UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

AUDIT SERVICES
Sacramento Audit Region

December 20, 2012

Control Number
ED-OIG/A09M0003

Doris Smith
Administrator
Arkansas Department of Finance and Administration
Office of Intergovernmental Services
1515 West 7th Street
Little Rock, AR 72201-8031

Dr. Tom W. Kimbrell
Commissioner of Education
Arkansas Department of Education
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Dear Administrator Smith and Commissioner Kimbrell:

As part of a nationwide U.S. Department of Education (Department) Office of Inspector General review of final expenditures under the American Recovery and Reinvestment Act of 2009 (Recovery Act), we reviewed Recovery Act expenditures at El Dorado School District (El Dorado) and Little Rock School District (Little Rock) in Arkansas. The purpose of the nationwide audit was to determine whether selected local educational agencies (LEAs) obligated and spent final Recovery Act funding on reasonable, allocable, and allowable activities in accordance with applicable Federal requirements. The Office of Inspector General plans to issue a separate audit report to the Department to present the results of the nationwide audit. The purpose of this final audit report, "Arkansas: Final Recovery Act Expenditures Supplemental Report," is to separately address questioned costs at El Dorado and internal control weaknesses over inventory at Little Rock so that your agencies can take appropriate corrective action.

Our review covered January 1 through December 31, 2011, and selected Recovery Act expenditures for the State Fiscal Stabilization Fund, Education Stabilization Fund (ESF); Title I Part A of the Elementary and Secondary Education Act (Title I); and Part B of the Individuals with Disabilities Education Act (IDEA) grant programs.

BACKGROUND

The Department awarded $363.1 million in ESF funds to the Governor of Arkansas, who designated the Arkansas Division of Finance and Administration (Finance and Administration) as the entity responsible for administering the ESF grant. Finance and Administration subsequently shared administration and oversight responsibility for ESF with the Arkansas Department of Education (Arkansas Education). The Department also awarded $111.1 million in Recovery Act Title I funds and $112.2 million in Recovery Act IDEA funds to Arkansas Education, which was solely responsible for administering and overseeing those funds.

For the three grants covered by the audit, El Dorado was awarded more than $6.6 million and Little Rock received almost $36.3 million, as shown in Table 1. The grant period for each of these grants ended September 30, 2011.[1]

Table 1: Recovery Act Grant Award Amounts for El Dorado and Little Rock

Recovery Act Grant	El Dorado	Little Rock
ESF	$3,969,657	$22,717,522
Title I	1,523,640	7,549,743
IDEA	1,120,781	6,028,310
Total	**$6,614,078**	**$36,295,575**

Source: Grant information provided by Arkansas Education.

AUDIT RESULTS

El Dorado and Little Rock generally obligated and spent the Recovery Act ESF, Title I, and IDEA funds we reviewed in accordance with applicable laws, regulations, guidance, and program requirements. However, we questioned El Dorado's use of $237,302 in ESF funds for a purpose prohibited by the Recovery Act. We also identified control weaknesses in Little Rock's asset inventory system that resulted in the district not properly accounting for and safeguarding equipment purchased with Recovery Act funds (and potentially other Federal funds) in a timely manner.

We provided a draft of this report to Finance and Administration and Arkansas Education for review and comment on October 4, 2012. Finance and Administration and Arkansas Education did not state whether they agreed with our findings but did describe the corrective actions taken to address our recommendations. Their comments are included as an enclosure to this report.

[1] Under § 421(b) of the General Education Provisions Act (Tydings Amendment), the school districts had to obligate the Recovery Act grant funds by September 30, 2011. Department regulation required the districts to liquidate (or make final payment on) the obligations no later than 90 days after the end of the grant period (34 C.F.R. § 80.23). As described in the Scope and Methodology section, our review covered expenditures from January 1 through December 31, 2011.

FINDING NO. 1 – Finance and Administration and Arkansas Education Should Ensure That El Dorado Used ESF Funds for Allowable Purposes

El Dorado improperly spent $237,302, or about 6 percent of its ESF grant, to replace a gymnasium roof at an old high school that the district no longer used as a school. The district transferred the students to a newly constructed high school for the 2011–2012 school year. El Dorado's superintendent said that the district planned to use the old high school's gymnasium for sporting events and community activities and other school buildings for administrative offices. The unallowable costs included $213,777 to construct the gymnasium roof and $23,525 for architectural services.

