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RECOVERY ACT

States' and Localities' Current and Planned Uses of Funds While Facing Fiscal Stresses

Statement of Gene L. Dodaro
Acting Comptroller General of the United States

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Accountability * Integrity * Reliability

GAO-09-908T

July 2009

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GAO Accountability • Integrity • Reliability

Highlights

Highlights of GAO-09-908T a testimony before the Committee on Homeland Security and Government Affairs, U.S. Senate

Why GAO Did This Study

This testimony is based on GAO's second report in response to a mandate under the American Recovery and Reinvestment Act of 2009 (Recovery Act). The report addresses: (1) selected states' and localities' uses of Recovery Act funds, (2) the approaches taken by the selected states and localities to ensure accountability for Recovery Act funds, and (3) states' plans to evaluate the impact of Recovery Act funds. GAO's work for the report is focused on 16 states and certain localities in those jurisdictions as well as the District of Columbia—representing about 65 percent of the U.S. population and two-thirds of the intergovernmental federal assistance available. GAO collected documents and interviewed state and local officials. GAO analyzed federal agency guidance and spoke with Office of Management and Budget (OMB) officials and with program officials at the Centers for Medicare and Medicaid Services, and the Departments of Education, Energy, Housing and Urban Development, Justice, Labor, and Transportation.

What GAO Recommends

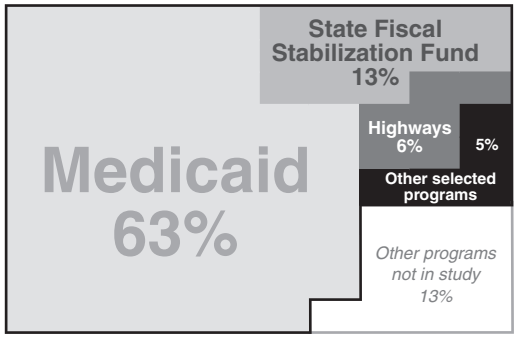
GAO makes recommendations and a matter for congressional consideration discussed on the next page. The report draft was discussed with federal and state officials who generally agreed with its contents. OMB officials generally agreed with GAO's recommendations to OMB; DOT agreed to consider GAO's recommendation.

View GAO-09-908T, GAO-09-829 or key components. For state summaries, see GAO-09-830SP.For more information, contact J. Christopher Mihm at (202) 512-6806 or mihmj@gao.gov.

What GAO Found

Across the United States, as of July 10, 2009, Treasury had outlayed about $35 billion of the estimated $49 billion in Recovery Act funds projected for use in states and localities in fiscal year 2009. More than 90 percent of the federal outlays has been provided through the increased Medicaid Federal Medical Assistance Percentage (FMAP) and the State Fiscal Stabilization Fund (SFSF) administered by the Department of Education.

GAO's work focused on nine federal programs that are estimated to account for approximately 87 percent of federal Recovery Act outlays in fiscal year 2009 for programs administered by states and localities. The following figure shows the distribution by program of anticipated federal Recovery Act spending in fiscal year 2009 for the nine programs discussed in this report.



87% of estimated federal Recovery Act outlays to states and localities in fiscal year 2009 will be in the nine programs reviewed by GAO.

1% IDEA, Parts B and C
1% WIA Youth Programs
1% ESEA, Title 1 Part A
Less than 1%
- Byrne grants
- Weatherization Assistance Program
- Public Housing Capital Fund

Source: GAO analysis of data from CBO and Federal Funds Information for States.

Increased Medicaid FMAP Funding

All 16 states and the District have drawn down increased Medicaid FMAP grant awards of just over $16 billion for October 1, 2008, through July 16, 2009. Medicaid enrollment increased for most of the selected states and the District, and several states noted that the increased FMAP funds were critical in their efforts to maintain coverage at current levels. States and the District reported they are planning to use the increased federal funds to cover their increased Medicaid caseload and to maintain current benefits and eligibility levels. Due to the increased federal share of Medicaid funding, most state officials also said they would use freed-up state funds to help cope with fiscal stresses.

Highway Infrastructure Investment

As of July 15, the Department of Transportation (DOT) had obligated about $9.7 billion for about 3,000 highway infrastructure and other eligible projects in the 16 states and the District and had reimbursed about $138.2 million. Across the nation, almost half of the obligations have been for pavement improvement projects because they did not require extensive environmental clearances, were quick to design, obligate and bid on, could employ people quickly, and could be completed within 3 years. Officials from most states considered project readiness, including the 3-year completion requirement, when making project selections and only later identified to what

extent these projects fulfilled the economically distressed area requirement. We found substantial variation in how states identified economically distressed areas and how they prioritized project selection for these areas.

State Fiscal Stabilization Fund

As of July 1, 2009, all of the 16 states and the District of Columbia covered by our review had submitted an SFSF application. Pennsylvania and Texas have recently submitted applications to Education, but as of July 16, 2009 their applications had not yet been approved. Education has made a total of over $18 billion in funding available to the remaining 14 states and the District of Columbia—of which over $6.1 billion has been drawn down. School districts said they would use SFSF funds to maintain current levels of education funding, particularly for retaining staff and current education programs. They also told us that SFSF funds would help offset state budget cuts. Overall, states reported using Recovery Act funds to stabilize state budgets and to cope with fiscal stresses. The funds helped them maintain staffing for existing programs and minimize or avoid tax increases as well as reductions in services.

Accountability

States have implemented various internal control programs; however, federal Single Audit guidance and reporting does not fully address Recovery Act risk. The Single Audit reporting deadline is too late to provide audit results in time for the audited entity to take action on deficiencies noted in Recovery Act programs. Moreover, current guidance does not achieve the level of accountability needed to effectively respond to Recovery Act risks. Finally, state auditors need additional flexibility and funding to undertake the added Single Audit responsibilities under the Recovery Act.

Impact

Direct recipients of Recovery Act funds, including states and localities, are expected to report quarterly on a number of measures, including the use of funds and estimates of the number of jobs created and retained. The first of these reports is due in October 2009. OMB—in consultation with a range of stakeholders—issued additional implementing guidance for recipient reporting on June 22, 2009, that clarifies some requirements and establishes a central reporting framework.

In addition to employment-related reporting, OMB requires reporting on the use of funds by recipients and nonfederal subrecipients receiving Recovery Act funds. The tracking of funds is consistent with the Federal Funding Accountability and Transparency Act (FFATA). Like the Recovery Act, FFATA requires a publicly available Web site—www.USAspending.gov—to report financial information about entities awarded federal funds. Yet, significant questions have been raised about the reliability of the data on www.USAspending.gov, primarily because what is reported by the prime recipients is dependent on the unknown data quality and reporting capabilities of subrecipients.

GAO's Recommendations

Accountability and Transparency

To leverage Single Audits as an effective oversight tool for Recovery Act programs, the Director of OMB should

- develop requirements for reporting on internal controls during 2009 before significant Recovery Act expenditures occur, as well as for ongoing reporting after the initial report;
- provide more direct focus on Recovery Act programs through the Single Audit to help ensure that smaller programs with high risk have audit coverage in the area of internal controls and compliance;
- evaluate options for providing relief related to audit requirements for low-risk programs to balance new audit responsibilities associated with the Recovery Act; and
- develop mechanisms to help fund the additional Single Audit costs and efforts for auditing Recovery Act programs.

Matter for Congressional Consideration: Congress should consider a mechanism to help fund the additional Single Audit costs and efforts for auditing Recovery Act programs.

Reporting on Impact

The Director of OMB should work with federal agencies to provide recipients with examples of the application of OMB's guidance on recipient reporting of jobs created and retained. In addition, the Director of OMB should work with agencies to clarify what new or existing program performance measures are needed to assess the impact of Recovery Act funding.

Communications and Guidance

To strengthen the effort to track funds and their uses, the Director of OMB should (1) ensure more direct communication with key state officials, (2) provide a long range time line on issuing federal guidance, (3) clarify what constitutes appropriate quality control and reconciliation by prime recipients, and (4) specify who should best provide formal certification and approval of the data reported.

The Secretary of Transportation should develop clear guidance on identifying and giving priority to economically distressed areas that are in accordance with the requirements of the Recovery Act and the Public Works and Economic Development Act of 1965, as amended, and more consistent procedures for the Federal Highway Administration to use in reviewing and approving states' criteria.

Mr. Chairman, Ranking Member Collins, and Members of the Committee:

I am pleased to be here today to discuss our work examining the uses and planning by selected states and localities for funds made available by the American Recovery and Reinvestment Act of 2009 (Recovery Act).[1] As federal funds provided by the Recovery Act flow into the U.S. economy, state fiscal conditions continue to be stressed. Actual declines in sales, personal income, and corporate income tax revenues influenced state actions to begin to fill an estimated $230 billion in budget gaps for fiscal years 2009 through 2011.[2] The national unemployment rate also increased to 9.5 percent in June 2009, and high unemployment can place greater stress on state budgets as demand for services, such as Medicaid, increases. Some economists have pointed to signs of economic improvement, although associations representing state officials have also reported that state fiscal conditions historically lag behind any national economic recovery.

The Recovery Act specifies several roles for GAO, including conducting bimonthly reviews of selected states' and localities' use of funds made available under the act.[3] The report that we issued on July 8th, the second in response to the act's mandate, addressed the following objectives: (1) selected states' and localities' uses of Recovery Act funds, (2) the approaches taken by the selected states and localities to ensure accountability for Recovery Act funds, and (3) states' plans to evaluate the impact of the Recovery Act funds they received.[4] The report provides overall findings, makes recommendations, and discusses the status of actions in response to the recommendations we made in our April 2009 report.[5] Individual summaries for the 16 selected states and the District of Columbia (District) are accessible through GAO's recovery page at

[1]Pub. L. No. 111-5, 123 Stat. 115 (February 17, 2009).

[2]The estimated budget gaps are reported by associations representing state officials. See The National Governors Association and the National Association of State Budget Officers, *The Fiscal Survey of States* (Washington, D.C., June 2009).

[3]Recovery Act, div. A, title IX, §901.

[4]GAO, *Recovery Act: States' and Localities' Current and Planned Uses of Funds While Facing Fiscal Stresses*, GAO-09-829 (Washington, D.C.: Jul. 8, 2009).

[5]GAO, *Recovery Act: As Initial Implementation Unfolds in States and Localities, Continued Attention to Accountability Issues Is Essential*, GAO-09-580 (Washington, D.C.: Apr. 23, 2009).

www.gao.gov/recovery. In addition, all of the summaries have been compiled into an electronic supplement, GAO-09-830SP.

As reported in our April 2009 review, to address these objectives, we selected a core group of 16 states and the District that we will follow over the next few years.[6] Our bimonthly reviews examine how Recovery Act funds are being used and whether they are achieving the stated purposes of the act. These purposes include

- to preserve and create jobs and promote economic recovery;
- to assist those most impacted by the recession;
- to provide investments needed to increase economic efficiency by spurring technological advances in science and health;
- to invest in transportation, environmental protection, and other infrastructure that will provide long-term economic benefits; and
- to stabilize state and local government budgets, in order to minimize and avoid reductions in essential services and counterproductive state and local tax increases.

The states selected for our bimonthly reviews contain about 65 percent of the U.S. population and are estimated to receive collectively about two-thirds of the intergovernmental federal assistance funds available through the Recovery Act. We selected these states and the District on the basis of federal outlay projections, percentage of the U.S. population represented, unemployment rates and changes, and a mix of states' poverty levels, geographic coverage, and representation of both urban and rural areas. In addition, we visited a nonprobability sample of more than 175 local entities within the 16 selected states and the District.[7]

GAO's work for this report focused on nine federal programs primarily because they have begun disbursing funds to states or have known or

[6]The states we are following as part of our analysis are Arizona, California, Colorado, Florida, Georgia, Illinois, Iowa, Massachusetts, Michigan, Mississippi, New Jersey, New York, North Carolina, Ohio, Pennsylvania, and Texas.

[7]This total includes two entities in the District of Columbia that received direct federal funding that was not passed through the District government.

potential risks.[8] These risks can include existing programs receiving significant amounts of Recovery Act funds or new programs. We collected documents from and conducted semistructured interviews with executive-level state and local officials and staff from state offices including governors' offices, "recovery czars," state auditors, and controllers. In addition, our work focused on federal, state, and local agencies administering the selected programs receiving Recovery Act funds. We analyzed guidance and interviewed officials from the federal Office of Management and Budget (OMB). We also analyzed other federal agency guidance on programs selected for this review and spoke with relevant program officials at the Centers for Medicare and Medicaid Services (CMS), the U.S. Departments of Education, Energy, Housing and Urban Development, Justice, Labor, and Transportation. Where attributed to state officials, we did not review state legal materials for this report, but relied on state officials and other state sources for description and interpretation of relevant state constitutions, statutes, legislative proposals, and other state legal materials. The information obtained from this review cannot be generalized to all states and localities receiving Recovery Act funding. A detailed description of our scope and methodology can be found in appendix 1 of the full report.

We conducted this performance audit from April 21, 2009 to July 2, 2009, and selectively updated data, where available, for this statement 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.

