California Department of Education Advances of Federal Funding to Local Educational Agencies

FINAL AUDIT REPORT

ED-OIG/A09H0020
March 2009

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, California

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Statements that managerial practices need improvements, as well as other conclusions and recommendations in this report represent the opinions of the Office of Inspector General. Determinations of corrective action to be taken, including the recovery of funds, will be made by the appropriate Department of Education officials in accordance with the General Education Provisions Act.

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UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

Audit Services
Sacramento Region

March 9, 2009

Jack T. O'Connell
State Superintendent of Public Instruction
California Department of Education
1430 N Street
Sacramento, California 95814

Dear Superintendent O'Connell:

Enclosed is our final audit report, Control Number ED-OIG/A09H0020, entitled *California Department of Education Advances of Federal Funding to Local Educational Agencies*. 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
Delegated to Perform the Functions of the
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/

Beverly A. Dalman
Acting Regional Inspector General for Audit

Enclosures

Electronic cc: Kevin Chan, Director, Audits and Investigations Division (AID), CDE
Annie Baccay, Audit Response Coordinator, CDE-AID

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EXECUTIVE SUMMARY

The California Department of Education (CDE) received fiscal year 2007-08 grant awards totaling $4.1 billion in Federal assistance from the U.S. Department of Education for 23 education programs. CDE passes most of the Federal education assistance through subgrants to local educational agencies (LEAs), such as school districts, county offices of education, and direct-funded charter schools. Hence, CDE needs to have an effective system for managing the flow of cash to ensure LEAs receive Federal funds when needed to pay Federal program costs while also ensuring Federal funds are not drawn earlier than needed. Premature draws of Federal funds result in increased borrowing costs for the U.S. Department of the Treasury (U.S. Treasury).

CDE has yet to implement an agency-wide cash management system that minimizes the time elapsing between LEA receipt and disbursement of Federal education funds, despite repeated audit findings over many years. Because it uses an advance payment method for most Federal education programs, CDE needs a cash management system that ensures Federal program cash is disbursed at or about the time that LEAs need to pay Federal program costs.

One objective of our audit was to determine whether CDE's method for disbursing funds to LEAs complies with Federal cash management requirements. We concluded that CDE's advance payment method does not comply with Federal requirements because it does not consistently ensure that LEAs receive Federal funds when needed to pay program costs. Under the advance method, CDE periodically disburses Federal funds to LEAs based largely on internal CDE processes and timelines, rather than controlling the timing of cash flows based on known or anticipated LEA program disbursement patterns. As a result, CDE disburses cash to LEAs well in advance of the actual cash needs for some Federal programs, and long after the LEAs have paid costs for other Federal programs. Our work at nine LEAs found that the timing of CDE disbursements generally did not match the LEAs' cash needs.

- CDE has not implemented cash management procedures for the largest Federal education program it administers—Title I, Part A, Basic Grants to LEAs of the Elementary and Secondary Education Act (ESEA). In State fiscal year 2006-07, CDE disbursed more than $1.6 billion to over 1,100 LEAs in California for the Title I Program. Auditors performing the annual single audit for the State of California have reported the lack of cash management procedures for the Title I Program for the last six years.

  CDE routinely disburses Title I funds to LEAs without determining whether the LEAs need program cash at the time of disbursement. Our work at nine LEAs indicates that CDE is likely disbursing Title I funds to LEAs across the State in advance of their needs for all or a significant part of the year. As a result of CDE's premature Title I disbursements, we estimate that the U.S. Treasury has incurred additional borrowing costs of about $13 million annually, and will continue to incur these added costs until CDE implements cash management procedures that assess LEA cash needs prior to Title I disbursements.

- CDE has implemented cash management procedures for other Federal programs, but we found that these procedures were inadequate and inconsistent. Specifically, CDE's procedures were inadequate because they involved reviewing expenditure data to assess LEA funding needs, but did not take into account LEA cash balances that were available to pay program costs. CDE also did not assess LEAs' actual or projected cash disbursements for individual programs. To ensure effective cash management, CDE should regularly review information on LEA cash balances, as well as actual or projected monthly cash disbursements. This would enable CDE to assess LEAs' immediate cash needs and make disbursement decisions based on those needs.

  We also concluded that CDE's cash management procedures were inconsistent in design and application. Individual CDE program offices developed their own procedures, funding thresholds, and reporting timeframes, with little coordination across programs. In addition, LEA reporting requirements and deadlines varied across programs.

The lack of a systemic approach for CDE's disbursement of Federal program funds causes confusion and increases the administrative burden for LEAs. LEA personnel must keep track of the various reporting requirements across programs. In addition, they have little or no information on when CDE will disburse Federal cash for a particular program.

The State of California recognizes that its financial management systems are outdated and decentralized across State agencies, and is working to design and implement a single integrated system known as the Financial Information System for California (FI$Cal). According to the project manager, FI$Cal will provide CDE with the capability to perform cash management and grant management activities for Federal and State funds disbursed to LEAs. The current project plan indicates that CDE will convert to the new system in 2013. In the interim, CDE has convened a task force to develop a proposal to address cash management in response to the numerous and persistent single audit findings and concerns raised by U.S. Department of Education officials. However, CDE's options for a technology-based interim solution may be restricted because the California Department of Finance placed a moratorium on information system projects that duplicate functionality that is being developed under FI$Cal.

The second objective of our review was to determine the fiscal impact that CDE's advance payment method has on LEAs. Specifically, we assessed the impact on the amount of Federal cash on hand at LEAs, including the use of cash from other resources to pay Federal education program costs and the earning of interest on Federal cash balances. Our work at nine LEAs found that LEAs experienced varying fiscal impacts depending on whether fiscal year 2005-06 Federal funds were received too late or too early.

- When CDE disbursed Federal program funds too late, LEAs used other available cash resources to pay program costs. The temporary use of other cash resources takes away the LEA's opportunity to earn interest on the cash, which is no longer available for investment. We found that cash shortfalls were common across LEAs in the Special Education Program, which is authorized by Part B of the Individuals with Disabilities Education Act (IDEA), for a substantial part or all of State fiscal year 2005-06. Delayed disbursements of Federal program funds may also intensify situations in which LEAs are anticipating cash shortfalls or are experiencing fiscal stress as a result of budget shortfalls during economic downturns.

LEA officials told us that delays in receiving Federal program funds generally did not affect program implementation and the delivery of educational services. When Federal funds were delayed, the LEA was able to use other available cash resources to pay program costs without disrupting program operations.

- When CDE disbursed Federal funds too early, LEAs earned interest on the resulting cash balances. In some cases, LEAs earned significant amounts of interest on Federal cash advances. For example, we estimated that one LEA earned over $469,000 in interest for the Title I Program in State fiscal year 2005-06. Federal cash management rules require LEAs to remit interest earned on cash advances for any amounts exceeding $100 on a timely basis. Even though they earned interest on Federal cash balances, most of the LEAs we reviewed did not calculate and remit their interest earnings. Those LEAs that did calculate and remit interest made errors resulting in underpayments. Statewide, we estimate that LEAs earned about $11 million in interest on Title I cash balances in State fiscal year 2005-06.

  We found that CDE does not have an adequate system in place to ensure LEA compliance with the Federal interest requirement. In particular, CDE can do more to ensure LEA compliance by issuing consistent guidance to LEAs that accurately and completely communicates the regulatory requirements, instructs on the method to properly calculate interest earnings, and specifies when interest earnings are to be remitted.

We recommend that the Chief Financial Officer (CFO) encourage CDE to consider centralizing its funding processes under the authority of a single organizational unit to ensure cash management procedures are consistently and effectively implemented across all Federal programs. We also recommend that the CFO require CDE to take other specified steps to establish or strengthen cash management procedures to ensure that LEAs receive Federal funds when needed to pay program costs. Additionally, we recommend that the CFO require CDE to strengthen its controls to ensure that LEAs accurately calculate and promptly remit interest earned on Federal cash advances.

CDE generally concurred with our findings in its comments to the draft report, but did not opine on our overall projections of cash balances and interest estimates. CDE described the corrective actions taken or planned to address each recommendation. Its comments on the draft report are summarized at the end of each finding and included in their entirety, except for the attachment of screen prints from its planned cash management reporting system, as Enclosure 3 to this report.

BACKGROUND

Congress enacted the Cash Management Improvement Act of 1990, as amended, (CMIA) to ensure greater efficiency, effectiveness, and equity in the exchange of funds between the Federal Government and the states. California enters into an agreement with the U.S. Treasury (Treasury-State Agreement or TSA) each year that prescribes specific cash management principles that the State will adhere to for its largest Federal programs, including the methods and timing for drawing Federal cash. The TSA in effect for State fiscal year (SFY) 2005-06 (July 1, 2005 to June 30, 2006) covered three Federal education programs administered by CDE—84.010 Title I Basic Grants to LEAs (ESEA Title I), 84.027 Special Education Grants to States (IDEA Special Education), and 84.367 Improving Teacher Quality State Grants (ESEA Title II). The TSA specified that the State would use the pre-issuance funding method to draw Federal funds, which meant that CDE was expected to disburse cash advances to LEAs not more than three days after it drew down the Federal funds.[1] For programs not covered by the TSA, CDE adopted a policy that disbursements of Federal funds to LEAs would occur within 14 days of the funds being drawn from the U.S. Treasury.

Under 34 C.F.R. § 80.37(a)(4) of the *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments,* states are required to substantially conform advances of Federal grant funds to subgrantees to the same standards of timing and amount that apply to cash advances received from Federal agencies. Under an advance payment method, CDE would need to disburse Federal funds to LEAs in a manner that would ensure that LEAs could comply with the same time periods specified in the TSA (3 days) or CDE's own policy (14 days).

The U.S. Department of Education (ED) provided about $4.1 billion in Federal assistance for 23 education programs for fiscal year (FY) 2007-08.[2] Most of the Federal education assistance provided to CDE is passed through to LEAs, such as school districts, county offices of education (COEs), and direct-funded charter schools. In 2007-08, there were 992 school districts operating in the State, along with 58 COEs and 458 direct-funded charter schools.[3]

CDE generally categorizes its funding processes for disbursing Federal and State funds to LEAs as either apportionments or grants. The primary difference between the two funding processes is the CDE entity that administers the process. Under the apportionments process, the School Fiscal Services Division calculates LEA allocation amounts for general-purpose State funding

[1] Under the TSA, CDE would be required to calculate and remit interest to the U.S. Treasury on Federal funds held from the date the funds are credited to a State account until the date they are disbursed to LEAs.

[2] As used in this report, FY refers to the Federal grant award year, which generally starts on July 1 and ends 15 months later on September 30. The SFY is a 12-month period beginning July 1. CDE tries to align Federal programs with the SFY to the extent possible.

[3] A direct-funded charter school (charter school LEA) is a charter school that has opted to receive Federal and State funds directly from CDE.

(principal apportionments),[4] and for State and Federal categorical programs (categorical apportionments). Examples of categorical apportionment programs include Federal entitlement programs, such as the Title I and Title II programs. Under the grants process, the respective program office calculates LEA grant award amounts. Federal programs administered through the grants process include the Special Education, Reading First, and Vocational Education programs.[5]

When the time comes to disburse Federal funds to LEAs, CDE draws the funds electronically from ED's grants payment system for deposit in the State Treasury. Disbursements to LEAs are manual, and entail the California State Controller's Office issuing a paper warrant to the LEA's County Treasurer or other designated payee.

By State education law, LEAs maintain substantially all cash received from Federal, State, and local sources in the County Treasury, credited to the applicable LEA fund. Each County Treasurer pools and invests cash holdings of school districts, county agencies, and other local districts located within county boundaries. When an LEA needs to make a payment for goods or services, it either issues a paper warrant, or requests the COE to issue the warrant, against its cash held in the County Treasury. LEAs are responsible for accounting for the receipt and use of funds for each Federal program.

Over the last six years, the California State Bureau of Audits has repeatedly found for various Federal programs that CDE has not developed or implemented procedures to minimize the time elapsing between LEA receipt and disbursement of Federal funds. The audits also identified weaknesses in other programs in which CDE had implemented procedures to assess LEA funding needs prior to releasing Federal funds.

[4] The majority of State funding for LEAs is allocated through principal apportionments, which provide a steady stream of funds to LEAs throughout the year.

[5] The Reading First Program is authorized under Title I, Part B, Subpart 1 of the ESEA; and the Vocational Education Program is authorized by the Carl D. Perkins Vocational and Technical Education Act of 1998.

AUDIT RESULTS

CDE does not have an agency-wide cash management system to assess the immediate cash needs of LEAs and disburse Federal funds in time to meet those needs. While some individual programs have implemented procedures to assess LEA funding needs prior to disbursing Federal funds, other programs have not implemented cash management procedures. We identified weaknesses in the procedures, where implemented, as well as internal processes that delayed disbursements to LEAs. Our work at nine LEAs found that the timing of CDE's disbursements generally did not match LEAs' cash needs, and resulted in varying fiscal impacts. In most cases, LEAs received Federal program funds either too late, and had to temporarily use other available cash resources to pay program costs; or too early, and earned significant amounts of interest on Federal cash balances. As a result, CDE cannot ensure that its advance payment method for disbursing Federal funds to LEAs complies with Federal cash management requirements.

We concluded that CDE needs to do more to ensure compliance with applicable Federal regulations. In particular, CDE should implement a coordinated approach to cash management across all Federal programs. To comply with Federal cash management and interest requirements, CDE's method for disbursing Federal funds must ensure that LEAs receive Federal funds when needed to pay program costs. CDE also needs to strengthen controls to ensure that LEAs accurately calculate and promptly remit interest earned on Federal cash advances.

Our review covered eight of the largest Federal education programs administered by CDE. These eight programs received about $3.9 billion in Federal funding for FY 2005-06, or 89 percent of the total amount of Federal education assistance provided to CDE that year. We also performed work at nine school districts in three counties: (1) Fresno County (Fresno Unified School District (USD), Parlier USD, and Sierra USD); (2) Los Angeles County (Glendale USD and Long Beach USD); and (3) Sacramento County (Center USD, Elk Grove USD, Galt Joint Union High School District (JUHSD), and Sacramento City USD).[6] The eight Federal education programs we covered, the legislation that authorized the programs, and our LEA selection methodology can be found in the Objectives, Scope, and Methodology section of the report.

FINDING NO. 1 – CDE's Method for Disbursing Federal Funds Must Ensure that LEAs Receive Federal Funding When Needed to Pay Program Costs

CDE used the advance payment method to disburse FY 2005-06 grant funds to LEAs for the eight programs we reviewed. This method generally entailed periodic disbursements of set portions of an LEA's entitlement or grant award throughout the period that Federal funding was available. We concluded that CDE's disbursement method does not minimize the time between

[6] We performed a focused review of the Title I Program only at Sacramento City USD, as described in the Objectives, Scope, and Methodology section.

when LEAs receive and disburse the funds, as required by Federal regulation. In particular, CDE does not have an agency-wide management system that encompasses all Federal education programs. Depending on the program, cash management procedures were either nonexistent, or inadequate and inconsistent. Moreover, CDE's internal processes delayed disbursements to LEAs. We found that CDE's disbursement method had varying fiscal impacts on LEAs. Pending conversion to a new financial management system, CDE needs to implement an interim solution that adequately addresses cash management requirements.

