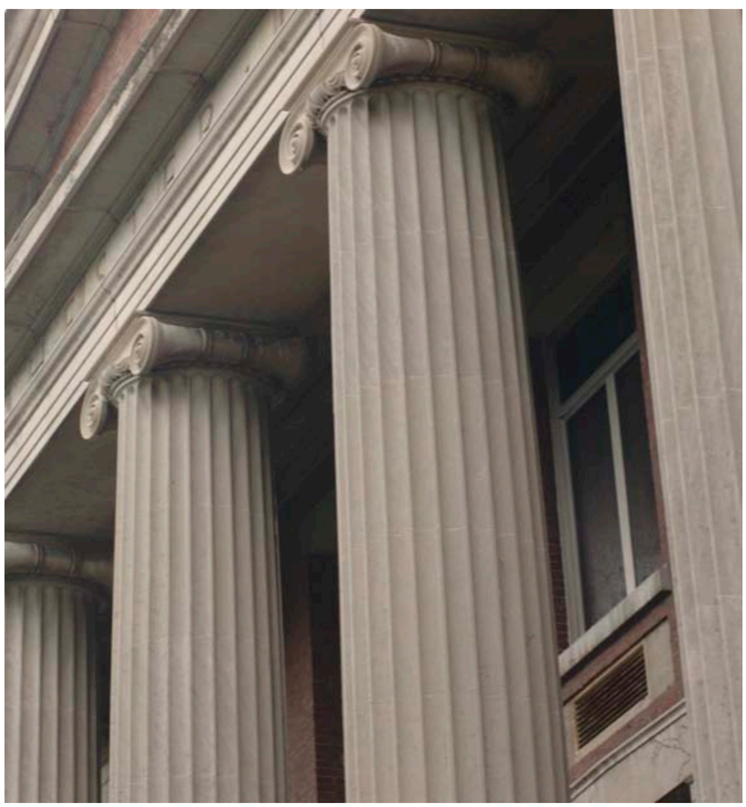
U.S. Department of Education
Office of Inspector General

American Recovery and Reinvestment Act of 2009

State Educational Agencies' Implementation of Federal Cash Management Requirements under the American Recovery and Reinvestment Act

Alert Memorandum



ED-OIG/L09J0007 **October 2009**

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

AUDIT SERVICES

October 21, 2009

ALERT MEMORANDUM

To: Thomas Skelly
Acting Chief Financial Officer
Office of the Chief Financial Officer

Phil Maestri
Director
Risk Management Service

From: Keith West /s/
Assistant Inspector General for Audit

Subject: State Educational Agencies' Implementation of Federal Cash Management Requirements under the American Recovery and Reinvestment Act
Control Number ED-OIG/L09J0007

The purpose of this memorandum is to bring to your attention two issues of concern related to State educational agencies' (SEAs') management of the flow of American Recovery and Reinvestment Act (ARRA) funds to local educational agencies (LEAs). Ongoing OIG audits in seven States and Puerto Rico have identified a number of instances where SEA cash management systems (1) disburse ARRA funds without adequate information on whether LEAs are ready to spend the funds and (2) do not ensure LEAs remit interest earned on ARRA funds received in advance of LEA needs, or both. One of the key principles of ARRA is to distribute the funding quickly to save and create jobs and promote economic activity. However, ARRA funding should not be distributed to LEAs until the funds are needed to pay ARRA-authorized expenses. If funding is distributed in advance of when it is needed, SEAs should ensure that LEAs minimize the time between receipt and disbursement of the funds and remit interest earned on the advanced funds in a timely manner.

We recently reported on cash management issues and the need for U.S. Department of Education (Department) guidance based on audits we conducted in California during 2007 and 2008.[1] Our current ARRA audits have shown that these issues are not limited to California. We have identified cash management concerns with respect to ARRA funds passed through to LEAs in five of the seven States being audited, as summarized in Table 1.

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

Table 1. States in Which OIG Identified Cash Management Issues Under ARRA						
Issue	**CA**	**IL**	**IN**	**NY**	**PA**	**Total**
Minimizing Time: SEA method for disbursing ARRA funds needs to ensure that LEAs receive the funds when needed to pay program costs.	•	•	•	•	•	**5**
Interest Remittance: SEA needs to strengthen controls to ensure that LEAs remit interest earned on ARRA cash balances promptly and at least quarterly.	•	•	•	•	•	**5**
Note: The OIG is currently conducting ARRA audits in seven States—the five States identified above, Tennessee, and Texas—as well as in Puerto Rico. Identification of a State with the described cash management issues is based on audit work completed as of mid-August.						