Background

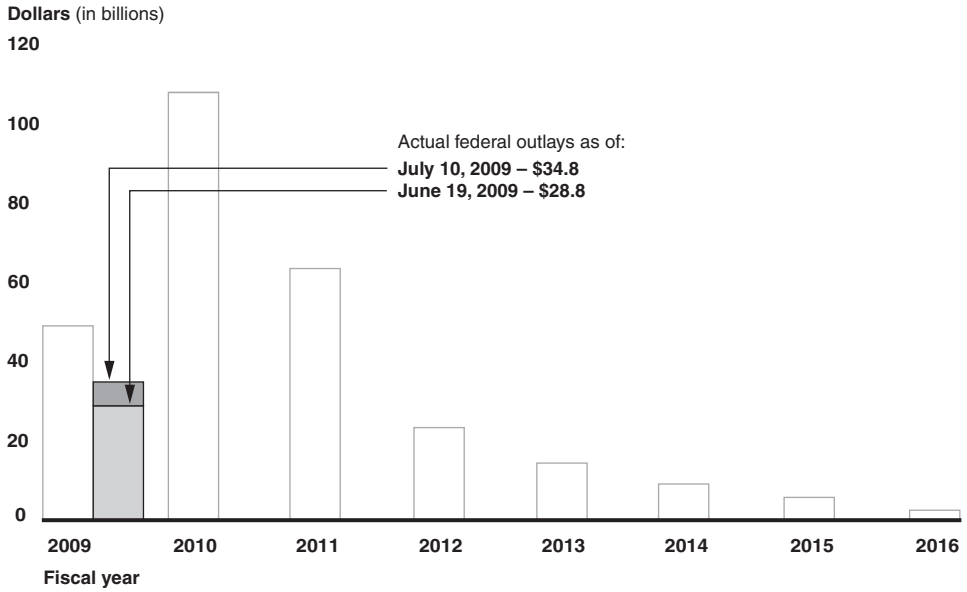
Our analysis of initial estimates of Recovery Act spending provided by the Congressional Budget Office (CBO) suggested that about $49 billion would be outlayed to states and localities by the federal government in fiscal year

[8]For this report, GAO reviewed states' and localities' uses of Recovery Act funds for the (1) Medicaid Federal Medical Assistance Percentage (FMAP), (2) the State Fiscal Stabilization Fund (SFSF), (3) the Federal-Aid Highway Surface Transportation Program, (4) Public Housing Capital Fund, (5) Title I, Part A of the Elementary and Secondary Education Act of 1965 (ESEA); (6) Parts B and C of the Individuals with Disabilities Education Act (IDEA); (7) Weatherization Assistance Program; (8) Edward Byrne Memorial Justice Assistance Grant (JAG) Program; and (9) Workforce Investment Act (WIA) Youth Program.

2009, which runs through September 30. However, our analysis of actual federal outlays reported on www.recovery.gov[9] at the time of our bi-monthly review indicated that in the 4 months since enactment, the federal Treasury had paid out approximately $29 billion to states and localities, which was about 60 percent of the payments estimated for fiscal year 2009. Since the release of our report, outlay data for an additional 3 weeks has been posted to recovery.gov that show the federal government outlayed an additional $6 billion in Recovery Act funds to states and localities during that period for a total of $35 billion as of July 10, 2009. Although this pattern may not continue for the remainder of the fiscal year, at present spending is slightly ahead of estimates. Figure 1 shows the original estimate of federal outlays to states and localities under the Recovery Act compared with actual federal outlays as reported by federal agencies on www.recovery.gov. More than 90 percent of the $35 billion in federal outlays has been provided through the increased Federal Medical Assistance Percentage (FMAP) grant awards and the State Fiscal Stabilization Fund administered by the Department of Education. Figure 1 shows actual federal outlays reported at the time of our report and the amount as of July 10, 2009. According to the Office of Management and Budget (OMB), an estimated $149 billion in Recovery Act funding will be obligated to states and localities in fiscal year 2009.

[9]The Web site www.recovery.gov is mandated by the Recovery Act to foster greater accountability and transparency in the use of the act's funds. The Web site is required to include plans from federal agencies; information on federal awards of formula grants and awards of competitive grants; and information on federal allocations for mandatory and other entitlement programs by state, county, or other appropriate geographical unit. The Web site is maintained by the Recovery Accountability and Transparency Board.

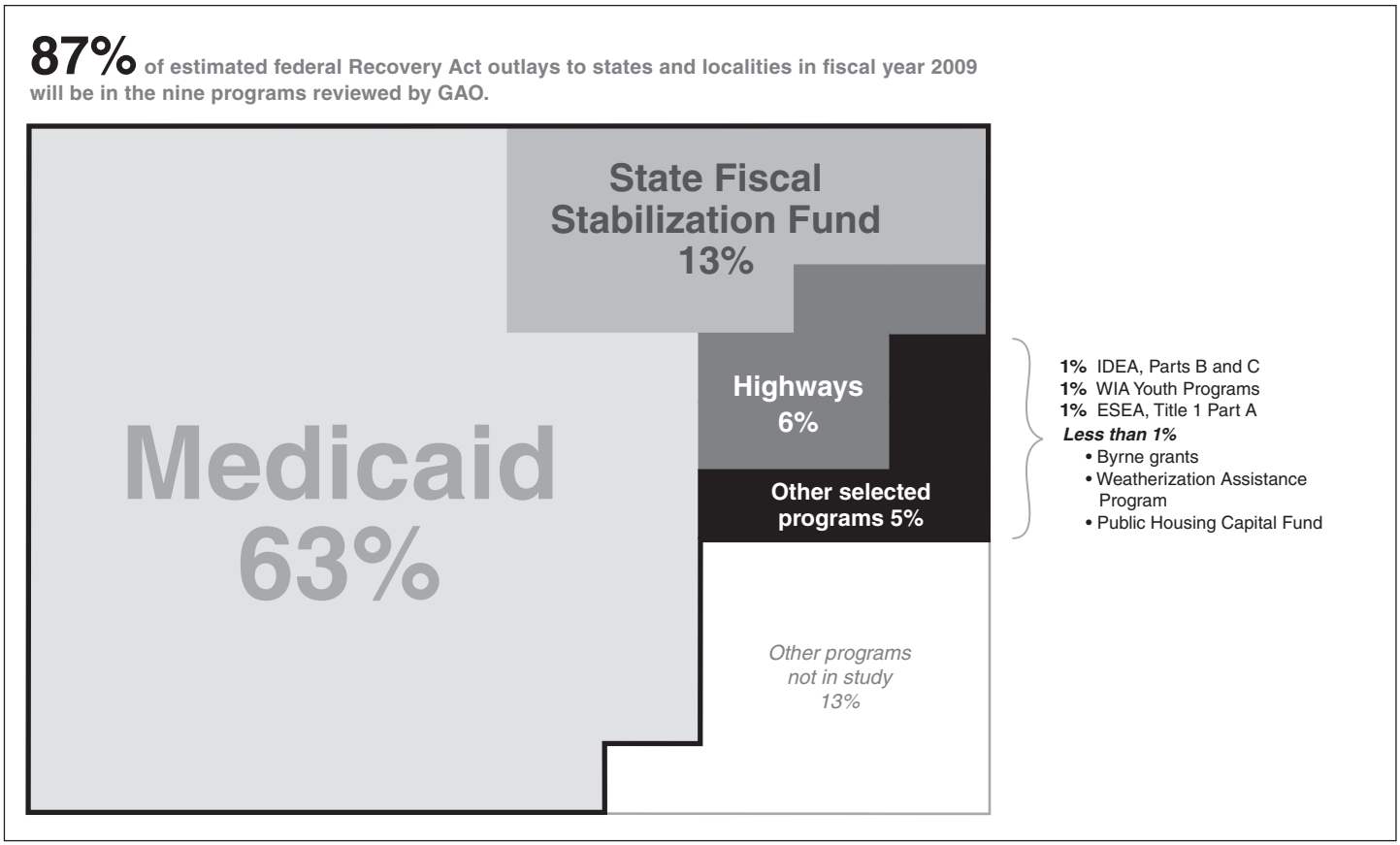
Figure 1: Projected versus Actual Federal Outlays to States and Localities under the Recovery Act



Source: GAO analysis of CBO, Federal Funds Information for States, and Recovery.gov data.

Our work for our July bimonthly report focused on nine federal programs, selected primarily because they have begun disbursing funds to states and include programs with significant amounts of Recovery Act funds, programs receiving significant increases in funding, and new programs. Recovery Act funding of some of these programs is intended for further disbursement to localities. Together, these nine programs are estimated to account for approximately 87 percent of federal Recovery Act outlays to state and localities in fiscal year 2009. Figure 2 shows the distribution by program of anticipated federal Recovery Act spending in fiscal year 2009 to states and localities.

Figure 2: Programs in July Review, Estimated Federal Recovery Act Outlays to States and Localities in Fiscal Year 2009 as a Share of Total



Source: GAO analysis of data from CBO and Federal Funds Information for States.

States and Localities Are Using Recovery Act Funds for Purposes of the Act and to Help Address Fiscal Stresses

Increased FMAP Has Helped States Finance Their Growing Medicaid Programs, but Concerns Remain about Compliance with Recovery Act Provisions

The Recovery Act provides eligible states with an increased FMAP for 27 months between October 1, 2008, and December 31, 2010.[10] On February 25, 2009, CMS made increased FMAP grant awards to states, and states may retroactively claim reimbursement for expenditures that occurred prior to the effective date of the Recovery Act.

For the third quarter of fiscal year 2009, the increases in FMAP for the 16 states and the District of Columbia compared with the original fiscal year 2009 levels are estimated to range from 6.2 percentage points in Iowa to 12.24 percentage points in Florida, with the FMAP increase averaging almost 10 percentage points. When compared with the first two quarters of fiscal year 2009, the FMAP in the third quarter of fiscal year 2009 is estimated to have increased in 12 of the 16 states and the District.

From October 2007 to May 2009, overall Medicaid enrollment in the 16 states and the District increased by 7 percent.[11] In addition, each of the states and the District experienced an enrollment increase during this period, with the highest number of programs experiencing an increase of 5 percent to 10 percent. However, the percentage increase in enrollment varied widely ranging from just under 3 percent in California to nearly 20 percent in Colorado.

[10]Recovery Act, div. B, title V, § 5001. Medicaid is a joint federal-state program that finances health care for certain categories of low-income individuals, including children, families, persons with disabilities, and persons who are elderly. The federal government matches state spending for Medicaid services according to a formula based on each state's per capita income in relation to the national average per capita income. The rate at which states are reimbursed for Medicaid service expenditures is known as the FMAP, which may range from 50 percent to no more than 83 percent. Generally, for fiscal year 2009 through the first quarter of fiscal year 2011, the increased FMAP, which is calculated on a quarterly basis, provides for (1) the maintenance of states' prior year FMAPs, (2) a general across-the-board increase of 6.2 percentage points in states' FMAPs, and (3) a further increase to the FMAPs for those states that have a qualifying increase in unemployment rates. The increased FMAP available under the Recovery Act is for state expenditures for Medicaid services. However, the receipt of this increased FMAP may reduce the funds that states would otherwise have to use for their Medicaid programs, and states have reported using these available funds for a variety of purposes.

[11]The percentage increase is based on actual state enrollment data for October 2007 to April 2009 and projected enrollment data for May 2009, with the exception of New York, which provided projected enrollment data for March, April and May 2009. Three states—Florida, Georgia, and Mississippi—did not provide projected enrollment data for May 2009. We estimated enrollment for these states for May 2009 to determine the total change in enrollment for October 2007 to May 2009.

With regard to the states' receipt of the increased FMAP, all 16 states and the District had drawn down increased FMAP grant awards totaling just over $16.0 billion for the period of October 1, 2008 through July 16, 2009, which amounted to almost 68 percent of funds available.[12] In addition, except for the initial weeks that increased FMAP funds were available, the weekly rate at which the sample states and the District have drawn down funds through June 2009 has remained relatively constant.

States reported that they are using or are planning to use the funds that have become freed up as a result of increased FMAP for a variety of purposes. Most commonly, states reported that they are using or planning to use freed-up funds to cover their increased Medicaid caseload, to maintain current benefits and eligibility levels, and to help finance their respective state budgets. Several states noted that given the poor economic climate in their respective states, these funds were critical in their efforts to maintain Medicaid coverage at current levels.

Medicaid officials from many states and the District raised concerns about their ability to meet the Recovery Act requirements and, thus, maintain eligibility for the increased FMAP.[13] While officials from several states spoke positively about CMS's guidance related to FMAP requirements, at least nine states and the District reported they wanted CMS to provide additional guidance regarding (1) how they report daily compliance with prompt pay requirements, (2) how they report monthly on increased FMAP spending, and (3) whether certain programmatic changes would affect their eligibility for funds. For example, Medicaid officials from

[12] In our recent report, *Recovery Act: States' and Localities' Current and Planned Uses of Funds While Facing Fiscal Stresses* (GAO-09-829) we noted that the 16 states and the District had drawn down 86 percent of increased FMAP funds available as of June 29, 2009. This percentage was based on grant awards for the first three quarters of federal fiscal year 2009. Since that report, increased FMAP grants have been awarded for the fourth quarter of federal fiscal year 2009. The 68 percent noted above is based on the fourth quarter grant awards which states have just begun to draw down.