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

> (c) Advances. Grantees and subgrantees shall be paid in advance, provided they maintain or demonstrate the willingness and ability to maintain procedures to minimize the time elapsing between the transfer of the funds and their disbursement by the grantee or subgrantee.
>
> (d) Reimbursement. Reimbursement shall be the preferred method when the requirements in paragraph (c) of this section are not met.

CDE Does Not Have an Agency-Wide Cash Management System

CDE does not have an agency-wide cash management system to assess the immediate cash needs of LEAs and disburse Federal funds in time to meet those needs. Instead, responsibility for funding decisions and cash management are decentralized across a variety of CDE organizational components. There is no centralized management structure responsible for overseeing cash management for the entire agency. The budget and accounting functions, including activities for drawing Federal funds and generating claim schedules to the State Controller for disbursing Federal and State funds to LEAs, are centralized within CDE's Fiscal and Administrative Services Division. However, neither this division, nor any other single organizational component, has oversight responsibility to ensure that cash management requirements applicable to Federal pass-through funds are met across all Federal programs.

CDE has standardized to some extent the way that it manages and allocates funds to LEAs. Its *Funding Handbook* provides a guide for CDE staff on the funding processes (apportionments and grants). Under the apportionments process, the School Fiscal Services Division calculates LEA entitlement and apportionment amounts and, in some cases, uses data collected by the program office to allocate funds. For programs funded through CDE's grants process, program offices determine LEA grant award and payment amounts.[7] Regardless of the funding process, CDE holds the individual program office responsible for ensuring that LEAs do not accumulate Federal funds in excess of immediate needs. However, we found little, if any, coordination

[7] As described in the Background section, CDE categorizes its funding processes as either apportionments (e.g., Title I and Title II programs) or grants (e.g., Special Education). Under the apportionments process, each disbursement of Federal or State funds is referred to as an "apportionment." Disbursements are called "payments" under the grants process.

across programs regarding cash management procedures. Additionally, the *Funding Handbook* does not include cash management procedures.

Cash Management Procedures Were Either Nonexistent, or Inadequate and Inconsistent

CDE efforts to implement cash management procedures were nonexistent, or inadequate and inconsistent, depending on the program. CDE cash management procedures were generally developed in response to single audit findings targeting individual programs and were not implemented across all Federal programs. Program offices for two of the eight programs we reviewed had not implemented cash management procedures. The remaining six programs had procedures in place to assess LEA funding needs prior to some disbursements of FY 2005-06 funds. (Each program's procedures are described in Enclosure 1.)

Two Programs Did Not Have Cash Management Procedures

Two programs had not developed any procedures to assess LEA funding needs and ensure that funding was disbursed when needed to pay program costs. The Title I and Title IV Safe and Drug-Free Schools and Communities State Grants (ESEA Title IV) program offices had procedures to review LEA expenditures reported on the Consolidated Application (ConApp),[8] in order to ensure LEA compliance with Federal carryover limits. However, neither program office used the LEA-reported expenditure data or any other information to assess LEA funding needs. CDE has not developed cash management procedures for the Title I Program, even though the program is substantially larger than all other Federal education assistance programs and has been the subject of single audit findings about the lack of cash management procedures for the last six years. Our work at nine LEAs found that the LEAs earned interest in SFY 2005-06 on cash balances in the Title I Program.

Six Programs Had Cash Management Procedures

Six programs had implemented or were attempting to implement procedures to assess LEA funding needs by reviewing LEA-reported expenditure or attendance data. However, we found the procedures were not adequate to ensure CDE disbursements met LEAs' immediate cash needs for the following three reasons:

- <u>No Assessment of LEA Cash Needs</u>. Program office procedures did not consider LEAs' cash balances, or their actual or projected cash disbursements. One program used LEA-reported attendance data to determine interim disbursement amounts, and expenditure data for the final payment. For the remaining five programs, LEAs were required to report expenditure data at certain points during the funding period, but the expenditures may not have reflected actual cash disbursements. Moreover, four of the six programs instructed LEAs to include encumbrances or legally obligated expenditures when reporting expenditures. These unpaid obligations could be purchase orders,

[8] LEAs apply, and report expenditure and performance data, for some Federal and State categorical program funds through the Consolidated Application process each year. The ConApp has two parts—Part I is due on June 30, and Part II on January 31. It includes programs administered through the apportionments process, such as the ESEA Title I, Title II, Title III, and Title IV programs we reviewed.

contracts, and other commitments that may not require payment until a future period and may reflect less immediate cash needs. The six program offices generally compared LEA-reported expenditures to the program's funding threshold prior to releasing a disbursement.

CDE's *California Schools Accounting Manual* (CSAM) defines "expenditure" as the cost of goods delivered or services rendered, whether paid or unpaid.[9] In contrast, the CSAM defines "disbursement" as payments by currency, check, or warrant, and points out that disbursements are not synonymous with expenditures. A comparison of expenditure and disbursement data for one LEA illustrates the difference. For SFY 2005-06, the LEA's records for the Title II Program showed about $2.0 million in expenditures and $1.5 million in cash disbursements, or a difference of 35 percent.

While six program offices had procedures to review LEA reported expenditure or attendance data, these methods did not assess the cash position of the LEAs or their immediate cash needs. To perform cash management, CDE's procedures should take into account whether LEAs have a demonstrated need for cash. Information on LEA cash balances, and actual or projected monthly cash disbursements, would enable CDE to more accurately assess LEAs' immediate cash needs as it makes disbursement decisions. Our work at LEAs showed that many program costs are related to routine, anticipated costs, such as employee pay and benefits. Therefore, LEAs should be able to project their immediate cash needs and report their anticipated needs to CDE in order to help ensure that funding can be made available to meet these needs. Reviewing LEA expenditure data that may or may not reflect immediate cash needs is not sufficient for cash management purposes.

- <u>LEA Funding Needs Not Assessed Prior to Each Disbursement</u>. While the six CDE program offices had implemented procedures to review LEA expenditures prior to the final FY 2005-06 disbursements, these program offices typically did not perform similar procedures for other disbursements during the period that Federal funds were available. For the four programs administered through the grants process, LEAs only had to submit a signed grant award notification to receive their first disbursement. To receive their final disbursement, the LEAs had to submit an expenditure report at the end of the grant period.

Program offices for two of the apportionment programs we reviewed implemented procedures in FY 2005-06 to attempt to limit the funding provided to LEAs in advance of need. However, the procedures were not applied to one or more disbursements. To receive Title II and Title III English Language Acquisition State Grants (ESEA Title III) program funds, LEAs must have reported expenditures of at least 80 percent of their prior-year entitlement. If an LEA met the threshold, it received a portion of its entitlement in the first apportionment schedule, along with a like amount of funding automatically in the second apportionment schedule. LEAs not meeting the threshold would receive disbursements in subsequent apportionment schedules once funding thresholds were met. We found that the Title II program office deviated from its

[9] California State education law requires school districts to follow the accounting definitions, instructions, and procedures in the CSAM. We use CDE's definition of "expenditure" and "disbursement" throughout this report.

procedures by releasing a portion of FY 2005-06 funding to the majority of LEAs, which had not met the threshold initially, without re-assessing the LEAs' need for funding. Title II program officials attributed this oversight to staff turnover and the significant passage of time between apportionment schedules.

- No Consistent Reporting Method. Variation in program office reporting procedures could reduce the accuracy of LEA-reported information. Two programs, which are funded through CDE's apportionments process, collected expenditure data through the electronically submitted ConApp, as well as by requiring additional manual reports. The four programs funded through the grants process each relied on their own manual reporting process.

  The ConApp format was generally consistent across Federal programs and included automated error checks. However, it did not assure consistent reporting as LEAs were instructed to report year-to-date expenditures either without any specified dates or for different reporting periods.

  The manual reports required by the six CDE program offices differed in format, requested information, frequency, reporting periods, and due dates. Under a manual reporting process, CDE program office personnel are required to input LEA-reported data into their own database. While some program officials stated that procedures were in place to ensure the accuracy of data inputs, such manual processes require additional resources and are subject to data entry errors.

Beginning in the FY 2006-07 funding cycle, two of the six programs changed or modified their disbursement method. In response to single audit findings, the Vocational Education Program changed from an advance payment method to full reimbursement whereby LEAs could submit quarterly claims for reimbursement. Instead of basing interim funding decisions on attendance data, the 21st-Century Community Learning Centers Program modified its disbursement method to a quasi-reimbursement method whereby CDE provides an initial advance payment and subsequently reimburses LEAs for quarterly reported expenditures.

CDE's Internal Processes Delayed Disbursements to LEAs

Disbursement schedules across the eight reviewed programs varied widely in the number of disbursements, proportion of an LEA's entitlement or grant award represented by each disbursement, and disbursement dates. Depending on the program, disbursement schedules generally involved two or three disbursements (apportionments or grant payments) of set percentages of an LEA's entitlement or grant award. (Each program's disbursement schedule is described in Enclosure 1.)

CDE disbursed FY 2005-06 funds to most LEAs during SFY 2005-06 or shortly thereafter. However, disbursements for some programs did not occur for up to 12 months or more after the SFY had ended. For example, final Title II disbursements of FY 2005-06 funds for most of the LEAs we reviewed did not occur until June 2007, or nearly a full year after the SFY had ended. In some cases, LEAs did not receive program funds until long after they spent their full entitlement. Two LEAs reported they spent their entire Title II entitlement amount by September 30, 2006, but did not receive their first disbursement until the third apportionment schedule in April 2007. The LEAs had not met the program office's funding threshold for the first apportionment schedule a year earlier and, thus, were subject to funding delays caused by program staff turnover.[10]

For the eight reviewed programs, a significant portion, if not all, of the Federal education assistance funds were available for CDE to draw down on or about July 1, 2005. By October 2005, the remaining funds were available for drawdown.[11] Although Federal funds were available for disbursement to LEAs early in the year, CDE's internal processes delayed the first disbursement of the funds by an average of 7 months, ranging from 4 to 11 months depending on the program. CDE fiscal and program officials attributed the delays to the following five factors:

- <u>State Budget Process</u>. Under California law, State agencies cannot disburse Federal funds until the State Legislature has enacted, and the Governor has signed, the State budget. State law also requires that the budget be enacted by June 30 to ensure funding is available at the beginning of the SFY on July 1. Since CDE cannot disburse any Federal funds to LEAs until the State budget is in place, a late budget could contribute to delays in making the first disbursements. However, California's SFY 2005-06 budget was signed by the Governor on July 11, 2005 and, thus, did not contribute to delays in disbursing Federal funds to LEAs in that year.

- <u>New or Significantly Expanding Charter School LEAs</u>. For programs administered through the apportionments process, CDE waits until after September 30 to calculate LEA entitlements pending receipt of enrollment estimates for new or significantly expanding charter school LEAs. In California, charter schools complete an annual Charter Schools Funding Survey to indicate whether they want to receive Federal and State funds directly from CDE (direct-funded charter school or charter school LEA) or indirectly as a public school of a school district LEA. CDE also uses the Survey to collect estimated enrollment information for these charter schools.[12] State education law stipulates that a new charter school must commence instruction between July 1 and September 30 to be eligible for State funding. Although charter schools are expected to submit the Survey by May 31, CDE waits until September 30 to accommodate late submissions and the statutory deadline.

  CDE needs to explore alternatives to its policy of delaying LEA entitlement calculations until after September 30. This policy contributed to significant delays in disbursing

[10] The disbursement schedule and funding threshold for the Title II Program are described in Enclosure 1.

[11] Nearly all FY 2005-06 Federal funds for the Reading First Program were available to CDE by October 1, 2005; the remaining 4 percent of the State grant award became available in September 2006.

[12] Under § 5206 of the ESEA, States must ensure that eligible new or significantly expanding charter schools that open or expand enrollment on or before November 1 of an academic year receive a proportionate amount of Federal funds. The SEA must base a new or expanding charter school LEA's allocation on actual enrollment or eligibility data. If actual data are not available when the charter school first opens or significantly expands enrollment, the State may use estimates to calculate the charter school LEA's allocation. The State must then use actual data to make appropriate adjustments to the amount of funds previously allocated to the new or significantly expanding charter school LEA, as well as to other LEAs under the applicable program, before program funds are allocated for the succeeding academic year.

FY 2005-06 Federal funds to as many as about 1,000 LEAs statewide pending information on 209 new or significantly expanding charter school LEAs. Federal guidance already permits states to reserve an appropriate amount from their Federal program allocation for new or expanding charter schools in order to reduce the administrative burden on states and LEAs. States can also use prior-year carryover, reallocations, State administration, or other discretionary funds for charter school LEA allocations. Thus, CDE could compute the entitlements for the larger body of LEAs and begin disbursing funds to them earlier, if warranted based on LEA cash needs, while setting aside Federal program funds for new or significantly expanding charter school LEAs. Alternatively, CDE could use historical data on new or significantly expanding charter schools and data available from the Charter Schools Funding Survey obtained to date to estimate LEA entitlements. Preliminary LEA entitlements could then be adjusted for late Survey submissions in order to finalize all LEA entitlements.

- New Cash Management Procedures. Program offices that began implementing procedures to assess LEA funding needs in SFY 2005-06 experienced additional delays in releasing the first disbursement of FY 2005-06 funds to LEAs. The first LEA disbursements occurred near the end of the SFY—in March 2006 for the Title II Program and June 2006 for the Title III Program. Both program offices have continued to refine their procedures in subsequent years with mixed results. The first disbursement of Title III funds was four months earlier for FY 2006-07 funding. However, the Title II program office has struggled with its attempts to improve procedures resulting in an even later first disbursement for FY 2006-07 and no disbursements of FY 2007-08 funds as of August 2008.

- Other Program Office Delays. For the Special Education Program, CDE released the first disbursement of FY 2005-06 program funds to LEAs in November 2005, or four months into the SFY. The program office could not calculate LEA grant amounts until special education pupil counts and poverty data were available in September 2005. Our LEA work found that funding to school districts that provide special education services may be delayed an additional month or so when the district is a member of a multi-district Special Education Local Planning Area (SELPA).[13]

  For the Title IV Program, LEA entitlements were posted on CDE's website in November 2005. However, the program office has historically waited until after CDE releases the ConApp Part II in December before releasing Title IV funds for disbursement to LEAs.

- Review and Approval Process. Each disbursement (apportionment and grant payment) must be reviewed and approved before funds can be released to LEAs. All proposed disbursements of Federal education funds to LEAs are subjected to reviews by various levels of management within both the program and fiscal offices. We found that the review and approval process delays LEA disbursements by several weeks or, in some cases, even months. Once CDE releases the disbursements to the State Controller's

[13] The SELPA is the LEA for Special Education funding purposes. A SELPA may be a single school district or comprised of multiple districts. In a multi-district SELPA, the SELPA may provide special education services for member districts, or disburse funds to districts to provide services.

Office for payment, it takes about two additional weeks to issue the paper warrant and deposit the funds into the respective County Treasury.

The lack of a systemic approach or coordination across individual programs causes confusion and increases the administrative burden for LEAs. LEA fiscal staff stated that a significant amount of staff time is spent completing, filing, and tracking the various expenditure reports. They would like to see more consistency across programs in reporting requirements and dates, as well as the timing of disbursements. LEA fiscal staff also told us that they would prefer more consistency across programs' disbursement schedules, and to know the LEA's final allocation and receive Federal program funds earlier. The inconsistencies in disbursement schedules and late disbursements can cause budgeting, planning, and staffing problems at the LEA. For example, one LEA reported that its Reading First Program is regularly impacted because the district cannot post or fill positions until program funding is in place. If funding is delayed, the district must issue layoff notices to its reading coaches, and later retract the notices when the funding becomes available. LEAs also reported a preference for more timely receipt of funds to match their spending needs, and receipt of current-year funds during the SFY rather than in subsequent years.