Section 14003(b) of the Recovery Act specified four prohibited uses of ESF funds, including a prohibition against using the funds to improve stand-alone facilities that are not primarily used to educate children, including buildings for central office administration, operations, or logistical support.

Even though Arkansas Education provided guidance and training to LEAs on allowable uses of Recovery Act funds, El Dorado officials responsible for administering the ESF grant said they were not aware that the Recovery Act prohibited the district from using ESF funds for facilities that are not primarily used to educate children. El Dorado's business manager was primarily responsible for administering the ESF grant and participated in a Recovery Act webinar presented by Arkansas Education. However, the manager told us that she did not know about the ESF prohibitions. Further, El Dorado's plan for the roofing project, which Arkansas Education approved, did not accurately describe the project or its goals. We determined that the district submitted a project plan that mirrored the goals from another roofing project for an operating elementary school.

Arkansas Education issued guidance to all of its LEAs identifying the ESF prohibitions and, along with Finance and Administration, monitored LEAs' Recovery Act expenditures. However, their monitoring processes did not include testing specifically for the prohibited uses of ESF funds. Had El Dorado officials been aware of the ESF prohibitions, the district could have used the $237,302 of improperly spent ESF funds for allowable education-related purposes during the grant period. In response to our finding, El Dorado's superintendent and business manager stated that the district reversed the costs we questioned from the ESF account and transferred in a like amount of allowable expenditures from other accounts. We did not verify whether the transferred expenditures were allowable charges or were obligated during the grant period.

RECOMMENDATION

1.1 We recommend that the Director of the Department's Implementation and Support Unit determine whether El Dorado's transfer of other expenditures to offset the $237,302 in questioned ESF costs was an allowable activity more than 6 months after the grant had ended.

- If the transfer was an allowable activity, the Director should require Finance and Administration and Arkansas Education to verify that the transferred expenditures conformed to applicable Federal requirements, including verifying that the replacement expenditures were allowable and represented expenditures that were obligated during the grant period. Finance and Administration and Arkansas Education should also be required to confirm that the same expenditures were not charged to both the ESF account and the accounts that were the source for the transferred expenditures.

- If the transfer was not an allowable activity, or if it was an allowable activity but the transfer included improper charges or expenditures that were not obligated during the grant period, the Director should require Finance and Administration and Arkansas Education to either (1) ensure El Dorado returns the appropriate amount of ESF funds, with applicable interest, to the Department; or (2) provide documentation showing that El Dorado incurred at least $237,302 in other allowable expenditures during the grant period that were not but could have been charged to the ESF account.

Finance and Administration and Arkansas Education Comments

Finance and Administration and Arkansas Education stated that the finding has been corrected. El Dorado reclassified $237,302 in questioned costs from the ESF account to its operating fund and moved $237,302 of fringe benefits from the operating account to the ESF account. Based on its review of accounting and payroll records at El Dorado, Arkansas Education confirmed that the district had incurred and paid all of the fringe benefit costs between July 1 and September 30, 2011.

Office of Inspector General Response

The corrective action identified in Finance and Administration's and Arkansas Education's comments addresses our recommendation. However, we did not review the accounting and payroll documentation to assess the adequacy of the corrective action. Because Finance and Administration's and Arkansas Education's comments included updated information on the corrective action, we removed some of the information that El Dorado had previously provided in response to the finding. We also expanded the recommendation by adding another option in the event that the Department determines that the transfer was not an allowable activity or was an allowable activity that included improper charges or expenditures.

FINDING NO. 2 – Little Rock Needs to Strengthen Controls Over Assets Purchased With Recovery Act Funds

Little Rock's asset inventory procedures did not ensure that assets purchased with Recovery Act funds, and potentially other Federal funds, were properly accounted for and safeguarded in a timely manner. The district did not have effective control or accountability over assets purchased with Recovery Act funds for more than 5 months after it received the assets. In April 2012, we assessed the adequacy of the district's internal controls by testing seven nonpersonnel expenditures for technology-related equipment and furniture that the district purchased with Recovery Act funds in September 2011. We found that four of the seven purchases included assets that had not been recorded in Little Rock's fixed asset inventory system even though the district received the assets more than 5 months before our review, as shown in Table 2 below. The four purchases totaled almost $196,000, or about 43 percent of the $459,000 in purchases that we tested.

In May 2012, we performed a physical inventory and confirmed that the Computer Information Services department and eight schools received the assets. When we visited two schools where a vendor had installed wireless Internet systems, we identified discrepancies between the district's accounting records and the schools' inventory information. Serial numbers for a wireless Internet switch and two controllers, totaling $33,000, did not match the invoices for the wireless Internet equipment.