[13] For states to qualify for the increased FMAP available under the Recovery Act, they must meet a number of requirements, including the following: States generally may not apply eligibility standards, methodologies, or procedures that are more restrictive than those in effect under their state Medicaid programs on July 1, 2008. States must comply with prompt payment requirements. States cannot deposit or credit amounts attributable (either directly or indirectly) to certain elements of the increased FMAP into any reserve or rainy-day fund of the state. States with political subdivisions—such as cities and counties—that contribute to the nonfederal share of Medicaid spending cannot require the subdivisions to pay a greater percentage of the nonfederal share than would have been required on September 30, 2008.

several states told us they were hesitant to implement minor programmatic changes, such as changes to prior authorization requirements, pregnancy verifications, or ongoing rate changes, out of concern that doing so would jeopardize their eligibility for increased FMAP. In addition, at least three states raised concerns that glitches related to new or updated information systems used to generate provider payments could affect their eligibility for these funds. Specifically, Massachusetts Medicaid officials said they are implementing a new provider payment system that will generate payments to some providers on a monthly versus daily basis and would like guidance from CMS on the availability of waivers for the prompt payment requirement. A CMS official told us that the agency is in the process of finalizing its guidance to states on reporting compliance with the prompt payment requirement of the Recovery Act, but did not know when this guidance would be publicly available. However, the official noted that, in the near term, the agency intends to issue a new Fact Sheet, which will include questions and answers on a variety of issues related to the increased FMAP.

Due to the variability of state operations, funding processes, and political structures, CMS has worked with states on a case-by-case basis to discuss and resolve issues that arise. Specifically, communications between CMS and several states indicate efforts to clarify issues related to the contributions to the state share of Medicaid spending by political subdivisions or to rainy-day funds.

States Are Using Highway Infrastructure Funds Mainly for Pavement Improvements and Are Generally Complying with Recovery Act Requirements

The Recovery Act provides funding to the states for restoration, repair, and construction of highways and other eligible surface transportation projects. The act requires that 30 percent of these funds be suballocated for projects in metropolitan and other areas of the state.[14] In March 2009, $26.7 billion was apportioned to all 50 states and the District of Columbia (District) for highway infrastructure and other eligible projects. As of July 15, 2009, $16.7 billion of the funds had been obligated[15] for over 5,600 projects nationwide, and $9.7 billion had been obligated for over 2,900 projects in the 16 states and the District that are the focus of GAO's review.

More than half of Recovery Act highway obligations nationwide have been for pavement improvements. Specifically, $8.8 billion is being used for projects such as reconstructing or rehabilitating deteriorated roads. Many state officials told us they selected a large percentage of resurfacing and other pavement improvement projects because they did not require extensive environmental clearances, were quick to design, could be quickly obligated and bid, could employ people quickly, and could be completed within 3 years. In addition, $3.1 billion, or about 19 percent of Recovery Act funds nationally, has been obligated for pavement-widening projects and around 10 percent has been obligated for the replacement, improvement or rehabilitation of bridges.[16]

As of July 15, 2009, $382.6 million had been reimbursed nationwide by the Federal Highway Administration (FHWA) and $138.2 million had been reimbursed in the 16 states and the District. States are just beginning to get projects awarded so that contractors can begin work, and U.S. Department

[14]Highway funds are apportioned to the states through federal-aid highway program mechanisms, and states must follow the requirements of the existing program, which include ensuring the project meets all environmental requirements associated with the National Environmental Policy Act (NEPA), paying a prevailing wage in accordance with federal Davis-Bacon requirements, complying with goals to ensure disadvantaged businesses are not discriminated against in the awarding of construction contracts, and using American-made iron and steel in accordance with Buy America program requirements. However, the maximum federal fund share of highway infrastructure investment projects under the Recovery Act is 100 percent, while the federal share under the existing federal-aid highway program is generally 80 percent.

[15]The U.S. Department of Transportation has interpreted the term obligation of funds to mean the federal government's contractual commitment to pay for the federal share of the project. This commitment occurs at the time the federal government signs a project agreement.

[16] Data are as of July 10, 2009.

of Transportation (DOT) officials told us that although funding has been obligated for more than 5,000 projects, it may be months before states can request reimbursement. Once contractors mobilize and begin work, states make payments to these contractors for completed work, and may request reimbursement from FHWA. FHWA told us that once funds are obligated for a project, it may take 2 or more months for a state to bid and award the work to a contractor and have work begin.

According to state officials, because an increasing number of contractors are looking for work, bids for Recovery Act contracts have come in under estimates. State officials told us that bids for the first Recovery Act contracts were ranging from around 5 percent to 30 percent below the estimated cost. Several state officials told us they expect this trend to continue until the economy substantially improves and contractors begin taking on enough other work.

Funds appropriated for highway infrastructure spending must be used as required by the Recovery Act. States are required to do the following:

- Ensure that 50 percent of apportioned Recovery Act funds are obligated within 120 days of apportionment (before June 30, 2009) and that the remaining apportioned funds are obligated within 1 year. The 50 percent rule applies only to funds apportioned to the state and not to the 30 percent of funds required by the Recovery Act to be suballocated, primarily based on population, for metropolitan, regional, and local use. The Secretary of Transportation is to withdraw and redistribute to other states any amount that is not obligated within these time frames.[17]

- Give priority to projects that can be completed within 3 years and to projects located in economically distressed areas. These areas are defined by the Public Works and Economic Development Act of 1965, as amended.[18] According to this act, to qualify as an economically distressed area, an area must meet one or more of three criteria related

[17]Recovery Act, div. A, title XII, 123 Stat. 115, 206.

[18]*Id.*

to income and unemployment based on the most recent federal or state data.[19]

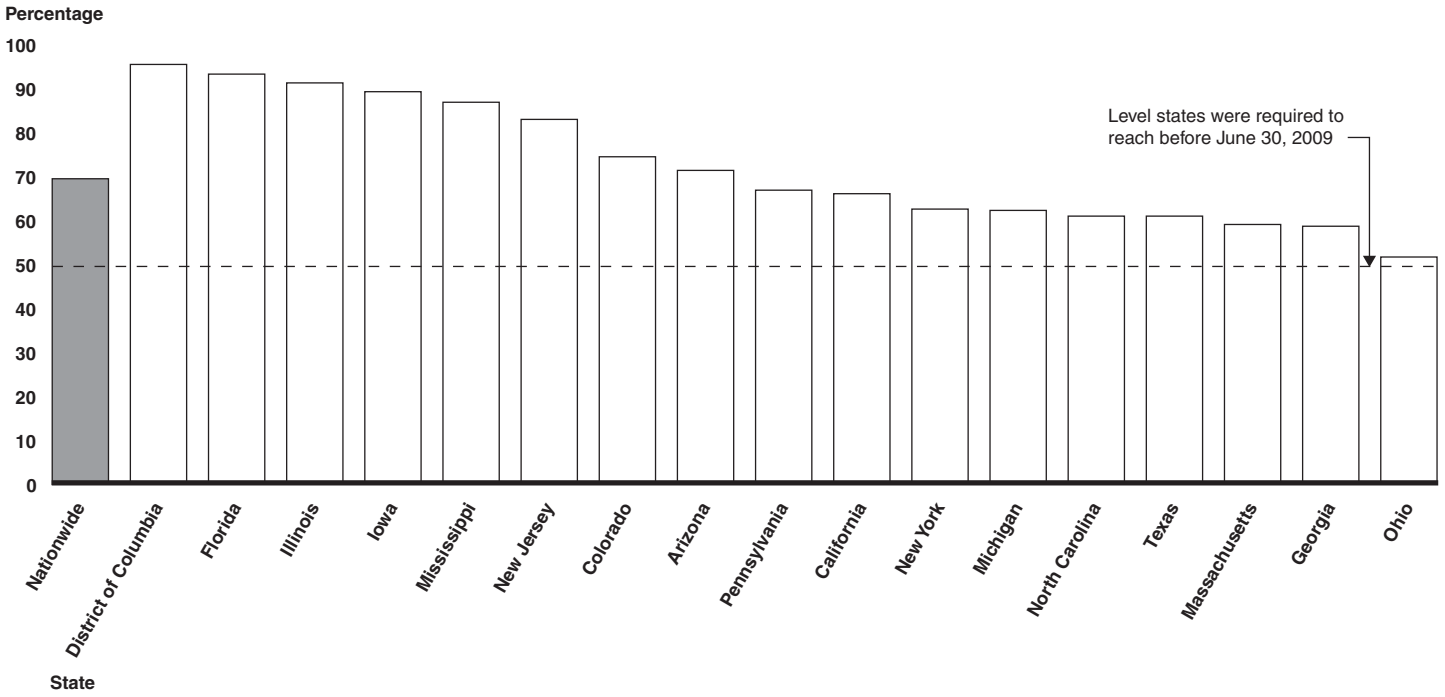
- Certify that the state will maintain the level of spending for the types of transportation projects funded by the Recovery Act that it planned to spend the day the Recovery Act was enacted. As part of this certification, the governor of each state is required to identify the amount of funds the state plans to expend from state sources from February 17, 2009, through September 30, 2010.[20]

All states have met the first Recovery Act requirement that 50 percent of their apportioned funds are obligated within 120 days. Of the $18.7 billion nationally that is subject to this provision, 69 percent was obligated as of June 25, 2009. The percentage of funds obligated nationwide and in each of the states included in our review is shown in figure 3.

[19]According to these criteria, to qualify as an economically distressed area, the area must (1) have a per capita income of 80 percent or less of the national average; (2) have an unemployment rate that is, for the most recent 24-month period for which data are available, at least 1 percent greater than the national average unemployment rate; or (3) be an area the Secretary of Commerce determines has experienced or is about to experience a special need arising from actual or threatened severe unemployment or economic adjustment problems resulting from severe short-term or long-term changes in economic conditions (42 U.S.C. § 3161(a)). Eligibility must be supported using the most recent federal data available or, in the absence of recent federal data, by the most recent data available through the government of the state in which the area is located. Federal data that may be used include data reported by the Bureau of Economic Analysis, the Bureau of Labor Statistics, the Census Bureau, the Bureau of Indian Affairs, or any other federal source determined by the Secretary of Commerce to be appropriate (42 U.S.C. § 3161((c)).

[20]Recovery Act, div. A, title XII, § 1201.

Figure 3: Percentage of Recovery Act Highway Funds Obligated as of June 25, 2009



Source: GAO analysis of Federal Highway Adminstration data.

[a]This figure does not include obligations that are not subject to the 120-day redistribution requirement (including funds suballocated to localities) and obligations associated with apportioned funds that were transferred from FHWA to the Federal Transit Administration (FTA) for transit projects. Generally, FHWA has authority pursuant to 23 U.S.C. § 104(k)(1) to transfer funds made available for transit projects to FTA.

The second Recovery Act requirement is to give priority to projects that can be completed within 3 years and to projects located in economically distressed areas. Officials from most states reported they expect all or most projects funded with Recovery Act funds to be completed within 3 years. We found that due to the need to select projects and obligate funds quickly, many states first selected projects based on other factors and only later identified to what extent these projects fulfilled the requirement to give priority to projects in economically distressed areas. According to the American Association of State Highway and Transportation Officials, in December 2008, states had already identified more than 5,000 "ready-to-go" projects as possible selections for federal stimulus funding, 2 months prior to enactment of the Recovery Act. Officials from several states also told us they had selected projects prior to the enactment of the Recovery Act and that they only gave consideration to economically distressed areas after they received guidance from DOT.

States also based project selection on other priorities. State officials we met with said they considered factors based on their own state priorities, such as geographic distribution and a project's potential for job creation or other economic benefits. The use of state planning criteria or funding formulas to distribute federal and state highway funds was one factor that we found affected states' implementation of the Recovery Act's prioritization requirements. According to officials in North Carolina, for instance, the state used its statutory Equity Allocation Formula to determine how highway infrastructure investment funds would be distributed. Similarly, in Texas, state officials said they first selected highway preservation projects by allocating a specific amount of funding to each of the state's 25 districts, where projects were identified that addressed the most pressing needs. Officials then gave priority for funding to those projects that were in economically distressed areas.

We also found some instances of states developing their own eligibility requirements using data or criteria not specified in the Public Works and Economic Development Act, as amended. According to the act, the Secretary of Commerce, not individual states, has the authority to determine the eligibility of an area that does not meet the first two criteria of the act. In each of these cases, FHWA approved the use of the states' alternative criteria, however it did not first consult with the Department of Commerce and it is not clear on what authority FHWA approved these criteria. For example:

- Arizona based the identification of economically distressed areas on home foreclosure rates and disadvantaged business enterprises—data not specified in the Public Works Act. Arizona officials said they used alternative criteria because the initial determination of economic distress based on the act's criteria excluded three of Arizona's largest and most populous counties, which also contain substantial areas that, according to state officials, are clearly economically distressed and include all or substantial portions of major Indian reservations and many towns and cities hit especially hard by the economic downturn.