LEAs Have Little or No Control over When They Receive Federal Funds Resulting in Varying Fiscal Impacts

CDE's advance payment method disburses Federal funding to LEAs rather than allowing LEAs to draw the funds when needed to pay program costs. Our analysis of LEA monthly cash receipts and disbursements for four programs[14] showed that the LEAs either received Federal program funds too late, and had to pay program costs by temporarily using other available cash resources, or received funding too early, and earned interest on the program cash balances. We concluded that LEAs can do little to minimize the time elapsing between receipt and disbursement of Federal funds due to the absence of a funding system that assesses LEAs' immediate cash needs, or that allows LEAs to draw funds when program costs need to be paid.

LEAs Pay Program Costs Whether or Not CDE Has Disbursed Program Funds

LEAs pay Federal program costs whether or not CDE has disbursed Federal funds to the LEA for the specific program. State education law requires that all cash received by an LEA be credited to its General Fund, unless the cash is required to be placed in a separate fund. LEAs use their General Fund to finance the ordinary operations of the LEA, including Federal education programs. Most General Fund revenues are from non-Federal sources, such as continuously appropriated State general purpose education funds and local property taxes. Federal dollars comprise a small portion of the General Fund (4 to 14 percent in the nine LEAs we reviewed).

Once deposited in the County Treasury, the source of General Fund revenues (Federal and non-Federal) is indistinguishable for purposes of paying LEA operational costs. An LEA's entitlement or subgrant award, as well as its approved budget, authorize the amount of funds available to pay Federal program costs. From a program perspective, the LEA ensures that

[14] We reviewed the Title I, Title II, Title IV, and Special Education programs at eight LEAs, and only the Title I Program at one LEA (as described in the Objectives, Scope, and Methodology section).

disbursements are for program purposes, are in accordance with the approved budget, and do not exceed the LEA's entitlement or subgrant award. From a fiscal perspective, the LEA ensures that sufficient funds are available in the General Fund to pay program costs. Thus, LEA accounting records will show a negative cash balance for a program when costs are paid in advance of CDE disbursing program funds to the LEA. Conversely, there will be a positive cash balance when CDE has disbursed program funds in advance of the LEA's need. Thus, LEAs' accounting process enables the LEA to mitigate the mismatch between the timing of program disbursements and the receipt of revenues, and continue to operate Federal programs pending receipt of program funds from CDE.

Eight LEAs Experienced Negative Fiscal Impacts

Delays in CDE disbursements resulted in eight of the nine reviewed LEAs experiencing cash shortfalls in individual Federal programs during SFY 2005-06. The eight LEAs began the year with cash shortfalls in at least one and as many as all four programs. The LEAs had negative cash balances for as little as two months before prior-year FY 2004-05 funding was received in SFY 2005-06, or for as long as the entire year despite receiving FY 2005-06 funds in the affected programs. Cash shortfalls were most typical in the Special Education and Title IV programs as seven LEAs had negative cash balances in both programs for a substantial part or all of the year. Several LEAs also had cash shortfalls in the Title II Program for the entire year.

Negative fiscal impacts can result when cash shortfalls occur in a Federal program. When a program has a negative cash balance, LEAs use other available cash resources to pay program costs. All LEAs included in our review had cash available in their General Fund to pay program costs pending receipt of Federal program funds. However, when an LEA has to temporarily use other cash resources to pay Federal program costs, the amount of cash available to the LEA for other educational purposes is decreased, which could put additional fiscal pressure on the LEA. The use of other cash resources also causes a lost opportunity for the LEA to earn interest because the cash is no longer available for investment. Every dollar of interest earnings that an LEA is unable to generate because of the need to cover Federal program costs, is a dollar that cannot be recovered and is no longer available for investment in the LEA's other educational programs. For example, we found that cash shortfalls were common across LEAs in the Special Education Program for a substantial part or all of SFY 2005-06. We estimated that the eight LEAs lost the opportunity to earn about $462,000 in interest because the cash from other General Fund revenue sources, which the LEAs used to pay program costs pending receipt of Special Education disbursements from CDE, was no longer available for investment.[15]

LEA program and fiscal officials stated that delays in receipt of Federal funding did not affect the delivery of services for the four programs because other cash resources in their General Fund were available to pay program costs. However, four of the eight LEAs had expected to experience cash shortfalls in their General Fund during SFY 2005-06. To address these projected shortfalls, three of the LEAs issued short-term debt instruments called Tax Revenue Anticipation Notes, which constitute borrowing against future tax and other revenues. The other

[15] We calculated the estimate of lost interest earnings by multiplying the LEA's negative month-end cash balance for the Special Education Program by the applicable monthly interest rate. For reporting purposes, we used month-end cash balances to estimate interest. As noted in Finding No. 2, however, use of month-end balances could understate or overstate the actual interest earned.

LEA obtained a loan from its COE. While not a direct cause for the shortfall in the General Fund, delays in receipt of Federal funds were likely a contributing factor.

Nine LEAs Had Significant Cash Balances for Some Programs

All the reviewed LEAs had significant cash balances for one or more programs during SFY 2005-06. The cash balances resulted from the LEA having unspent prior-year FY 2004-05 program cash advances that they either carried over from SFY 2004-05 or received the following year, as well as FY 2005-06 advances received during SFY 2005-06. LEAs that had Federal cash balances earned interest on these balances, particularly in the Title I Program. All nine LEAs had cash balances in the Title I Program for some portion of the year. Six of the LEAs had Title I balances for nearly the entire year. We estimated that the nine LEAs earned about $858,000 in interest on Title I cash balances during the year.[16] Cash balances were not as commonplace in the other three programs and, as a result, LEAs generally generated lower or no interest earnings in those programs.

CDE Needs to Implement an Interim Solution that Adequately Addresses Cash Management Requirements

Pending the State of California's new statewide financial management system (FI$Cal),[17] CDE plans to implement an interim solution to address cash management. In 2007, CDE convened a task force to develop a cash management proposal in response to the longstanding single audit findings, concerns raised by ED's Risk Management Team, and the Office of Inspector General's (OIG) cash management audits. At the time of our review, CDE was planning to pilot a web-based system for LEAs to report cash balances for the Title II Program, and phase in other programs after it could verify the system was operating as intended.

Based on our State and LEA work, CDE should ensure that its interim solution takes into account the following two factors:

- <u>Consistent Requirements Across All Federal Programs</u>. Reporting requirements that are consistent across programs, such as the format, requested information, frequency, and due dates, would help to minimize the administrative burden on LEAs and better assure the accuracy of LEA-reported information. Additionally, cash management procedures should be implemented for *all* Federal programs, including the Title I and Title IV programs.

- <u>Assessment of LEA Cash Needs</u>. Cash management procedures should involve a review of LEAs' *cash* needs prior to *all* advances. To minimize the time between when LEAs receive and disburse Federal program funds, CDE should release funds in time to meet LEAs' immediate cash needs (i.e., not too late or too early). Information on LEA

[16] We calculated the estimate of interest earnings similar to our calculation for interest losses. For each month, we multiplied the LEA's positive month-end cash balance for the Title I Program by the applicable monthly interest rate.

[17] As described in the Executive Summary, FI$Cal will provide CDE with the capability to perform cash management and grant management activities for Federal and State funds disbursed to LEAs. CDE is expected to convert to the new system in 2013.

cash balances, and actual or projected monthly cash disbursements, would enable CDE to more accurately assess LEAs' immediate cash needs as it makes disbursement decisions.

As it develops and implements an interim solution, we encourage CDE to involve LEAs and COEs. LEAs have an inherent interest in receiving their Federal program funds timely. They can help to ensure that the interim solution is practical and not overly burdensome. Making LEAs a part of the solution would improve their understanding of CDE's funding processes, and better assure their cooperation and compliance with cash management procedures. The COEs may also have information or suggestions that may be helpful in developing CDE's interim solution. As discussed in Finding No. 2, cash information may be available at COEs for many school districts that could help CDE implement cash management procedures.

When CDE draws Federal funds for disbursement to LEAs too far in advance of their immediate cash needs, there is an additional cost to the U.S. Treasury. Because of the Federal deficit, the U.S. Treasury must borrow the cash needed to fund Federal programs and, as a result, incurs interest costs. Federal program funds drawn too early results in additional Federal borrowing costs that would not have been incurred if CDE had disbursed the funds to LEA when needed to pay program costs. Thus, if CDE implements an effective cash management system, we estimate that more timely disbursements to LEAs for the Title I Program alone would result in the avoidance of about $13 million in future, annual borrowing costs to the U.S. Treasury.[18]

Recommendations

We recommend that the Chief Financial Officer encourage CDE to—

1.1 Consider centralizing its funding processes under the authority of a single organizational unit to ensure cash management procedures are consistently and effectively implemented across all Federal programs

We further recommend that the Chief Financial Officer require CDE to—

1.2 Make the first disbursement of Federal funds available to LEAs earlier in the State fiscal year if LEAs have demonstrated the need for program funds. CDE should consider

[18] We estimated the $13 million of future, annual borrowing costs using the following formula:

Statewide FY 2006-07 Title I allocation to LEAs		Estimated percentage of allocation on-hand at LEAs statewide		Annualized interest rate stipulated in the State of California's Treasury-State Agreement for FY 2006-07
$1,640,256,330	X	15.65%	X	5.02%

The "estimated percentage of allocation on-hand at LEAs statewide" was derived using the following formula:

$$\frac{\text{Sum of the nine LEAs' average SFY 2005-06 Title I cash balances} \quad \$20{,}854{,}820}{\text{FY 2006-07 Title I allocations for the nine LEAs} \quad \$133{,}281{,}078} = 15.65\%$$

Each LEA's average Title I cash balance was calculated by summing the LEA's month-end cash balances for the year and dividing by 12. The individual LEA calculations may have included months in which ending cash balances were negative.

alternatives to enable earlier first disbursements, such as (1) providing a provisional first disbursement that is subject to adjustment once LEA entitlements and grant amounts are finalized; and/or (2) setting aside Federal program funds for new or expanding charter school LEAs to enable earlier calculation of LEA entitlements and disbursements, and performing separate entitlement calculations for these charter school LEAs after September 30, when enrollment estimates are available, while ensuring their funds are disbursed within statutory timelines.

1.3 Proactively work with the FI$Cal project development team to ensure that the cash management component of the new system meets Federal requirements, allows LEAs to draw Federal funds when needed to pay program costs, and includes internal controls to ensure LEAs minimize the time between when they receive and disburse Federal program funds. If CDE implements an effective cash management system, we estimate that more timely disbursements to LEAs for the Title I Program alone would result in the avoidance of about $13 million in future, annual borrowing costs to the U.S. Treasury.

1.4 Develop an interim solution that is consistent across all Federal programs, and assesses LEA cash needs prior to all advances.

CDE Comments and OIG Response

In its overall comments, CDE concurred with the finding in general, but did not opine on our projections of cash balances and interest estimates. It stated that its foremost cash management goals are to: (1) improve cash balance reporting, fiscal monitoring, and funding processes to minimize the time between sub-recipients' receipt and disbursement of Federal funds; and (2) revert interest earned on unspent Federal funds to the U.S. Treasury. To help in this endeavor, CDE is coordinating efforts with ED's Risk Management Services for advice and suggestions on improving CDE's cash management over Federal funds.

CDE also provided comments and described the corrective actions already taken or planned for each of our recommendations. Where we believe the stated corrective action did not sufficiently address a recommendation, we provide our response below. We have not modified our recommendations based on CDE's comments.

- Recommendation 1.1. CDE stated that, upon consideration of centralizing the multitude of program funding processes under a single organizational unit, it determined it would be more feasible to consistently apply universal core cash management procedures to its grant and apportionment processes to ensure LEAs receive Federal funding when needed to pay program costs.

- Recommendations 1.2 and 1.4. In its response to Recommendation 1.2, CDE commented that its proposed quarterly funding process (described below) will enable CDE to effectively disburse Federal funding throughout the year and accommodate an LEA's demonstrated need for program funds.

  In its response to Recommendation 1.4, CDE summarized its interim cash management improvement plan, which was recently submitted to ED. Under the plan, CDE would institute quarterly sub-recipient (LEA) reporting of cash balances and quarterly disbursement of Federal funds. LEAs would use a web-based system to report outstanding cash balances by program. Based on this information, CDE would determine whether (1) adjustments are necessary to subsequent scheduled funding and (2) LEAs may have earned interest on unspent funds. CDE could adjust funding by releasing or increasing the following scheduled funding amount if an LEA reports a relatively small amount or negative cash balance. Alternatively, CDE could withhold or decrease the scheduled funding and query the LEA about the disposition of interest earnings when the cash balance is relatively high. CDE stated that program funding on a quarterly basis would allow more timely disbursements since, in theory, LEAs would not be without funding for longer than 90 days. While the plan refers to a quarterly funding schedule, CDE noted that the schedule may be modified to accommodate the complexities of individual programs. The system could also be modified to capture interest earned on Federal funds and other program information.

Citing sensitive ramifications for programs currently funded less than four times a year, such as the Title I Program, CDE plans to pilot the new system with the Title II Program (Improving Teacher Quality). Other programs would be phased in after the new cash management system and processes are better understood and operating as intended.

OIG Response. In addition to the corrective actions above, CDE needs to ensure its cash management improvement plan or other corrective actions address the following critical issues noted in the finding:

- A timeline for implementing the pilot program and phasing in all other programs. In particular, CDE needs to phase in the Title I Program as soon as possible given the longstanding unresolved single audit findings and significant cash balances we found at many reviewed LEAs.

- Steps to alleviate the internal delays that caused the first disbursement across reviewed programs to occur 4 to 11 months into the year. CDE officials had attributed the delays to such factors as the State budget process, new or significantly expanding charter school LEAs, and processes for reviewing and approving disbursements. LEAs with a demonstrated need for Federal program cash early in the year should not have to use other cash resources to cover Federal program costs.

- More detailed assessment of LEA cash needs. Under the proposed cash management reporting system, having LEAs report only cash balances may not sufficiently address LEAs' future cash needs. CDE could compare cash balances for two quarters to determine the amount spent in the preceding quarter to estimate an LEA's future cash needs, However, this measure alone may not ensure individual LEAs receive Federal program funds to cover all anticipated Federal program costs. Also obtaining information from LEAs on projected cash needs would assure that LEAs receive sufficient funds in the following quarter for anticipated, non-routine costs, such as equipment, one-time costs, and other large purchases, in addition to routine costs, such as employee pay and benefits.

CDE should also solicit input from LEAs when designing and assessing the new cash management reporting system to better assure the system operates as intended and to determine whether LEAs are receiving funds when needed to pay program costs under the new system.

- Recommendation 1.3. CDE stated that representatives attend FI$Cal project development meetings and work proactively with the California Department of Finance on the CDE and government requirements that should be addressed and incorporated into the new statewide financial management project.

