

GAO

Testimony

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RECOVERY ACT

As Initial Implementation Unfolds in States and Localities, Continued Attention to Accountability Issues Is Essential

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GAO

Accountability * Integrity * Reliability

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 The Recovery Act is estimated to cost about \$787 billion over the next several years, of which about \$280 billion will be administered through states and localities. Funds made available under the Recovery Act are being distributed to states, localities, and other entities and individuals through a combination of grants and direct assistance. As you know, the stated purposes of the Recovery Act are to:

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

As I described in my March testimony,² 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 My statement today is based on our report being released today, *Recovery Act: As Initial Implementation Unfolds in States and Localities, Continued Attention to Accountability Issues Is Essential*, which is the first in a series of bimonthly reviews we will do on states' and localities' uses of Recovery Act funding and covers the actions taken under the Act through April 20, 2009.⁴ Our report and our other work related to the Recovery Act can be found on our new website called *Following the Money: GAO's Oversight of the Recovery Act*, which is accessible through GAO's home page at www.gao.gov.

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

² [GAO-09-453T](#).

³Recovery Act, div. A, title IX, §901

⁴ [GAO-09-580](#).

Like the report, my statement this morning discusses (1) selected states' and localities' uses of and planning for 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. Our report addresses each of these objectives in detail and contains an appendix on each of the 16 states and the District of Columbia (the District) where we did our detailed work that discusses our reporting objectives as they apply to each of those locations.

As discussed in my March testimony, we selected a core group of 16 states and the District that we will follow over the next few years to provide an ongoing longitudinal analysis of the use of funds provided in conjunction with the Recovery Act. The states are Arizona, California, Colorado, Florida, Georgia, Iowa, Illinois, Massachusetts, Michigan, Mississippi, New Jersey, New York, North Carolina, Ohio, Pennsylvania, and Texas. These states 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 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 for this bimonthly review, we visited a non-probability sample of about 60 localities within the 16 selected states.⁵

We collected documents from and conducted semi-structured interviews with executive-level state and local officials and staff from Governors' offices, "Recovery Czars," State Auditors, Controllers, and Treasurers. We also interviewed staff from state legislatures. In addition, our work focused on federal, state, and local agencies administering programs receiving Recovery Act funds. We analyzed data and interviewed officials from the federal Office of Management and Budget (OMB). We also analyzed other federal guidance on programs selected for this review and spoke with relevant program officials at the Centers for Medicare & Medicaid Services (CMS), the U.S. Department of Transportation and the U.S. Department of Education. 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,

⁵This total includes two entities in the District which received direct federal funding that was not passed through the District government.

legislative proposals, and other state legal materials. A detailed description of our scope and methodology can be found in an appendix to our report.

We conducted a performance audit for our first bimonthly review from February 17, 2009, to April 20, 2009 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.

In addition to our ongoing work on selected states' and localities' use of Recovery Act funding, we have completed two of the other mandates included for us in the Recovery Act. First, on April 3, 2009, we announced the appointment of 13 members to the Health Information Technology Policy Committee, a new advisory body established by the Recovery Act. Additionally, on April 16, 2009, we issued a report on the actions of the Small Business Administration (SBA) to, among other things, increase liquidity in the secondary market for SBA loans.⁶

Summary of GAO Findings

Uses of Funds

About 90 percent of the estimated \$49 billion Recovery Act funding to be provided to states and localities in fiscal year 2009 will be through health, transportation and education programs. Within these categories, the three largest programs are increased Medicaid Federal Medical Assistance Percentage (FMAP) grant awards, funds for highway infrastructure investment, and the State Fiscal Stabilization Fund (SFSF). Table 1 shows the breakout of funding available for these three programs in the 16 selected states and the District. The Recovery Act funding for these 17 jurisdictions accounts for a little less than two-thirds of total Recovery Act funding for these three programs.

⁶ GAO, *Small Business Administration's Implementation of Administrative Provisions in the American Recovery and Reinvestment Act of 2009*, [GAO-09-507R](#) (Washington, D.C.: April 16, 2009).

Table 1: Notification of Recovery Act Funds for GAO Core States and the District for Select Programs (Dollars in thousands)

State	Medicaid FMAP	Highways	Fiscal Stabilization Fund
Arizona	\$534,576	\$521,958	\$681,360
California	\$3,331,167	\$2,569,568	\$3,993,379
Colorado	\$226,959	\$403,924	\$509,363
District of Columbia	\$87,831	\$123,508	\$59,883
Florida	\$1,394,945	\$1,346,735	\$1,809,196
Georgia	\$521,251	\$931,586	\$1,032,684
Illinois	\$992,042	\$935,593	\$1,376,965
Iowa	\$136,023	\$358,162	\$316,467
Massachusetts	\$1,182,968	\$437,865	\$666,153
Michigan	\$700,522	\$847,205	\$1,066,733
Mississippi	\$225,471	\$354,564	\$321,131
New Jersey	\$549,847	\$651,774	\$891,424
New York	\$3,143,641	\$1,120,685	\$2,021,924
North Carolina	\$657,111	\$735,527	\$951,704
Ohio	\$760,647	\$935,677	\$1,198,882
Pennsylvania	\$1,043,920	\$1,026,429	\$1,276,766
Texas	\$1,448,824	\$2,250,015	\$2,662,203
Total Case Study	\$16,937,745	\$15,550,776	\$20,836,218
Percent of National Total	70	58	64
National Total	\$24,233,145	\$26,660,000	\$32,552,620
Notifications as of	April 3, 2009	March 2, 2009	April 2, 2009

Source: GAO analysis of agency data.

Note: For Medicaid FMAP amounts shown are the increased Medicaid FMAP Grant Awards as of April 3, 2009. For Highways, the amounts shown are the full state apportionment. For the SFSF, the amounts shown are the initial release of the state allocation.

Increased Medicaid FMAP Funding

The 16 states and the District have drawn down approximately \$7.96 billion in increased FMAP grant awards for the period October 1, 2008, through April 1, 2009. The increased FMAP is for state expenditures for Medicaid services. The receipt of this increased FMAP may reduce the state share for their Medicaid programs. States have reported using funds made available as a result of the increased FMAP for a variety of purposes. For example, states and the District most frequently reported using these funds to maintain their current level of Medicaid eligibility and benefits, cover their increased Medicaid caseloads—which are primarily populations that are sensitive to economic downturns, including children and families,

and to offset their state general fund deficits, thereby avoiding layoffs and other measures detrimental to economic recovery.

Highway Infrastructure
Investment

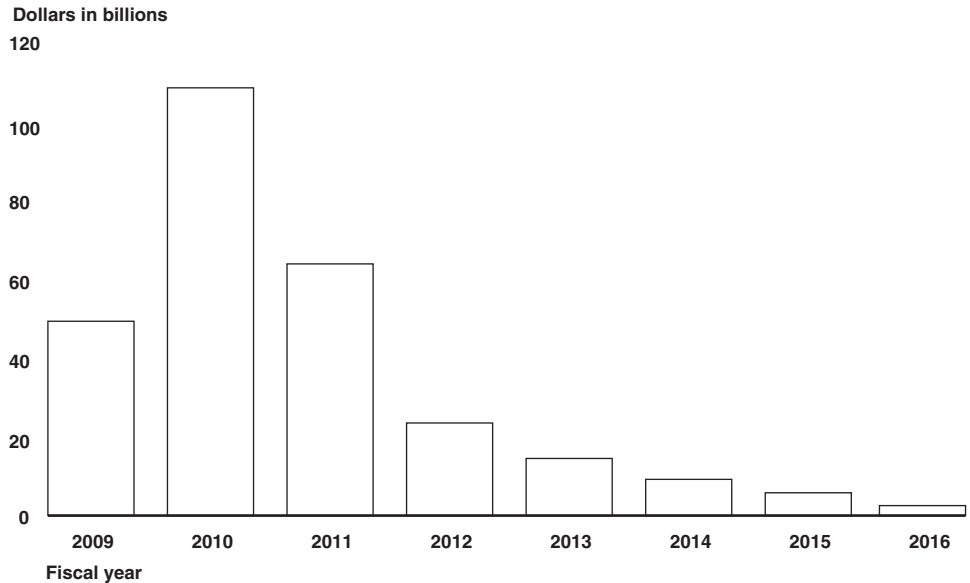
States are undertaking planning activities to identify projects, obtain approval at the state and federal level, and move them to contracting and implementation. Some state officials told us they were focusing on construction and maintenance projects, such as road and bridge repairs. Before they can expend Recovery Act funds, states must reach agreement with the Department of Transportation on the specific projects; as of April 16, 2009, two of the 16 states had agreements covering more than 50 percent of their states' apportioned funds, and three states did not have agreement on any projects. While a few, including Mississippi and Iowa had already executed contracts, most of the 16 states were planning to solicit bids in April or May. Thus, states generally had not yet expended significant amounts of Recovery Act funds.