- Illinois based its classification on increases in the number of unemployed persons and the unemployment rate,[21] whereas the act

[21]The state based its classification on (1) whether the 2008 year-end unemployment rate was at or above the statewide average, (2) whether the change in the unemployment rate between 2007 and 2008 was at or above the statewide average, or (3) whether the number of unemployed persons for 2008 had grown by 500 or more.

bases this determination on how a county's unemployment rate compares with the national average unemployment rate. According to FHWA, Illinois opted to explore other means of measuring recent economic distress because the initial determination of economic distress based on the act's criteria did not appear to accurately reflect the recent economic downturn in the state. Illinois's use of alternative criteria resulted in 21 counties being identified as economically distressed that would not have been so classified following the act's criteria.[22]

In commenting on a draft of our report, DOT agreed that states must give priority to projects located in economically distressed areas, but said that states must balance all the Recovery Act project selection criteria when selecting projects including giving preference to activities that can be started and completed expeditiously, using funds in a manner that maximizes job creation and economic benefit, and other factors. While we agree with DOT that there is no absolute primacy of economically distressed area projects in the sense that they must always be started first, the specific directives in the act that apply to highway infrastructure are that priority is to be given to projects that can be completed in 3 years, and are located in economically distressed areas. DOT also stated that the basic approach used by selected states to apply alternative criteria is consistent with the Public Works and Economic Development Act and its implementing regulations on economically distressed areas because it makes use of flexibilities provided by the Act to more accurately reflect changing economic conditions. However the result of DOT's interpretation would be to allow states to prioritize projects based on criteria that are not mentioned in the highway infrastructure investment portion of the Recovery or the Public Works Acts without the involvement of the Secretary or Department of Commerce. We plan to continue to monitor states' implementation of the economically distressed area requirements and interagency coordination at the federal level in future reports.

Finally, the states are required to certify that they will maintain the level of state effort for programs covered by the Recovery Act. With one exception, the states have completed these certifications, but they face

[22]Illinois's criteria resulted in 21 counties being classified as economically distressed areas that were not so classified by FHWA and 8 counties not being classified as economically distressed areas that were so classified by FHWA, for a net difference of 13 counties. The map tool that FHWA developed to help states identify which projects are located in is based on the criteria in the Public Works Act.

challenges. Maintaining a state's level of effort can be particularly important in the highway program. We have found that the preponderance of evidence suggests that increasing federal highway funds influences states and localities to substitute federal funds for funds they otherwise would have spent on highways.[23] As we previously reported, substitution makes it difficult to target an economic stimulus package so that it results in a dollar-for-dollar increase in infrastructure investment.[24]

Most states revised the initial certifications they submitted to DOT. As we reported in April, many states submitted explanatory certifications—such as stating that the certification was based on the "best information available at the time"—or conditional certifications, meaning that the certification was subject to conditions or assumptions, future legislative action, future revenues, or other conditions. On April 22, 2009, the Secretary of Transportation sent a letter to each of the nation's governors and provided additional guidance, including that conditional and explanatory certifications were not permitted, and gave states the option of amending their certifications by May 22. Each of the 16 states and District selected for our review resubmitted their certifications. According to DOT officials, the department has concluded that the form of each certification is consistent with the additional guidance, with the exception of Texas. Texas submitted an amended certification on May 27, 2009, which contained qualifying language explaining that the Governor could not certify any expenditure of funds until the legislature passed an appropriation act. According to DOT officials the status of Texas' revised certification remains unresolved. Texas officials told us the state plans to submit a revised certification letter, removing the qualifying language. For the remaining states, while DOT has concluded that the form of the

[23] In 2004, we estimated that during the 1983 through 2000 period, states used roughly half of the increases in federal highway funds to substitute for funding they would otherwise have spent from their own resources and that the rate of substitution increased during the 1990s. The federal-aid highway program creates the opportunity for substitution because states typically spend substantially more than the amount required to meet federal matching requirements. As a consequence, when federal funding increases, states are able to reduce their own highway spending and still obtain increased federal funds. The federal share under the existing federal-aid highway program is generally 80 percent and the matching requirement for states is usually 20 percent. In 2004, we reported that in 2002, states and localities contributed 54 percent of the nation's capital investment in highways, while the federal government contributed 46 percent (in 2001 dollars). GAO, *Federal-Aid Highways: Trends, Effect on State Spending, and Options for Future Program Design*, GAO-04-802 (Washington, D.C.: Aug. 31, 2004).

[24] GAO, *Physical Infrastructure: Challenges and Investment Options for the Nation's Infrastructure*, GAO-08-763T (Washington, D.C.: May 8, 2008).

revised certifications is consistent with the additional guidance, it is currently evaluating whether the states' method of calculating the amounts they planned to expend for the covered programs is in compliance with DOT guidance.

States face drastic fiscal challenges, and most states are estimating that their fiscal year 2009 and 2010 revenue collections will be well below estimates. In the face of these challenges, some states told us that meeting the maintenance-of-effort requirements over time poses significant challenges. For example, federal and state transportation officials in Illinois told us that to meet its maintenance-of-effort requirements in the face of lower-than-expected fuel tax receipts, the state would have to use general fund or other revenues to cover any shortfall in the level of effort stated in its certification. Mississippi transportation officials are concerned about the possibility of statewide, across-the-board spending cuts in 2010. According to the Mississippi transportation department's budget director, the agency will try to absorb any budget reductions in 2010 by reducing administrative expenses to maintain the state's level of effort.

Most States We Visited Have Received State Fiscal Stabilization Funds and Have Planned to Allocate Most Education Stabilization Funds to LEAs

The Recovery Act created a State Fiscal Stabilization Fund (SFSF) in part to help state and local governments stabilize their budgets by minimizing budgetary cuts in education and other essential government services, such as public safety.[25] Beginning in March 2009, the Department of Education issued a series of fact sheets, letters, and other guidance to states on the SFSF. Specifically, a March fact sheet, the Secretary's April letter to Governors, and program guidance issued in April and May mention that the purposes of the SFSF include helping stabilize state and local budgets, avoiding reductions in education and other essential services, and ensuring LEAs and public IHEs have resources to "avert cuts and retain teachers and professors." The documents also link educational progress to economic recovery and growth and identify four principles to guide the distribution and use of Recovery Act funds: (1) spend funds quickly to retain and create jobs; (2) improve student achievement through school improvement and reform; (3) ensure transparency, public reporting, and accountability; and (4) invest one-time Recovery Act funds thoughtfully to avoid unsustainable continuing commitments after the funding expires, known as the "funding cliff."

[25]Stabilization funds for education distributed under the Recovery Act must be used to alleviate shortfalls in state support for education to school districts and public institutions of higher education (IHEs). The U.S. Department of Education (Education), the federal agency charged with administration and oversight of the SFSF, distributes the funds on a formula basis, with 81.8 percent of each state's allocation designated for the education stabilization fund for local educational agencies (LEA) and public IHEs. The remaining 18.2 percent of each state's allocation is designated for the government services fund for public safety and other government services, which may include education. Consistent with the purposes of the Recovery Act—which include, in addition to stabilizing state and local budgets, promoting economic recovery and preserving and creating jobs—the SFSF can be used by states to restore cuts to state education spending. In return for SFSF funding, a state must make several assurances, including that it will maintain state support for education at least at fiscal year 2006 levels. In order to receive SFSF funds, each state must also assure it will implement strategies to advance education reform in four specific ways as described by Education: 1) Increase teacher effectiveness and address inequities in the distribution of highly qualified teachers; 2)Establish a pre-K-through-college data system to track student progress and foster improvement; 3) Make progress toward rigorous college- and career-ready standards and high-quality assessments that are valid and reliable for all students, including students with limited English proficiency and students with disabilities; and 4) Provide targeted, intensive support and effective interventions to turn around schools identified for corrective action or restructuring. Schools identified for corrective action have missed academic targets for 4 consecutive years and schools implementing restructuring have missed academic targets for 6 consecutive years. Along with these education reform assurances, additional state assurances must address federal requirements concerning accountability, transparency, reporting, and compliance with certain federal laws and regulations.

After meeting assurances to maintain state support for education at least at fiscal year 2006 levels, states are required to use the education stabilization fund to restore state support to the greater of fiscal year 2008 or 2009 levels for elementary and secondary education, public IHEs, and, if applicable, early childhood education programs. States must distribute these funds to school districts using the primary state education formula but maintain discretion in how funds are allocated to public IHEs. If, after restoring state support for education, additional funds remain, the state must allocate those funds to school districts according to the Elementary and Secondary Education Act of 1965 (ESEA), Title I, Part A funding formula. On the other hand, if a state's education stabilization fund allocation is insufficient to restore state support for education, then a state must allocate funds in proportion to the relative shortfall in state support to public school districts and public IHEs. Education stabilization funds must be allocated to school districts and public IHEs and cannot be retained at the state level.

Once education stabilization funds are awarded to school districts and public IHEs, they have considerable flexibility over how they use those funds. School districts are allowed to use education stabilization funds for any allowable purpose under ESEA, the Individuals with Disabilities Education Act (IDEA), the Adult Education and Family Literacy Act, or the Carl D. Perkins Career and Technical Education Act of 2006 (Perkins Act), subject to some prohibitions on using funds for, among other things, sports facilities and vehicles. In particular, Education's guidance states that because allowable uses under the Impact Aid provisions of ESEA are broad, school districts have discretion to use education stabilization funds for a broad range of things, such as salaries of teachers, administrators, and support staff, and purchases of textbooks, computers, and other equipment. The Recovery Act allows public IHEs to use education stabilization funds in such a way as to mitigate the need to raise tuition and fees, as well as for the modernization, renovation, and repair of facilities, subject to certain limitations. However, the Recovery Act prohibits public IHEs from using education stabilization funds for such things as increasing endowments; modernizing, renovating, or repairing sports facilities; or maintaining equipment. Education's SFSF guidance expressly prohibits states from placing restrictions on LEAs' use of education stabilization funds, beyond those in the law, but allows states some discretion in placing limits on how IHEs may use these funds.

The SFSF provides states and school districts with additional flexibility, subject to certain conditions, to help them address fiscal challenges. For example, the Secretary of Education is granted authority to permit waivers

of state maintenance-of-effort (MOE) requirements if a state certified that state education spending will not decrease as a percentage of total state revenues. Education issued guidance on the MOE requirement, including the waiver provision, on May 1, 2009. Also, the Secretary may permit a state or school district to treat education stabilization funds as nonfederal funds for the purpose of meeting MOE requirements for any program administered by Education, subject to certain conditions. Education, as of June 29, 2009, has not provided specific guidance on the process for states and school districts to apply for the Secretary's approval.

States have broad discretion over how the $8.8 billion in the SFSF government services fund are used. The Recovery Act provides that these funds must be used for public safety and other government services and that these services may include assistance for education, as well as modernization, renovation, and repairs of public schools or IHEs.

On April 1, 2009, Education made at least 67 percent of each state's SFSF funds[26] available, subject to the receipt of an application containing state assurances, information on state levels of support for education and estimates of restoration amounts, and baseline data demonstrating state status on each of the four education reform assurances. If a state could not certify that it would meet the MOE requirement, Education required it to certify that it will meet requirements for receiving a waiver—that is, that education spending would not decrease relative to total state revenues. In determining state level of support for elementary and secondary education, Education required states to use their primary formula for distributing funds to school districts but also allowed states some flexibility in broadening this definition. For IHEs, states have some discretion in how they establish the state level of support, with the provision that they cannot include support for capital projects, research and development, or amounts paid in tuition and fees by students. In order to meet statutory requirements for states to establish their current status regarding each of the four required programmatic assurances, Education provided each state with the option of using baseline data Education had identified or providing another source of baseline data. Some of the data provided by Education was derived from self-reported data submitted annually by the states to Education as part of their Consolidated State

[26]This was phase I funding. A state will receive the remaining allotment of its SFSF allocation in phase II after Education approves the state's comprehensive plan for making progress with respect to the four education reform assurances. Education anticipates that phase II funds will be awarded by September 30, 2009.

Performance Reports (CSPR), but Education also relied on data from third parties, including the Data Quality Campaign (DQC), the National Center for Educational Achievement (NCEA), and Achieve.[27]

Education has reviewed applications as they arrive for completeness and has awarded states their funds once it determined all assurances and required information had been submitted. Education set the application deadline for July 1, 2009. On June 24, 2009, Education issued guidance to states informing them they must amend their applications if there are changes to the reported levels of state support that were used to determine maintenance of effort or to calculate restoration amounts.

As of July 1, 2009, all of the 16 states and the District of Columbia covered by our review had submitted an SFSF application. Pennsylvania and Texas have recently submitted applications to Education, but as of July 16, 2009 their applications had not yet been approved. Education has made a total of over $18.4 billion in funding available to the remaining 14 states and the District of Columbia. As of July 10, 2009, 10 of these states had drawn down SFSF Recovery Act funds. In total, $6.1 billion or about 33 percent of available funds had been drawn down by these states.

Three of the selected states—Florida, Massachusetts, and New Jersey—said they would not meet the maintenance-of-effort requirements but would meet the eligibility requirements for a waiver and that they would apply for a waiver. Most of the states' applications show that they plan to provide the majority of education stabilization funds to LEAs, with the remainder of funds going to IHEs. Several states and the District of Columbia estimated in their application that they would have funds remaining beyond those that would be used to restore education spending in fiscal years 2009 and 2010. These funds can be used to restore education spending in fiscal year 2011, with any amount left over to be distributed to LEAs.

