



UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

June 4, 2010

FINAL MANAGEMENT INFORMATION REPORT

To: Phillip Maestri
Director
Office of the Secretary, Risk Management Service

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

Subject: Subrecipient Monitoring under the American Recovery and Reinvestment Act of 2009
Control Number ED-OIG/X05J0019

This Final Management Information Report (MIR) summarizes issues with subrecipient monitoring identified in our audit work under the American Recovery and Reinvestment Act of 2009 (ARRA) that the Department should consider in its future risk assessments and monitoring visits. Our audits of the systems of internal control in seven States¹ (Phase I audits) identified several issues regarding those States' subrecipient monitoring plans. The most frequently identified issue was that five States had not sufficiently modified existing program monitoring methods to provide reasonable assurance of subrecipient compliance with ARRA requirements. Other issues we identified included: (a) State monitoring plans addressing only programmatic, not fiscal, issues, (b) States' not reviewing supporting documentation or verifying expenditures prior to making ARRA payments, and (c) no determination of which State entity will be responsible for monitoring subrecipients' uses of State Fiscal Stabilization Fund (SFSF) funds.

Subrecipient monitoring at the State level is crucial to ensuring that both ARRA and non-ARRA funds are expended and accounted for in accordance with applicable requirements. In our individual State reports, we recommended that the States develop and implement monitoring plans that address all applicable grant requirements, including fiscal monitoring. Although the States might have already initiated corrective actions to address our recommendations, we strongly encourage the Department to use the information in this report and our individual ARRA reports when assessing risk and planning monitoring visits to States.

We provided a copy of the draft of this Management Information Report to Risk Management Service (RMS) on May 14, 2010. On May 27, 2010, RMS informed us that it did not have any official comments on the draft. However, RMS stated that it takes very seriously the monitoring of subrecipients and the challenges it poses. RMS further stated that the information in this report and the individual audits will be very helpful as RMS works to improve the process.

¹ The seven States are California, Illinois, Indiana, New York, Pennsylvania, Texas, and Tennessee.

Background

As part of ARRA, enacted February 17, 2009, Congress dramatically increased State educational agency (SEA) and local educational agency (LEA) funding and expectations for transparency and accountability in how that funding is used. In our July 2009 MIR, we discussed widespread fiscal issues included in prior U.S. Department of Education, Office of Inspector General (ED-OIG) work regarding LEAs' uses of Federal education funds prior to enactment of ARRA.² In that report, we identified instances of significant internal control weaknesses that resulted in fiscal issues and fraud schemes. Specifically, we identified inadequate policies and procedures, failure to monitor subrecipients, and lack of understanding of regulations and guidance on the part of the SEAs and LEAs that resulted in significant instances of noncompliance with laws and regulations. Therefore, it is important that SEAs and LEAs exercise adequate oversight of grants and account for how funding is used. The prior MIR was issued to provide the Department with information that might be beneficial in overseeing grants provided to SEAs.

Since enactment of ARRA, ED-OIG has completed audits of seven States. The purpose of our individual audits was to determine whether the SEA, other State agencies, and selected LEAs charged with responsibility for overseeing ARRA funds had designed systems of internal control that are sufficient to provide reasonable assurance of compliance with applicable laws, regulations, and guidance. We assessed the design of internal control over the administration of ARRA funds for Title I, Part A, of the Elementary and Secondary Education Act of 1965, as amended (Title I); Individuals with Disabilities Education Act, as amended, Part B, Special Education Grants to States (IDEA); the Vocational Rehabilitation Act; and the SFSF programs. Among other areas, we assessed the design of State-level internal control over subrecipient monitoring. This MIR is a compilation of the issues regarding those States' subrecipient monitoring plans for ARRA funds.