State Fiscal Stabilization Fund

The states and the District must apply to the Department of Education for SFSF funds. Education will award funds once it determines that an application contains key assurances and information on how the state will use the funds. As of April 20, applications from three states had met that determination-South Dakota, and two of GAO's sample states, California and Illinois. The applications from other states are being developed and submitted and have not yet been awarded. The states and the District report that SFSF funds will be used to hire and retain teachers, reduce the potential for layoffs, cover budget shortfalls, and restore funding cuts to programs.

Planning continues for the use of Recovery Act funds. Figure 1 below shows the projected timing when funds will be made available to states and localities.

Figure 1: Projected Timing of Federal Recovery Act Funding Made Available to States and Localities by Fiscal Year



Source: GAO analysis of CBO and FFIS data.

State planning activities include appointing Recovery Czars, establishing task forces and other entities, and developing public websites to solicit input and publicize selected projects. In many states, legislative authorization is needed before the state can receive and/or expend funds or make changes to programs or eligibility requirements.

Accountability Approaches

We found that the selected states and the District are taking various approaches to ensure that internal controls are in place to manage risk up-front; they are assessing known risks and developing plans to address those risks. However, officials in most of the states and the District expressed concerns regarding the lack of Recovery Act funding provided for accountability and oversight. Due to fiscal constraints, many states reported significant declines in the number of oversight staff—limiting their ability to ensure proper implementation and management of Recovery Act funds. State auditors are also planning their work including conducting required single audits and testing compliance with federal requirements. The single audit process is important for effective oversight but can be modified to be a more timely and effective audit and oversight

tool for the Recovery Act and OMB is weighing options on how to modify it.

Nearly half of the estimated spending programs in the Recovery Act will be administered by non-federal entities. State officials suggested opportunities to improve communication in several areas. For example, they wish to be notified when Recovery Act funds are made available directly to prime recipients within their state that are not state agencies.

Plans to Evaluate Impact

An important objective of the Recovery Act is to preserve and create jobs and promote economic recovery. Officials in nine of the 16 states and the District expressed concern about determining jobs created and retained under the Recovery Act, as well as methodologies that can be used for estimation of each.

GAO's Recommendations

OMB has moved out quickly to guide implementation of the Recovery Act. As OMB's initiatives move forward, it has opportunities to build upon its efforts to date by addressing several important issues.

Accountability and Transparency Requirements

The Director of OMB should:

- adjust the single audit process to provide for review of the design of internal controls during 2009 over programs to receive Recovery Act funding, before significant expenditures in 2010.
- continue efforts to identify methodologies that can be used to determine jobs created and retained from projects funded by the Recovery Act.
- evaluate current requirements to determine whether sufficient, reliable and timely information is being collected before adding further data collection requirements.

Administrative Support and Oversight

The Director of OMB should clarify what Recovery Act funds can be used to support state efforts to ensure accountability and oversight.

Communications

The Director of OMB should provide timely and efficient 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 state-wide interest in this information, and (3) all recipients, on

planned releases of federal agency guidance and whether additional guidance or modifications are expected.

OMB, States, and District Comments on the Draft of Our Report

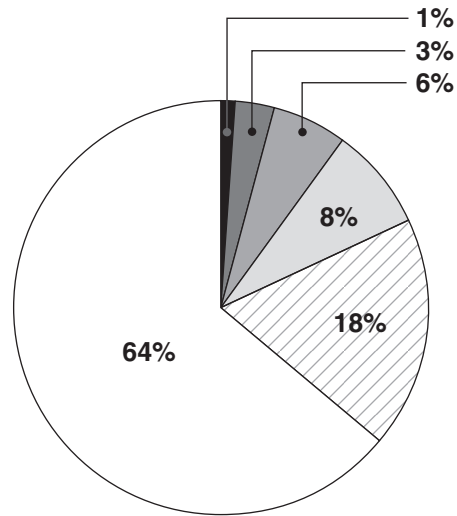
We provided the Director of the Office of Management and Budget with a draft of this report for comment on April 20, 2009. OMB staff responded the next day, noting that in its initial review, OMB concurred with the overall objectives of our recommendations. OMB staff also provided some clarifying information, adding that OMB will complete a more thorough review in a few days. We have incorporated OMB's clarifying information as appropriate. In addition, OMB said it plans to work with us to define the best path forward on our recommendations and to further the accountability and transparency of the Recovery Act. The Governors of each of the 16 states and the Mayor of the District were provided drafts for comment on each of their respective appendixes in this report. Those comments are included in the appendixes.

Background

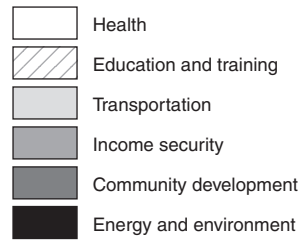
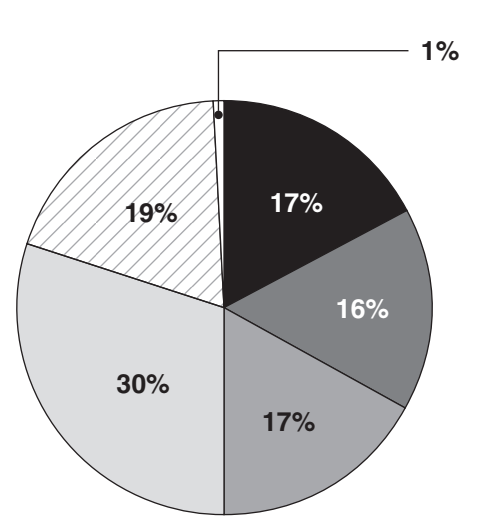
Over time, the programmatic focus of Recovery Act spending will change. As shown in figure 2, about two-thirds of Recovery Act funds expected to be spent by states in the current 2009 fiscal year will be health-related spending, primarily temporary increases in Medicaid FMAP funding. Health, education, and transportation is estimated to account for approximately 90 percent of fiscal year 2009 Recovery Act funding for states and localities. However, by fiscal year 2012, transportation will be the largest share of state and local Recovery Act funding. Taken together, transportation spending, along with investments in community development, energy, and environmental areas that are geared more toward creating long-run economic growth opportunities, will represent approximately two-thirds of state and local Recovery Act funding in 2012.

Figure 2: Composition of State and Local Recovery Act Funding, Fiscal Years 2009 and 2012

Fiscal year 2009



Fiscal year 2012



Source: GAO analysis of CBO and FFIS data.

States' and Localities' Use of and Plans for Recovery Act Funds Focuses on Purposes of the Act and States' Fiscal Stresses

Medicaid FMAP

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.⁷ The amount of federal assistance states receive for Medicaid service expenditures is known as the FMAP.