[27]DQC is a national collaborative effort involving more than 50 organizations working to encourage and support state policymakers to improve the availability and use of high-quality education data to improve student achievement. NCEA, a nonprofit organization owned by ACT Inc.—a company that develops and markets assessments—focuses on raising student achievement based on higher college and career readiness standards. Achieve, created in 1996 by the nation's governors and corporate leaders, is an independent, bipartisan, nonprofit education reform organization focused on raising academic standards and graduation requirements, improving assessments, and strengthening accountability.

States have flexibility in how they allocate education stabilization funds among IHEs but, once they establish their state funding formula, not in how they allocate the funds among LEAs. Florida and Mississippi allocated funds among their IHEs, including universities and community colleges, using formulas based on factors such as enrollment levels. Other states allocated SFSF funds taking into consideration the budget conditions of the IHEs.

Regarding LEAs, most states planned to allocate funds based on states' primary funding formulae. Many states are using a state formula based on student enrollment weighted by characteristics of students and LEAs. For example, Colorado's formula accounts for the number of students at risk while the formula used by the District allocates funds to LEAs using weights for each student based on the relative cost of educating students with specific characteristics. For example, an official from Washington, D.C. Public Schools said a student who is an English language learner may cost more to educate than a similar student who is fluent in English.

States may use the government services portion of SFSF for education but have discretion to use the funds for a variety of purposes. Officials from Florida, Illinois, New Jersey, and New York reported that their states plan to use some or most of their government services funds for educational purposes. Other states are applying the funds to public safety. For example, according to state officials, California is using the government services fund for it corrections system, and Georgia will use the funds for salaries of state troopers and staff of forensic laboratories and state prisons.

Officials in many school districts told us that SFSF funds would help offset state budget cuts and would be used to maintain current levels of education funding. However, many school district officials also reported that using SFSF funds for education reforms was challenging given the other more pressing fiscal needs.

Although their plans are generally not finalized, officials in many school districts we visited reported that their districts are preparing to use SFSF funds to prevent teacher layoffs, hire new teachers, and provide professional development programs. Most school districts will use the funding to help retain jobs that would have been cut without SFSF funding. For example, Miami Dade officials estimate that the stabilization funds will help them save nearly two thousand teaching positions. State and school district officials in eight states we visited (California, Colorado, Florida, Georgia, Massachusetts, Michigan, New York, and North Carolina)

also reported that SFSF funding will allow their state to retain positions, including teaching positions that would have been eliminated without the funding. In the Richmond County School System in Georgia, officials noted they plan to retain positions that support its schools, such as teachers, paraprofessionals, nurses, media specialists and guidance counselors. Local officials in Mississippi reported that budget-related hiring freezes had hindered their ability to hire new staff, but because of SFSF funding, they now plan to hire. In addition, local officials in a few states told us they plan to use the funding to support teachers. For example, officials in Waterloo Community and Ottumwa Community School Districts in Iowa as well as officials from Miami-Dade County in Florida cited professional development as a potential use of funding to support teachers.

Although school districts are preventing layoffs and continuing to provide educational services with the SFSF funding, most did not indicate they would use these funds to pursue educational reform. School district officials cited a number of barriers, which include budget shortfalls, lack of guidance from states, and insufficient planning time. In addition to retaining and creating jobs, school districts have considerable flexibility to use these resources over the next 2 years to advance reforms that could have long-term impact. However, a few school district officials reported that addressing reform efforts was not in their capacity when faced with teacher layoffs and deep budget cuts. In Flint, Michigan, officials reported that SFSF funds will be used to cope with budget deficits rather than to advance programs, such as early childhood education or repairing public school facilities. According to the Superintendent of Flint Community Schools, the infrastructure in Flint is deteriorating, and no new school buildings have been built in over 30 years. Flint officials said they would like to use SFSF funds for renovating buildings and other programs, but the SFSF funds are needed to maintain current education programs.

Officials in many school districts we visited reported having inadequate guidance from their state on using SFSF funding, making reform efforts more difficult to pursue. School district officials in most states we visited reported they lacked adequate guidance from their state to plan and report on the use of SFSF funding. Without adequate guidance and time for planning, school district officials told us that preparing for the funds was difficult. At the time of our visits, several school districts were unaware of their funding amounts, which, officials in two school districts said, created additional challenges in planning for the 2009-2010 school year. One charter school we visited in North Carolina reported that layoffs will be required unless their state notifies them soon how much SFSF funding

they will receive. State officials in North Carolina, as well as in several other states, told us they are waiting for the state legislature to pass the state budget before finalizing SFSF funding amounts for school districts.

IHEs Plan to Use SFSF Funds for Faculty Salaries and Other Purposes and Expect the Funds to Save Jobs and Mitigate Tuition Increases

Although many IHEs had not finalized plans for using SFSF funds, the most common expected use for the funds at the IHEs we visited was to pay salaries of IHE faculty and staff.[28] Officials at most of the IHEs we visited told us that, due to budget cuts, their institutions would have faced difficult reductions in faculty and staff if they were not receiving SFSF funds. Other IHEs expected to use SFSF funds in the future to pay salaries of certain employees during the year.

Several IHEs we visited are considering other uses for SFSF funds. Officials at the Borough of Manhattan Community College in New York City want to use some of their SFSF funds to buy energy saving light bulbs and to make improvements in the college's very limited space such as, by creating tutoring areas and study lounges. Northwest Mississippi Community College wants to use some of the funds to increase e-learning capacity to serve the institution's rapidly increasing number of students. Several other IHEs plan to use some of the SFSF funds for student financial aid.

Because many IHEs expect to use SFSF funds to pay salaries of current employees that they likely would not have been able to pay without the SFSF funds, IHEs officials said that SFSF funds will save jobs. Officials at several IHEs noted that this will have a positive impact on the educational environment such as, by preventing increases in class size and enabling the institutions to offer the classes that students need to graduate. In addition to preserving existing jobs, some IHEs anticipate creating jobs with SFSF funds. Besides saving and creating jobs at IHEs, officials noted that SFSF monies will have an indirect impact on jobs in the community. IHE officials also noted that SFSF funds will indirectly improve employment because some faculty being paid with the funds will help unemployed workers develop new skills, including skills in fields, such as health care, that have a high demand for trained workers. State and IHE officials also believe that SFSF funds are reducing the size of tuition and fee increases.

[28]During our review, we met with IHEs and state officials responsible for IHE oversight in 8 states—California, Florida, Georgia, Illinois, Mississippi, New York, North Carolina, and Ohio.

Other Selected Programs

Our report provides additional details on the use of Recovery Act funds for these three programs in the 16 selected states and the District. In addition to Medicaid FMAP, Highway Infrastructure Investment, and SFSF, we also reviewed six other programs receiving Recovery Act funds. These programs are:

- Title I, Part A of the Elementary and Secondary Education Act of 1965 (ESEA)
- Parts B and C of the Individuals with Disabilities Education Act (IDEA)
- Workforce Investment Act (WIA) Youth Program
- Public Housing Capital Fund
- Edward Byrne Memorial Justice Assistance Grant (JAG) Program
- Weatherization Assistance Program

Additional detail regarding the states' and localities' use of funds for these programs is available in the full report, GAO-09-829. Individual state summaries for the 16 selected states and the District are accessible through GAO's recovery page at www.gao.gov/recovery and in an electronic supplement, GAO-09-830SP.

Recovery Act Funding Helped States Address Budget Challenges

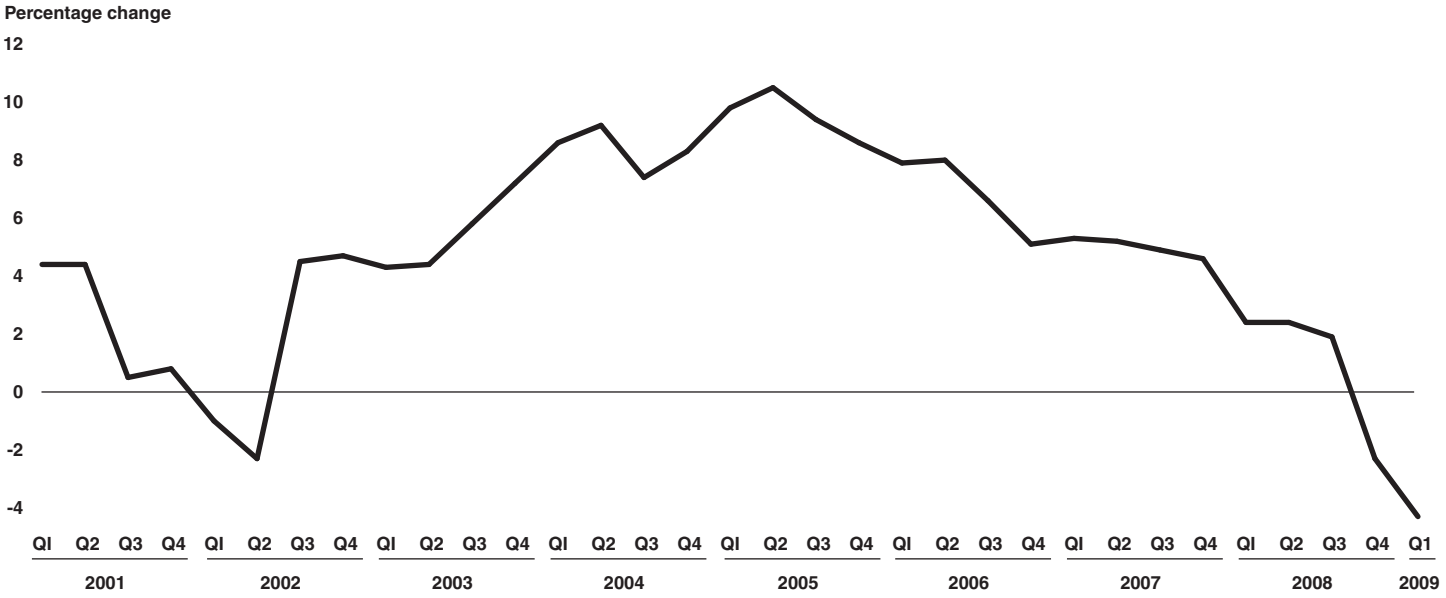
State revenue continued to decline and states used Recovery Act funding to reduce some of their planned budget cuts and tax increases to close current and anticipated budget shortfalls for fiscal years 2009 and 2010.[29] Of the 16 states and the District, 15 estimate fiscal year 2009 general fund revenue collections will be less than in the previous fiscal year.[30] For two of the selected states —Iowa and North Carolina—revenues were lower than projected but not less than the previous fiscal year. As shown in figure 4, data from the Bureau of Economic Analysis (BEA) also indicate that the rate of state and local revenue growth has generally declined since

[29]According to the National Association of State Budget Officers (NASBO), most states have balanced-budget requirements for general funds, which may include requirements such as (1) requiring governors to submit a balanced budget, (2) mandating that their legislatures pass a balanced budget, (3) directing governors to sign a balanced budget, or (4) requiring governors to execute a balanced budget. According to NASBO, all of the states we visited have balanced-budget requirements. (In its report, NASBO did not provide information on the District of Columbia's balanced budget requirements.) See NASBO, *Budget Processes in the States* (Washington, D.C.: Summer 2008).

[30]Michigan—along with the District of Columbia—has a fiscal year that begins October 1. New York's fiscal year begins April 1, and the fiscal year for Texas begins on September 1. All other states we visited have fiscal years beginning July 1.

the second quarter of 2005, and the rate of growth has been negative in the fourth quarter of 2008 and the first quarter of 2009.[31]

Figure 4: Year-Over-Year Change in State and Local Government Current Tax Receipts



Source: GAO analysis of BEA data.

Officials in most of the selected states and the District expect these revenue trends to contribute to budget gaps (estimated revenues less than estimated disbursements) anticipated for future fiscal years. All of the 16 states and the District forecasted budget gaps in state fiscal year 2009-2010 before budget actions were taken.

Consistent with one of the purposes of the act, states' use of Recovery Act funds to stabilize their budgets helped them minimize and avoid reductions in services as well as tax increases. States took a number of

[31]Recent reports provide additional details regarding revenue declines beyond our selected states. For example, see The National Governors Association and the National Association of State Budget Officers (NASBO), *The Fiscal Survey of States* (Washington, D.C., June 2009); National Conference of State Legislatures, *Budget Update: April 2009* (Washington, D.C., April 2009); Lucy Dadayan and Donald J. Boyd, The Nelson A. Rockefeller Institute of Government, *April is the Cruelest Month: Personal Income Tax Revenues Portend Deepening Trouble for Many States* (Albany, N.Y., June 18, 2009).

actions to balance their budgets in fiscal year 2009-2010, including staff layoffs, furloughs, and program cuts. The use of Recovery Act funds affected the size and scope of some states' budgeting decisions, and many of the selected states reported they would have had to make further cuts to services and programs without the receipt of Recovery Act funds. For example, California, Colorado, Georgia, Illinois, Massachusetts, Michigan, New York, and Pennsylvania budget officials all stated that current or future budget cuts would have been deeper without the receipt of Recovery Act funds.