  OIG Response. When attending meetings and working with the State Department of Finance, CDE needs to proactively ensure the FI$Cal system meets Federal cash management requirements. In accordance with 34 C.F.R. § 80.21, CDE's method and procedures for disbursing Federal program funds must enable LEAs to minimize the time between when LEAs receive and disburse the funds. Moreover, 34 C.F.R. § 80.37(a)(4) requires CDE to substantially conform advances of Federal program funds to LEAs to the same standards of timing and amount that apply to cash advances CDE receives from ED. CDE draws down Federal funds prior to making disbursements to LEAs, and is expected to disburse the funds within 3 days for programs covered by the Treasury-State Agreement on cash management principles and 14 days for non-TSA programs. Thus, LEAs must be able to comply with these same timelines.

  CDE's current and proposed interim disbursement methods continue to largely control when LEAs receive Federal program funds since LEAs are unable to request or draw funds when actually needed. CDE's interim plans for a quarterly disbursement schedule may help to improve the elapsed time between LEA receipt and disbursement of funds, but a system where "sub-recipients would not be without funding longer than 90 days" does not conform to the same timing standards (3 days for TSA programs and 14 days for non-TSA programs) applicable to CDE's receipt of Federal funds from ED. Moreover, LEAs cannot be held responsible for minimizing the time between their receipt and disbursement of funds if they have little or no control over when funds are received.

  To comply with Federal cash management requirements, CDE needs to ensure the FI$Cal system enables LEAs to request or draw down Federal programs funds at or about the time the funds are needed to pay program costs. Once FI$Cal is in place, CDE should monitor subgrantee drawdowns to ensure LEAs adhere to cash management requirements.

We have not modified the finding, except to make some clarifying edits, update information on CDE's planned cash management reporting system, and update some of the figures used to estimate interest earnings for the nine reviewed LEAs and future borrowing costs to the U.S. Treasury. We re-calculated the interest estimates based on corrected Title I cash balance data from one LEA.

FINDING NO. 2 – CDE Needs to Strengthen Controls to Ensure that LEAs Correctly Calculate and Promptly Remit Interest Earned on Federal Cash Advances

We concluded that CDE's procedures to ensure LEA compliance with the Federal interest requirement were ineffective. Our work at nine LEAs found that they had earned interest on Federal cash balances in SFY 2005-06, but most LEAs did not remit interest. Moreover, the LEAs that remitted interest did not calculate interest correctly or remit promptly. We found that CDE procedures were inconsistent across Federal programs. Additionally, LEAs need guidance on the proper method for calculating and frequency for remitting interest. We also identified ways in which COEs could help CDE implement cash management procedures and LEAs comply with the interest requirement.

When CDE releases funds to LEAs, the cash is deposited in an interest-bearing account until disbursed for program costs. As described in Finding No. 1, LEAs may receive Federal program funds well in advance of their need because CDE disburses funds without first assessing LEAs' cash needs. The interest LEAs earn on Federal cash advances must be returned to ED in accordance with regulatory requirements.

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

> . . . [G]rantees and subgrantees shall promptly, but at least quarterly, remit interest earned on advances to the Federal agency. The grantee or subgrantee may keep interest amounts up to $100 per year for administrative expenses.

LEAs were generally instructed to remit interest earned on Federal program funds to CDE. Upon receipt of an LEA's remittance, CDE's Accounting Office processed the payment and mailed State warrants covering batches of LEA remittances to ED.[19] Our limited testing concluded that, when it received checks from LEAs, the Accounting Office had adequate controls in place to process and remit LEA interest payments to ED. However, we concluded that CDE needs to strengthen controls to ensure that LEAs do remit interest, when required, and calculate interest amounts properly.

CDE records show that few LEAs have remitted interest earned on Federal cash advances. Statewide, only 24 of over 1,000 LEAs remitted interest earnings totaling about $409,000 during SFY 2005-06, and 26 LEAs remitted about $692,000 in SFY 2006-07.[20] In the California single audit for SFY 2005-06, the Auditor reported the SFY 2005-06 interest earnings total and concluded that CDE did not appear to adequately monitor LEA compliance with cash management requirements based on the number and amount of interest payments CDE had

[19] Upon receipt of interest remittances from grantees, ED returns the funds to the U.S. Treasury.

[20] The SFY 2006-07 interest earnings total does not include Los Angeles USD, which remitted almost $23 million that it had earned and retained over more than a ten-year period. We recently reported that the LEA began in March 2007 to remit interest that it had been earning across all Federal programs since 1995. (*Los Angeles Unified School District's Procedures for Calculating and Remitting Interest Earned on Federal Cash Advances* (ED-OIG/A09H0019, December 2, 2008)).

remitted to ED on LEAs' behalf. Our work at nine LEAs confirmed that many LEAs were not complying with the Federal interest requirement.

CDE Procedures to Ensure LEA Compliance with Interest Requirement Were Inconsistent Across Federal Programs

CDE relies on LEAs to self-report and remit interest earned on Federal cash balances. CDE generally cites the applicable Federal regulation in program apportionment letters, grant award notifications, and other documents distributed to local agencies. In addition, three of the eight reviewed programs request LEAs to include interest earnings in the program's year-end expenditure report. However, we found that the information and instructions provided in these documents did not ensure LEA compliance with the interest requirement for the following four reasons:

- <u>LEAs Unaware of Interest Requirement</u>. Fiscal staff at five of the nine LEAs in our review stated that they were unaware of the interest requirement. Under its apportionments funding process, CDE addresses program funding letters to county-level officials and requests that the County Superintendent of Schools forward the information to the LEAs within the county.[21] The COEs we contacted either sent a copy of the funding letter to its LEAs, or posted the letters to a website.

  For seven of the eight programs reviewed, the requirement was included as standard language with other information in program funding letters (apportionment or grant award notifications). Instead of informing the LEA of the interest requirement in the grant award notification, the remaining program reminded LEAs of the requirement in the program's expenditure report forms. Using these methods to disseminate information increases the potential for LEA staff to overlook the requirement.

- <u>Inconsistent and Incomplete Information on Remittance Procedures</u>. We found that program offices provided inconsistent information about where LEAs should remit interest payments. Six programs instructed LEAs to remit interest to CDE, while two programs instructed LEAs to remit directly to ED. Only one program informed LEAs that they should remit interest promptly and at least quarterly, as required by the regulation. The other programs did not address when or how often interest should be remitted.

- <u>Inconsistent Reporting Requirements and Instructions</u>. Three programs requested LEAs to report interest earned on FY 2005-06 funds in the program's year-end or grant close-out expenditure report. The Title II and Title III programs indicated that LEAs would be invoiced for any reported interest, while the Special Education Program instructed LEAs to include a payment for interest earnings when submitting the expenditure report. The remaining five programs did not have LEAs report interest earnings.

[21] State law requires the County Superintendent of Schools, who is the chief administrator of the COE, to disseminate the information to school districts in the county.

- Lack of Assurance that LEAs Report and Remit Interest Earnings. Even when LEAs are required to report interest earnings on expenditure reports, program offices have no assurance that LEAs will report the information. We identified six LEAs that did not report interest earnings on expenditure reports, even though our analyses of LEA cash reports determined that interest was earned. Four of the LEAs had not calculated interest earned on Federal cash balances. The remaining two LEAs incorrectly determined that one program had no interest earnings, and did not report interest earned in another program.

  The Federal interest requirement should be covered under each LEA's single audit, which is performed by an Independent Public Accountant (IPA) each year. Thus, CDE should be able to rely on the single audits to help assure LEAs remit interest earnings. However, single audits for some LEAs may not have addressed the issue. We found that IPAs for six of the nine LEAs did not report instances in which interest was earned but not remitted. The six LEAs earned interest in programs designated by the IPA as a major program. Such designation requires the IPA to perform specific compliance tests, including testing whether the LEA complied with the interest requirement.[22] Absent assurance that the LEAs' single audits cover the interest requirement, CDE should consider including steps to its categorical program monitoring process to review LEA compliance with the interest requirement.[23]

We found that seven of the nine LEAs we reviewed did not remit any interest earned in SFY 2005-06 on Federal cash balances for one or more of the four programs reviewed. We estimated that the seven LEAs should have remitted nearly $625,000 for the year. Estimated interest earnings for each LEA by program are listed in Enclosure 2.

LEAs Need Guidance on the Proper Method for Calculating and Frequency for Remitting Interest

As described earlier, cash received by an LEA from Federal, State, and other sources is deposited in a pooled investment account maintained by the County Treasurer. The investment account also includes cash received by county agencies and other school and local districts. Each County Treasurer distributes interest earned on its investments on a pro-rata basis to the local agencies participating in the investment pool. The interest earned is then allocated to the applicable participating funds, such as the General Fund, on a periodic basis. Under this process, an LEA cannot identify the interest earned on Federal cash balances in the General Fund because the fund contains amounts from Federal, State, and other sources. Thus, the LEA needs to calculate the Federal portion of its interest earnings in order to comply with the regulatory requirement to remit interest earned on Federal advances.

[22] OIG discussed this issue with the California State Controller's Office, which has primary responsibility for monitoring and assessing the quality of LEA single audits. In September 2008, the State Controller's Office issued its annual advisory providing information to assist IPAs in performing the SFY 2007-08 LEA audits, including the need for IPAs to address the Federal interest requirement when conducting LEA single audits.

[23] Under its categorical program monitoring process, CDE monitors LEAs for compliance with categorical program and fiscal requirements by conducting monitoring visits to each LEA every four years. Current monitoring procedures do not address LEA compliance with the Federal interest requirement.

CDE has not developed or communicated the proper method that LEAs should use to calculate interest earnings, has not specified the data that LEAs should use to perform these calculations, and has not routinely instructed LEAs to remit interest promptly and at least quarterly. Six of the nine reviewed LEAs did not calculate or remit any Federal interest earnings. The three LEAs that did remit interest, calculated their earnings incorrectly, remitted interest for SFY 2005-06 only once after the year had ended, and, in two cases, did not remit interest earned on cash advances for all Federal programs. Absent guidance from CDE, the three LEAs developed their own methodology for calculating interest. We found that the methodologies were generally inconsistent across the LEAs, although calculations were commonly by individual program. For the three LEAs that remitted interest, we identified the following seven errors:

- Actual Interest Earned Not Determined. When distributing interest to participating investors, State law requires the respective County Treasurer to calculate interest earned on the pooled investment account using the account's average daily balance. However, the three LEAs did not use average daily balance data to calculate interest earned on Federal cash balances. Instead, the LEAs calculated interest based on the month-end balances for individual programs and, as a result, only calculated estimates of the interest earned. Use of month-end balances may understate or overstate the actual interest earned by the LEA. Using average daily balances to calculate interest is the generally accepted method among financial institutions. This method provides a more accurate interest calculation than using month-end balances because it factors in the daily fluctuations in an LEA's cash balance resulting from cash receipts and disbursements.

  To illustrate the inaccuracy of the LEAs' method, we analyzed average daily cash balances that one LEA was able to provide for the Title I Program for two separate months. When compared to the interest calculated using average daily balances, our analysis found that estimates of monthly interest earnings using the LEA's month-end balances either overstated or understated the earnings for individual months because of the timing of cash receipts and disbursements during each month. We determined that using the month-end cash balances to calculate interest overstated this LEA's estimated interest earnings for July 2005 by nearly $6,600, and understated interest earnings by nearly $5,400 in June 2006.

  To determine actual interest earnings, LEAs should calculate interest earned on Federal cash advances using the same methodology used to calculate their overall interest earnings (i.e., average daily balance method). However, we recognize that some LEAs may not have the information available or capacity to determine average daily balances and, thus, using this method may not be feasible or may be cost prohibitive.

- Improper Netting of Interest. Two of the three LEAs inappropriately reduced the interest amount due to ED for SFY 2005-06. The LEAs calculated negative interest amounts in months in which the LEA did not have adequate program cash available to pay program costs (i.e., a cash shortfall existed at month-end). They combined the months with positive month-end cash balances with the months that had negative balances ("netting") to determine the amount of interest earned for the year. This practice reduced the interest earnings reported or remitted to CDE.[24]

Federal law and regulation do not contain provisions for compensating LEAs for the temporary use of cash from other available resources to pay program costs when program cash shortfalls exist. The two LEAs' practice of netting interest resulted in incorrect determinations that interest earnings for the SFY were zero (or negative). Fiscal staff at one LEA told us that they were not aware that the netting of interest was contrary to the Federal interest requirement. Fiscal staff at the other LEA stated that they netted interest to compensate for the interest earnings lost in its investment account caused by CDE not making Federal program funds available during all or part of the year.

- Incorrect Data Used. LEAs should use actual cash held in accounts at the County Treasury (Cash in County Treasury)[25] to perform interest calculations. They should not use expenditure data for interest calculations because expenditures include amounts that the LEAs have recognized as expenses but have not yet issued payments (i.e., accrued expenses). These recorded expenditures may not impact a program's cash account (cash disbursement) for weeks or even months. Use of expenditure data to calculate interest earnings would typically result in a lower amount of interest earned than if calculated on the Cash in County Treasury balance.

  Two of the three LEAs appropriately used cash data. However, the remaining LEA incorrectly used expenditure data to perform its calculations and remitted interest to CDE based on the incorrect data. When we reviewed Cash in County Treasury data provided by this LEA, we determined that its use of expenditure data understated interest earnings for the Title I Program by over 55 percent. Combined with other errors made by the LEA when calculating interest earnings, we estimated that it should have remitted about $59,000 for the Title I Program rather than the $33,113 it did remit for SFY 2005-06.[26]

- Inappropriate Interest Rate Used. Because Federal regulation requires LEAs to "remit interest earned on advances," LEAs should use the actual rate earned on funds held in their respective County Treasurer's investment pool. We found that two of the three LEAs used an incorrect rate to perform their SFY 2005-06 interest calculations. To calculate interest earnings, fiscal staff at the two LEAs used the estimated fourth-quarter interest rate provided by the COE because the actual rate was not available at year-end when the LEA closed its books. The estimated rate happened to be the same as the actual third-quarter rate that year. When the actual fourth-quarter became available, the LEAs should have used the actual rate to adjust their calculations and remitted any additional interest, if applicable. Since the estimated rate used was lower than the actual rate, the two LEAs underestimated the amount earned.

[24] The third LEA that had remitted interest did not reduce interest earnings by negative monthly amounts in SFY 2005-06, but informed us that the LEA began netting interest in SFY 2006-07 after consulting with its IPA.

[25] The CSAM defines "Cash in County Treasury" as a balance sheet account for cash balances on deposit in the County Treasury for the various funds of the LEA.

[26] The LEA also incorrectly used expenditure data to calculate and remit interest for the ESEA Title II Part D Education Technology Program in SFY 2005-06.

- Payments Not Remitted Quarterly. Federal regulation states that LEAs are to remit interest "promptly, but at least quarterly." The three LEAs only remitted once for interest earned during SFY 2005-06.

- Interest Earnings Not Remitted on All Federal Programs. One of the three LEAs had procedures to calculate and remit interest earned on advances across all Federal programs as part of its SFY 2005-06 year-end fiscal closing process. However, the other two LEAs did not remit interest for all the Federal education programs in which the LEAs had earned interest.

  One of the two LEAs calculated interest earnings for each Federal program, but only remitted interest if it received an invoice from CDE. The LEA had reported interest earnings for its Title III Program on an expenditure report and subsequently remitted the interest upon receipt of the invoice. Since it had not received any other invoices from CDE, the LEA did not remit interest earned for other Federal programs, despite having calculated these amounts. We estimated that the LEA should have remitted nearly $12,000 for interest earned in SFY 2005-06 for three of the four programs we reviewed in detail.