In September 2009, the Government Accountability Office (GAO) issued a report, entitled *Funds Continue to Provide Fiscal Relief to States and Localities While Accountability and Reporting Challenges Need to be Fully Addressed* (GAO-09-1016), that discussed the Department issued guidance and also pointed out that some States face challenges establishing monitoring procedures for SFSF funds. The GAO report recommended the Department review State monitoring plans and provide training and technical assistance to help States develop and implement their monitoring plans. Subsequently, GAO issued a report in March 2010, entitled *One Year Later, States' and Localities' Uses of Funds and Opportunities to Strengthen Accountability* (GAO-10-437). In that report GAO stated the Department had developed a plan to monitor State implementation of the SFSF program that will include reviewing State processes and documents for monitoring subrecipients and making site visits to selected States. Department officials also stated that they are taking several steps both to monitor information they are receiving from States and to provide technical assistance to States.

The use of ARRA funds and the implementation of monitoring systems is an evolving process for the States, and our audits provide only a snapshot of each State's processes as of the dates of each audit.

² Management Information Report, *Fiscal Issues Reported in ED-OIG Work Related to LEAs and SEAs*, Control Number ED-OIG/X05J0005, issued July 21, 2009.

Positive Efforts

In three States (Texas, Tennessee, and Illinois), SEAs had taken actions to update their monitoring policies and procedures to help ensure that subrecipients account for and use ARRA funds in accordance with requirements. For example, the Texas Education Agency’s Division of Formula Funding, using a sampling methodology, will monitor Title I, IDEA, and SFSF ARRA funds. Also, subsequent to our audit work, the Texas Higher Education Coordinating Board (THECB) reported that it implemented a secure, web-based reporting system to gather and validate required data, and it developed a monitoring plan that assesses control risk to ensure the quality and accuracy of reported ARRA data. In Tennessee, the Governor directed the creation of the Office of Tennessee Recovery Act Management to coordinate ARRA activities. The Illinois State Board of Education, External Assurance group will increase its sample sizes when it tests whether LEA ARRA program expenditures comply with ARRA requirements.

Areas of Concern

SEAs, LEAs, and other State agencies that we reviewed have made changes to their systems of internal control because of guidance disseminated by the Office of Management and Budget, issued by the Department, and in response to our early audit efforts. The Department, through an email on August 27, 2009, specifically reminded States of their responsibility to thoroughly and effectively monitor subrecipients under the SFSF program. (The content of the email is shown in Attachment 2 to this MIR.) However, despite progress in the States we reviewed, systems of internal control over subrecipient monitoring could be strengthened to help provide reasonable assurance that LEAs account for and use ARRA funds appropriately. Without adequate systems of internal control, the risk that ARRA funds might be misused and that the misuse may go undetected is significantly increased. The following table summarizes the issues that we identified during our audits.³

Issue	CA	IL	IN	NY	PA	TX	Total
SEA’s and other State agency’s existing program monitoring methods not modified to cover all ARRA funds	•		•	•	•	•	5
SEA’s monitoring lacks adequate coverage of fiscal matters	•			•	•		3
SEA did not review supporting documentation or verify expenditures prior to making ARRA payments to LEAs				•	•		2
Prime recipient uncertain who will monitor SFSF funds provided to subrecipients		•					1

³ We did not identify any subrecipient monitoring issues in Tennessee.

Monitoring Methods Not Modified to Cover ARRA Funds

California. At the time of our audit, the SEA had not modified existing Title I and IDEA program monitoring procedures to ensure timely and adequate oversight of LEAs' administration and use of ARRA funds. In addition, the SEA and Governor's Office had not established subrecipient monitoring procedures for SFSF funds disbursed to LEAs. As of November 2009, the SEA reported that it was in the process of developing enhancements to program monitoring procedures that will address ARRA Title I, IDEA, and SFSF requirements.