Recovery Act funds helped cushion the impact of states' planned budget actions but officials also cautioned that current revenue estimates indicate that additional state actions will be needed to balance future-year budgets. Future actions to stabilize state budgets will require continued awareness of the maintenance-of-effort (MOE) requirements for some federal programs funded by the Recovery Act. For example, Massachusetts officials expressed concerns regarding MOE requirements attached to federal programs, including those funded through the Recovery Act, as future across-the-board spending reductions could pose challenges for maintaining spending levels in these programs. State officials said that MOE requirements that require maintaining spending levels based upon prior-year fixed dollar amounts will pose more of a challenge than upholding spending levels based upon a percentage of program spending relative to total state budget expenditures. In addition, some states also reported accelerating their use of Recovery Act funds to stabilize deteriorating budgets.

Many states, such as Colorado, Florida, Georgia, Iowa, New Jersey, and North Carolina, also reported tapping into their reserve or rainy-day funds in order to balance their budgets. In most cases, the receipt of Recovery Act funds did not prevent the selected states from tapping into their reserve funds, but a few states reported that without the receipt of Recovery Act funds, withdrawals from reserve funds would have been greater.[32] Officials from Georgia stated that although they have already used reserve funds to balance their fiscal year 2009 and 2010 budgets, they may use additional reserve funds if, at the end of fiscal year 2009, revenues are lower than the most recent projections. In contrast, New York officials stated they were able to avoid tapping into the state's reserve funds due to

[32]According to NASBO, the selected states have varying legal requirements regarding contributions to and withdrawals from various types of reserve funds.

the funds made available as a result of the increased Medicaid FMAP funds provided by the Recovery Act.

Approaches to Developing Exit Strategies for End of Recovery Act Funding Influenced by Nature of State Budget Processes

States' approaches to developing exit strategies for the use of Recovery Act funds reflect the balanced-budget requirements in place for all of our selected states and the District. Budget officials referred to the temporary nature of the funds and fiscal challenges expected to extend beyond the timing of funds provided by the Recovery Act. Officials discussed a desire to avoid what they referred to as the "cliff effect" associated with the dates when Recovery Act funding ends for various federal programs.

Budget officials in some of the selected states are preparing for the end of Recovery Act funding by using funds for nonrecurring expenditures and hiring limited-term positions to avoid creating long-term liabilities. A few states reported that although they are developing preliminary plans for the phasing out of Recovery Act funds, further planning has been delayed until revenue and expenditure projections are finalized.

States Have Implemented Various Internal Control Programs: However, Single Audit Guidance and Reporting Does Not Adequately Address Recovery Act Risk

Given that Recovery Act funds are to be distributed quickly, effective internal controls over use of funds are critical to help ensure effective and efficient use of resources, compliance with laws and regulations, and in achieving accountability over Recovery Act programs. Internal controls include management and program policies, procedures, and guidance that help ensure effective and efficient use of resources; compliance with laws and regulations; prevention and detection of fraud, waste, and abuse; and the reliability of financial reporting. Management is responsible for the design and implementation of internal controls and the states in our sample have a range of approaches for implementing their internal controls.

Some states have internal control requirements in their state statutes and others have undertaken internal control programs as management initiatives. In our sample, 7 states - California, Colorado, Florida, Michigan, Mississippi, New York, and North Carolina –have statutory requirements for internal control programs and activities. An additional 9 states – Arizona, Georgia, Illinois, Iowa, Massachusetts, New Jersey, Ohio, Pennsylvania, and Texas – have undertaken various internal control programs. In addition, the District of Columbia has taken limited actions related to its internal control program. An effective internal control program helps manage change in response to shifting environments and evolving demands and priorities, such as changes related to implementing the Recovery Act.

Risk assessment and monitoring are key elements of internal controls, and the states in our sample and the District have undertaken a variety of actions in these areas.

- Risk assessment involves performing comprehensive reviews and analyses of program operations to determine if internal and external risks exist and to evaluate the nature and extent of risks which have been identified. Approaches to risk analysis can vary across organizations because of differences in missions and the methodologies used to qualitatively and quantitatively assign risk levels.

- Monitoring activities include the systemic process of reviewing the effectiveness of the operation of the internal control system. These activities are conducted by management, oversight entities, and internal and external auditors. Monitoring enables stakeholders to determine whether the internal control system continues to operate effectively over time. Monitoring also provides information and feedback to the risk assessment process.

Challenges Exist in Tracking Recovery Act Funds

States and localities are responsible for tracking and reporting on Recovery Act funds.[33] OMB has issued guidance to the states and localities that provides for separate identification—"tagging"—of Recovery Act funds so that specific reports can be created and transactions can be specifically identified as Recovery Act funds.[34] The flow of federal funds to the states varies by program, the grantor agencies have varied grants management processes and grants vary substantially in their types, purposes, and administrative requirements.[35]

Several states and the District of Columbia have created unique codes for their financial systems in order to tag the Recovery Act funds. Most state and local program officials told us that they will apply existing controls

[33]Recovery Act, div. A, title XV, § 1512.

[34]OMB memoranda, M-09-10, *Initial Implementing Guidance for the American Recovery and Reinvestment Act of 2009*, February 18, 2009, and M-09-15, *Updated Implementing Guidance for the American Recovery and Reinvestment Act of 2009*, April 3, 2009.

[35]GAO, *Grants Management: Additional Actions Needed to Streamline and Simplify Process*, GAO-05-335 (Washington, D.C.: April 2005).

and oversight processes that they currently apply to other program funds to oversee Recovery Act funds.

In addition to being an important accountability mechanism, audit results can provide valuable information for use in management's risk assessment and monitoring processes. The single audit report, prepared to meet the requirements of the Single Audit Act,[36] as amended (Single Audit Act), is a source of information on internal control and compliance findings and the underlying causes and risks. The report is prepared in accordance with OMB's implementing guidance in OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations*,[37] which provides guidance to auditors on selecting federal programs for audit and the related internal control and compliance audit procedures to be performed.

In our April 23, 2009 report, we reported that the guidance and criteria in OMB Circular No. A-133 do not adequately address the substantial added risks posed by the new Recovery Act funding. Such risks may result from (1) new government programs, (2) the sudden increase in funds or programs that are new to the recipient entity, and (3) the expectation that some programs and projects will be delivered faster so as to inject funds into the economy. With some adjustment, the single audit could be an effective oversight tool for Recovery Act programs, addressing risks associated with all three of these factors.

[36]The Single Audit Act requires states, local governments, and nonprofit organizations expending over $500,000 in federal awards in a year to obtain an audit in accordance with requirements set forth in the Act. A single audit consists of (1) an audit and opinions on the fair presentation of the financial statements and the Schedule of Expenditures of Federal Awards; (2) gaining an understanding of and testing internal control over financial reporting and the entity's compliance with laws, regulations, and contract or grant provisions that have a direct and material effect on certain federal programs (i.e., the program requirements); and (3) an audit and an opinion on compliance with applicable program requirements for certain federal programs.

[37]The auditor identifies the applicable federal programs, including "major programs," based on risk criteria, including minimum dollar thresholds, set out in the Single Audit Act and OMB Circular No. A-133. Guidance on identifying compliance requirements for most large federal programs is set out in the Compliance Supplement to OMB Circular No. A-133. OMB has 14 requirements that generally are to be tested for each major federal program to opine on compliance and report on significant deficiencies in internal control over compliance with each applicable compliance requirement.

Our April 2009 report on the Recovery Act included recommendations that OMB adjust the current audit process to:

- focus the risk assessment auditors use to select programs to test for compliance with 2009 federal program requirements on Recovery Act funding;
- provide for review of the design of internal controls during 2009 over programs to receive Recovery Act funding, before significant expenditures in 2010; and
- evaluate options for providing relief related to audit requirements for low-risk programs to balance new audit responsibilities associated with the Recovery Act.

Since April, although OMB has taken several steps in response to our recommendations, these actions do not sufficiently address the risks leading to our recommendations. To focus auditor risk assessments on Recovery Act-funded programs and to provide guidance on internal control reviews for Recovery Act programs, OMB is working within the framework defined by existing mechanisms—Circular No. A-133 and the Compliance Supplement. In this context, OMB has made limited adjustments to its single audit guidance and is planning to issue additional guidance later this month.

Focusing Auditors' Program Risk Assessments on Programs with Recovery Act Funding

On May 26, OMB issued the 2009 edition of the Circular A-133 Compliance Supplement. The new Compliance Supplement is intended to focus auditor risk assessment on Recovery Act funding by, among things (1) requiring that auditors specifically ask auditees about and be alert to expenditure of funds provided by the Recovery Act, and (2) providing an appendix that highlights some areas of the Recovery Act impacting single audits. The appendix adds a requirement that large programs and program clusters with Recovery Act funding cannot be assessed as low-risk for the purposes of program selection without clear documentation of the reasons they are considered low risk. It also calls for recipients to separately identify expenditures for Recovery Act programs on the Schedule of Expenditures of Federal Awards.

However, OMB has not yet identified program groupings critical to auditors' selection of programs to be audited for compliance with program requirements. OMB Circular A-133 relies heavily on the amount of federal expenditures in a program during a fiscal year and whether findings were reported in the previous period to determine whether detailed compliance testing is required for that year. Although OMB is considering ways to

cluster programs for single audit selection to make it more likely that Recovery Act programs would be selected as major programs subject to internal control and compliance testing, the dollar formulas would not change under this plan. This approach may not provide sufficient assurance that smaller, but nonetheless significant, Recovery Act-funded programs would be selected for audit.

In addition, the 2009 Compliance Supplement does not yet provide specific auditor guidance for new programs funded by the Recovery Act, or for new compliance requirements specific to Recovery Act funding within existing programs, that may be selected as major programs for audit. OMB acknowledges that additional guidance is called for and plans to address some Recovery Act-related compliance requirements by mid-July 2009.

Reviewing the Design of Internal Controls over Recovery Act-funded Programs before Significant Expenditures in 2010

To provide additional focus on internal control reviews, OMB has drafted guidance it plans to finalize in July 2009 that indicates the importance of such reviews and encourages auditors to communicate weaknesses to management early in the audit process, but does not add requirements for auditors to take these steps. Addressing this recommendation through the existing audit framework, however, would not change the reporting timeframes and therefore would not address our concern that internal controls over Recovery Act programs should be reviewed before significant funding is expended. In addition, if the guidance is limited to major programs this may not adequately consider Recovery Act program risks. Further, if this is done within the current single audit framework and reporting timelines, the auditor evaluation of internal control and related reporting will occur too late—after significant levels of federal expenditures have already occurred.

Providing relief to Balance Expected Increased Workload

While OMB has noted the increased responsibilities falling on those responsible for performing single audits, it has not issued any proposals or plans to address this recommendation to date. A recent survey conducted by the staff of the National State Auditors' Association (NSAA) [38] highlighted the need for relief to over-burdened state audit organizations that have experienced staffing reductions and furloughs.

[38]NSAA's mission is to unite state auditors by encouraging and providing opportunities for the free exchange of information and ideas between auditors on the state, federal and local levels.

OMB officials told us they are considering reducing auditor workload by decreasing the number of risk assessments of smaller federal programs. Auditors conduct these risk assessments as part of the planning process to identify which federal programs will be subject to detailed internal control and compliance testing. We believe that this step alone will not provide sufficient relief to balance out additional audit requirements for Recovery Act programs. Without action now audit coverage of Recovery Act programs will not be sufficient to address Recovery Act risks and the audit reporting that does occur will be after significant expenditures have already occurred.

Congress is currently considering a bill that could provide some financial relief to auditors lacking the staff capacity necessary to handle the increased audit responsibilities associated with the Recovery Act. S. 1064, which is currently before this Committee and its companion bill that was passed by the House, H.R. 2182, would amend the Recovery Act to provide for enhanced state and local oversight of activities conducted pursuant to the Act. One key provision of the legislation would allow state and local governments to set aside 0.5 percent of Recovery Act funds, in addition to funds already allocated to administrative expenditures, to conduct planning and oversight. I support these efforts to provide financial support to auditors to meet their responsibilities associated with the Recovery Act. Chairman Lieberman, Ranking Member Collins, and this Committee are to be commended for their leadership on this matter.

Single Audit Reporting Will Not Facilitate Timely Reporting of Recovery Act Program Findings and Risks

The single audit reporting deadline is too late to provide audit results in time for the audited entity to take action on deficiencies noted in Recovery Act programs. The Single Audit Act requires that recipients submit their Single Audit reports to the federal government no later than nine months after the end of the period being audited.[39] As a result an audited entity may not receive feedback needed to correct an identified internal control or compliance weakness until the latter part of the subsequent fiscal year. For example, states that have a fiscal year end of June 30th have a reporting deadline of March 31st, which leaves program management only 3 months to take corrective action on any audit findings before the end of the subsequent fiscal year. For Recovery Act programs, significant

[39]Single Audit Act Section 7502(b)(2). The guidance provides that under certain conditions, Single Audit auditees may be audited biennially instead of annually. For entities that are audited biennially, it is longer before internal control and compliance weaknesses are identified and remediated.

expenditure of funds could occur during the period prior to the audit report being issued.

The timing problem is exacerbated by the extensions to the 9 month deadline that are routinely granted by the awarding agencies, consistent with OMB guidance. For example, 13 of the 17 states in our sample have a June 30 fiscal year end and 7 of these 13 states requested and received extensions for their March 31, 2009 submission requirement of their fiscal year 2008 reporting package.[40] The Health and Human Services Office of Inspector General (HHS OIG) is the cognizant agency for most of the states, including all of the states selected for review under the Recovery Act. According to a HHS OIG official, beginning in May 2009 HHS IG adopted a policy of no longer approving requests for extensions of the due dates for single audit reporting package submissions. OMB officials have stated that they plan to eliminate allowing extensions of the reporting package, but have not issued any official guidance or memorandum to the agencies, OIGs, or federal award recipients.