Under the Recovery Act, states are eligible for an increased FMAP for expenditures that states make in providing services to their Medicaid populations.⁸ The Recovery Act provides eligible states with an increased FMAP for 27 months between October 1, 2008 and December 31, 2010. 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.⁹ 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. For the first two quarters of 2009, the increases in

⁷States may use certain sources for financing the non-federal share of Medicaid expenditures, including contributions from political subdivisions in the state, such as cities or counties.

⁸See Recovery Act, div. B, title V, § 5001 (a)-(c). U.S. territories are also eligible for an increased FMAP subject to a different formula than states. Recovery Act div. B, title V, § 5001 (d).

⁹Although the effective date of the Recovery Act was February 17, 2009, states generally may claim reimbursement for Medicaid service expenditures made on or after October 1, 2008.

the FMAP for the 16 states and the District ranged from 7.09 percentage points in Iowa to 11.59 percentage points in California, as shown in table 2.

Table 2: FMAP Changes from Fiscal Year 2008 to the First Two Quarters of Fiscal Year 2009, for 16 states and the District

State	FY 2008 FMAP	FY 2009 FMAP, first two quarters	Difference
Arizona	66.20	75.01	8.81
California	50.00	61.59	11.59
Colorado	50.00	58.78	8.78
District of Columbia	70.00	77.68	7.68
Florida	56.83	67.64	10.81
Georgia	63.10	73.44	10.34
Illinois	50.00	60.48	10.48
Iowa	61.73	68.82	7.09
Massachusetts	50.00	58.78	8.78
Michigan	58.10	69.58	11.48
Mississippi	76.29	83.62	7.33
New Jersey	50.00	58.78	8.78
New York	50.00	58.78	8.78
North Carolina	64.05	73.55	9.50
Ohio	60.79	70.25	9.46
Pennsylvania	54.08	63.05	8.97
Texas	60.56	68.76	8.20

Source: GAO analysis of HHS data.

In our sample of 16 states and the District, officials from 15 states and the District indicated that they had drawn down increased FMAP grant awards, totaling \$7.96 billion for the period of October 1, 2008 through April 1, 2009—47 percent of their increased FMAP grant awards. In our sample, the extent to which individual states and the District accessed these funds varied widely, ranging from 0 percent in Colorado to about 66 percent in New Jersey. Nationally, the 50 states and several territories combined have drawn down approximately \$11 billion as of April 1, 2009,

which represents almost 46 percent of the increased FMAP grants awarded for the first three quarters of federal fiscal year 2009 (table 3).¹⁰

Table 3: FMAP Grant Awards and Funds Drawn Down, for 16 States and the District

(Dollars in thousands)

State	FMAP grant awards	Funds drawn	Percentage of funds drawn
Arizona	\$534,576	\$286,286	53.6
California	\$3,331,167	\$1,511,539	45.4
Colorado	\$226,959	0	0.0
District of Columbia	\$87,831	\$49,898	56.8
Florida	\$1,394,945	\$817,025	58.6
Georgia	\$521,251	\$311,515	59.8
Illinois	\$992,042	\$117,081	11.8
Iowa	\$136,023	\$81,663	60.0
Massachusetts	\$1,182,968	\$272,559	23.0
Michigan	\$700,522	\$462,982	66.1
Mississippi	\$225,471	\$114,112	50.6
New Jersey	\$ 549,847	\$362,235	65.9
New York	\$3,143,641	\$1,739,073	55.3
North Carolina	\$657,111	\$414,644	63.1
Ohio	\$760,647	\$420,630	55.3
Pennsylvania	\$1,043,920	\$330,811	31.7
Texas	\$1,448,824	\$665,665	45.9
Total	\$16,937,745	\$7,957,718	47.0

Source: GAO analysis of HHS data.

Note: FMAP grant awards are those funds awarded as of April 3, 2009, and funds drawn down are as of April 1, 2009.

In order for states to qualify for the increased FMAP available under the Recovery Act, they must meet certain requirements. In particular

- **Maintenance of Eligibility:** In order to qualify for the increased FMAP, states generally may not apply eligibility standards, methodologies, or procedures that are more restrictive than those in

¹⁰This amount includes funds drawn down by U.S. territories and the District.

effect under their state Medicaid programs on July 1, 2008.¹¹ In guidance to states, CMS noted that examples of restrictions of eligibility could include (1) the elimination of any eligibility groups since July 1, 2008 or (2) changes in an eligibility determination or redetermination process that is more stringent than what was in effect on July 1, 2008. States that fail to initially satisfy the maintenance of eligibility requirements have an opportunity to reinstate their eligibility standards, methodologies, and procedures before July 1, 2009 and become retroactively eligible for the increased FMAP.

- **Compliance with Prompt Payment:** Under federal law states are required to pay claims from health practitioners promptly.¹² Under the Recovery Act, states are prohibited from receiving the increased FMAP for days during any period in which that state has failed to meet this requirement.¹³ Although the increased FMAP is not available for any claims received from a practitioner on each day the state is not in compliance with these prompt payment requirements, the state may receive the regular FMAP for practitioner claims received on days of non-compliance. CMS officials told us that states must attest that they are in compliance with the prompt payment requirement, but that enforcement is complicated due to differences across states in methods used to track this information. CMS officials plan to issue guidance on reporting compliance with the prompt payment requirement and are currently gathering information from states on the methods they use to determine compliance.
- **Rainy Day Funds:** States are not eligible for an increased FMAP if any amounts attributable (either directly or indirectly) to the increased FMAP are deposited or credited into any reserve or rainy day fund of the state.¹⁴
- **Percentage Contributions from Political Subdivisions:** In some states, political subdivisions—such as cities and counties—may be

¹¹See Recovery Act § 5001(f)(1).

¹²States are required to pay 90 percent of clean claims from health care practitioners within 30 days of receipt and 99 percent of these claims within 90 days of receipt. See 42 U.S.C. § 1396a(a)(37)(A).

¹³This provision only applies to claims received after February 17, 2009, the date of enactment of the Recovery Act. See Recovery Act § 5001(f)(2).

¹⁴This prohibition does not apply to any increase in FMAP based on maintenance of the states' prior year FMAPs.

required to help finance the state's share of Medicaid spending. States that have such financing arrangements are not eligible to receive the increased FMAP if the percentage contributions required to be made by a political subdivision are greater than what was in place on September 30, 2008.¹⁵

In addition to meeting the above requirements, states that receive the increased FMAP must submit a report to CMS no later than September 30, 2011 that describes how the increased FMAP funds were expended, in a form and manner determined by CMS.¹⁶ In guidance to states, CMS has stated that further guidance will be developed for this reporting requirement. CMS guidance to states also indicates that, for federal reimbursement, increased FMAP funds must be drawn down separately, tracked separately, and reported to CMS separately. Officials from several states told us they require additional guidance from CMS on tracking receipt of increased FMAP funds and on reporting on the use of these funds.

The increased FMAP available under the Recovery Act is for state expenditures for Medicaid services.¹⁷ However, the receipt of this increased FMAP may reduce the state share for their Medicaid programs. States have reported using these available funds for a variety of purposes. In our sample, individual states and the District reported that they would use the funds to maintain their current level of Medicaid eligibility and benefits, cover their increased Medicaid caseloads—which are primarily populations that are sensitive to economic downturns, including children and families, and to offset their state general fund deficits thereby avoiding layoffs and other measures detrimental to economic recovery. Ten states and the District reported using these funds to maintain program eligibility. Nine states and the District reported using these funds to maintain benefits. Specifically, Massachusetts reported that during a previous financial downturn, the state limited the number of individuals eligible for some services and reduced certain program benefits that were optional for the state to cover. However, with the funds made available as a result of the increased FMAP, the state did not have to make such reductions.

