's recommendation that the District should be required to identify other amounts of interest earned on Federal cash advances that were not remitted.

2.4 Promptly transmit to ED the interest amounts remitted by LAUSD under Recommendations 2.2 and 2.3.

LAUSD does not concur with Recommendation 2.4. Based on LAUSD's objections to Recommendations 2.2 and 2.3, it should not be obligated to remit any additional funds to CDE for FY1995 through FY2007. Thus, this Recommendation should be moot.

(E) LAUSD CONCURS IN PART WITH PRELIMINARY FINDING NO. 3

As OIG notes, LAUSD issued Policy Bulletin ADD-007-004 in March 2007 to update its procedures for prompt remittance of interest earned on Federal cash advances to CDE and other grantor agencies. See Draft Audit Report at 15. This Policy Bulletin has substantially improved the District's internal controls for interest calculation, interest remittance, and remittance verification, and it has helped update and standardize the worksheets analysts use to calculate monthly interest for revenue codes.

Notwithstanding these revisions, OIG found that LAUSD needs to make further improvements in its internal controls. *Id.* OIG compared LAUSD's analyst worksheets with the documentation accompanying the \$25 million in interest LAUSD has thus far remitted and found possible discrepancies. *Id.* It should be noted that this finding was tentative, not conclusive.

LAUSD believes that it has remitted all interest earned during the relevant period, but, as explained further below, it is still in the process of reviewing its records to resolve the possible discrepancies. Even if some discrepancies are identified, however, the District submits that development and implementation of more rigorous internal controls going forward may not be necessary. If CDE agrees to permit LAUSD to adopt OIG's proposed alternative interest calculation methodology, the District's Federal grant administration obligations would be vastly simplified. As a result, heightened internal controls should no longer be required.

(F) LAUSD CONCURS IN PART WITH PRELIMINARY RECOMMENDATIONS 3.1 THROUGH 3.6

OIG recommends that ED's CFO require CDE to take six corrective actions to address its third preliminary finding. Below LAUSD provides its response to each of OIG's preliminary recommendations.

3.1 Instruct LAUSD to remit the \$817,784 to CDE and other grantor agencies, as permitted under Federal law, for the amounts LAUSD identified as due for interest earned during FY2004 through FY2007 (3rd quarter), or if previously remitted, provide documentation confirming the remittance.

LAUSD does not concur with Recommendation 3.1. LAUSD believes that it has remitted all interest earned during FY2004 through the 3rd quarter of FY2007. As of the date of this letter, however,

LAUSD has not completed the extensive forensic accounting necessary to reconcile analysts' worksheets with prior remittance records in order to provide the requested documentation confirming the remittance. In the short response time permitted by OIG, other projects, such as fiscal year closeout, required the attention of the District's Controller's office.

Nevertheless, LAUSD fully intends to complete a full review of its records to verify the appropriateness of its interest remittances for FY2004 through FY2007 and to provide necessary documentation to confirm the remittance. The target date for completion of this review is October 31, 2008. The District reserves the right to supplement its response when the review is completed.^{15/}

Should LAUSD find that some amounts of interest were not remitted for this period, however, ED should not obligate recovery of those amounts. LAUSD has already demonstrated its good-faith commitment to resolve the audit review by voluntarily remitting interest for periods that, as explained in Section I, are covered by the five-year statute of limitations set forth in 20 U.S.C. § 1234a(k). Thus, LAUSD has gone far above and beyond what would be technically required under applicable law. The amounts LAUSD previously remitted should more than suffice to remedy any possible omissions due to discrepancies in documentation for prior years. Moreover, as indicated above, it was due, at least in part, to CDE's grant-by-grant reporting requirement that LAUSD developed such a staff-intensive interest remittance methodology in the first place. The more staff-intensive the District's methodology, the more likely inadvertent calculation errors may occur.

3.2 Instruct LAUSD to reconcile analysts' worksheets amounts with remittance documentation to identify earned interest for FY1995 through FY2003 that was not remitted to CDE or other grantor agencies and remit the identified interest to the agencies, as permitted under Federal law. We estimated that about \$1.42 million of additional earned interest may not have been remitted for FY1995 through FY2003.

LAUSD does not concur with Recommendation 3.2. For the reasons discussed above in Section I, the five-year statute of limitations in 20 U.S.C. § 1234a(k) bars ED from mandating that LAUSD remit funds associated with periods prior to FY2004.