Indiana. As of September 30, 2009, the SEA had not modified its monitoring guide, which only included programmatic monitoring, for the regular IDEA grants to include ARRA requirements. The State relies on the Indiana State Board of Accounts to conduct fiscal monitoring during its biennial Single Audits of LEAs. The SEA plans to contract with an outside firm that will conduct fiscal monitoring using a revised fiscal monitoring guide for regular IDEA funds and for funds received under the ARRA IDEA program. In February 2010, the SEA provided the Office of Special Education and Rehabilitation Services with a revised fiscal monitoring guide that covers both regular IDEA and funds received under the ARRA IDEA program (because these changes were completed after our audit, we did not assess the design of internal control over the new processes).

Because SFSF replaced State funds that could be used for general fund expenses, the SEA believed that LEAs have much greater latitude for expending SFSF. The SEA will keep track of how rapidly the LEAs expend their SFSF distributions and will require the LEAs to report specific data, such as the number of jobs funded by SFSF and vendors that have used SFSF. However, the SEA did not have procedures in place to (1) ensure that LEAs are spending SFSF in accordance with ARRA requirements or properly reporting complete and accurate SFSF information, or (2) follow up with LEAs if they fail to spend SFSF in accordance with ARRA requirements.

New York. The SEA indicated that it planned to monitor subrecipients of ARRA funds using the same methodology it used to monitor subrecipients of non-ARRA funds. The SEA's protocols had extensive programmatic monitoring procedures for Title I and IDEA. However, at the time of our audit, they had not been revised to address ARRA requirements. To strengthen its monitoring, the SEA stated that when finalized the revised protocols will reflect ARRA requirements. We also noted that the SEA provided LEAs with up-to-date guidance about the appropriate uses and the proper administration of ARRA funds, as well as information about ARRA reporting requirements.

Pennsylvania. While the SEA generally provides on-site monitoring of the Title I program at least once every 3 years, at the time of our audit, it had not made revisions to include a review of the ARRA IDEA program. The Title I program monitoring instrument included only (1) ensuring that Title I ARRA funds and expenditures were tracked separately from regular Title I funds and (2) determining that source data were available to support information reported to the SEA. Additionally, the monitoring instrument did not include procedures to verify that the LEAs were spending Federal funds in accordance with Federal regulations and the subrecipient's plan.

Texas. During our audit period, THECB's program monitoring methods and data collection efforts had not been modified to address ARRA funds. THECB was in the process of developing a comprehensive ARRA application for the Institutions of Higher Education (IHE) receiving SFSF funds. In addition to the comprehensive application, THECB planned to use the process it currently uses to monitor ARRA funds at IHEs. As of September 30, 2009, this process had not been modified to cover non-educational entities that will receive ARRA SFSF government services funds. As a result of our audit, THECB officials reported that they have implemented a secure, web-based reporting system to gather and validate required data, and they have developed a monitoring plan that assesses control risk to ensure the quality and accuracy of data reported at FederalReporting.gov. THECB also conducted a training seminar in September 2009 to ensure eligible entities were aware of ARRA guidelines (because these changes were completed after our audit, we did not assess the design of internal control over the new processes).

Monitoring Lacks Adequate Coverage of Fiscal Areas

California. At the time of our audit, the SEA only reviewed LEA Single Audit reports to monitor compliance with fiscal requirements. Reliance on Single Audits will not identify or resolve problems with LEAs' administration of ARRA funds in a timely manner. Significant amounts of ARRA Title I and SFSF funds were disbursed to LEAs more than a year before the Single Audits covering these funds will become available to the SEA. As of August 2009, the SEA did plan to request additional administrative funding to ensure LEAs appropriately spend and account for ARRA funds. As of November 2009, the SEA reported that it also was in the process of developing monitoring procedures addressing fiscal requirements under ARRA.

New York. The SEA's monitoring programs did not address fiscal areas such as LEA controls over financial recordkeeping, procurement, reporting, and payroll.