¹⁵This prohibition does not apply to any increase in FMAP based on maintenance of the states' prior year FMAPs.

¹⁶Recovery Act, div. B, title V, § 5001 (g)(1).

¹⁷Recovery Act, div. B, title V, § 5001 (a)-(c), (h)(1).

Similarly, New Jersey reported that the state used these funds to eliminate premiums for certain children in its State Children's Health Insurance Program, allowing it to retain coverage for children whose enrollment in the program would otherwise have been terminated for non-payment of premiums.

Nine states and the District reported using these funds to cover increases to their Medicaid caseloads, primarily to populations that are sensitive to economic downturns, such as children and families. For example, New Jersey indicated that these funds would help the state meet the increased demand for Medicaid services. According to a New Jersey official, due to significant job losses, the state's proposed 2010 budget would not have accommodated all the applicants newly eligible for Medicaid and that the funds available as a result of the increased FMAP have allowed the state to maintain a "safety net" of coverage for uninsured and unemployed people. Six states in our sample also reported that they used funds made available as a result of the increased FMAP to comply with prompt payment requirements. Specifically, Illinois reported that these funds will permit the state to move from a 90-day payment cycle to a 30-day payment cycle for all Medicaid providers. Three states also reported using these funds to restore or to increase provider payment rates.

In addition, 10 states and the District indicated that the funds made available as a result of the increased FMAP would help offset deficits in their general funds. Pennsylvania reported that because funding for its Medicaid program is derived, in part, from state revenues, program funding levels fluctuate as the economy rises and falls. However, the state was able to use the funds made available to offset the effects of lower state revenues. Arizona officials also reported that the state used funds made available as a result of the increased FMAP to pay down some of its debt and make payroll payments, thus allowing the state to avoid a serious cash flow problem.

In our sample, many states and the District indicated that they need additional guidance from CMS regarding eligibility for the increased FMAP funds. Specifically, 5 states raised concerns about whether certain programmatic changes could jeopardize the state's eligibility for these funds. For example, Texas officials indicated that guidance from CMS is needed regarding whether certain programmatic changes being considered by Texas, such as a possible extension of the program's eligibility period, would affect the state's eligibility for increased FMAP funds. Similarly, Massachusetts wanted clarification from CMS as to whether certain changes in the timeframe for the state to conduct eligibility re-

determinations would be considered a more restrictive standard. Four states also reported that they wanted additional guidance from CMS regarding policies related to the prompt payment requirements or changes to the non-federal share of Medicaid expenditures. For example, California officials noted that the state reduced Medicaid payments for in-home support services, but that counties could voluntarily choose to increase these payments without altering the cost sharing arrangements between the counties and the state. The state wants clarification from CMS on whether such an arrangement would be allowable in light of the Recovery Act requirements regarding the percentage of contributions by political subdivisions within a state toward the non-federal share of expenditures.

In response to states' concerns regarding the need for guidance, CMS told us that it is in the process of developing draft guidance on the prompt payment provisions in the Recovery Act. One official noted that this guidance will include defining the term practitioner, describing the types of claims applicable under the provision, and addressing the principles that are integral to determining a state's compliance with prompt payment requirements. Additionally, CMS plans to have a reporting mechanism in place through which states would report compliance under this provision. With regard to Recovery Act requirements regarding political subdivisions, CMS described their current activities for providing guidance to states. Due to the variability of state operations, funding processes, and political structures, CMS has been working with states on a case-by-case basis to discuss particular issues associated with this provision and to address the particular circumstances for each state. A CMS official told us that if there were an issue(s) or circumstance(s) that had applicability across the states, or if there were broader themes having national significance, CMS would consider issuing guidance.

Highway Infrastructure Investment

The Recovery Act provides approximately \$48 billion to fund grants to states, localities and regional authorities for transportation projects of which the largest piece is \$27.5 billion for highway and related infrastructure investments. The Recovery Act largely provides for increased transportation funding through existing programs—such as the Federal-Aid Highway Surface Transportation Program—a federally funded, state-administered program. Under this program, funds are apportioned annually to each state department of transportation (or equivalent) to construct and maintain roadways and bridges on the federal-aid highway system. The Federal-Aid Highway Program refers to the separately funded formula grant programs administered by the Federal Highway Administration (FHWA) in the U.S. Department of Transportation.

Of the \$27.5 billion provided in the Recovery Act for highway and related infrastructure investments, \$26.7 billion is provided to the 50 states for restoration, repair, construction and other activities allowed under the Federal-Aid Highway Surface Transportation Program. Nearly one-third of these funds are required to be sub-allocated to metropolitan and other areas. States must follow the requirements for the existing program, and in addition, the Recovery Act requires that the Governor must certify that the state will maintain its current level of transportation spending, and the governor or other appropriate chief executive must certify that the state or local government to which funds have been made available has completed all necessary legal reviews and determined that the projects are an appropriate use of taxpayer funds. The certifications must include a statement of the amount of funds the state planned to expend from state sources as of the date of enactment, during the period beginning on the date of enactment through September 30, 2010, for the types of projects that are funded by the appropriation.

The U.S. Department of Transportation is reviewing the Governors' certifications regarding maintaining their level of effort for highways. According to the Department, of the 16 states in our review and the District, three states have submitted a certification free of explanatory or conditional language—Arizona, Michigan, and New York. Eight submitted “explanatory” certifications—certifications that used language that articulated assumptions used or stated the certification was based on the “best information available at the time,” but did not clearly qualify the expected maintenance of effort on the assumptions proving true or information not changing in the future. Six submitted a “conditional” certification, which means that the certification was subject to conditions or assumptions, future legislative action, future revenues, or other conditions.¹⁸

Recovery Act funding for highway infrastructure investment differs from the usual practice in the Federal-Aid Highway Program in a few important ways. Most significantly, for projects funded under the Recovery Act, the federal share is 100 percent; typically projects require a state match of 20 percent while the federal share is typically 80 percent. Under the Recovery Act, priority is also to be given to projects that are projected to be completed within three years. In addition, within 120 days after the

¹⁸The legal effect of such qualifications is currently being examined by the U.S. Department of Transportation and has not been reviewed by GAO.

apportionment by the Department of Transportation to the states (March 2, 2009), 50 percent of the apportioned funds must be obligated.¹⁹ Any amount of this 50 percent of apportioned funding that is not obligated may be withdrawn by the Secretary of Transportation and redistributed to other states that have obligated their funds in a timely manner. Furthermore, one year after enactment, the Secretary will withdraw any remaining unobligated funds and redistribute them based on states' need and ability to obligate additional funds. These provisions are applicable only to those funds apportioned to the state and not those funds required by the Recovery Act to be suballocated to metropolitan, regional and local organizations.

Finally, states are required to give priority to projects that are located in economically distressed areas as defined by the Public Works and Economic Development Act of 1965, as amended. In March 2009, FHWA directed its field offices to provide oversight and take appropriate action to ensure that states gave adequate consideration to economically distressed areas in selecting projects. Specifically, field offices were directed to discuss this issue with the states and to document its review and oversight of this process.

States are undertaking planning activities to identify projects, obtain approval at the state and federal level, and move projects to contracting and implementation. However, because of the steps necessary before implementation, states generally had not yet expended significant amounts of Recovery Act Funds. States are required to reach agreement with DOT on a list of projects. States will then request reimbursement from DOT as the state makes payments to contactors working on approved projects.

As of April 16, 2009, the U.S. Department of Transportation reported that nationally \$6.4 billion of the \$26.6 billion in Recovery Act highway infrastructure investment funding provided to the states had been obligated—meaning Transportation and the states had reached agreements on projects worth this amount. As shown in Table 4 below, for the locations that GAO reviewed, the extent to which the Department of Transportation had obligated funds apportioned to the states and the

¹⁹For federal-aid highway projects, the Federal Highway Administration of 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 a project. This commitment occurs at the time the federal government approves a project agreement and the project agreement is executed.