  The other LEA only remitted interest for two Federal programs that had single audit findings for SFY 2005-06, even though the LEA had determined that interest was earned on other Federal programs. Combined with other errors the LEA made when calculating interest earnings, we estimated that the LEA should have remitted over $87,000 more for the four reviewed programs.

- Calculation Error. One LEA miscalculated the amount of interest earned on multiple programs by using the incorrect number of days in some months when the LEA computed the interest rate to apply to the month-end cash balances. In addition, the LEA understated the Title I ending cash balance for June 2006. In conjunction with its use of an incorrect rate in the fourth-quarter of SFY 2005-06, these errors resulted in an estimated underpayment of interest of about $16,000 for the four reviewed programs.

To ensure that LEAs calculate interest correctly and promptly remit interest earned on all Federal cash advances, CDE needs to provide guidance to LEAs that addresses the noted deficiencies. CDE should also include steps to confirm LEA compliance with the interest requirement when it performs its periodic categorical program monitoring visits to LEAs since IPAs may not be covering the requirement in LEA single audits.

We estimated that the nine reviewed LEAs earned Federal interest totaling about $937,000 in SFY 2005-06 for the four reviewed programs. Only two LEAs remitted interest totaling $208,581, or about 22 percent of the total estimated amount due from the nine LEAs.[27] We estimated that the nine LEAs owe ED about $729,000 resulting from their incorrect calculations or failure to calculate or remit interest. Our estimate of interest earnings for the nine LEAs and our calculation methodology can be found in Enclosure 2.

[27] Interest remitted by a third LEA was for the Title III Program, which we did not review in detail at the LEA.

County Offices of Education Could Help CDE Implement Cash Management Procedures and Ensure LEAs Comply with Interest Requirement

There are 58 COEs statewide, which are required by California State law to provide fiscal oversight of school districts within their respective county. With about 1,000 school districts statewide, COEs could help CDE implement cash management procedures (addressed in Finding No. 1) and ensure LEA compliance with the Federal interest requirement. Instead of collecting information on cash balances and interest remittances from school districts separately, CDE should consider exploring the capacity of COEs to assist in these efforts.

COEs Have Access to Cash Data for Many LEAs

Our work in three counties found that the COEs can either extract cash data from many school districts' accounting systems, or request districts to provide the desired data. Collecting the data from the COEs would ease the administrative burden on school districts and provide information CDE can use to assess LEAs' immediate cash needs prior to disbursing Federal cash advances. Information on LEA cash balances would also help CDE to monitor whether LEAs remit interest earned on the balances, as required by regulation.

COEs Could Help LEAs Identify and Remit Federal Interest Earnings

An OIG audit in Los Angeles USD, as well as our current work at CDE and selected LEAs, identified the following three ways that COEs may be able to help CDE ensure that LEAs comply with the Federal interest requirement:

- <u>Actual Interest Earned on Federal Cash Balances</u>. COEs may be able to help LEAs identify actual interest earned on Federal cash balances. As addressed in our audit report on Los Angeles USD's procedures for calculating interest,[28] the respective COE's financial reporting system allows educational agencies within the County to use subfunds within their General Fund to separately identify the cash balances for Federal programs as long as non-Federal programs are not included in the same subfund. There is no regulatory or ED requirement that requires states or LEAs to return interest earned on Federal funds on a program-by-program or grant-by-grant basis. Under the subfund concept, COE reports could contain the information LEAs need to determine and remit the actual interest earned on all Federal cash advances.

- <u>Consolidation of LEA Interest Remittances</u>. CDE could explore the feasibility of having the COE consolidate interest earnings for the LEAs within their jurisdiction and remit interest earnings on the LEAs' behalf. Our review of LEA interest payments statewide found that some LEAs sent separate checks for individual programs, and other LEAs included payments for multiple programs in a single check. Consolidating interest payments at the COE would reduce the volume of interest remittances to CDE, as well as

[28] *Los Angeles Unified School District's Procedures for Calculating and Remitting Interest Earned on Federal Cash Advances* (ED-OIG/A09H0019, December 2, 2008).

the administrative burden associated with processing and remitting interest payments to ED.

- LEA Certification of Compliance with Interest Requirement. CDE could require LEAs to confirm that they have the proper procedures in place and are remitting interest as required by Federal regulation. To ensure consistency and coverage of all Federal programs, the annual financial report that LEAs submit to their COE may be an appropriate mechanism for LEA certification.[29]

Recommendations

We recommend that the Chief Financial Officer require CDE to—

2.1 Clearly and consistently communicate the Federal interest requirement at 34 C.F.R. § 80.21(i) to LEAs, and reinforce the requirement's applicability to all Federal education programs. To ensure they receive consistent and complete information across programs, CDE should also include appropriate information on the interest requirement in its accounting and/or financial management guidance distributed to LEAs, such as in the *California Schools Accounting Manual*.

2.2 Develop and disseminate guidance to LEAs on the proper method for calculating and frequency for remitting interest. To ensure that LEAs calculate interest correctly and remit interest earned on all Federal cash advances promptly, the guidance should include instructions specifying that (1) the netting of interest is not allowed, (2) interest should be calculated using Cash in County Treasury data, and (3) interest must be remitted promptly and at least quarterly in accordance with the applicable regulations.

2.3 Ensure that the nine reviewed LEAs (1) correct the noted deficiencies, (2) calculate interest on Cash in County Treasury correctly, and (3) remit interest earned in SFY 2005-06 and in subsequent years across all Federal education programs. We estimated that these LEAs owe ED about $729,000 for interested earned in SFY 2005-06 for the four programs reviewed in detail, as shown in Enclosure 2.

2.4 Ensure that all LEAs within the State have calculated interest correctly and remitted interest earned in SFY 2005-06 and in subsequent years across all Federal education programs. CDE could work with the California State Controller's Office to ensure the LEAs' next single audit addresses LEA compliance with the Federal interest requirement, including correct interest calculations for all Federal cash advances and remittances for

[29] State education law requires each school district to submit an annual financial statement of the district's receipts and expenditures for the preceding SFY to the respective COE by September 15. After verifying the mathematical accuracy of the districts' statements, the COE must transmit a copy of the financial statements to CDE by October 15.

interest earned in SFY 2005-06 and subsequent years. We estimated that LEAs earned about $11 million in interest statewide in SFY 2005-06 for the Title I Program alone.[30]

2.5 Absent assurance of adequate single audit coverage, include steps in its categorical program monitoring process to review LEA compliance with the interest requirement, including the LEAs' methodology for computing interest earnings. To review compliance across all Federal programs, CDE could add appropriate procedures to the cross-cutting section of its monitoring protocol.

We further recommend that the Chief Financial Officer encourage CDE to—

2.6 Explore the potential for enlisting the assistance of COEs and their capacity to collect cash data to help CDE implement cash management procedures and ensure LEA compliance with the Federal interest requirement. COEs could facilitate and ease the administrative burden associated with collecting cash information on cash balances, identifying interest earnings, and processing interest remittances.

CDE Comments and OIG Response

In addition to the overall comments summarized at the end of Finding No. 1, CDE provided comments and described the corrective actions already taken or planned for each of our recommendations in this finding. Where we believe the stated corrective actions did not sufficiently address a recommendation, we provide our response below. We have not modified our recommendations based on CDE's comments.

- Recommendation 2.1. CDE identified three corrective actions already taken or to be considered. First, CDE referred to the Federal interest requirements included as standard language in various program funding correspondence, as noted in our report. Second, on December 24, 2008, CDE finalized a written communication on the applicability of the Federal requirements for interest earned on Federal funds to further remind LEAs to calculate interest correctly and remit interest earned on Federal cash advances promptly. Third, CDE plans to explore incorporating references to the Federal interest requirement in other written guidance, such as CSAM and the audit guide used by IPAs conducting single audits of LEAs.

  OIG Response: In addition to the second and third corrective actions above, CDE needs to ensure that the Federal interest requirements included as standard language in program funding correspondence is consistent and complete across all programs. Based on deficiencies noted in our review, some programs will need to modify their correspondence to convey consistent information on where and how often to remit interest. The program funding correspondence should be consistent with the information in CDE's written correspondence of December 24, 2008, regarding interest earned on Federal funds.

[30] We estimated statewide interest earnings for the Title I Program by multiplying the FY 2005-06 Title I allocations for all LEAs statewide ($1,652,080,458) by the "composite interest earnings percentage" derived for the nine LEAs reviewed. To obtain the "composite interest earnings percentage," we divided the total interest earnings that we estimated for the nine LEAs ($858,152) by the total FY 2005-06 Title I allocations for the same nine LEAs ($134,306,028). CDE records did not always identify the program or applicable SFY associated with LEA interest remittances. As a result, our statewide interest estimate has not been adjusted for interest earnings that LEAs have already remitted to CDE.

- Recommendation 2.2. CDE stated that its December 24, 2008, correspondence on interest earned on Federal funds: (1) specifies the Federal interest requirements; (2) prohibits reducing or offsetting Federal interest earnings for the temporary use of non-Federal cash resources for Federal programs (netting); and (3) advises school district and charter school business officials to coordinate with their COEs in developing internal controls and a sound methodology to, at least quarterly, calculate and return interest over $100 to the U.S. Treasury via CDE.

  OIG Response: In addition to the above corrective action, CDE needs to provide more detailed guidance to LEAs and COEs on appropriate methodologies for calculating interest earned on Federal funds. The guidance should articulate standards applicable to all LEAs. For example, interest should be calculated using Cash in County Treasury data, the correct interest rate, and the appropriate number of days in the calculation period. While three reviewed LEAs and our estimates of interest earnings used month-end cash balances, average daily balance data (if available) would provide a more accurate interest calculation. Moreover, internal controls should include steps to ensure that LEA interest calculations are accurate and interest is remitted timely.

- Recommendation 2.3. CDE plans to follow up with the nine reviewed LEAs on the corrective actions taken to address our reported deficiencies. Follow-up will include obtaining from the LEAs: (1) specific corrective actions taken; (2) interest calculation methodologies used; and (3) the amount of interest due and remitted for SFYs 2005-06 through 2008-09.

- Recommendation 2.4. CDE stated that it is exploring and considering the feasibility of options within limited available resources, including developing new single audit procedures, to obtain assurance that LEAs properly calculated and remitted interest on Federal funds during SFY 2005-06 and subsequent years across all Federal education programs. CDE also cited its correspondence of December 24, 2008, regarding interest earned on Federal funds, as a corrective action to ensure LEAs correctly calculate interest earnings.

- Recommendation 2.5. CDE plans to develop and implement fiscal review processes that will strengthen the cross-cutting funding dimensions of categorical program monitoring and ensure LEAs are in compliance with Federal interest requirements. CDE is also considering new cash management monitoring during SFY 2008-09 that will entail high-level verification of LEAs' reported quarterly Federal cash balances. If significant amounts of unspent Federal program funds are identified through this process, the sub-recipient may be required to: (1) submit a disbursement plan with the timeline for spending the funds on hand; (2) explain the need for additional funding; and (3) communicate the disposition of interest earned on unspent program funds.

- Recommendation 2.6. CDE cited its written communication of December 24, 2008, encouraging district and charter school officials to coordinate with their COEs in developing internal controls and sound methodologies to calculate and return, at least quarterly, interest earned in excess of $100 on Federal program funds.

OIG Response: We believe that CDE needs to be more proactive in exploring the potential for COE involvement in cash management activities. In addition to encouraging LEAs to coordinate with their respective COE, CDE could solicit input and suggestions from all COEs about their capacity to collect cash data and assist LEAs throughout their respective counties in determining and remitting interest earned on Federal cash balances. CDE could also collect and disseminate information on best practices, such as in Los Angeles County where the COE's financial reporting system allows educational agencies within the county to use subfunds to separately identify cash balances for Federal programs.

We have not modified the finding, except to update our interest estimates based on corrected Title I cash balance data provided by one LEA.

OBJECTIVES, SCOPE, AND METHODOLOGY

The purpose of the audit was to review CDE's process for disbursing Federal education funds to LEAs. Our audit objectives were to: (1) determine whether CDE's method for disbursing funds to LEAs complies with applicable Federal laws, regulations, and other cash management requirements; and (2) assess the impact that CDE's disbursement method has on the amount of Federal cash on hand at LEAs, including the use of cash from other resources to pay Federal education program costs and the earning of interest on Federal cash balances. Our audit focused on FY 2005-06 funding for eight Federal programs that were among the nine largest Federal elementary and secondary education programs, based on CDE grant amounts received during SFY 2005-06.[31] The eight programs were authorized by three statutes. The following list includes the Catalog of Federal Domestic Assistance number and abbreviated program name:

- Elementary and Secondary Education Act of 1965, as amended (ESEA)
  - Title I, Part A, Basic Grants to LEAs (84.010 Title I)
  - Title I, Part B, Subpart 1, Reading First State Grants (84.357 Reading First)
  - Title II, Part A, Improving Teacher Quality State Grants (84.367 Title II)
  - Title III, English Language Acquisition State Grants (84.365A Title III)
  - Title IV, Part A, Safe and Drug-Free Schools and Communities: State Grants (84.186 Title IV)
  - Title IV, Part B, 21st-Century Community Learning Centers (84.287 21st CCLC)
- Individuals with Disabilities Education Act, as amended (IDEA)
  - Part B, Special Education—Grants to States (84.027 Special Education)
- Carl D. Perkins Vocational and Technical Education Act of 1998 (Perkins Act)
  - Vocational Education—Basic Grants to States (84.048A Vocational Education)

To address our audit objectives at the State level, we interviewed CDE program and fiscal administrators and staff responsible for (1) overseeing each of the eight reviewed programs and making LEA funding decisions, (2) releasing LEA funding results to the State Controller's Office for payment, and (3) processing and remitting LEA interest payments to ED. We also interviewed CDE fiscal and audit managers, as well as representatives from the California Department of Finance and the Legislative Analyst's Office, about the State budget process as it relates to the disbursement of Federal education funds to LEAs. We assessed CDE internal controls (policies, procedures, and guidance provided to LEAs) regarding each program's (1) method and schedule for disbursing Federal funds, (2) activities to assess LEA funding needs prior to disbursements, and (3) efforts to ensure LEAs remit interest earned on Federal funds. We also assessed CDE policies and procedures for the receipt, processing, and remittance of LEA interest payments to ED.

[31] Source: *State of California: Internal Control and State and Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2006* (single audit report).

To gain an understanding of the breadth of cash management issues at CDE, we reviewed State of California single audit reports for SFY 2002-03 through SFY 2006-07. We also coordinated our efforts with ED's Risk Management Team, which has been working with CDE on these issues for several years. To further understand CDE procedures for disbursing FY 2005-06 Federal funds, we reviewed the auditors' working papers that describe CDE internal controls for four of our reviewed programs (Special Education, Title I, Title II, and Title III) and support cash management findings on the three ESEA programs. Based on our State-level work, we selected the Title I, Title II, Title IV, and Special Education programs for more detailed work at the local level. The four programs represent a mix of programs that had and had not implemented procedures to assess LEA funding needs prior to CDE's disbursement of FY 2005-06 funds. The programs also provide a mix of other risk factors and attributes, including (1) the number of subgrantees, (2) elapsed time between the start of the SFY and the first disbursement date, (3) single audit coverage and cash management findings, and (4) CDE designation of the funding process as an apportionment or grant.