Table 2: Assets Not Recorded in Little Rock's Fixed Asset Inventory System as of April 2012

Purchase Order	Asset	Date of Obligation	Date Asset Received	Purchase Amount	Recovery Act Grant
320001439*	8 partitions	9/15/2011	11/29/2011	$11,087	IDEA
320001799	Wireless Internet equipment	9/30/2011	12/2/2011	57,927	Title I
320001802	Wireless Internet equipment	9/30/2011	11/15/2011	67,213	ESF
320001812	4 hard drive chassis	9/30/2011	12/1/2011	59,634	ESF
Total Purchase Amount				**$195,861**	

* The purchase order totaled $15,245 for 11 partitions that were shipped to 6 schools. Eight of the 11 partitions were not recorded in the inventory system. We estimated the purchase amount for the 8 partitions by dividing the total amount of the purchase order by 11 to calculate a unit cost and multiplying the unit cost by 8 ($15,245/11 x 8 = $11,087).

Source: Accounting and inventory records provided by Little Rock.

The Education Department General Administrative Regulations require States and school districts to maintain effective control and accountability over all assets purchased with Federal grant funds, including adequately safeguarding the assets (34 C.F.R. § 80.20(b)(3)) and maintaining proper inventory records for equipment acquired with Federal grant funds (34 C.F.R. § 80.32(d)(1)).

Little Rock's inventory procedures did not support the timely accounting for and safeguarding of assets purchased with Recovery Act and potentially other Federal funds. Toward the end of the grant period, the district purchased a large volume of assets that we confirmed were reasonable and necessary. Although most of the purchased items were shipped to the Procurement department, vendors shipped some equipment directly to the Computer Information Services department and individual schools. However, staff at those locations did not always provide inventory information to the Procurement department in a timely manner. For the four purchases shown in Table 2, staff from the locations that received the assets had not confirmed receipt or provided inventory information to the district's Procurement department for input into the fixed asset inventory system. According to the district's inventory procedures, staff at the receiving locations were responsible for inspecting and inventorying the assets upon receipt; tagging them with a district identification number; and providing information, such as the tag number, model, serial number, and location, to the Procurement department for input into the fixed asset inventory system.

The Procurement department's fixed asset property manager maintained a record of purchased items shipped to schools and other district locations for which staff had not provided inventory information. As of April 2012, the property manager had not verified that the locations received the purchased assets. Instead, the property manager told us that she planned to follow up with staff at these locations when she accounted for all district assets in the fixed asset inventory system before the district closed its accounting records on September 30, 2012.

For the two schools where we identified inventory discrepancies related to wireless Internet equipment, the district purchased the same equipment, which included switches and controllers, for installation at multiple schools. The fixed asset property manager said that the district designated individual switches and controllers by serial number for each school, but the vendor mixed up one or both of the devices when installing them at the schools. In response to our finding, the manager reported that district staff inventoried and accounted for all of the wireless equipment installed by that vendor. For the inventory discrepancies we identified at two schools, the district provided an updated inventory report and vendor invoices showing the correct locations where the switch and two controllers were installed.

Because staff at receiving locations did not provide inventory information when assets were received and the Procurement department did not follow up on the status of the purchases in a timely manner, the district's fixed asset inventory system was not accurate or complete for an extended period of time. The absence of strong inventory controls increased the risk that the purchased assets might be subject to misuse or theft. Although we reviewed only selected Recovery Act transactions, the control weaknesses we identified could have also affected assets purchased with other Federal funds.

RECOMMENDATION

2.1 We recommend that the Director of the Department's Implementation and Support Unit, in conjunction with the Assistant Secretary for Elementary and Secondary Education and the Assistant Secretary for Special Education and Rehabilitative Services, require Finance and Administration and Arkansas Education to ensure that Little Rock strengthens internal controls over assets purchased with Federal funds. Specifically, the district should be required to develop and implement additional policies and procedures for schools and district departments to provide accurate inventory information to the Procurement department in a timely manner and reconcile their inventory information with district records on a regular basis. Further, the procedures should include steps for the Procurement department to routinely follow up with receiving locations that have assets on the outstanding inventory list to verify receipt and ensure that they provide the required inventory information timely.