Pennsylvania. The SEA's written policies and procedures for monitoring Title I and IDEA funds did not include steps to ensure that each subrecipient's system properly accounted for procurement of goods and services and maintained financial records accurately and timely. Instead, the SEA planned to rely on Single Audits to determine what fiscal issues, if any, exist at the LEAs. Reliance on the Single Audit is not sufficient to timely identify problems that might arise regarding the LEAs' use of funds and ensure that ARRA funds are spent in accordance with both ARRA requirements as well as the plans of the LEAs.

No Review of Supporting Documentation or Verification of Expenditures Prior to Making ARRA Payments to LEAs

New York. The SEA did not verify LEA reported expenditures were supported, allowable, and in line with the approved budget prior to payment. The only information reported was (1) total payments and expenditures to date, (2) anticipated expenditures, and (3) additional funds requested. Because there was a lack of detailed information reported, there was no specific information for the SEA to review to ensure that reported expenditures were allowable and supportable. Officials explained that the SEA simply did not have the resources necessary to review all reports submitted by LEAs. In response to a preliminary version of our final audit report entitled *New York State System of Internal Control Over*

American Recovery and Reinvestment Act Funds, issued November 10, 2009, the SEA stated that it would conduct detailed onsite review at a selected 30 LEAs based on risk. While performing the reviews, the SEA planned to review support for information reported by the LEAs.

Pennsylvania. LEAs were not required to submit adequate documentation to support that expenditures had actually been made and were reasonable and allowable before LEAs are advanced additional funds or reimbursed. On a quarterly basis, LEAs are required to report total project expenditures to the Commonwealth of Pennsylvania's Office of the Comptroller (Comptroller's Office). However, this report showed only aggregated project expenditures without supporting documentation. As a result, the Comptroller's Office cannot test any of the LEAs' quarterly expenditures for reasonability and allowability. Also, the Comptroller's Office did not require the LEAs to submit any detailed expenditure information. According to a Comptroller's Office official, the primary purpose of the quarterly reports was to ensure that the scheduled payments to the LEAs were adequate to cover their monthly cash needs.

Uncertainty about Who Will Monitor SFSF Funds Provided to Subrecipients

Illinois. At the time of our audit, the Governor's Office of Management and Budget (GOMB) and the SEA were still defining responsibilities and roles for monitoring subrecipients. GOMB and the SEA subsequently signed an interagency agreement in December 2009. The agreement defined responsibilities for subrecipient monitoring of SFSF where LEAs are the subrecipients. In addition, the interagency agreement identifies the entity or entities that will be responsible for administering the SFSF government services funds. The SEA also was working on a proposal to contract fiscal monitoring of ARRA SFSF expenditures by LEAs for compliance with Federal requirements. Because the interagency agreement was not completed until after our audit, we did not assess the design of internal control over all of Illinois' SFSF funds.

Purpose and Methodology

The purpose of this final MIR is to highlight issues of concern related to States' monitoring of ARRA funds passed through to subrecipients. We conducted audit work in seven States (California, Illinois, Indiana, New York, Pennsylvania, Texas, and Tennessee). We updated the status of issues based on information provided by the auditees subsequent to our audit work. However, we have not verified the additional information.

To accomplish the objective of this MIR, we reviewed audit documentation and summarized subrecipient monitoring issues identified in the following ED-OIG issued reports:

- *Fiscal Issues Reported in ED-OIG Work Related to LEAs and SEAs*, Control Number ED-OIG/X05J0005, issued July 21, 2009.
- *New York State System of Internal Control Over American Recovery and Reinvestment Act Funds*, Control Number ED-OIG/A02J0006, issued November 10, 2009.
- *Systems of State-level Internal Control Over American Recovery and Reinvestment Act Funds in Tennessee*, Control Number ED-OIG/A04J0010, issued December 15, 2009.
- *Internal Control Reviews at Three Local Educational Agencies (LEA) in Tennessee*, Control Number ED-OIG/A04K0002, issued December 18, 2009.