At the local level, we judgmentally selected Fresno, Los Angeles, and Sacramento Counties, which were among the largest counties in California based on 2005-06 enrollment. These counties also included a significant number of school districts of diverse size within county boundaries, and were located in different regions of the State.

Within each county, we judgmentally selected two to three school districts that participated in the four programs selected for more detailed review. The eight selected districts represent a mix of (1) enrollment size relative to other school districts in the county, (2) membership in a single- or multi-district SELPA, (3) positive and negative program cash balances from COE data where available, (4) overall financial condition from fiscal reports submitted to the State Controller's Office, and (5) interest remittances to CDE or lack thereof. We also selected an additional school district for a focused review of the Title I Program because COE records indicated that the district had significant balances of program cash on hand and CDE records indicated the district had not remitted any interest. We excluded from our LEA selection universe the COE, charter school LEAs, and school districts under State receivership. Additionally, we excluded the Los Angeles USD where the OIG was conducting a separate audit of the district's method for calculating interest earned on Federal cash advances. To solicit LEA officials' views on a change in the disbursement method for the Vocational Education Program subsequent to our audit period, we included unified and high school districts in the universe and excluded elementary school districts. Based on the factors described above, we selected for local-level work the nine school districts listed in the table below.

LEAs Selected for Local-Level Work			
LEA (Geographic Location)	**2005-06 Enrollment**	**No. of Districts in County or LEA Size**	**Special Education Local Planning Area Membership**
Fresno County (Central California)			
Countywide Totals	192,528	35	
Fresno USD	79,046	Large	Single-district SELPA
Parlier USD	3,867	Medium	Member of Fresno County SELPA
Sierra USD	2,435	Small	Member of Fresno County SELPA
Los Angeles County (Southern California)			
Countywide Totals	1,708,064	86	
Long Beach USD	93,589	Large	Single-district SELPA
Glendale USD	28,002	Medium	Administrative unit for Foothills SELPA
Sacramento County (Northern California)			
Countywide Totals	239,026	17	
Elk Grove USD	60,735	Large	Single-district SELPA
Center USD	6,112	Medium	Member of Sacramento County SELPA
Galt Joint Union HSD	2,251	Small	Member of Sacramento County SELPA
Sacramento City USD (a)	50,408	Large	Not applicable
(a) Selected for focused review of the Title I Program only.			

At each county, we interviewed COE fiscal staff about the COE's role and responsibilities regarding CDE's disbursement of Federal funds to LEAs, interest earnings on Federal education funds, the availability of countywide data on LEA cash balances for Federal education programs, and the overall financial condition of LEAs within county boundaries. We also interviewed County Treasurer officials in Fresno and Sacramento Counties on these same topics. We did not contact the Los Angeles County Treasurer because we had obtained sufficient information from the COE.

At eight LEAs, we interviewed LEA program administrators and staff responsible for overseeing the four programs selected for more detailed review and the Vocational Education Program. We also interviewed fiscal staff responsible for accounting for the receipt and disbursement of, and calculation of interest earned on, Federal funds. We solicited LEA officials' views on the fiscal and programmatic impact of CDE's methods for disbursing Federal funds, and the change from the advance payment method to reimbursement for the Vocational Education Program. We analyzed monthly cash reports generated by the LEA's accounting system for SFY 2005-06 to assess the fiscal impact of CDE disbursements (timing and amounts) on program cash balances. For the four school districts that are members of multi-district SELPAs, we performed similar work at the applicable SELPA that is the LEA for the Special Education Program (Fresno COE for Parlier USD and Sierra USD, and Sacramento COE for Center USD and Galt Joint Union HSD). At Sacramento City USD, our work was focused only on the Title I Program.

We assessed the reliability of computer-generated data at CDE and concluded that the data were sufficiently reliable to use for (1) assessing disbursement schedules for FY2005-06 funding, (2) identifying our LEA universe and selecting LEAs for local level work, and (3) testing CDE internal controls for processing and remitting LEA interest payments to ED. Specifically, we assessed statewide data files that the CDE program office and/or School Fiscal Services Division provided in support of funding decisions for the eight reviewed programs by performing the following three steps. First, we verified the disbursement schedule (dates and percent of LEA entitlement or grant award released in each disbursement) with information provided by program and School Fiscal Services Division officials during interviews and in written policies, procedures, and guidance to LEAs. Second, we confirmed that the data provided by both the program office and School Fiscal Services Division were consistent, where applicable. Third, we confirmed that the data were consistent with funding results published on CDE's website, where applicable. We also assessed the statewide interest payments database maintained by CDE's Accounting Office. We verified that CDE had received and processed interest payments identified by the nine selected LEAs and Los Angeles USD as having been remitted to CDE between July 1, 2005 and the time of our review. We also verified that ED had received the checks covering all LEA interest payments, which CDE records indicated were remitted to ED between October 2006 and August 2007. At the selected LEAs, we also confirmed CDE's disbursement dates and amounts for the four programs reviewed in more detail. We also confirmed LEA-reported expenditures, which CDE program offices used to assess LEA funding needs prior to disbursement of Title II and Special Education program funds.

At each selected LEA, we assessed the reliability of SFY 2005-06 cash data that the LEA had extracted from its accounting system by verifying Federal revenue amounts and receipt dates during the year for the four reviewed programs. We did not confirm the accuracy of beginning cash balances for the year or expenses on the monthly cash reports. Based on our assessment, we concluded that the data were sufficiently reliable for use in describing the fiscal impact of CDE's disbursement methods and estimating interest earnings on cash balances.

We performed our on-site work at CDE headquarters in Sacramento, as well as County and district offices in Sacramento County (Sacramento, Antelope, Elk Grove, and Galt), Fresno County (Fresno, Parlier, and Prather), and Los Angeles County (Downey, Glendale, and Long Beach), California. We held an exit briefing with CDE officials on July 29, 2008. We conducted this performance audit in accordance with generally accepted government auditing standards appropriate to the scope of the review described above.

Enclosure 1: CDE Disbursement and Cash Management Procedures for FY 2005-06 Funding for Eight Programs

For the eight programs reviewed, CDE used an advance payment method to disburse FY 2005-06 Federal program funds to LEAs. For each program, this enclosure provides information on: (1) CDE's funding process (apportionments or grants); (2) amount of FY 2005-06 Federal funding available for pass-through to LEAs; (3) number of LEA subgrantees; (4) funding period (beginning and ending dates of the LEA subgrant); (5) period that the funds remained available for LEA use;[32] (6) disbursement schedule, including the number of disbursements, whether CDE had procedures to assess LEA funding needs prior to disbursement and an applicable procedure number, proportion of LEA's entitlement or grant award disbursed, and disbursement dates; and (7) if applicable, program office procedures for reviewing LEA-reported expenditure or attendance data (procedure number corresponds to the procedure number shown in the disbursement schedule).

ESEA, Title I, Part A, Basic Grants to LEAs (84.010 Title I)			
Funding Process:	Apportionments		
Federal Funding Available for Pass-Through:	$1,687,716,960		
Number of LEA Subgrantees:	1,156		
Funding Period:	7/1/2005 to 9/30/2006 (15 months)		
Period of Availability:	7/1/2005 to 9/30/2007 (27 months)		
Disbursement Schedule:	**Apportionment No.**	**Percent of LEA Entitlement**	**CDE Disbursement Date**
For Most LEAs (3 disbursements)	1	40%	11/16/2005
	2	40%	3/29/2006
	3	20% Final Disbursement	6/2/2006
For Small No. of LEAs (1 disbursement)	4	100%	9/15/2006
	5	100%	3/15/2007
Procedures to Assess LEA Funding Needs Prior to Disbursement:	None.		

[32] Under the "Tydings Amendment," § 421(b) of the General Education Provisions Act, 20 U.S.C. § 1225(b), any funds not obligated and expended during the period for which they were awarded become carryover funds and may be obligated and expended during the succeeding fiscal year. For the program information presented in this enclosure, a period of availability that was greater than the funding period is due to the LEA being able to carry over program funds for use in the next fiscal year under the "Tydings Amendment." For each program, CDE determined both the funding period and the period the funds remained available for LEA use.

<table>
<tr><th colspan="5">ESEA, Title I, Part B, Subpart 1, Reading First State Grants
(84.357 Reading First)</th></tr>
<tr><td>Funding Process:</td><td colspan="4">Grants</td></tr>
<tr><td>Federal Funding Available for Pass-Through:</td><td colspan="4">$145,274,000</td></tr>
<tr><td>Number of LEA Subgrantees:</td><td colspan="4">121 (all cohorts) (a)</td></tr>
<tr><td>Funding Period:</td><td colspan="4">For Cohort No. 3: 7/1/2005 to 8/31/2006 (14 months)</td></tr>
<tr><td>Period of Availability:</td><td colspan="4">For Cohort No. 3: 7/1/2005 to 8/31/2007 (26 months)</td></tr>
<tr><td>Disbursement Schedule:
(4 disbursements)</td><td>Payment No.</td><td>Procedure to Assess LEA Funding Need</td><td>Percent of LEA Grant Award</td><td>CDE Disbursement Date</td></tr>
<tr><td rowspan="6">For Most Cohort No. 3 LEAs</td><td>1 – Batch 1</td><td>None</td><td>25%</td><td>10/29/2005</td></tr>
<tr><td>2 – Batch 1</td><td>(1)</td><td>25%</td><td>5/22/2006</td></tr>
<tr><td>3 – Batch 2</td><td rowspan="3">(2)</td><td rowspan="3">25%</td><td>6/21/2006</td></tr>
<tr><td>3 – Batch 3</td><td>8/8/2006</td></tr>
<tr><td>3 – Batch 4</td><td>9/6/2006</td></tr>
<tr><td>4 – Batch 8</td><td>(3)</td><td>25%
Final Disbursement</td><td>3/30/2007</td></tr>
<tr><td>Procedures to Assess LEA Funding Needs Prior to Disbursement:</td><td colspan="4">The program office processed disbursements in batches (per Batch No.) based on when LEAs submitted required documents. Delays in LEA submission delayed the LEA’s next disbursement. Batch numbers above correspond to disbursements for Cohort No. 3 LEAs.

<u>Program funding threshold</u>: An LEA must have actually expended 75 percent of funds previously advanced to receive its next disbursement. LEA funding needs were not assessed prior to the first disbursement (Payment No. 1).
(1) To receive a second disbursement, an LEA must have met the funding threshold based on actual expenditures as of 2/28/2006, as reported on its 1st Interim Expenditure Report due March 2006; when the threshold was met, the LEA received a disbursement (Payment No. 2).
(2) To receive a third disbursement, an LEA must have met the funding threshold based on actual expenditures as of 6/30/2006, as reported on its 2nd Interim Expenditure Report due July 2006; when the threshold was met, the LEA received a disbursement (Payment No. 3, Batches 2 through 4).
(3) To receive its final disbursement, an LEA must have met the funding threshold based on actual expenditures as of 8/31/2006, as reported on its End of Year Expenditure Report due when the grant award has been expended but no later than September 2006; when the threshold was met, the LEA received a final disbursement up to 25 percent of its grant award based on final expenditures (Payment No. 4).</td></tr>
<tr><td colspan="5">(a) At the time of our review, CDE had awarded three-year Reading First grants to LEAs in four cohort groups. The beginning of each cohort’s funding cycle was different, ranging from June 1 to September 1. We limit our presentation to the LEAs in Cohort No. 3 and the disbursement schedule applicable to most of these LEAs. Cohort No. 3 LEAs were in the second year of their grant, and the start of their funding cycle corresponded to the beginning of the SFY.</td></tr>
</table>

ESEA, Title II, Part A, Improving Teacher Quality State Grants (84.367 Title II)				
Funding Process:	Apportionments			
Federal Funding Available for Pass-Through:	$324,382,000			
Number of LEA Subgrantees:	1,207			
Funding Period:	7/1/2005 to 9/30/2006 (15 months)			
Period of Availability:	7/1/2005 to 9/30/2007 (27 months)			
Disbursement Schedule: (3 disbursements for Group A LEAs, and 2 disbursements for Group B LEAs)	**Apportionment No.**	**Procedure to Assess LEA Funding Need**	**Percent of LEA Entitlement**	**CDE Disbursement Date**
For Group A LEAs	1	(1)	40%	3/21/2006
	2	None	40%	1/18/2007
For Group B LEAs (most LEAs)	3	(2) None	80%	3/15/2007
For Groups A and B LEAs	4	(3)	20% Final Disbursement	6/6/2007
For some LEAs	5	(4)	Various % Final Disbursement	9/17/2007
Procedures to Assess LEA Funding Needs Prior to Disbursement:	Program funding threshold: An LEA must have expended or encumbered 80 percent of its prior-year entitlement, or funds received to date, to receive some disbursements. (1) An LEA must have met the funding threshold based on year-to-date expenditures and encumbrances related to its prior-year entitlement, as reported on the 2005-06 ConApp Part I due 6/30/2005 and Part II due 1/31/2006; if the threshold was met, the LEA received its first disbursement (Apportionment No. 1) and automatically received its second disbursement (Apportionment No. 2). (Group A LEAs) (2) If the funding threshold was not met during the initial assessment (Group B LEAs), the procedure was to review year-to-date expenditures and encumbrances related to the LEA's prior-year entitlement, as reported on the next ConApp; if the threshold was met, the LEA would receive its first disbursement (Apportionment No. 3). For FY 2005-06, the program office did not follow its procedure for the Group B LEAs because of staff turnover and over a year having passed since the Group A LEAs had received Apportionment No. 1. (3) To receive its final disbursement, an LEA must have met the funding threshold based on expenditures and encumbrances as of 3/31/2007 for funds received to date, as reported on the 2006-07 ConApp Part II due 1/31/2007; if the threshold was met, the LEA received a final disbursement (Apportionment No. 4). (Groups A and B LEAs) (4) If the funding threshold was not met, the program office reviewed expenditures and encumbrances as of 9/30/2007 for funds received to date, as reported on the subsequent ConApp (2007-08 ConApp Part I due 6/30/2007); if the threshold was met, the LEA received its final disbursement (Apportionment No. 5). Percent of LEA's entitlement disbursed varied, depending on the amount of funds received to date.			