In order to realize the single audit's full potential as an effective Recovery Act oversight tool, OMB needs to take additional action to focus auditors' efforts on areas that can provide the most efficient, and most timely, results. As federal funding of Recovery Act programs accelerates in the next few months, we are particularly concerned that the Single Audit process may not provide the timely accountability and focus needed to assist recipients in making necessary adjustments to internal controls so that they achieve sufficient strength and capacity to provide assurances that the money is being spent as effectively as possible to meet program objectives.

GAO's Review of Allegations of Fraud, Waste, and Abuse Submitted to FraudNet

As of July 14, 2009, GAO's FraudNet has received 57 Recovery Act-related allegations that were considered credible enough to warrant further review. Our Forensic Audits and Special Investigations unit is currently pursuing 8 of these allegations, which include wasteful and improper spending, conflicts of interest, Recover Act funds used to supplant other funds, and contract fraud. Of the remaining 49 allegations, GAO criminal

[40]Department of Health and Human Services is the cognizant agency for the 16 states and District of Columbia that are included in our study. According to OMB Circular No. A-133 §.400(a)(2), if an entity needs an extension for submission of their single audit report, the cognizant agency must consider auditee requests for extension to the report submission due date.

investigators found that 32 did not address waste, fraud, or abuse; lacked specificity; were not Recover Act-related; or reflected only a disagreement with how Recovery Act funds are being disbursed. GAO considers these allegations to be resolved and no further investigation is necessary. An additional 17 allegations were referred to the appropriate agency Inspectors General for further review and investigation. GAO will continue to monitor these referrals and will inform the Committee when outstanding allegations are resolved.

Efforts to Assess the Impact of Recovery Act Spending

As recipients of Recovery Act funds and as partners with the federal government in achieving Recovery Act goals, states and local units of government are expected to invest Recovery Act funds with a high level of transparency and to be held accountable for results under the Recovery Act. Under the Recovery Act, direct recipients of the funds, including states and localities, are expected to report quarterly on a number of measures including the use of funds and an estimate of the number of jobs created and the number of jobs retained. These measures are part of the recipient reports required under section 1512(c) of the Recovery Act and will be submitted by recipients starting in October 2009. OMB guidance described recipient reporting requirements under the Recovery Act's section 1512 as the minimum performance measures that must be collected, leaving it to federal agencies to determine additional information that would be required for oversight of individual programs funded by the Recovery Act, such as the Department of Energy Weatherization Assistance Program and the Department of Justice Edward Byrne Memorial Justice Assistance Grant (JAG) Program.

In general, states are adapting information systems, issuing guidance, and beginning to collect data on jobs created and jobs retained, but questions remained about how to count jobs and measure performance under Recovery Act-funded programs. Over the last several months OMB met regularly with state and local officials, federal agencies, and others to gather input on the reporting requirements and implementation guidance. OMB also worked with the Recovery Accountability and Transparency Board to design a nationwide data collection system that will reduce information reporting burdens on recipients by simplifying reporting instructions and providing a user-friendly mechanism for submitting required data. OMB will be testing this system in July.

In response to requests for more guidance on the recipient reporting process and required data, OMB, after soliciting responses from an array of stakeholders, issued additional implementing guidance for recipient

reporting on June 22, 2009.[41] In addition to other areas, the new OMB guidance clarifies that recipients of Recovery Act funds are required to report only on jobs directly created or retained by Recovery Act-funded projects, activities, and contracts. Recipients are not expected to report on the employment impact on materials suppliers ("indirect" jobs) or on the local community ("induced" jobs). The OMB guidance also provides additional instruction on estimating the number of jobs created and retained by Recovery Act funding. OMB's guidance on the implementation of recipient reporting should be helpful in addressing answers to many of the questions and concerns raised by state and local program officials. However, federal agencies may need to do a better job of communicating the OMB guidance in a timely manner to their state counterparts and, as appropriate, issue clarifying guidance on required performance measurement.

OMB's guidance for reporting on job creation aims to shed light on the immediate uses of Recovery Act funding; however, reports from recipients of Recovery Act funds must be interpreted with care. For example, accurate, consistent reports will only reflect a portion of the likely impact of the Recovery Act on national employment, since Recovery Act resources are also made available through tax cuts and benefit payments.[42] OMB noted that a broader view of the overall employment impact of the Recovery Act will be covered in the estimates generated by the Council of Economic Advisers (CEA) using a macro-economic approach. According to CEA, it will consider the direct jobs created and retained reported by recipients to supplement its analysis.[43]

[41]OMB memoranda, M-09-21, *Implementing Guidance for the Reports on Use of Funds Pursuant to the American Recovery and Reinvestment Act of 2009* (June 22, 2009).

[42]The recipient reporting requirement only covers a defined subset of the Recovery Act's funding. The reporting requirements apply to recipients who receive funding through discretionary appropriations, not recipients receiving funds through entitlement programs, such as Medicaid, or tax programs. Recipient reporting also does not apply to individuals.

[43]Executive Office of the President, Council of Economic Advisers, *Estimates of Job Creation From the American Recovery and Reinvestment Act of 2009* (May 2009).

Concluding Observations and Recommendations

Since enactment of the Recovery Act in February 2009, OMB has issued three sets of guidance—on February 18, April 3 and, most recently, June 22, 2009[44] —to, among other things, assist recipients of federal Recovery Act funds in complying with reporting requirements. OMB has reached out to Congress, federal, state, and local government officials, grant and contract recipients, and the accountability community to get a broad perspective on what is needed to meet the high expectations set by Congress and the administration. Further, according to OMB's June guidance they have worked with the Recovery Accountability and Transparency Board to deploy a nationwide data collection system at www.federalreporting.gov.

As work proceeds on the implementation of the Recovery Act, OMB and the cognizant federal agencies have opportunities to build on the early efforts by continuing to address several important issues.

These issues can be placed broadly into three categories, which have been revised from our last report to better reflect evolving events since April: (1) accountability and transparency requirements, (2) reporting on impact, and (3) communications and guidance.

Accountability and Transparency Requirements

Recipients of Recovery Act funding face a number of implementation challenges in this area. The act includes new programs and significant increases in funds out of normal cycles and processes. There is an expectation that many programs and projects will be delivered faster so as to inject funds into the economy, and the administration has indicated its intent to assure transparency and accountability over the use of Recovery Act funds. Issues regarding the Single Audit process and administrative support and oversight are important.

Single Audit: The Single Audit process needs adjustments to provide appropriate risk-based focus and the necessary level of accountability over Recovery Act programs in a timely manner.

[44]OMB Memorandum M-09-15, *Updated Implementing Guidance for the American Recovery and Reinvestment Act of 2009* (Apr. 3, 2009). This guidance supplements, amends, and clarifies the initial guidance issued by OMB on February 18, 2009. OMB memoranda, M-09-21, *Implementing Guidance for the Reports on Use of Funds Pursuant to the American Recovery and Reinvestment Act of 2009* (June 22, 2009).

In our April 2009 report, we reported that the guidance and criteria in OMB Circular No. A-133 do not adequately address the substantial added risks posed by the new Recovery Act funding. Such risks may result from (1) new government programs, (2) the sudden increase in funds or programs that are new to the recipient entity, and (3) the expectation that some programs and projects will be delivered faster so as to inject funds into the economy. With some adjustment, the Single Audit could be an effective oversight tool for Recovery Act programs because it can address risks associated with all three of these factors.

April report recommendations: Our April report included recommendations that OMB adjust the current audit process to focus the risk assessment auditors use to select programs to test for compliance with 2009 federal program requirements on Recovery Act funding; provide for review of the design of internal controls during 2009 over programs to receive Recovery Act funding, before significant expenditures in 2010; and evaluate options for providing relief related to audit requirements for low-risk programs to balance new audit responsibilities associated with the Recovery Act.

Status of April report recommendations: OMB has taken some actions and has other planned actions to help focus the program selection risk assessment on Recovery Act programs and to provide guidance on auditors' reviews of internal controls for those programs. However, we remain concerned that OMB's planned actions would not achieve the level of accountability needed to effectively respond to Recovery Act risks and does not provide for timely reporting on internal controls for Recovery Act programs. Therefore, we are re-emphasizing our previous recommendations in this area.

To help auditors with single audit responsibilities meet the increased demands imposed on them by Recovery Act funding, we recommend that the Director of OMB take the following four actions:

- Consider developing requirements for reporting on internal controls during 2009 before significant Recovery Act expenditures occur as well as ongoing reporting after the initial report.

- Provide more focus on Recovery Act programs through the Single Audit to help ensure that smaller programs with high risk have audit coverage in the area of internal controls and compliance.

- Evaluate options for providing relief related to audit requirements for low-risk programs to balance new audit responsibilities associated with the Recovery Act.

- To the extent that options for auditor relief are not provided, develop mechanisms to help fund the additional Single Audit costs and efforts for auditing Recovery Act programs.

Administrative Support and Oversight

States have been concerned about the burden imposed by new requirements, increased accounting and management workloads, and strains on information systems and staff capacity at a time when they are under severe budgetary stress.

April report recommendation: In our April report, we recommended that the director of OMB clarify what Recovery Act funds can be used to support state efforts to ensure accountability and oversight, especially in light of enhanced oversight and coordination requirements.

Status of April report recommendation: On May 11, 2009, OMB released a memorandum[45] clarifying how state grantees could recover administrative costs of Recovery Act activities.

Matter for Congressional Consideration

Because a significant portion of Recovery Act expenditures will be in the form of federal grants and awards, the Single Audit process could be used as a key accountability tool over these funds. However, the Single Audit Act, enacted in 1984 and most recently amended in 1996, did not contemplate the risks associated with the current environment where large amounts of federal awards are being expended quickly through new programs, greatly expanded programs, and existing programs. The current Single Audit process is largely driven by the amount of federal funds expended by a recipient in order to determine which federal programs are subject to compliance and internal control testing. Not only does this model potentially miss smaller programs with high risk, but it also relies on audit reporting 9 months after the end of a grantee's fiscal year—far too late to preemptively correct deficiencies and weaknesses before

[45]OMB memoranda, M-09-18, *Payments to State Grantees for Administrative Costs of Recovery Act Activities* (May 11, 2009).

significant expenditures of federal funds. Congress is considering a legislative proposal in this area and could address the following issues:

- To the extent that appropriate adjustments to the Single Audit process are not accomplished under the current Single Audit structure, Congress should consider amending the Single Audit Act or enacting new legislation that provides for more timely internal control reporting, as well as audit coverage for smaller Recovery Act programs with high risk.

- To the extent that additional audit coverage is needed to achieve accountability over Recovery Act programs, Congress should consider mechanisms to provide additional resources to support those charged with carrying out the Single Audit act and related audits.

Reporting on Impact

Under the Recovery Act, responsibility for reporting on jobs created and retained falls to nonfederal recipients of Recovery Act funds. As such, states and localities have a critical role in identifying the degree to which Recovery Act goals are achieved.

Performance reporting is broader than the jobs reporting required under section 1512 of the Recovery Act. OMB guidance requires that agencies collect and report performance information consistent with the agency's program performance measures. As described earlier in this report, some agencies have imposed additional performance measures on projects or activities funded through the Recovery Act.

April report recommendation: In our April report, we recommended that given questions raised by many state and local officials about how best to determine both direct and indirect jobs created and retained under the Recovery Act, the Director of OMB should continue OMB's efforts to identify appropriate methodologies that can be used to (1) assess jobs created and retained from projects funded by the Recovery Act; (2) determine the impact of Recovery Act spending when job creation is indirect; (3) identify those types of programs, projects, or activities that in the past have demonstrated substantial job creation or are considered likely to do so in the future and consider whether the approaches taken to estimate jobs created and jobs retained in these cases can be replicated or adapted to other programs.

Status of April report recommendation: OMB has been meeting on a regular basis with state and local officials, federal agencies, and others to

gather input on reporting requirements and implementation guidance and has worked with the Recovery Accountability and Transparency Board on a nationwide data collection system. On June 22, OMB issued additional implementation guidance on recipient reporting of jobs created and retained. This guidance is responsive to much of what we said in our April report. It states that there are two different types of jobs reports under the Recovery Act and clarifies that recipient reports are to cover only direct jobs created or retained. "Indirect" jobs (employment impact on suppliers) and "induced" jobs (employment impact on communities) will be covered in Council of Economic Advisers (CEA) quarterly reports on employment, economic growth, and other key economic indicators. Consistent with the statutory language of the act, OMB's guidance states that these recipient reporting requirements apply to recipients who receive funding through discretionary appropriations, not to those receiving funds through either entitlement or tax programs or to individuals. It clarifies that the prime recipient and not the subrecipient is responsible for reporting section 1512 information on jobs created or retained. The June 2009 guidance also provides detailed instructions on how to calculate and report jobs as full-time equivalents (FTE). It also describes in detail the data model and reporting system to be used for the required recipient reporting on jobs.