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

- 34 C.F.R. § 80.21 prescribes the basic standard and the methods under which grantees will make payments to subgrantees. The basic standard is that the "[m]ethods and procedures for payment shall minimize the time elapsing between the transfer of funds and disbursement by the grantee or subgrantee . . . ." Grantees and subgrantees shall be paid in advance if they maintain or demonstrate the willingness and ability to maintain procedures to minimize the time between receipt and disbursement of the funds to pay program costs. Reimbursement is the preferred disbursement method when the requirements for advancing funds are not met.

- 34 C.F.R. § 80.21(i) requires that ". . . [G]rantees and subgrantees shall promptly, but at least quarterly, remit interest earned on advances to the Federal agency. The grantee or subgrantee may keep interest amounts up to $100 per year for administrative expenses."

The Department reinforced these cash management requirements in the ARRA-specific guidance it issued in April 2009. In particular, the guidance addresses funds made available under ARRA for three programs included in our State audits: (1) Title I, Part A of the Elementary and Secondary Education Act (Title I); (2) section 611, Part B of the Individuals with Disabilities Education Act (IDEA); and (3) Title XIV of Division A of the ARRA, State Fiscal Stabilization Fund (SFSF).[2] In addition to the guidance, Risk Management Service (RMS) and the Office of the Chief Financial Officer (OCFO) have worked in consultation with departmental program offices and the Office of the General Counsel (OGC) to provide technical assistance to State and local agencies in the area of cash management. For example, cash management issues were considered during risk analyses to identify States needing additional technical assistance to ensure ARRA funds are spent appropriately. Additionally, cash management was a topic of one of a series of web conferences

[2] Department guidance for the three programs are titled: (1) *Funds Under Title I, Part A of the Elementary and Secondary Education Act of 1965 Made Available under The American Recovery and Reinvestment Act of 2009*; (2) *Funds for Part B of the Individuals with Disabilities Education Act Made Available under The American Recovery and Reinvestment Act of 2009*; and (3) *Guidance on the State Fiscal Stabilization Fund Program*.

the Department is conducting to assist grantees and subgrantees, such as SEAs and LEAs, in managing grants under ARRA.

SEAs Should Ensure LEAs Receive ARRA Funds When Needed to Pay Program Costs

To minimize the time between an LEA's receipt and disbursement of Federal funds, the SEA's method for disbursing the funds should ensure that LEAs receive ARRA funds when needed to pay program costs—that is, not too early and not too late.

Funds Should Not Be Disbursed Too Early

In five of the seven States currently being audited, SEAs are or will be advancing ARRA funds to LEAs without adequate information on whether LEAs are ready to spend the funds. As a result, LEAs may be receiving ARRA funds too early, which increases the borrowing costs of the U.S. Treasury and increases the risk that ARRA funds may be misused. We identified concerns about the SEAs' disbursement methods that could result in LEAs receiving ARRA funds too early in the following States:

California. The SEA disbursed most of its Title I and SFSF ARRA funds to LEAs without any information about whether the LEAs needed the funds at the time of disbursement.[3] Between late May and early July, the State drew down over $4 billion for disbursement to LEAs and other sub-recipients. This amount represents about 80 percent of the Title I and 86 percent of the SFSF ARRA funds the Department had awarded to California as of early August. Our work at three LEAs in California showed that, while they received most of their Title I and SFSF ARRA funds in June and early July, the LEAs had yet to spend any of the funds at the time of our visits in late July. The LEAs were still planning how they will use the funds, which includes needing to first negotiate with the teachers union for new teacher positions, or seeking technical assistance from the Department on allowable use of Title I funds. One of the three LEAs reviewed plans to spend half of its SFSF funds during school year 2009-10 and the other half the following year. This timeframe is more than a year after receiving the funds.

Illinois. The SEA is disbursing Title I and IDEA ARRA funds to LEAs on a monthly basis in increments that represent the monthly cash needs set by each LEA in its grant application. However, the SEA will assess LEAs' funding needs only on a quarterly basis. Under this approach, LEAs may not have a need for all the funds for the months within a quarter, which was the case in one LEA reviewed. Moreover, the SEA disbursed SFSF funds to replace State education funding to LEAs with no procedures in place to determine whether the LEAs needed the funds at the time. At two LEAs visited, we found that information would not be available to assess their need for SFSF funds because the LEAs do not track spending of the State funds and, thus, do not track SFSF expenditures either.