ESEA, Title III, English Language Acquisition State Grants (84.365A Title III)				
Funding Process:	Apportionments			
Federal Funding Available for Pass-Through:	$150,550,536			
Number of LEA Subgrantees:	587			
Funding Period:	7/1/2005 to 9/30/2006 (15 months)			
Period of Availability:	7/1/2005 to 9/30/2007 (27 months)			
Disbursement Schedule:	**Apportionment No.**	**Procedure to Assess LEA Funding Need**	**Percent of LEA Entitlement**	**CDE Disbursement Date**
For Most LEAs (3 disbursements)	1	(1)	40%	6/8/2006
	2	none	40%	6/20/2006
	3	(2)	20% Final Disbursement	9/15/2006
For Small No. of LEAs	4	(3)	Various % Final Disbursement	3/29/2007
For Small No. of LEAs	5	(4)	Various % Final Disbursement	9/7/2007
Procedures to Assess LEA Funding Needs Prior to Disbursement:	<u>Program funding threshold</u>: An LEA must have expended or encumbered 80 percent of its prior-year entitlement, or funds received to date, to receive some disbursements. (1) An LEA must have met the funding threshold based on year-to-date expenditures and encumbrances related to its prior-year entitlement, as reported on the 2005-06 ConApp Part I due 6/30/2005; if the threshold was met, the LEA received its first disbursement (Apportionment No. 1) and automatically received its second disbursement (Apportionment No. 2). (2) To receive its final disbursement, an LEA must have met the funding threshold based on expenditures and encumbrances as of 6/30/2006 related to funds received to date, as reported on the program's End of Year Expenditure Report due on or before 10/1/2006; if the threshold was met, the LEA received a final disbursement (Apportionment No. 3). (3) If the funding threshold was not met during program office reviews in (1) and/or (2) above, an LEA must have met the funding threshold related to its prior-year entitlement and FY 2005-06 funds received to date (if any), as reported on the program's Interim Expenditure Reports or subsequent End of Year Expenditure Report; if the threshold was met, the LEA received a disbursement (Apportionment No. 4). Percent of LEA's entitlement disbursed varied, depending on the amount of funds received to date. (4) If the funding threshold was not met during previous reviews above, the program office reviewed expenditures and encumbrances reported on Interim Expenditure Report or subsequent End of Year Expenditure Report; if the threshold was met, the LEA received a final disbursement (Apportionment 5). Percent of LEA's entitlement disbursed varied, depending on the amount of funds received to date.			

ESEA, Title IV, Part A, Safe and Drug-Free Schools and Communities: State Grants (84.186 Title IV)			
Funding Process:	Apportionments		
Federal Funding Available for Pass-Through:	$39,240,725		
Number of LEA Subgrantees:	1,016		
Funding Period:	7/1/2005 to 9/30/2006 (15 months)		
Period of Availability:	7/1/2005 to 9/30/2007 (27 months)		
Disbursement Schedule: (2 disbursements for most LEAs)	**Apportionment No.**	**Percent of LEA Entitlement**	**CDE Disbursement Date**
For Most LEAs	1	40% First Disbursement	4/18/2006
For Some LEAs	2	40% First Disbursement	6/2/2006
For Most LEAs	3	60% Final Disbursement	6/19/2006
For Some LEAs	4	60% or 100% Final Disbursement	10/12/2006
For Small No. of LEAs	5	60% or 100% Final Disbursement	12/22/2006
For Small No. of LEAs	6	60% or 100% Final Disbursement	6/13/2007
Procedures to Assess LEA Funding Needs Prior to Disbursement:	None. To receive a disbursement, an LEA must have met program requirements, such as program approval to carry over prior-year funds in excess of statutory limit, and having no outstanding billing requests. Delays in meeting program requirements would delay the LEA's first or final disbursement.		

ESEA, Title IV, Part B, 21st-Century Community Learning Centers (84.287 21st CCLC)				
Funding Process:	Grants			
Federal Funding Available for Pass-Through:	$123,038,972			
Number of LEA Subgrantees:	216			
Funding Period:	7/1/2005 to 12/31/2006 (18 months)			
Period of Availability:	7/1/2005 to 12/31/2006 (18 months)			
Disbursement Schedule: (6 disbursements)	**Payment No.**	**Procedure to Assess LEA Funding Need**	**Percent of LEA Grant Award**	**CDE Disbursement Date**
For Most LEAs	1 – Batches 1 and 2	None	15% Administrative Entitlement	11/18/2005
	2 – Batches 1 and 2	(1)	First Quarter Attendance	11/18/2005
	2 – Batches 3 and 4			12/9/2005

ESEA, Title IV, Part B, 21st-Century Community Learning Centers (84.287 21st CCLC)				
	3 – Batch 1	(2)	Second Quarter Attendance	2/14/2006
	4 – Batch 1	(3)	Third Quarter Attendance	5/12/2006
	5 – Batch 1	(4)	Fourth Quarter Attendance	8/7/2006
	5 – Batch 2			8/21/2006
	6 – Batch 1	(5)	Up to 10% Final Disbursement	3/29/2007
Procedures to Assess LEA Funding Needs Prior to Disbursement:	The program office processed disbursements in batches (per Batch No.) based on when LEAs submitted required documents. Delays in LEA submission delayed the LEA's next disbursement. LEA funding needs were not assessed prior to the first disbursement (Payment No. 1, Batches 1 and 2). (1) To receive a second disbursement, an LEA must have reported the actual number of students served for the period 7/1/2005 to 9/30/2005 in its 1st Quarter Attendance Report due 10/31/2005; the LEA was reimbursed for program services provided to students based on actual attendance multiplied by a State-legislated per pupil amount (PPA) (Payment No. 2, Batches 1 through 4). (2) To receive a third disbursement, an LEA must have reported actual attendance for the period 10/1/2005 to 12/31/2005 in its 2nd Quarter Attendance Report due 1/31/2006; the disbursement amount was based on actual attendance multiplied by the PPA (Payment No. 3). (3) To receive a fourth disbursement, an LEA must have reported actual attendance for the period 1/1/2006 to 3/31/2006 in its 3rd Quarter Attendance Report due 4/30/2006; the disbursement amount was based on actual attendance multiplied by the PPA (Payment No. 4). (4) To receive a fifth disbursement, an LEA must have reported actual attendance for the period 4/1/2006 to 6/30/2006 in its 4th Quarter Attendance Report due 7/31/2006; the disbursement amount was based on actual attendance multiplied by the PPA (Payment No. 5, Batches 1 and 2). (5) To receive its final disbursement, an LEA must have reported actual and legally obligated expenditures for the period 7/1/2005 to 12/31/2006 in its Closeout Expenditure Report due 1/31/2007; the disbursement amount was based on expenditures in excess of funds received to date, up to 10 percent of and not to exceed the LEA's grant award (Payment No. 6). Beginning in the FY 2006-07 funding cycle, the program office changed the disbursement method to quasi-reimbursement whereby LEAs receive an initial advance payment and subsequent reimbursements for quarterly reported expenditures.			

<table>
<tr><th colspan="5">IDEA, Part B, Special Education—Grants to States
(84.027 Special Education)</th></tr>
<tr><td>Funding Process:</td><td colspan="4">Grants</td></tr>
<tr><td>Federal Funding Available for Pass-Through:</td><td colspan="4">$967,188,533</td></tr>
<tr><td>Number of LEA Subgrantees:</td><td colspan="4">120</td></tr>
<tr><td>Funding Period:</td><td colspan="4">7/1/2005 to 9/30/2006 (15 months)</td></tr>
<tr><td>Period of Availability:</td><td colspan="4">7/1/2005 to 9/30/2006 (15 months)</td></tr>
<tr><td>Disbursement Schedule:
(3 disbursements)</td><td>Payment No.</td><td>Procedure to Assess LEA Funding Need</td><td>Percent of LEA Grant Award</td><td>CDE Disbursement Date</td></tr>
<tr><td rowspan="7">For Most LEAs</td><td>1 – Round 1</td><td>None</td><td>50%</td><td>11/9/2005</td></tr>
<tr><td>2 – Round 1</td><td>(1)</td><td>25%</td><td>4/6/2006</td></tr>
<tr><td>3 – Round 1</td><td rowspan="5">(2)</td><td rowspan="5">Up to 25%
Final Disbursement</td><td>8/9/2006</td></tr>
<tr><td>3 – Round 2</td><td>9/13/2006</td></tr>
<tr><td>3 – Round 3</td><td>10/19/2006</td></tr>
<tr><td>3 – Round 4</td><td>12/7/2006</td></tr>
<tr><td>3 – Round 5</td><td>12/18/2006</td></tr>
<tr><td rowspan="5">For Small No. of LEAs</td><td>1 – Round 2</td><td rowspan="2">none</td><td rowspan="2">50%</td><td>1/4/2006</td></tr>
<tr><td>1 – Round 3</td><td>2/7/2006</td></tr>
<tr><td>2 – Round 2</td><td>(1)</td><td>25%</td><td>5/1/2006</td></tr>
<tr><td>3 – Round 6</td><td rowspan="2">(2)</td><td rowspan="2">Up to 25%
Final Disbursement</td><td>2/2/2007</td></tr>
<tr><td>3 – Round 7</td><td>4/13/2007</td></tr>
<tr><td>Procedures to Assess LEA Funding Needs Prior to Disbursement:</td><td colspan="4">The program office processed disbursements in batches (per Round No.) based on when LEAs submitted required documents. Delays in LEA submission delayed the LEA’s next disbursement.

<u>Program funding threshold</u>: None stated. LEA funding needs were not assessed prior to the first disbursement (Payment No. 1, Rounds 1 through 3).
(1) To receive its second disbursement, our review of the program’s payment data file determined that the LEAs had expended more than half of the funds received to date based on actual or legally obligated expenditures as of 2/15/2006, as reported on their Mid-Year Expenditure Report due on or before 3/31/2006; thus, when the prior disbursement was substantially expended, the LEA received a second disbursement (Payment No. 2, Rounds 1 and 2).
(2) To receive its final disbursement, an LEA must have expended an amount greater than or equal to disbursements received to date based on actual expenditures as of 9/30/2006, as reported on its Final Expenditure Report due on or before 11/30/2006; the LEA received a final disbursement up to 25 percent of its grant award based on the final expenditures (Payment No. 3, Rounds 1 through 7).</td></tr>
</table>

<table>
<tr><th colspan="5">Perkins Act, Vocational Education—Basic Grants to States
(84.0048A Vocational Education)</th></tr>
<tr><td>Funding Process:</td><td colspan="4">Grants</td></tr>
<tr><td>Federal Funding Available for Pass-Through:</td><td colspan="4">$140,318,604</td></tr>
<tr><td>Number of LEA Subgrantees:</td><td colspan="4">441</td></tr>
<tr><td>Funding Process:</td><td colspan="4">7/1/2005 to 6/30/2006 (12 months)</td></tr>
<tr><td>Period of Availability:</td><td colspan="4">7/1/2005 to 6/30/2006 (12 months)</td></tr>
<tr><td>Disbursement Schedule:
(2 disbursements)</td><td>Payment No.</td><td>Procedure to Assess LEA Funding Need</td><td>Percent of LEA Grant Award</td><td>CDE Disbursement Date</td></tr>
<tr><td rowspan="4">For All LEAs</td><td>1 – Batch 1</td><td rowspan="4">None</td><td rowspan="4">75%</td><td>2/6/2006</td></tr>
<tr><td>1 – Batch 2</td><td>3/1/2006</td></tr>
<tr><td>1 – Batch 3</td><td>3/27/2006</td></tr>
<tr><td>1 – Batch 4</td><td>4/10/2006</td></tr>
<tr><td>For Most LEAs</td><td>2 – Batch 1</td><td rowspan="5">(1)</td><td rowspan="5">Up to 25%
Final Disbursement</td><td>8/11/2006</td></tr>
<tr><td rowspan="4">For Small No. of LEAs</td><td>2 – Batch 2</td><td>8/12/2006</td></tr>
<tr><td>2 – Batch 3</td><td>9/22/2006</td></tr>
<tr><td>2 – Batch 4</td><td>9/25/2006</td></tr>
<tr><td>2 – Batch 5</td><td>10/31/2006</td></tr>
<tr><td>Procedures to Assess LEA Funding Needs Prior to Disbursement:</td><td colspan="4">The program office processed disbursements in batches (per Batch No.) based on when LEAs submitted required documents. Delays in LEA submission delayed the LEA’s first or final disbursement.

LEA funding needs were not assessed prior to the first disbursement (Payment No. 1, Batches 1 through 4).
(1) To receive its final disbursement, an LEA must have expended an amount greater than or equal to its first disbursement based on actual expenditures as of 6/30/2006, as reported on a Claim Document due 7/31/2006; the LEA received a final disbursement up to 25 percent of its grant award based on its actual expenditures (Payment No. 2, Batches 1 through 5).

Beginning in the FY 2006-07 funding cycle, the program office changed the disbursement method to full reimbursement and no longer advances funds to LEAs.</td></tr>
</table>

Enclosure 2: OIG Estimate of Interest Earnings for Four Programs at Selected LEAs

We estimated that the nine selected LEAs earned Federal interest totaling about $937,000 in SFY 2005-06 for the four reviewed programs. Only two LEAs remitted a total of $208,581, and the remaining LEAs did not remit any interest for amounts earned in the four programs. We estimated that the nine LEAs owe ED about $729,000 for interest earned in the four programs in SFY 2005-06.

LEA	OIG Estimate of SFY 2005-06 Interest Earnings					LEA Remit-tances	Difference
	ESEA Title I	ESEA Title II	ESEA Title IV	Special Education	LEA Total		
Fresno County							
Fresno USD	$469,226	-	-	$1,859	$471,085	-	$471,085
Parlier USD	2,518	-	-	-	2,518	-	2,518
Sierra USD	1,711	$1,558	-	-	3,269	-	3,269
Sacramento County							
Center USD	3,372	3,965	$203	101	7,641	-	7,641
Elk Grove USD	3,754	4,265	-	3,970	11,989	(a)	11,989
Galt JUHSD	164	-	-	184	348	-	348
Sacramento City USD (b)	128,000				128,000	-	128,000
Subtotal – LEAs that Did Not Remit Interest	**$608,745**	**$9,788**	**$203**	**$6,114**	**$624,850**	**-**	**$624,850**
Los Angeles County							
Glendale USD	59,173	154	65	61,361	120,753	$33,113 (c)	87,640
Long Beach USD	190,234	998	397	-	191,629	175,468 (d)	16,161
Subtotal – LEAs that Remitted Interest	**$249,407**	**$1,152**	**$462**	**$61,361**	**$312,382**	**$208,581**	**$103,801**
Total	**$58,152**	**$10,940**	**$665**	**$67,475**	**$937,232**	**$208,581**	**$728,651**

(a) Elk Grove USD remitted interest earned in the Title III Program, but did not remit interest for the four reviewed programs.
(b) Our review in Sacramento USD was limited to the Title I Program only.
(c) Remittance was for interest earned in the Title I Program; Glendale USD also remitted for the ESEA Title II Part D Education Technology Program.
(d) Remittance was for interest earned in the Title I, Title II, and Title IV programs; Long Beach USD also remitted interest for numerous other Federal programs.

We estimated interest earnings by multiplying each LEA's month-end cash balance for each program spanning the period July 2005 to June 2006 by the applicable monthly interest rate. As noted in Finding No. 2, the use of month-end balances could result in an overstatement or understatement of interest earnings. The difference between our estimate of interest earnings and amounts remitted by LEAs does not take into account the $100 of interest amounts that 34 C.F.R. § 80.21(i) allows LEAs to keep for administrative expenses.

Enclosure 3: CDE Comments on the Draft Report

CDE's comments on the draft report included as an attachment screen prints from its planned web-based cash management reporting system. Because of the voluminous number of pages, we have not included the screen shots in this enclosure. Copies of the attachment are available upon request.

CALIFORNIA
DEPARTMENT OF
EDUCATION

JACK O'CONNELL
STATE SUPERINTENDENT OF PUBLIC INSTRUCTION

December 29, 2008

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

Dear Ms. Pilotti:

Subject: Draft Report—California Department of Education Advances of Federal Funding to Local Educational Agencies, Control Number ED-OIG/A09H0020

In response to the U.S. Department of Education (ED), Office of Inspector General's (OIG) draft report entitled *California Department of Education Advances of Federal Funding to Local Educational Agencies,* the California Department of Education (CDE) respectfully requests that CDE's written comments on the reported findings and recommendations are noted and considered in regard to the final report and subsequent program determinations.