District ranged from 0 to 65 percent. For two of the states, the Department of Transportation had obligated over 50 percent of the states' apportioned funds, for 4 it had obligated 30 to 50 percent of the states' funds, for 9 states it had obligated under 30 percent of funds, and for three it had not obligated any funds.

Table 4: Highway Apportionments and Obligations as of April 16, 2009 (Dollars in millions)

State	Amount apportioned	Amount obligated	Percent of apportionment obligated	Number of projects
Arizona	\$522	\$148	28	26
California	2,570	261	10	20
Colorado	404	118	29	19
District of Columbia	124	37	30	1
Florida	1,347	0	0	0
Georgia	932	0	0	0
Illinois	936	606	65	214
Iowa	358	221	62	107
Massachusetts	425	64	15	19
Michigan	847	111	13	27
Mississippi	355	137	39	32
New Jersey	652	281	43	12
New York	1,121	277	25	108
North Carolina	736	165	22	53
Ohio	936	0	0	0
Pennsylvania	1,026	309	30	108
Texas	2,250	534	24	159
Total	\$15,538	\$3,269	21	905

Source: FHWA.

Note: Totals may not add due to rounding.

While most states we visited had not yet expended significant funds, some told us they were planning to solicit bids in April or May. Officials, also stated that they planned to meet statutory deadlines for obligating the highway funds. A few states had already executed contracts. As of April 1, 2009, the Mississippi Department of Transportation (MDOT), for example,

had signed contracts for 10 projects totaling approximately \$77 million.²⁰ These projects include the expansion of State Route 19 in eastern Mississippi into a four-lane highway. This project fulfills part of MDOT's 1987 Four-Lane Highway Program which seeks to link every Mississippian to a four-lane highway within 30 miles or 30 minutes. Similarly, as of April 15, 2009, the Iowa Department of Transportation had competitively awarded 25 contracts valued at \$168 million. Most often however, we found that highway funds in the states and the District have not yet been spent because highway projects were at earlier stages of planning, approval, and competitive contracting. For example, in Florida, the Department of Transportation (FDOT) plans to use the Recovery Act funds to accelerate road construction programs in its preexisting 5-year plan which will result in some projects being reprioritized and selected for earlier completion. On April 15, 2009, the Florida Legislative Budget Commission approved the Recovery Act-funded projects that FDOT had submitted.

For the most part, states were focusing their selection of Recovery Act-funded highway projects on construction and maintenance, rather than planning and design, because they were seeking projects that would have employment impacts and could be implemented quickly. These included road repairs and resurfacing, bridge repairs and maintenance, safety improvements, and road widening. For example, in Illinois, the Department of Transportation is planning to spend a large share of its estimated \$655 million in Recovery Act funds²¹ for highway and bridge construction and maintenance projects in economically distressed areas, those that are shovel-ready, and those that can be completed by February 2012. In Iowa, the contracts awarded have been for projects such as bridge replacements and highway resurfacing—shovel-ready projects that could be initiated and completed quickly. Knowing that the Recovery Act would include opportunities for highway investment, states told us they worked

²⁰As of April 16, 2009, the U.S. Department of Transportation had obligated \$137.0 million for 32 Mississippi projects.

²¹According to the Federal Highway Administration, Illinois' share of Recovery Act funds for highway infrastructure investment is approximately \$936 million. This total consists of \$655 million for IDOT projects and \$281 million in sub-allocations for local governments' highway projects. The \$655 million to IDOT includes \$627 million for IDOT to use statewide and \$28 million for mandatory transportation enhancements. Transportation enhancements include activities such as provision of facilities for pedestrians and bicyclists, preservation of abandoned railway corridors, acquisition of scenic easements, and historic preservation projects.

in advance of the legislation to identify appropriate projects. For example, in New York, the state DOT began planning to manage anticipated federal stimulus money in November 2008. A key part of New York's DOT's strategy was to build on existing planning and program systems to distribute and manage the funds.

State Fiscal Stabilization Fund

The Recovery Act provided \$53.6 billion in appropriations for the State Fiscal Stabilization Fund (SFSF) to be administered by the U.S. Department of Education. The Act requires that the Secretary set aside \$5 billion for State Incentive Grants, referred to by the department as the Reach for the Top program, and the establishment of an Innovation Fund. The Recovery Act specifies that 81.8 percent (about \$39.5 billion) is to be distributed to states for support of elementary, secondary, and postsecondary education, and early childhood education programs. The remaining 18.2 percent of SFSF (about \$8.8 billion) is available for basic government services but may also be used for educational purposes. These funds are to be distributed to states by formula, with 61 percent of the state award based on the state's relative share of the population aged 5 to 24 and 39 percent based on the state's relative share of the total U.S. population. The Department of Education announced on April 1, 2009 that it will award the SFSF in two phases. The first phase—\$32.6 billion—represents about two-thirds of the SFSF.

The states and the District must apply to the Department of Education for SFSF funds and Education must approve those applications. As of April 20, 2009, applications from three states had been approved—South Dakota, and two of GAO's sample states, California and Illinois. Since applications from other states are now being developed and submitted, they have not yet received their SFSF funds. The applications to Education must contain certain assurances. For example, states must assure that, in each of fiscal years 2009, 2010, and 2011, they will maintain state support at fiscal year 2006 levels for elementary and secondary education and also for public institutions of higher education (IHEs). However, the Secretary of Education may waive maintenance of effort requirements if the state demonstrates that it will commit an equal or greater percentage of state revenues to education than in the previous applicable year. The state application must also contain (1) assurances that the state is committed to advancing education reform in increasing teacher effectiveness, establishing state-wide education longitudinal data systems, and improving the quality of state academic standards and assessments; (2) baseline data that demonstrates the state's current status in each of the education reform areas; and (3) a description of how the state intends to use its stabilization allocation.

Within two weeks of receipt of an approvable SFSF application, Education will provide the state with 67 percent of its SFSF allocation. Under certain circumstances, Education will provide the state with up to 90 percent of its allocation. In the second phase, Education intends to conduct a full peer review of state applications before awarding the final allocations.

After maintaining state support for education at fiscal year 2006 levels, states are required to use the education portion of the SFSF 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 Title I, Part A funding formula. However, 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 schools and IHEs. Education stabilization funds must be allocated to school districts and public IHEs and cannot be retained at the state level.

Once 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 stabilization funds for any allowable purpose under the Elementary and Secondary Education Act (ESEA), (commonly known as the No Child Left Behind Act), the Individuals with Disabilities Education Act (IDEA), the Adult Education and Family Literacy Act, or the Perkins Act, subject to some prohibitions on using funds for, among other things, sports facilities and vehicles. In particular, because allowable uses under the Impact Aid provisions of ESEA are broad, school districts have discretion to use Recovery Act funding for things ranging from salaries of teachers, administrators, and support staff to purchases of textbooks, computers, and other equipment. The Recovery Act allows public IHEs to use SFSF 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 stabilization funds for such things as increasing endowments, modernizing, renovating, or repairing sports facilities, or maintaining equipment. According to Education officials, there are no maintenance of effort requirements placed on local school districts. Consequently, as long as local districts use stabilization funds for

allowable purposes, they are free to reduce spending on education from local-source funds, such as property tax revenues.

States have broad discretion over how the \$8.8 billion in SFSF funds designated for basic government services are used. The Recovery Act provides that these funds can be used for public safety and other government services and that these services may include assistance for education, as well as for modernization, renovation, and repairs of public schools or IHEs, subject to certain requirements. Education's guidance provides that the funds can also be used to cover state administrative expenses related to the Recovery Act. However, the Act also places several restrictions on the use of these funds. For example, these funds cannot be used to pay for casinos (a general prohibition that applies to all Recovery Act funds), financial assistance for students to attend private schools, or construction, modernization, renovation, or repair of stadiums or other sports facilities.