Indiana. Similar to Illinois, the SEA is disbursing Title I and IDEA ARRA funds to LEAs on a monthly basis, but in increments representing one-twelfth of each LEA's total

[3] In California, the SEA is disbursing IDEA ARRA funds to LEAs in quarterly installments based on information on the amount of funds LEAs have spent to date.

allocation, with the option for LEAs to change the level of funding, if needed. Like Illinois, the SEA will assess LEAs' funding needs only on a quarterly basis. To replace a shortfall in State education funding, the SEA distributed SFSF funds to LEAs for the month of June without first assessing LEAs' cash needs. In early June, the SEA had drawn and disbursed $536 million in SFSF funds to LEAs. Our work at three LEAs showed that they had yet to spend any of the funds at the time of our visits in July and August. The SEA does not have procedures in place to assess LEAs' cash needs before disbursing SFSF funds, but officials stated they will use quarterly reports in the future.

New York. Although LEAs had not received ARRA funds as of early August, the SEA plans to use existing procedures for disbursing Title I, IDEA, and SFSF ARRA funds to LEAs. Under those procedures, LEAs are allowed to request an advance of up to 90 percent of its grant budget to the extent that the request includes actual expenditures to date plus anticipated expenditures for the next month. Although this approach enables the LEA to request funds to meet its near-term needs, the SEA does not have procedures in place to determine whether the funds are actually needed at that time.

Pennsylvania. Similar to Indiana, the SEA plans to advance ARRA funds to LEAs on a monthly basis in increments representing one-twelfth of each LEA's total allocation, and will assess LEAs' cash needs only on a quarterly basis. The State had not drawn down any Title I, IDEA, or SFSF ARRA funds as of mid-August.

LEA officials provided several explanations for not spending the ARRA funds immediately upon receipt. One reason is due to the uncertainty about allowable uses of funds. Another reason cited is that LEAs anticipate possible future budget cuts and are waiting to determine whether SFSF funds will be needed to pay expenses normally paid with State or local funding.

It is important that SEAs do not draw and disburse ARRA funds before LEAs actually need the funds. As we have previously reported (ED-OIG/A09H0020), the U.S. Treasury incurs additional borrowing costs when an SEA draws and disburses Federal funds to LEAs in advance of their immediate cash needs. Because of the Federal deficit, the U.S. Treasury must borrow the cash needed to fund Federal programs and, as a result, incurs interest costs. Federal program funds drawn too early by an SEA results in additional Federal borrowing costs that would not have been incurred if the SEA had disbursed the funds at the time needed by LEAs to pay program costs.

It is also important that funds are not drawn prematurely because the funds may be more susceptible to misuse when held in local accounts for extended periods. Past OIG work has identified instances involving non-ARRA funds where internal controls were weak, by-passed, or nonexistent, and LEA officials were able to commit improper and illegal acts that resulted in millions of dollars in misspent funds.[4] As shown in the Attachment, only a handful of States have drawn down significant amounts of Title I, IDEA, and SFSF ARRA funds as of August 28. Hence, the Department has the opportunity to further reinforce the cash management requirements and remind States to ensure that ARRA funds are needed before disbursing to LEAs.

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

Funds Should Not Be Disbursed Too Late

In addition to ensuring that LEAs do not receive ARRA funds too early, SEAs should also ensure that LEAs do not receive these funds too late. In the remaining two States where we are conducting ARRA audits, the SEAs generally reimburse LEAs for Federal expenditures instead of advancing Federal funds. Our ongoing work in these States has not addressed whether LEAs are receiving ARRA funds too late to meet program needs or the rationale for the SEAs using reimbursement as the disbursement method. Nevertheless, it is important that SEAs' methods for disbursing ARRA funds ensure that LEAs do not receive the funds too late to pay program costs.

Our prior cash management audit in California (ED-OIG/A09H0020) found that LEAs used other available cash resources to pay Federal program costs when LEAs did not receive Federal funds timely. 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. In addition, the use of other non-Federal cash resources causes a lost opportunity for the LEA to earn interest because the cash is no longer available for investment.

As shown in the Attachment, most States have drawn down little or no Title I, IDEA, or SFSF ARRA funds. State officials have told us that delays in drawing down ARRA funds are caused by State budgetary requirements, such as the need for the State legislature to enact supplemental appropriations for ARRA funding, or administrative processes, such as the need to approve program and funding applications. States may have also delayed ARRA draws because LEAs do not need the funds while on summer break. However, States should ensure that LEAs are not harmed as a result of delays in drawing down ARRA funds and that funding is disbursed in time to meet ARRA goals, including the goal of saving and creating jobs.