The CDE is continually improving its cash management processes for disbursing Federal program funds to sub-recipients. To further strengthen CDE's processes for disbursing and monitoring Federal funds, the CDE established an internal task force to develop a cash management improvement plan. The CDE's foremost cash management goals are to: (1) improve cash balance reporting, fiscal monitoring, and funding processes to minimize the time between sub-recipients' receipt and disbursement of Federal funds; and (2) revert interest earned on unspent Federal funds back to the U.S. Treasury. To bolster this endeavor, the CDE is coordinating efforts with members of the U.S. Department of Education, Office of the Secretary, Risk Management Service (RMS), for advice and suggestions on improving CDE's cash management over Federal funds.

In general, the CDE concurs with the OIG's findings; however, without conducting in-depth statewide analyses of local educational agencies' current and past cash management practices, the CDE does not opine on the OIG's overall projections of cash balances and interest estimates.

If you have any questions regarding the CDE's response to the draft report, please contact Kevin W. Chan, Director, Audits and Investigations Division, at 916-323-1547, or by e-mail at kchan@cde.ca.gov.

Sincerely,

/s/

GAVIN PAYNE
Chief Deputy Superintendent of Public Instruction

GP:kwc:dr
Enclosures

California Department of Education
Response to the U.S. Department of Education, Office of Inspector General
Draft Report, Control Number ED-OIG/A09H0020

California Department of Education Advances of Federal Funding to Local Educational Agencies

Finding No. 1 - CDE's Method for Disbursing Federal Funds Must Ensure that Local Educational Agencies (LEAs) Receive Federal Funding When Needed to Pay Program Costs

Recommendation 1.1:

Consider centralizing funding processes under the authority of a single organizational unit to ensure cash management procedures are consistently and effectively implemented across all Federal programs.

CDE Comments and Corrective Action:

Upon consideration of centralizing the multitude of CDE's educational program funding processes under a single organizational unit, the CDE determined that it would be more feasible to consistently apply universal core cash management procedures to CDE's grant and apportionment funding processes in ensuring that LEAs timely receive Federal funding when needed to pay program costs.

Recommendation 1.2:

Make the first disbursement of Federal funds available to LEAs earlier in the State fiscal year (SFY) if LEAs have demonstrated the need for program funds.

CDE Comments and Corrective Action:

To accommodate an LEA's demonstrated need for program funds, CDE's proposed new adjustable quarterly funding processes will enable the CDE to effectively disburse federal funding throughout the year.

Recommendation 1.3:

Proactively work with the Financial Information System for California (FI$Cal) project development team to ensure that the cash management component of the new system meets Federal requirements, allows LEAs to draw Federal funds when needed to pay program costs, and includes internal controls to ensure LEAs minimize the time between when they receive and disburse Federal program funds.

CDE Comments and Corrective Action:

CDE representatives attend FI$Cal project development meetings and work proactively with the California Department of Finance on both the CDE and government requirements that should be addressed and incorporated into the new statewide financial management project.

Recommendation 1.4:

Develop an interim solution that is consistent across all Federal programs and assesses LEA cash needs prior to all advances.

CDE Comments and Corrective Actions:

Since the CDE is not scheduled to convert to FI$Cal until 2013, the CDE has developed an interim cash management improvement plan that institutes quarterly sub-recipient reporting of cash balances and quarterly disbursement of Federal funds (see Enclosure 2 for a copy of a letter sent to the U.S. Department of Education, Office of the Secretary, summarizing CDE's cash management improvement plan). As part of this plan, the CDE has created a web-based reporting format to facilitate sub-recipients' reporting of outstanding cash balances. Additionally, the CDE is currently recruiting staff that will be assigned duties specifically related to CDE's new cash management processes.

The CDE expects to commence the cash management improvement plan with a pilot Federal program. Once the pilot program is functioning as intended, and deemed successful, other Federal funded programs will be systematically incorporated into the new cash management processes.

Finding No. 2 – CDE Needs to Strengthen Controls to Ensure that LEAs Correctly Calculate and Promptly Remit Interest Earned on Federal Cash Advances

Recommendation 2.1:

Clearly and consistently communicate the Federal interest requirement to LEAs and reinforce the requirement's applicability to all Federal education programs. To ensure they receive consistent and complete information across programs, the CDE should also include appropriate information on the interest requirement in its accounting and/or financial management guidance distributed to LEAs, such as in the *California Schools Accounting Manual*.

CDE Comments and Corrective Actions:

As the OIG states in the report, the CDE includes the federal interest requirements as standard language in various program funding correspondence (apportionment and grant notification letters). Resultantly, during the 2007-08 and 2008-09 state fiscal years, the CDE has remitted interest back to the Federal Treasury on behalf of over 70 LEAs.

To further remind LEAs to calculate interest correctly and remit interest earned on Federal cash advances promptly, the CDE has prepared written communication on the applicability of the Federal requirements for interest earned on Federal funds. The written communication will be disseminated to all county and district superintendents, county and district chief business officials, and charter school administrators (see Enclosure 3).

To provide consistent and complete guidance for all Federal education programs, the CDE will explore incorporating references to the Federal interest requirements (Title 34 *Code of Federal Regulations*, Part 80.21) in other written guidance, such as the *California School Accounting Manual* and the audit guide used by independent certified public accountants conducting single audits of LEAs.

Recommendation 2.2:

Develop and disseminate guidance to LEAs on the proper method for calculating and frequency for remitting interest. To ensure that LEAs calculate interest correctly and remit interest earned on all Federal cash advances promptly, the guidance should include instructions specifying that: (1) the netting of interest is not allowed; (2) interest should be calculated using Cash in County Treasury data; and (3) interest must be remitted promptly and at least quarterly in accordance with the applicable regulations.

CDE Comments and Corrective Actions:

The CDE has prepared and will issue written communication to all county and district superintendents, county and district chief business officials, and charter school administrators regarding Federal requirements on interest earned on Federal funds (see Enclosure 3). The written communication: (1) specifies the Federal requirements on interest earned on Federal funds; (2) prohibits reducing or offsetting federal interest earnings for the temporary use of non-Federal cash resources for Federal programs; and (3) advises school district and charter school business officials to coordinate with their county offices of education in developing internal controls and a sound methodology to calculate and return, at least quarterly, interest over $100 to the Federal Treasury via the CDE.

Recommendation 2.3:

Ensure that the nine reviewed LEAs: (1) correct the noted deficiencies; (2) calculate interest on cash in County Treasury correctly; and (3) remit interest earned in SFY 2005-06 and in subsequent years across all Federal education programs.

CDE Comments and Corrective Actions:

The CDE will follow up with the nine LEAs on the corrective actions taken to the ED OIG's reported deficiencies. CDE's follow-up will include obtaining from each of the nine LEAs: (1) specifics of corrective action taken on the reported deficiencies; (2) Federal interest calculation methodologies; and (3) the amount of interest due and remitted for the SFYs 2005-06 through 2008-09.

Recommendation 2.4:

Ensure that all LEAs within the State have calculated interest correctly and remitted interest earned in SFY 2005-06 and in subsequent years across all Federal education programs. The CDE could work with the California State Controller's office to ensure the LEAs' next Single Audit addresses LEA compliance with the Federal interest requirement, including correct interest calculations for all Federal cash advances and remittances for interest earned in SFY 2005-06 and subsequent years.

CDE Comments and Corrective Actions:

The CDE is exploring and considering the feasibility of options within limited available resources, including the development of new Single Audit procedures, to obtain assurance that LEAs properly calculated and remitted interest on Federal funds during the SFY 2005-06 and in subsequent years across all Federal education programs.

To ensure that LEAs correctly calculate interest on advanced Federal funds, the CDE sent written communication on the Federal interest requirements to all county and district superintendents, county and district chief business officials, and charter school administrators (see CDE's responses and corrective actions for Recommendations 2.1 and 2.2 above).

Recommendation 2.5:

Absent assurance of adequate Single Audit coverage include steps in its categorical program monitoring process to review LEA compliance with the interest requirement, including LEAs' methodologies for computing interest earnings. To review compliance across all Federal programs, the CDE could add appropriate procedures to the cross-cutting section of its monitoring protocol.

CDE Comments and Corrective Actions:

To ensure that LEAs are in compliance with Federal interest requirements, the CDE plans to develop and implement fiscal review processes that will strengthen the cross-cutting funding dimensions of categorical program monitoring.

Additionally, during SFY 2008-09, and depending on available resources, the CDE is considering new cash management monitoring that entails a high-level verification of LEAs' reported quarterly Federal cash balances. In conducting cash management monitoring, CDE fiscal staff will verify the most recent quarter's reported cash balances from a number of selected sub-recipients throughout the year. This verification process entails CDE staff contacting sub-recipients' accounting offices to obtain fiscal information which reasonably supports reported cash balances. If significant amounts of unspent Federal program funds are identified through this process, the sub-recipient may be required to: (1) submit a disbursement plan delineating the timeline when funds on hand will be spent; (2) explain the need for additional funding; and (3) communicate the disposition of interest earned on unspent federal program funds.

Recommendation 2.6:

Explore the potential for enlisting the assistance of County Offices of Educations (COEs) and their capacity to collect cash data to help the CDE implement cash management procedures and ensure LEA compliance with the Federal interest requirement. COEs could facilitate and ease the administrative burden associated with collecting cash information on cash balances, identifying interest earnings, and processing interest remittances.

CDE Comments and Corrective Actions:

In CDE’s written communication to all county and district superintendents, county and district chief business officials, and charter school administrators, the CDE encourages district and school fiscal officials to coordinate with their COEs in developing internal controls and sound methodologies to calculate and return, at least quarterly, interest earned in excess of $100 on Federal program funds administrators (see CDE’s responses and corrective actions for Recommendations 2.1 and 2.2 above).

CALIFORNIA
DEPARTMENT OF
EDUCATION

JACK O'CONNELL
STATE SUPERINTENDENT OF PUBLIC INSTRUCTION

December 24, 2008

Cynthia Bond-Butler, Senior Consultant
U.S. Department of Education
Office of the Secretary
400 Maryland Avenue, SW
Washington, D.C. 20202

Dear Ms. Bond-Butler:

Subject: Cash Management Improvement Plan

Per your request, attached is a summary the California Department of Education (CDE) draft plan for improving cash management over federal program funds. CDE's cash management improvement plan will commence with a pilot program, Title II Improving Teacher Quality, and implementation of quarterly sub-recipient reporting of cash balances and quarterly disbursement of federal funds. Although we initially discussed including Special Education as a pilot program, the CDE implemented alternative interim processes to ensure that sub-recipients receive and disburse federal funds in a timely manner.

We appreciate the assistance that you have provided us in developing our cash management improvement plan. If you have any questions regarding our plan, please contact me directly at (916) 323-1547.

Sincerely,

Original Signed By:

Kevin W. Chan, Director
Audits and Investigations Division

Attachment
KWC:dr

Cash Management Improvement Plan

This cash management improvement plan is designed to minimize the time elapsing between a sub-recipient's receipt and use of federal program funds by requiring sub-recipients to submit fiscal information with which the California Department of Education (CDE) can: (1) monitor and disburse federal funds timely to meet sub-recipients' needs, and (2) identify and follow up on fiscal conditions where interest may have been earned on unspent federal funds.

This plan calls for sub-recipients to submit fiscal information utilizing a web-based system specifically designed for minimizing the time between a sub-recipient's receipt and use of federal funds. The basic methodology behind this plan involves obtaining sub-recipient fiscal information on a scheduled basis, disbursing funds in consideration of cash balances, and identification of interest on unspent federal funds. This plan refers to a quarterly funding schedule which may, for practical purposes, be modified to accommodate the complexities of various individual federal programs.

Program funding on a quarterly basis would allow CDE to make more timely funding disbursements. In theory, with quarterly funding, sub-recipients would not be without funding longer than 90 days. However, since several of CDE's federal programs are currently funded less than four times a year, funding schedule changes may involve sensitive ramifications and would have to be systematically phased in by program. For example, Title I, CDE's largest federal program, would require relatively major process changes and may have significant fiscal impact to both large and small sub-recipients. Therefore, this plan will commence with a pilot program, Title II Improving Teacher Quality; other programs, such as Title I, will be phased in after the new cash management system and processes are better understood and operating as intended.

To facilitate the CDE's ability to make funding disbursement adjustments, this plan calls for sub-recipients to submit periodic fiscal information to the CDE. Sub-recipients will be required to quarterly report unspent federal funds by program; based on this information, CDE will determine whether adjustments are necessary to subsequent scheduled funding. For example, if a sub-recipient reports a relatively small amount or negative cash balance, then the CDE can either release or increase the following scheduled funding amount. On the other hand, if a sub-recipient reports a relatively high cash balance, then the CDE can either withhold or decrease the following scheduled funding, and query the sub-recipient of the disposition of possible interest earnings. **Attachment I** contains screen prints of CDE's newly developed web-based cash management reporting system. This reporting system is designed to capture sub-recipients' federal program cash balances for a designated quarter period. The system reports can also be readily modified to capture the amount of interest earned on federal funds and other information to fit the needs of individual programs. CDE's web-based reporting system is still in the finalization stage; however, once fully operational, sub-recipients will be required to conveniently transmit and certify cash balance information to the CDE electronically via the Internet.

If significant amounts of unspent federal program funds are identified through CDE's new cash management processes, sub-recipients may be required to: 1) submit a disbursement plan delineating the timeline when funds on hand will be spent; 2) explain the need for additional funding; and 3) communicate the disposition of interest earned on unspent federal program funds.

CALIFORNIA
DEPARTMENT OF
EDUCATION

JACK O'CONNELL
STATE SUPERINTENDENT OF PUBLIC INSTRUCTION

December 24, 2008

Dear County and District Superintendents, County and District Chief Business Officials, and Charter School Administrators:

INTEREST EARNED ON FEDERAL FUNDS

The United States Department of Education, Office of Inspector General, has conducted audits that review the cash management practices of the California Department of Education (CDE) and Local Education Agencies (LEAs). These audits include an examination of LEA compliance with those requirements of federal law that require remission of interest earned on federal funds.

In this regard, *Code of Federal Regulations, Title 34 –Education, Part 80 – Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments, Subpart C – Post Award Requirements, Section 80.21 Payment,* requires grantees and sub-grantees to promptly, but at least quarterly, remit interest earned on advances to the federal agency. The grantee or sub-grantee may keep interest amounts up to $100 per year for administrative expense. Thus, LEAs are required to remit to CDE interest earned on federal funds.

In addition, grantees and sub-grantees are prohibited from reducing or offsetting federal interest earnings for the temporary use of non-federal cash resources for federal programs. For example, although an LEA may have temporarily supported a federal program with non-federal funds, the amount of interest that the sub-grantee could have earned on those non-federal funds cannot be offset or netted against the interest earned on the unspent funds of another federal program.

To ensure compliance with federal administrative requirements, school district and charter school fiscal officials should coordinate with their county offices of education in developing internal controls and a sound methodology to calculate and return at least quarterly, interest earned in excess of $100 on federal program funds.

If you have any questions regarding the administrative requirements for interest earned on federal funds, please contact me directly at 916-323-1547, or by e-mail at kchan@cde.ca.gov.

Sincerely,

Original Signed By:

Kevin W. Chan, Director
Audits and Investigations Division

KWC:dr