States expected that SFSF uses by school districts and public IHEs would include retaining current staff and spending on programmatic initiatives, among other uses. Some states' fiscal condition could affect their ability to meet maintenance of effort (MOE) requirements in order to receive SFSF monies, but they are awaiting final guidance from Education on procedures to obtain relief from these requirements. For example, due to substantial revenue shortages, Florida has cut its state budget in recent years and the state will not be able to meet the maintenance-of-effort requirement to readily qualify for these funds. The state will apply to Education for a waiver from this requirement; however, it is awaiting final instructions from Education on submission of the waiver. Florida plans to use SFSF funds to reduce the impact of any further cuts that may be needed in the state education budget.

In Arizona, state officials expect that SFSF recipients, such as local school districts, will generally use their allocations to improve the tools they use to assess student performance and determine to what extent performance meets federal academic standards, rehire teachers that were let go because of prior budget cuts, retain teachers, and meet the federal requirement that all schools have equal access to highly qualified teachers, among other things. Funds for the state universities will help them maintain services and staff as well as avoid tuition increases. Illinois officials stated that the state plans to use all of the \$2 billion in State Fiscal Stabilization funds, including the 18.2 percent allowed for government services, for K-12 and higher education activities and hopes to avert layoffs and other cutbacks many districts and public colleges and universities are

facing in their fiscal year 2009 and 2010 budgets. State Board of Education officials also noted that U.S. Department of Education guidance allows school districts to use stabilization funds for education reforms, such as prolonging school days and school years, where possible. However, officials said that Illinois districts will focus these funds on filling budget gaps rather than implementing projects that will require long-term resource commitments. While planning is underway, most of the selected states reported that they have not yet fully decided how to use the 18.2 percent of the SFSF, which is discretionary.

Plans to Track Recovery Act Funds

States' and localities' tracking and accounting systems are critical to the proper execution and accurate and timely recording of transactions associated with the Recovery Act. OMB has issued guidance to the states and localities that provides for separate "tagging" of Recovery Act funds so that specific reports can be created and transactions traced. Officials from all 16 of the selected states and the District told us they have established or were establishing methods and processes to separately identify, monitor, track, and report on the use of Recovery Act funds they receive. Officials in some states expressed concern that the use of different accounting software among state agencies may make it difficult to provide consistent and timely reporting. Others reported that their ability to track Recovery Act funds may be affected by state hiring freezes, resulting from budget shortfalls.

State officials reported a range of concerns regarding the federal requirements to identify and track Recovery Act funds going to sub-recipients, localities, and other non-state entities. These concerns include their ability to track these funds within existing systems, uncertainty regarding state officials' accountability for the use of funds which do not pass through state government entities, and their desire for additional federal guidance to establish specific expectations on sub-recipient reporting requirements. Officials in many states expressed concern about being held accountable for funds flowing directly from federal agencies to localities or other recipients. Officials in some states said they would like to at least be informed about funds provided to non-state entities, in order to facilitate planning for their use and so they can coordinate Recovery Act activities.

States' Actions to Plan for Use of Recovery Act Funds Include New and Existing Entities and Processes

All of the 16 selected states and the District reported taking action to plan for and monitor the use of Recovery Act funding. Some states reported that Recovery Act planning activities for funds received by the state are directed primarily by the governor's office. In New York, for example, the governor provides program direction to the state's departments and offices, and he established a Recovery Act Cabinet comprised of representatives from all state agencies and many state authorities to coordinate and manage Recovery Act funding throughout the state. In North Carolina, Recovery Act planning efforts are led by the newly created Office of Economic Recovery and Investment, which was established by the governor to oversee the state's economic recovery initiatives.

Other states reported that their Recovery Act planning efforts were less centralized. In Mississippi, the governor has little influence over the state Departments of Education and Transportation, as they are led by independent entities. In Texas, oversight of federal Recovery Act funds involves various stakeholders, including the Office of the Governor, the Office of the Comptroller of Public Accounts, and the State Auditor's Office as well as two entities established within the Texas legislature specifically for this purpose—the House Select Committee on Federal Economic Stabilization Funding and the House Appropriations' Subcommittee on Stimulus.²²

Several states reported that they have appointed "Recovery Czars" or identified a similar key official and established special offices, task forces or other entities to oversee the planning and monitor the use of Recovery Act funds within their states. In Michigan, the governor appointed a Recovery Czar to lead a new Michigan Economic Recovery Office, which is responsible for coordinating Recovery Act programs across all state departments and with external stakeholders such as GAO, the federal OMB, and others.

Some states began planning efforts before Congress enacted the Recovery Act. For example, the state of Georgia recognized the importance of accounting for and monitoring Recovery Act funds and directed state agencies to take a number of steps to safeguard Recovery Act funds and

²²Under Texas law, the governor is the state's chief budget officer, but the state legislature and the Legislative Budget Board have a large role in the state's budget process, which operates on a 2-year cycle. Both the governor and the Legislative Budget Board develop budget recommendations and submit budget proposals to the legislature, which adopts a budget (general appropriations bill) for the 2-year period.

mitigate identified risks. Georgia established a small core team in December 2008 to begin planning for the state's implementation of the Recovery Act. Within 1 day of enactment, the governor appointed a Recovery Act Accountability Officer, and she formed a Recovery Act implementation team shortly thereafter. The implementation team includes a senior management team, officials from 31 state agencies, an accountability and transparency support group comprised of officials from the state's budget, accounting, and procurement offices, and five cross-agency implementation teams. At one of the first implementation team meetings, the Recovery Act Accountability Officer disseminated an implementation manual to agencies, which included multiple types of guidance on how to use and account for Recovery Act funds, and new and updated guidance is disseminated at the weekly implementation team meetings.

Officials in other states are using existing mechanisms rather than creating new offices or positions to lead Recovery Act efforts. For example, a District official stated that the District would not appoint a Recovery Czar, and instead would use its existing administrative structures to distribute and monitor Recovery Act funds to ensure quick disbursement of funds. In Mississippi, officials from the Governor's office said that the state did not establish a new office to provide statewide oversight of Recovery Act funding, in part because they did not believe that the Recovery Act provided states with funds for administrative expenses—including additional staff. The Governor did designate a member of his staff to act as a Stimulus Coordinator for Recovery Act activities.

All 16 states we visited and the District have established Recovery Act web sites to provide information on state plans for using Recovery funding, uses of funds to date, and, in some instances, to allow citizens to submit project proposals. For example, Ohio has created www.recovery.Ohio.gov, which represents the state's efforts to create an open, transparent, and equitable process for allocating Recovery Act funds. The state has encouraged citizens to submit proposals for use of Recovery Act funds, and as of April 8, 2009, individuals and organizations from across Ohio submitted more than 23,000 proposals. Iowa officials indicated they want to use the state's recovery web site (www.recovery.Iowa.gov) to host a "dashboard" function to report updated information on Recovery Act spending that is easily searchable by the public. Also in Colorado, the state plans to create a web-based map of projects receiving recovery funds to help inform the public about the results of Recovery Act spending in Colorado.