The guidance provided for reporting job creation aims to shed light on the immediate uses of Recovery Act funding and is reasonable in that context. It will be important, however, to interpret the recipient reports with care. As noted in the guidance, these reports are only one of the two distinct types of reports seeking to describe the jobs impact of the Recovery Act. CEA's quarterly reports will cover the impact on employment, economic growth, and other key economic indicators. Further, the recipient reports will not reflect the impact of resources made available through tax provisions or entitlement programs.[46]

Recipients are required to report no later than 10 days after the end of the calendar quarter. The first of these reports is due on October 10, 2009.

[46]Consistent with GAO's past work showing that tax expenditures receive less scrutiny than outlay programs (e.g., GAO, *Government Performance and Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Reexamined*, GAO-05-690 (Washington, D.C.: Sept. 23, 2005), we have begun work to determine the level of transparency and oversight that will be provided for the Recovery Act tax provisions. Administration officials are formulating plans for what information will be collected, analyzed, and reported for the tax provisions. See also: GAO, *American Recovery and Reinvestment Act: GAO's Role in Helping to Ensure Accountability and Transparency*, GAO-09-453T (Washington, D.C.: Mar. 5, 2009).

After prime recipients and federal agencies perform data quality checks, detailed recipient reports are to be made available to the public no later than 30 days after the end of the quarter. Initial summary statistics will be available on www.recovery.gov. The guidance explicitly does not mandate a specific methodology for conducting quality reviews. Rather, federal agencies are directed to coordinate the application of definitions of material omission and significant reporting error to "ensure consistency" in the conduct of data quality reviews. Although recipients and federal agency reviewers are required to perform data quality checks, none are required to certify or approve data for publication. It is unclear how any issues identified under data quality reviews would be resolved and how frequently data quality problems would have been identified in the reviews. We will continue to monitor this data quality and recipient reporting requirements.

Our recommendations: To increase consistency in recipient reporting or jobs created and retained, the Director of OMB should work with federal agencies to have them provide program-specific examples of the application of OMB's guidance on recipient reporting of jobs created and retained. This would be especially helpful for programs that have not previously tracked and reported such metrics.

Because performance reporting is broader than the jobs reporting required by section 1512, the Director of OMB should also work with federal agencies—perhaps through the Senior Management Councils—to clarify what new or existing program performance measures—in addition to jobs created and retained—that recipients should collect and report in order to demonstrate the impact of Recovery Act funding.[47]

In addition to providing these additional types of program-specific examples of guidance, the Director of OMB should work with federal agencies to use other channels to educate state and local program officials

[47]According to OMB guidance, rather than establishing a new council, agencies are encouraged to leverage their existing Senior Management Councils to oversee Recovery Act performance across the agency, including risk management. The Senior Management Council should be composed of the Chief Financial Officer, Senior Procurement Executive, Chief Human Capital Officer, Chief Information Officer, Performance Improvement Officer, and managers of programmatic offices. The agency's Senior Accountable Official should also participate and assume a leadership role. Agencies should also consider having their Office of General Counsel and Office of Inspectors General serve in advisory roles on the Senior Management Council.

on reporting requirements, such as Web- or telephone-based information sessions or other forums.

Communications and Guidance

Funding notification and program guidance: State officials expressed concerns regarding communication on the release of Recovery Act funds and their inability to determine when to expect federal agency program guidance. Once funds are released there is no easily accessible, real-time procedure for ensuring that appropriate officials in states and localities are notified. Because half of the estimated spending programs in the Recovery Act will be administered by nonfederal entities, states wish to be notified when funds are made available to them for their use as well as when funding is received by other recipients within their state that are not state agencies.

OMB does not have a master timeline for issuing federal agency guidance. OMB's preferred approach is to issue guidance incrementally. This approach potentially produces a more timely response and allows for mid-course corrections; however, this approach also creates uncertainty among state and local recipients responsible for implementing programs. We continue to believe that OMB can strike a better balance between developing timely and responsive guidance and providing a longer range time line that gives some structure to states' and localities' planning efforts.

April report recommendation: In our April report, we recommended that to foster timely and efficient communications, the Director of OMB should develop an approach that provides dependable notification to (1) prime recipients in states and localities when funds are made available for their use, (2) states—where the state is not the primary recipient of funds but has a statewide interest in this information—and (3) all nonfederal recipients on planned releases of federal agency guidance and, if known, whether additional guidance or modifications are recommended.

Status of April recommendation: OMB has made important progress in the type and level of information provided in its reports on Recovery.gov. Nonetheless, OMB has additional opportunities to more fully address the recommendations we made in April. By providing a standard format across disparate programs, OMB has improved its Funding Notification reports, making it easier for the public to track when funds become available. Agencies update their Funding Notification reports for each program individually whenever they make funds available. Both reports are available on www.recovery.gov. OMB has taken the additional step of

disaggregating financial information, i.e., federal obligations and outlays by Recovery Act programs and by state in its Weekly Financial Activity Report.

Our recommendation: The Director of OMB should continue to develop and implement an approach that provides easily accessible, real-time notification to (1) prime recipients in states and localities when funds are made available for their use, and (2) states—where the state is not the primary recipient of funds but has a statewide interest in this information. In addition, OMB should provide a long range time line for the release of federal guidance for the benefit of nonfederal recipients responsible for implementing Recovery Act programs.

Recipient financial tracking and reporting guidance: In addition to employment related reporting, OMB's guidance calls for the tracking of funds by the prime recipient, recipient vendors, and subrecipients receiving payments. OMB's guidance also allows that "prime recipients may delegate certain reporting requirements to subrecipients." Either the prime or sub-recipient must report the D-U-N-S number (or an acceptable alternative) for any vendor or sub-recipient receiving payments greater than $25 thousand. In addition, the prime recipient must report what was purchased and the amount, and a total number and amount for sub-awards of less than $25 thousand. By reporting the DUNS number, OMB guidance provides a way to identify subrecipients by project, but this alone does not ensure data quality.

The approach to tracking funds is generally consistent with the Federal Funding Accountability and Transparency Act (FFATA). Like the Recovery Act, the FFATA requires a publicly available Web site—USAspending.gov—to report financial information about entities awarded federal funds. Yet, significant questions have been raised about the reliability of the data on USAspending.gov, primarily because what is reported by the prime recipients is dependent on the unknown data quality and reporting capabilities of their subrecipients.

For example, earlier this year, more than 2 years after passage of FFATA, the Congressional Research Services (CRS) questioned the reliability of the data on USAspending.gov. We share CRS's concerns associated with USAspending.gov, including incomplete, inaccurate, and other data quality problems. More broadly, these concerns also pertain to recipient financial reporting in accordance with the Recovery Act and its federal reporting vehicle, www.FederalReporting.gov, currently under development.

Our recommendation: To strengthen the effort to track the use of funds, the Director of OMB should (1) clarify what constitutes appropriate quality control and reconciliation by prime recipients, especially for subrecipient data, and (2) specify who should best provide formal certification and approval of the data reported.

Agency-specific guidance: DOT and FHWA have yet to provide clear guidance regarding how states are to implement the Recovery Act requirement that economically distressed areas are to receive priority in the selection of highway projects for funding. We found substantial variation both in how states identified areas in economic distress and how they prioritized project selection for these areas. As a result, it is not clear whether areas most in need are receiving priority in the selection of highway infrastructure projects, as Congress intended. While it is true that states have discretion in selecting and prioritizing projects, it is also important that this goal of the Recovery Act be met.

Our recommendation: To ensure states meet Congress's direction to give areas with the greatest need priority in project selection, the Secretary of Transportation should develop clear guidance on identifying and giving priority to economically distressed areas that are in accordance with the requirements of the Recovery Act and the Public Works and Economic Development Act of 1965, as amended, and more consistent procedures for the Federal Highway Administration to use in reviewing and approving states' criteria.

Agency Comments and Our Evaluation

We received comments on a draft of our report from the U.S. Office of Management and Budget (OMB) and the U.S. Department of Transportation (DOT) on our report recommendations.

U.S. Office of Management and Budget: OMB concurs with the overall objectives of our recommendations made to OMB in our report. OMB offered clarifications regarding the area of Single Audit and did not concur with some of our conclusions related to communications. What follows summarizes OMB's comments and our responses.

Single Audit Act

OMB agreed with the overall objectives of our recommendations and offered clarifications regarding the areas of Single Audit. OMB also noted it believes that the new requirements for more rigorous internal control reviews will yield important short-term benefits and the steps taken by

state and local recipients to immediately initiate controls will withstand increased scrutiny later in the process.

OMB commented that it has already taken and is planning actions to focus program selection risk assessment on Recovery Act programs and to increase the rigor of state and local internal controls on Recovery Act activities. However, our report points out that OMB has not yet completed critical guidance in these areas. Unless OMB plans to change the risk assessment process conducted for federal programs under Circular A-133, smaller, but significantly risky programs under the Recovery Act may not receive adequate attention and scrutiny under the Single Audit process.

OMB acknowledged that acceleration of internal control reviews could cause more work for state auditors, for which OMB and Congress should explore potential options for relief. This is consistent with the recommendations we make in this report. OMB also noted that our draft report did not offer a specific recommendation for achieving acceleration of internal control reporting. Because there are various ways to achieve the objective of early reporting on internal controls, we initially chose not to prescribe a specific method; however, such accelerated reporting could be achieved in various ways. For instance, OMB could require specific internal control certifications from federal award recipients meeting certain criteria as of a specified date, such as December 31, 2009, before significant Recovery Act expenditures occur. Those certifications could then be reviewed by the auditor as part of the regular single audit process. Alternatively, or in addition, OMB could require that the internal control portion of the single audit be completed early, with a report submitted 60 days after the recipient's year end. We look forward to continuing our dialog with OMB on various options available to achieve the objective of early reporting on internal controls. We will also continue to review OMB's guidance in the area of single audits as such guidance is being developed.

Communications

OMB has made important progress relative to some communications. In particular, we agree with OMB's statements that it requires agencies to post guidance and funding information to agency Recovery Act websites, disseminates guidance broadly, and seeks out and responds to stakeholder input. In addition, OMB is planning a series of interactive forums to offer training and information to Recovery Act recipients on the process and mechanics of recipient reporting and they could also serve as a vehicle for additional communication. Moving forward and building on the progress it has made, OMB can take the following additional steps related to funding notification and guidance.

First, OMB should require direct notification to key state officials when funds become available within a state. OMB has improved Funding Notification reports by providing a standard format across disparate programs, making it easier for the public to track when funds become available. However, it does not provide an easily accessible, real-time notification of when funds are available. OMB recognized the shared responsibilities of federal agencies and states in its April 3, 2009 guidance when it noted that federal agencies should expect states to assign a responsible office to oversee data collection to ensure quality, completeness, and timeliness of data submissions for recipient reporting. In return, states have expressed a need to know when funds flow into the state regardless of which level of government or governmental entity within the state receives the funding so that they can meet the accountability objectives of the Recovery Act. We continue to recommend more direct notification to (1) prime recipients in states and localities when funds are made available for their use, and (2) states-where the state is not the primary recipient of funds but has a statewide interest in this information.

Second, OMB should provide a long range time line for the release of federal guidance. In an attempt to be responsive to emerging issues and questions from the recipient community, OMB's preferred approach is to issue guidance incrementally. This approach potentially produces a more timely response and allows for mid-course corrections; however, this approach also creates uncertainty among state and local recipients. State and local officials expressed concerns that this incremental approach hinders their efforts to plan and administer Recovery Act programs. As a result, we continue to believe OMB can strike a better balance between developing timely and responsive guidance and providing some degree of a longer range time line so that states and localities can better anticipate which programs will be affected and when new guidance is likely to be issued. OMB's consideration of a master schedule and its acknowledgement of the extraordinary proliferation of program guidance in response to Recovery Act requirements seem to support a more structured approach. We appreciate that a longer range time line would need to be flexible so that OMB could also continue to issue guidance and clarifications in a timely manner as new issues and questions emerge.

U.S. Department of Transportation: DOT generally agreed to consider the recommendation that it develop clear guidance on identifying and giving priority to economically distressed areas and more consistent procedures for reviewing and approving states' criteria. DOT agreed that states must give priority to projects located in economically distressed

areas, but said that states must balance all the Recovery Act project selection criteria when selecting projects including giving preference to activities that can be started and completed expeditiously, using funds in a manner that maximizes job creation and economic benefit, and other factors. While we agree with DOT that there is no absolute primacy of economically distressed area projects in the sense that they must always be started first, the specific directives in the act that apply to highway infrastructure are that priority is to be given to projects that can be completed in 3 years, and are located in economically distressed areas. DOT also stated that the basic approach used by selected states to apply alternative criteria is consistent with the Public Works and Economic Development Act and its implementing regulations on economically distressed areas because it makes use of flexibilities provided by the Public Works Act to more accurately reflect changing economic conditions. However the result of DOT's interpretation would be to allow states to prioritize projects based on criteria that are not mentioned in the highway infrastructure investment portion of the Recovery or the Public Works Acts without the involvement of the Secretary or Department of Commerce. We plan to continue to monitor states' implementation of the economically distressed area requirements and interagency coordination at the federal level in future reports.

Mr. Chairman, Senator Collins, and Members of the Committee this concludes my statement. I would be pleased to respond to any questions you may have.

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