Finance and Administration and Arkansas Education Comments

Finance and Administration and Arkansas Education stated that Arkansas Education confirmed that Little Rock recorded the four purchases and corrected serial numbers for the wireless equipment in its fixed asset inventory system. They also provided a copy of Little Rock's updated procurement procedures, which included mandatory timelines for receiving and recording fixed assets. Little Rock planned to issue a memorandum requiring all departments and schools to comply with the revised procedures beginning January 1, 2013.

Office of Inspector General Response

The corrective action identified in Finance and Administration's and Arkansas Education's comments addresses our recommendation. We reviewed Little Rock's updated procurement procedures for capturing fixed assets in the property accounting system and determined that they addressed the types of procedures specified in our recommendation. However, we did not evaluate their implementation. We did not modify our finding or recommendation based on Finance and Administration's and Arkansas Education's comments.

SCOPE AND METHODOLOGY

The objective of the nationwide audit was to determine whether selected LEAs (including the two Arkansas school districts covered by this report) obligated and spent final Recovery Act funding in accordance with applicable Federal requirements. The purpose of this supplemental report was to address our findings related to questioned costs and internal control weaknesses so that Finance and Administration and Arkansas Education can take appropriate corrective action.

Our review covered two school districts (El Dorado and Little Rock) as well as two State agencies (Finance and Administration and Arkansas Education). Our review covered January 1 through December 31, 2011, and Recovery Act expenditures for three education-related grants:[2] (1) State Fiscal Stabilization Fund, Education Stabilization Fund, 84.394; (2) Title I Part A of the Elementary and Secondary Education Act, 84.389; and (3) Part B of the Individuals with Disabilities Education Act, 84.391.

For the findings contained in this report, we interviewed Finance and Administration and Arkansas Education officials responsible for administering and overseeing the three Recovery Act grants and reviewed State policies, procedures, and guidance to gain an understanding of the processes and controls for monitoring LEAs' Recovery Act expenditures. At each school district, we interviewed fiscal and program officials responsible for administering the Recovery Act grants. We also reviewed district policies and procedures to gain an understanding of their processes for financial and inventory management, procurement, and reimbursement of Recovery Act expenditures from Arkansas Education. To determine whether Recovery Act funds were used in accordance with Federal requirements, we reviewed district accounting records, contracts, and inventory records. At each district, we also reviewed and considered the results and findings of prior Single Audit reports as well as State monitoring reports on Recovery Act plans and expenditures.

We performed a limited assessment of the two districts' policies and procedures by judgmentally selecting samples of nonpersonnel expenditure transactions made by each district from January 1 through December 31, 2011, to determine whether the costs charged to Recovery Act grants complied with applicable Federal requirements. Using a risk-based approach, we selected transactions for each grant that represented high dollar amounts; transaction dates during or after

[2] We also provide the Catalog of Federal Domestic Assistance number assigned for grant-tracking purposes.

September 2011, the last month of the grant period; and different types of purchases such as technology, supplies, furniture, and construction. For El Dorado, we selected a total of 15 transactions totaling $820,747 from a universe of $2,493,886 in ESF nonpersonnel expenditures during our audit period. For Little Rock, we selected 20 transactions totaling $2,399,008 from a universe of $11,028,790 in ESF, Title I, and IDEA nonpersonnel expenditures during our audit period. The selected transactions at Little Rock also included transactions that occurred early in our audit period or that represented smaller dollar amounts. Because we judgmentally selected samples of nonpersonnel expenditure transactions, the results presented in this report cannot be projected to the universe of expenditures for the period covered by our testing.

We relied on computer-processed data contained in the Arkansas Education and Little Rock accounting systems for purposes of determining Recovery Act grant award, revenue, expenditure, and refund amounts at the two school districts. El Dorado used Arkansas Education's statewide accounting system and Little Rock used its own accounting system. We reconciled the districts' Recovery Act grant amounts with the amounts in Arkansas Education's accounting system. We also reviewed the fiscal year 2011 financial and Single Audit reports to identify findings at each district or Arkansas Education related to internal controls or other matters that might negatively affect data reliability. Further, we interviewed El Dorado, Little Rock, and Arkansas Education officials to gain an understanding of the accounting systems and verify grant amounts. Based on our assessment, we determined that the computer-processed data were sufficiently reliable for the purposes of our review.

We performed fieldwork in April and May 2012 at school district offices in Little Rock and El Dorado as well as Finance and Administration and Arkansas Education offices in Little Rock, Arkansas.

We conducted the audit work related to this supplemental report in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

ADMINISTRATIVE MATTERS

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

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 Department action officials listed below, who will consider them before taking final Department action on this audit.