Selected States' and Localities' Internal Controls and Safeguards to Manage and Mitigate the Risk of Mismanagement, Waste, Fraud, and Abuse of Recovery Act Funds

The selected states and the District are taking various approaches to ensure that internal controls are in place to manage risk up-front, rather than after problems develop and deficiencies are identified after the fact, and have different capacities to manage and oversee the use of Recovery Act funds. Many of these differences result from the underlying differences in approaches to governance, organizational structures, and related systems and processes that are unique to each jurisdiction. A robust system of internal control specifically designed to deal with the unique and complex aspects of the Recovery Act funds will be key to helping management of the states and localities achieve the desired results. Effective internal control can be achieved through numerous different approaches, and, in fact, we found significant variation in planned approaches by state. For example,

- New York's Recovery Act cabinet plans to establish a working group on internal controls; the Governor's office plans to hire a consultant to review the state's management infrastructure and capabilities to achieve accountability, effective internal controls, compliance and reliable reporting under the act; and, the state plans to coordinate fraud prevention training sessions.
- Michigan's Recovery Office is developing strategies for effective oversight and tracking of the use of Recovery Act funds to ensure compliance with accountability and transparency requirements.
- Ohio's Office of Internal Audit plans to assess the adequacy and effectiveness of the current internal control framework and test whether state agencies adhere to the framework.
- Florida's Chief Inspector General established an enterprise-wide working group of agency program Inspectors General who are updating their annual work plans by including the Recovery Act funds in their risk assessments and will leave flexibility in their plans to address issues related to funds.
- Massachusetts's Joint Committee on Federal Recovery Act Oversight will hold hearings regarding the oversight of Recovery Act spending.
- Georgia's State Auditor plans to provide internal control training to state agency personnel in late April. The training will discuss basic internal controls, designing and implementing internal controls for Recovery Act programs, best practices in contract monitoring, and reporting on Recovery Act funds.

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. Because Recovery Act funds are to be distributed as quickly as possible, controls are evolving as various aspects of the program become operational. Effective internal control is a major part of managing any organization to achieve desired outcomes and manage risk. GAO's Standards for Internal Control include five key elements: control environment, risk assessment, control activities, information and communication, and monitoring.²³ Our report contains a discussion of these elements and the related effort underway in the jurisdictions we visited.

Current Single Audit Focus May Not Provide Timely Oversight Information for Recovery Act Funds

OMB's Circular No. A-133 sets out implementing guidelines for the single audit and defines roles and responsibilities related to the implementation of the Single Audit Act, including detailed instructions to auditors on how to determine which federal programs are to be audited for compliance with program requirements in a particular year at a given grantee. The Circular No. A-133 Compliance Supplement is issued annually to guide auditors on what program requirements should be tested for programs audited as part of the single audit. OMB has stated that it will use its Circular No. A-133 Compliance Supplement to notify auditors of program requirements that should be tested for Recovery Act programs, and will issue interim updates as necessary.

Both the Single Audit Act and OMB Circular No. A-133 call for a "risk-based" approach to determine which programs will be audited for compliance with program requirements as part of a single audit. In general, the prescribed approach relies heavily on the amount of federal expenditures during a fiscal year and whether findings were reported in the previous period to determine whether detailed compliance testing is required for a given program that year.²⁴ Under the current approach for risk determination in accordance with Circular No. A-133, certain risks unique to the Recovery Act programs may not receive full consideration.

²³ GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

²⁴ The Single Audit Act requires that all major programs be audited and specifies minimum dollar amounts and minimum proportions of federal funds expended for programs to be identified by the auditor as major programs. See 31 U.S.C. §§ 7501.

Recovery Act funding carries with it some unique challenges. The most significant of these challenges are associated with (1) new government programs, (2) the sudden increase in funds or programs that are new for the recipient entity, and (3) the expectation that some programs and projects will be delivered faster so as to inject funds into the economy. This makes timely and efficient evaluations in response to the Recovery Act's accountability requirements critical. Specifically,

- new programs and recipients participating in a program for the first time may not have the management controls and accounting systems in place to help ensure that funds are distributed and used in accordance with program regulations and objectives;
- Recovery Act funding that applies to programs already in operation may cause total funding to exceed the capacity of management controls and accounting systems that have been effective in past years;
- the more extensive accountability and transparency requirements for Recovery Act funds will require the implementation of new controls and procedures; and
- risk may be increased due to the pressures of spending funds quickly.

In response to the risks associated with Recovery Act funding, the single audit process needs adjustment to put appropriate focus on Recovery Act programs and to provide the necessary level of accountability over these funds in a timely manner. The single audit process could be adjusted to require the auditor to perform procedures such as the following as part of the routine single audit:

- provide for review of the design and implementation of internal control over compliance and financial reporting for programs under the Recovery Act;
- consider risks related to Recovery Act-related programs in determining which federal programs are major programs; and
- specifically, test Recovery Act programs to determine whether the auditee complied with laws and regulations.²⁵

The first two items above should preferably be accomplished during 2009 before significant expenditures of funds in 2010 so that the design of internal control can be strengthened prior to the majority of those

²⁵The Single Audit Act sets out minimum federal expenditure amounts and proportions to use as criteria in defining which programs are to be tested for compliance with program requirements during a single audit. OMB will need to consider those statutory criteria when considering revisions to the single audit process.

expenditures. We further believe that OMB Circular No. A-133 and/or the Circular No. A-133 Compliance Supplement could be adjusted to provide some relief on current audit requirements for low-risk programs to offset additional workload demands associated with Recovery Act funds.

OMB told us that it is developing audit guidance that would address the above audit objectives. OMB also said that it is considering reevaluating potential options for providing relief from certain existing audit requirements in order to provide some balance to the increased requirements for Recovery Act program auditing.

State and Local Capacity to Manage Risks

Officials in several states also expressed concerns regarding the lack of funding provided to state oversight entities, given the additional federal requirements placed on states to provide proper accounting and ensure transparency. Due to fiscal constraints, many states reported significant declines in the number of oversight staff, limiting their ability to ensure proper implementation and management of Recovery Act funds. Although the majority of states reported that they lack the necessary resources to ensure adequate oversight of Recovery Act funds, some states reported that they are either hiring new staff or reallocating existing staff for this purpose.

Officials we interviewed in several states said the lack of funding for state oversight entities in the Recovery Act presents them with a challenge, given the increased need for oversight and accountability. According to state officials, state budget and staffing cuts have limited the ability of state and local oversight entities to ensure adequate management and implementation of the Recovery Act. For example, Colorado's state auditor reported that state oversight capacity is limited, noting that the Department of Health Care Policy and Financing has had 3 controllers in the past 4 years and the state legislature's Joint Budget Committee recently cut field audit staff for the Department of Human Services in half. In addition, the Colorado Department of Transportation's deputy controller position is vacant, as is the Department of Personnel & Administration's internal auditor position. Colorado officials noted that these actions are, in part, due to the natural tendency in an economic downturn to cut administrative expenses in an attempt to maintain program delivery levels. Our report contains more examples of capacity issues from our selected states and the District.

Although most states indicated that they lack the resources needed to provide effective monitoring and oversight, some states indicated they will

hire additional staff to help ensure the prudent use of Recovery Act funds. For example, according to officials with North Carolina's Governor's Crime Commission, the current management capacity in place is not sufficient to implement the Recovery Act. Officials explained that the Recovery Act funds for the Edward Byrne Memorial Justice Assistance Grant program have created such an increase in workload that the department will have to hire additional staff to handle over the next 3 years. Officials explained that these staff will be hired for the short term since the money will run out in 3 years. Additionally, officials explained that they are able to use 10 percent of the Justice Assistance Grants funding to pay for the administrative positions that are needed.

A number of states expressed concerns regarding the ability to track Recovery Act funds due to state hiring freezes, resulting from budget shortfalls. For instance, New Jersey has not increased its number of state auditors or investigators, nor has there been an increase in funding specifically for Recovery Act oversight. In addition, the state hiring freeze has not allowed many state agencies to increase their Recovery Act oversight efforts. For example, despite an increase of \$469 million in Recovery Act funds for state highway projects, no additional staff will be hired to help with those tasks or those directly associated with the Recovery Act, such as reporting on the number of jobs created. While the state's Department of Transportation has committed to shift resources to meet any expanded need for internal Recovery Act oversight, one person is currently responsible for reviewing contractor-reported payroll information for disadvantaged business enterprises, ensuring compliance with Davis-Bacon wage requirements, and development of the job creation figures. State education officials in North Carolina also said that greater oversight capacity is needed to manage the increase in federal funding. However, due to the state's hiring freeze, the agency will be unable to use state funds to hire the additional staff needed to oversee Recovery funds. The North Carolina Recovery Czar said that his office will work with state agencies to authorize hiring additional staff when directly related to Recovery Act oversight.