- *Systems of Internal Control Over Selected ARRA Funds in the State of Indiana*, Control Number ED-OIG/A05J0011, issued January 14, 2010.
- *State and Local Controls Over ARRA Funds in California*, Control Number ED-OIG/A09J0006, issued January 15, 2010.
- *Systems of Internal Control Over Selected ARRA Funds in the State of Texas*, Control Number ED-OIG/A06J0013, issued January 27, 2010.
- *Systems of Internal Control Over Selected ARRA Funds in the State of Illinois*, Control Number ED-OIG/A05J0012, issued February 23, 2010.
- *Commonwealth of Pennsylvania Recovery Act Audit of Internal Controls over Selected Funds*, Control Number ED-OIG/A03J0010, issued March 15, 2010.

We conducted our work in accordance with the ED-OIG quality standards for Management Information Reports.

Administrative Matters

Statements that managerial practices need improvements, as well as other conclusions and suggestions in this report, represent the opinions of the Office of Inspector General.

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.

If you would like to discuss the information presented in this MIR or obtain additional information, please call Gary D. Whitman, Regional Inspector General for Audit, at (312) 730-1620, or me at (202) 245-7050.

Attachments

Acronyms/Abbreviations Used in this Report

ARRA	American Recovery and Reinvestment Act of 2009
C.F.R.	Code of Federal Regulations
Comptroller's Office	Office of the Comptroller (Pennsylvania)
ED-OIG	U.S. Department of Education, Office of Inspector General
GAO	Government Accountability Office
GOMB	Governor's Office of Management and Budget (Illinois)
IDEA	Individuals with Disabilities Education Act, Part B
IHE	Institutions of Higher Education
LEA	Local Educational Agency
MIR	Management Information Report
SEA	State Educational Agency
SFSF	State Fiscal Stabilization Fund
THECB	Texas Higher Education Coordinating Board
Title I	Elementary and Secondary Education Act, Title I, Part A, Basic Grants

MONITORING: States' Responsibility to Monitor Subrecipients Under the State Fiscal Stabilization Fund,

U.S. Department of Education, August 27, 2009
<http://www.ed.gov/programs/statestabilization/index.html>

The purpose of this e-mail is to remind States of their responsibility to thoroughly and effectively monitor subrecipients under the State Fiscal Stabilization Fund program.

In the April 2009 Guidance on the State Fiscal Stabilization Fund Program, the U.S. Department of Education (Department) emphasized that funds awarded under the American Recovery and Reinvestment Act of 2009 (ARRA) must be spent with an unprecedented level of transparency and accountability. The Department noted that States have important oversight responsibilities and must monitor grant and subgrant supported activities to ensure compliance with all applicable Federal requirements. (Guidance at VII-1)

In its Application for Initial Funding under the State Fiscal Stabilization Program, each State assured that it would comply with all of the accountability, transparency, and reporting requirements that apply to the Stabilization program. Each State also assured, among other things, that it would comply with the applicable provisions of the Education Department General Administrative Regulations (EDGAR), including the uniform administrative requirements in 34 C.F.R. Part 80. (Application for Initial Funding at Parts 6 and 7)

The regulations at 34 C.F.R. 80.40 state as follows:

“Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grant monitoring must cover each program, function or activity”.

Each State's Grant Award Notification (GAN) also included, under the terms and conditions, the statement that funds awarded under the State Fiscal Stabilization Fund program are subject to all applicable statutes and regulations, including Title IV of ARRA, the General Education Provisions Act (GEPA), and EDGAR.

To comply with these requirements, each State must have a comprehensive monitoring plan and protocol to review grant and subgrant supported activities. The monitoring plans should address areas such as the following:

- A monitoring schedule;
- Monitoring policies and procedures;
- Data collection instruments (e.g., interview guides, review checklists);
- Monitoring reports and feedback to subrecipients; and
- Processes for verification of implementation of required corrective actions.

During its monitoring of grantees, the Department will review each State's monitoring plan and protocols to ensure that the State is complying with Federal monitoring requirements.

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