SEAs Should Ensure that LEAs Calculate and Remit Interest Earnings Promptly

In five of the seven States currently being audited, the SEA does not have a process in place for LEAs to remit interest earned from Federal cash advances, has not instructed LEAs to remit interest promptly and at least quarterly, or does not sufficiently monitor LEAs' compliance with the interest requirement. As a result, LEAs may be retaining interest that should be returned to the U.S. Treasury. We identified concerns with SEA controls for ensuring LEAs remit interest in a timely manner in the following States:

> **California.** We previously reported that the SEA relied on LEAs to self-report and remit interest earned on non-ARRA cash balances. Additionally, the LEAs we reviewed were calculating interest incorrectly or not at all. In response to a draft of our March 2009 audit report (ED-OIG/A09H0020), the SEA issued guidance to LEAs on calculating and remitting interest earned on Federal funds. However, we noted in the final report that the guidance did not sufficiently address appropriate methodologies for calculating interest. As of August, the SEA had not issued more detailed guidance but was beginning to pilot procedures to monitor LEA compliance with the interest requirement for both ARRA and non-ARRA funds.

Illinois. The SEA has not modified existing procedures for non-ARRA funds and will calculate and remit LEAs' interest earnings annually rather than at least quarterly as required by Federal regulation. Moreover, the SEA has not calculated interest earnings correctly. Our work in one LEA found that it also calculated interest incorrectly and the interest earnings it calculated differed from the SEA's because they each used different interest rates.

Indiana. The SEA does not have a mechanism to determine interest due from LEAs or to return LEAs' interest earnings to the Department.

New York. The SEA relies on LEAs to comply with Federal interest requirements and has not established a process to ensure that LEA interest earnings are returned to the Department.

Pennsylvania. The SEA does not have an effective process in place to ensure that LEAs calculate and remit interest promptly. Instead, the SEA relies on independent public accountants to test LEA compliance with the interest remittance requirement during the annual single audit. This approach will not assure that LEAs comply with the interest requirement until well after the LEAs have received ARRA funding.

In our recent alert memorandum (ED-OIG/L09I0013), we encouraged the Department's OCFO to issue guidance to SEAs and LEAs to (1) help ensure that LEAs accurately calculate and promptly remit interest earnings and (2) reinforce SEA responsibility for ensuring LEA compliance with the cash management requirements. The need for such guidance has only become more evident as we have performed cash management work in additional States under ARRA. As articulated in the alert memorandum, the guidance should instruct LEAs on the appropriate methodology for calculating interest earnings and emphasize the need for interest to be remitted promptly and at least quarterly.

Recommendation

1.1 We recommend that the Chief Financial Officer and the Director of Risk Management Service examine the most effective methods to address the issues concerning cash management and provide appropriate technical assistance and guidance to States and LEAs. The methods could include (1) technical assistance to States that have drawn down significant amounts of ARRA funding to ensure LEAs are minimizing the time between receipt and disbursement of ARRA funds; (2) additional webinars and guidance for SEAs and LEAs to reinforce the cash management requirements applicable to LEAs; (3) dissemination of information on challenges and best practices related to cash management; and (4) as suggested in our previous alert memorandum on LEA interest calculations and remittance (ED-OIG/L09I0013), issuance of fiscal guidance for SEAs and LEAs on appropriate methodologies for calculating interest earned on Federal cash advances to LEAs.

Department Response

A preliminary copy of this memorandum was provided to the Department for comment. We discussed the results of our review and recommendations with Department officials from OCFO, RMS, Office of Elementary and Secondary Education (OESE), Office of Special Education and Rehabilitation Services (OSERS), and OGC, on September 22, 2009. The officials stated that the information in the alert memorandum was helpful to the Department in considering a number of issues regarding cash management and ARRA. The Department recognizes cash management as an important issue and has taken steps to address it under ARRA. The officials commented that ensuring LEAs can minimize the time between receipt and disbursement of Federal funds will require long-term solutions in some States. Based on the discussion, we consolidated our original three recommendations into one modified recommendation. The Department officials concurred with the modified recommendation.

Corrective actions proposed (resolution phase) and implemented (closure phase) by your office(s) will be monitored and tracked through the Department's Audit Accountability and Resolution Tracking System (AARTS). For further information, please contact me at 202-245-7041.

Alert memoranda issued by the Office of Inspector General will be made available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Freedom of Information Act (5 U.S.C. § 552).