^{15/} LAUSD's understanding is that this course of action will be satisfactory to OIG. OIG recently "clarif[ied] that it is not necessary or expected that CDE or LAUSD complete the corrective actions to address the recommendations prior to providing comments on the draft report. . . . When the recommendation requires the remittance of a specific amount (such as recommendation 3.1), CDE could explain in its comments that LAUSD is reviewing its records to confirm the amount due." G. Pilotti, Email to K. Chan, regarding "Extension to provide comments on draft audit report ED-OIG/A09H0019" (July 11, 2008).

3.3 Promptly transmit to ED the interest amounts remitted by LAUSD under Recommendations 3.1 and 3.2.

LAUSD does not concur with Recommendation 3.3. Based on LAUSD's objection to Recommendations 3.1 and 3.2, it should not be obligated to remit any additional funds to CDE. Thus, this Recommendation should be moot.

3.4 Obtain confirmation from LAUSD that it has remitted to CDE or other grantor agencies all amounts LAUSD identified as due for interest earned for the 4th quarter of FY2007 and later.

LAUSD concurs with Recommendation 3.4. By September 30, 2008, LAUSD will have remitted to CDE and other grantor agencies all amounts it has identified as due for interest earned for the 4th quarter of FY2007 and for FY2008. There has been some delay in LAUSD's remittances due to continued implementation issues with the District's new financial accounting system. LAUSD does not expect that such issues will similarly affect interest remittances for FY2009 and subsequent years.

3.5 Evaluate LAUSD's internal controls for ensuring that all interest earned on Federal cash advances are remitted promptly to grantor agencies and require LAUSD to implement any needed additional controls.

LAUSD partially concurs with Recommendation 3.5. LAUSD is eager to collaborate with CDE in the evaluation of its internal controls for ensuring that all interest earned on Federal cash advances is remitted promptly to grantor agencies. LAUSD also is willing to implement additional controls identified in the course of this evaluation, provided such controls are not unduly burdensome to the District. Nevertheless, it is unlikely that such an evaluation will identify additional controls that will be necessary going forward. Assuming CDE agrees to make the changes required to permit LAUSD to adopt OIG's proposed alternative interest calculation methodology, the District's Federal grant administration obligations will be vastly simplified and, thus, much more easily monitored and reviewed.

3.6 Monitor LAUSD, on an on-going basis, to ensure that it continues to remit interest earnings to CDE on a quarterly basis.

LAUSD partially concurs with Recommendation 3.6. LAUSD stands ready to assist CDE to monitor the District, on an on-going basis, to ensure that it continues to remit interest earnings to CDE, provided that such monitoring is not unduly burdensome to the District. LAUSD is eager to begin conversations with CDE to discuss how best to arrange a fully collaborative monitoring process.

CONCLUSION

In sum, LAUSD has acted in good-faith throughout this audit review process and is committed to working with CDE, LACOE, and ED to revise its interest remittance policies and practices, on a prospective basis, provided such revisions are not unduly burdensome to the District. LAUSD

disagrees, however, that it should be required to remit additional amounts beyond the \$25 million it has already repaid for the period from FY1995 through FY2007. Of the \$6.3 million in additional interest that OIG has recommended LAUSD remit, at least \$4 million is excludable pursuant to the applicable statute of limitations. Even where the statute of limitations may not apply, LAUSD believes it should not be required to remit the remaining \$2.3 million or any other amounts for fiscal years covered by this audit review for the reasons stated in more detail above.

LAUSD looks forward to working with you further on this matter, and will be pleased to answer any questions you may have or to receive your comments.

Sincerely,

/s/

David L. Brewer III
Superintendent of Schools
Los Angeles Unified School District

c: Gloria Pilotti
Regional Inspector General for Audits
U.S. Department of Education

Los Angeles Unified School District
INTER-OFFICE CORRESPONDENCE

TO: ANALYSIS Date: October 31, 2006

FROM: HELEN RIEL

SUBJECT: FY 06 4th QTR INTEREST INCOME ADJUSTMENT

Please recalculate the interest income (expense) of your Federal Grants for the 4th Quarter FY 2005-06 based on the actual interest rate of 4.86%. Please book only the difference of the amount booked at the rate of 4.27% and the recalculated amount at 4.86%.

Please use the following account codes to book the interest income (expense):

For interest income earned:		DR	CR
31-001-07R-8534	Interest Income-FY	XXX	
02-001-9667	Federal Interest Payable		XXX

A copy of your work papers and journal voucher should be give to Patt not later than 4:00 p.m. on 11/07/06 for review and approval.

Please see me if you have any questions.

HR: pp