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It is the policy of the U.S. Department of Education to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, receipt of your comments within **30 days** would be appreciated.

In accordance with the Freedom of Information Act (5 U.S.C. §552), reports issued by the Office of Inspector General are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

Sincerely,

/s/

Raymond Hendren
Regional Inspector General for Audit

Enclosure

Enclosure

Finance and Administration’s and Arkansas Education’s Comments to the Draft Report

ARKANSAS DEPARTMENT OF EDUCATION

Dr. Tom W. Kimbrell
Commissioner

November 5, 2012

Control Number
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Mr. Raymond Hendren
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Dear Mr. Hendren,

Thank you for the opportunity to comment on your Findings and Recommendations presented in the draft report "Arkansas: Final Recovery Act Expenditures Supplemental Report" (Report) dated October 4, 2012.

As stated in your letter, "the purpose of this draft audit report, "Arkansas: Final Recovery Act Expenditures Supplemental Report," is to separately address questioned costs at El Dorado and internal control weaknesses over inventory at Little Rock so that your agencies can appropriate corrective action."

In response to this Report Arkansas Education has worked with the El Dorado School District (EDSD) to document that corrective actions have been completed and with Little Rock School District (LRSD) to review their Procurement procedures, the current timeliness of their Procurement process, and to document that corrective actions have been taken. This letter will specifically address the findings and recommendation included in the Report.

El Dorado School District

Finding No. 1: Finance and Administration and Arkansas Education Should Ensure That El Dorado used ESF Funds for Allowable purposes

1. El Dorado improperly spent $237,302. The unallowable costs included $213,777 to construct the gymnasium roof and $23,525 for architectural services.

Recommendation:

Determine whether the transfer of expenditures to offset the $237,302 was an allowable activity

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- If the transfer was allowable, Arkansas Education should verify that the replacement expenditures were allowable and represented expenditures that were obligated during the grant period.
- Confirm that the expenditures were not charged to both the EF account and the accounts that were the source for the transferred expenditures.

El Dorado School District (EDSD) has reclassified $237,302.40 in questioned costs from the ESF account to its operating fund and moved $237,302.40 of allowable fringe benefits costs from the operating fund to ESF. Arkansas Education has received EDSD's Detail Expenditure Status Report and confirmed that all fringe benefit costs were incurred and paid between July 1, 2011 and September 30, 2011. EDSD also submitted a list of the individual benefit amounts paid, by the name of the employee and the date of payment, which were moved into the ESF account.

Benefits are an allowable expenditure per the Guidance on the State Fiscal Stabilization Fund Program (Guidance), USDOE April 2009, (page 20).

This finding has been corrected.

Little Rock School District

Finding No. 2: LRSD Needs to Strengthen Controls Over Assets Purchased with Recovery Act Funds

1. Four of seven purchases included assets not recorded in LRSD fixed asset inventory system
2. Serial numbers for a wireless Internet switch and two controllers did not match the invoices.
3. Of a large number of items purchased toward the end of the grant period, some equipment was shipped directly to the Computer Information Services and the individual schools. Staff at these locations did not always provide inventory information in a timely manner.

Recommendation:

- The District should be required to develop and implement additional policies and procedures for schools and district departments to provide accurate inventory information to the Procurement department in a timely manner and reconcile their inventory information with District records on a regular basis. Further, the procedures should include steps for the Procurement department to routinely follow up with receiving locations that have assets on the outstanding inventory list to verify receipt and ensure that they provided the required inventory information timely.

Arkansas Education confirmed that LRSD has recorded the four purchases in the fixed asset inventory system and corrected serial numbers for the wireless Internet switch in completion of the items identified in the audit.

Further, LRSD Procurement Department is updating their procedure manuals to reflect a new policy (see attached: LRSD Procurement Update). The revised procedures include mandatory timelines for receipting and recording of fixed assets. A memo will be issued to Central Procurement, schools and departments requiring mandatory compliance with the revised procedures beginning January 1, 2013. LRSD believes the implemented actions in accordance with the revised procedures will improve the accuracy and timeliness of inventory.

Arkansas Education and Finance and Administration appreciate the work performed by USDOE Office of Inspector General and the opportunity to address these Findings and Recommendations. If we can be of further assistance, please contact Patty Martin at 501.682.1114 or patricia.martin@arkansas.gov

Sincerely,

[redacted]

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cc: Jared Cleveland, Assistant Commissioner, Fiscal & Administrative Services