Attachment

Electronic cc:

Thelma Meléndez de Santa Ana, Assistant Secretary, OESE
Zollie Stevenson, Director, OESE-Student Achievement and School Accountability Programs
Joseph Conaty, Director, OESE-Academic Improvement and Teacher Quality Programs
Andrew Pepin, Delegated the Authority to Perform the Functions of the Assistant Secretary, OSERS
Patty Guard, Acting Director, OSERS-Office of Special Education Programs
Phil Rosenfelt, Deputy General Counsel, OGC
Abigail Cornish, Audit Liaison Officer, OCFO
Tina Otter, Audit Liaison Officer, RMS

Attachment

Table 2 lists the percentage of Title I, IDEA, and SFSF ARRA funds drawn down by each State, as of the week ended August 28, 2009. We summarized the percentages based on information on total obligations and outlays included in the Department's weekly ARRA Cumulative Percent Drawdown Report.

Table 2. ARRA Drawdowns by State

State	Title I ARRA	IDEA ARRA	SFSF (a)
AK-ALASKA	0.00%	0.00%	0.00%
AL-ALABAMA	0.06%	0.06%	0.00%
AR-ARKANSAS	8.70%	6.89%	6.42%
AS-AMERICAN SAMOA		0.00%	
AZ-ARIZONA	1.15%	0.09%	20.76%
CA-CALIFORNIA	80.06%	42.47%	94.34%
CO-COLORADO	0.50%	5.44%	32.38%
CT-CONNECTICUT	0.00%	0.15%	0.00%
DC-DISTRICT OF COLUMBIA	0.00%	0.00%	0.00%
DE-DELAWARE	0.00%	0.19%	0.00%
FL-FLORIDA	7.36%	12.33%	1.22%
GA-GEORGIA	0.25%	0.10%	27.08%
GU-GUAM		0.00%	
HI-HAWAII	16.84%	100.00%	0.00%
IA-IOWA	31.50%	40.00%	22.45%
ID-IDAHO	0.00%	0.32%	0.02%
IL-ILLINOIS	0.21%	0.60%	81.85%
IN-INDIANA	33.16%	43.71%	66.28%
KS-KANSAS	11.60%	0.00%	18.47%
KY-KENTUCKY	2.96%	5.31%	0.00%
LA-LOUISIANA	0.00%	0.00%	0.00%
MA-MASSACHUSETTS	1.85%	4.44%	56.76%
MD-MARYLAND	0.00%	0.08%	2.49%
ME-MAINE	4.10%	6.60%	24.28%
MI-MICHIGAN	0.00%	2.67%	49.35%
MN-MINNESOTA	0.00%	0.00%	0.97%
MO-MISSOURI	0.00%	0.00%	5.55%
MP-NORTHERN MARIANA ISLANDS		1.58%	
MS-MISSISSIPPI	0.00%	0.00%	4.78%
MT-MONTANA	0.00%	0.93%	0.12%
NC-NORTH CAROLINA	4.83%	13.43%	34.08%
ND-NORTH DAKOTA	0.01%	4.45%	0.00%
NE-NEBRASKA	2.58%	1.67%	0.61%
NH-NEW HAMPSHIRE	0.00%	0.00%	0.00%

Table 2. ARRA Drawdowns by State			
State	**Title I ARRA**	**IDEA ARRA**	**SFSF (a)**
NJ-NEW JERSEY	0.00%	0.00%	16.70%
NM-NEW MEXICO	0.00%	0.00%	0.00%
NV-NEVADA	0.00%	0.00%	48.23%
NY-NEW YORK	0.00%	0.00%	2.26%
OH-OHIO	0.26%	0.33%	4.68%
OK-OKLAHOMA	99.95%	99.96%	4.43%
OR-OREGON	0.00%	6.50%	34.10%
PA-PENNSYLVANIA	0.00%	0.00%	
PR-PUERTO RICO	0.00%	0.00%	8.44%
RI-RHODE ISLAND	0.00%	0.00%	44.11%
SC-SOUTH CAROLINA	25.12%	0.60%	0.00%
SD-SOUTH DAKOTA	5.01%	0.13%	42.51%
TN-TENNESSEE	2.87%	3.16%	3.17%
TX-TEXAS	0.51%	0.46%	0.00%
UT-UTAH	0.57%	5.42%	67.24%
VA-VIRGINIA	0.19%	0.28%	12.46%
VI-VIRGIN ISLANDS		0.00%	
VT-VERMONT	0.00%	0.00%	0.00%
WA-WASHINGTON	0.00%	0.00%	58.41%
WI-WISCONSIN	0.00%	0.34%	86.26%
WV-WEST VIRGINIA	0.08%	0.02%	0.00%
WY-WYOMING	0.00%	0.00%	0.00%

(a) SFSF percentages include both SFSF-Education Stabilization and SFSF-Government Services grants.

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