With respect to oversight of Recovery Act funding at the local level, varying degrees of preparedness were reported by state and local officials. While the California Department of Transportation (Caltrans) officials stated that extensive internal controls exist at the state level, there may be control weaknesses at the local level. Caltrans is collaborating with local entities to identify and address these weaknesses. Likewise, Colorado officials expressed concerns that effective oversight of funds provided to Jefferson County may be limited due to the recent termination of its

internal auditor and the elimination of its internal control audit function. Arizona state officials expressed some concerns about the ability of rural, tribal, and some private entities such as boards, commissions, and nonprofit organizations to manage, especially if the Recovery Act does not provide administrative funding.

State Plans to Assess Recovery Act Spending Impact

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. As a means of implementing that goal, guidance has been issued and will continue to be issued to federal agencies, as well as to direct recipients of funding. To date, OMB has issued two broad sets of guidance to the heads of federal departments and agencies for implementing and managing activities enacted under the Recovery Act.²⁶ OMB has also issued for public comment detailed proposed standard data elements that federal agencies will require from all recipients (except individuals) of Recovery Act funding.²⁷ When reporting on the use of funds, recipients must show the total amount of recovery funds received from a federal agency, the amount expended or obligated to the project, and project specific information including the name and description of the project, an evaluation of its completion status, the estimated number of jobs created and retained by the project, and information on any subcontracts awarded by the recipient, as specified in the Recovery Act.

State reactions vary widely and often include a mixture of responses to the reporting requirements. Some states will use existing federal program guidance or performance measures to evaluate impact, particularly for on-going programs. Other states are waiting for additional guidance from federal departments or from OMB on how and what to measure to assess impact. While Georgia is waiting on further federal guidance, the state is adapting an existing system (used by the State Auditor to fulfill its Single Audit Act responsibilities) to help the state report on Recovery Act funds.

²⁶See, 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.

²⁷OMB, *Information Collection Activities: Proposed Collection; Comment Request*, Federal Register – 74 Fed. Reg. 14824 (Apr. 1, 2009).

The statewide web-based system will be used to track expenditures, project status, and job creation and retention. The Georgia governor is requiring all state agencies and programs receiving Recovery Act funds to use this system. Some states indicated that they have not yet determined how they will assess impact.

Officials in 9 of the 16 states and the District expressed concern about the definitions of jobs retained and jobs created under the Recovery Act, as well as methodologies that can be used for estimation of each.²⁸ Officials from several of the states we met with expressed a need for clearer definitions of “jobs retained” and “jobs created.” Officials from a few states expressed the need for clarification on how to track indirect jobs,²⁹ while others expressed concern about how to measure the impact of funding that is not designed to create jobs. Mississippi state officials suggested the need for a clearly defined distinction for time-limited, part-time, full-time, and permanent jobs; since each state may have differing definitions of these two categories. Officials from Massachusetts expressed concern that contractors may overestimate the number of jobs retained and created. Some existing programs, such as highway construction, have methodologies for estimating job creation. But other programs, existing and new, do not have job estimation methodologies.

Some of the questions that states and localities have about Recovery Act implementation may have been answered in part via the guidance provided by OMB for the data elements as well as by guidance issued by federal departments. For example, OMB provided draft definitions for employment, as well as for jobs retained and jobs created via Recovery Act funding. However, OMB did not specify methodologies for estimating jobs retained and jobs created, which has been a concern for some states. Data elements were presented in the form of templates with section by section data requirements and instructions. OMB provided a comment period during which it is likely to receive many questions and requests for clarifications from states, localities, and other entities that can be direct recipients of Recovery Act funding. OMB plans to update this guidance

²⁸Recovery Act, § 3(a)(1). Non-federal entities receiving discretionary funds appropriated under the Recovery Act must report on the number of jobs created and retained, among other requirements. Mandatory and entitlement programs are excluded from this requirement. Recovery Act, div. A, title XV, § 1512.

²⁹Indirect jobs are jobs created as a result of a demand for goods and services generated by direct funding from the Recovery Act.

again in the next 30 to 60 days. Some federal agencies have also provided guidance to the states. The Departments of Education, Housing and Urban Development, Justice, Labor, Transportation, the Corporation for National Community Service, the National Institutes of Health, and the Centers for Medicare & Medicaid Services have provided guidance for program implementation, particularly for established programs. Although guidance is expected, some new programs, such as Broadband Deployment Grants, are awaiting issuance of implementation instructions.

Concluding Observations and Recommendations: Moving Forward to Clarify Recovery Act Roles and Responsibilities

It has been a little over two months since enactment of the Recovery Act and OMB has moved out quickly. In this period, OMB has issued two sets of guidance, first on February 18 and next on April 3, with another round to be issued within 60 days. OMB has sought formal public comment on its April 3 guidance update and before this, according to OMB, reached out informally to Congress, federal, state, and local government officials, and grant and contract recipients to get a broad perspective on what is needed to meet the high expectations set by Congress and the Administration. In addition, OMB is standing up two new reporting vehicles, Recovery.gov, which will be turned over to the Recovery Accountability and Transparency Board and is expected to provide unprecedented public disclosure on the use of Recovery Act funds, and a second system to capture centrally information on the number of jobs created or retained. As OMB's initiatives move forward and it continues to guide the implementation of the Recovery Act, OMB has opportunities to build upon its efforts to date by addressing several important issues.

These issues can be characterized broadly in three categories: (1) Accountability and Transparency Requirements, (2) Administrative Support and Oversight, and (3) Communications.

Accountability and Transparency Requirements

Recipients of Recovery Act funding face a number of implementation challenges in this area. The Act includes many programs that are new or new to the recipient and, even for existing programs; the sudden increase in funds is out of normal cycles and processes. Add to this the expectation that many programs and projects will be delivered faster so as to inject funds into the economy and it becomes apparent that timely and efficient evaluations are needed. The following are our recommendations to help strengthen ongoing efforts to ensure accountability and transparency.

Single Audit

The single audit process is a major accountability vehicle but should be adjusted to provide appropriate focus and the necessary level of accountability over Recovery Act funds in a timelier manner than the current schedule. OMB has been reaching out to stakeholders to obtain input and is considering a number of options related to the single audit process and related issues.

We Recommend: To provide additional leverage as an oversight tool for Recovery Act programs, the Director of OMB should 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.

Reporting on Impact

Responsibility for reporting on jobs created and retained falls to non-federal recipients of Recovery Act funds. As such, states and localities have a critical role in determining the degree to which Recovery Act goals are achieved. Senior Administration officials and OMB have been soliciting views and developing options for recipient reporting. In its April 3 guidance, OMB took an important step by issuing definitions, standard award terms and conditions, and clarified tracking and documenting Recovery Act expenditures. Furthermore, OMB and the Recovery Accountability and Transparency Board are developing the data architecture for the new federal reporting system that will be used to collect recipient reporting information. According to OMB, state chief information officers commented on an early draft and OMB expects to provide an update for further state review.

We Recommend: 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:

- assess jobs created and retained from projects funded by the Recovery Act;
- determine the impact of Recovery Act spending when job creation is indirect;

State and Federal Data
Collection

- 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. Consider whether the approaches taken to estimate jobs created and jobs retained in these cases can be replicated or adapted to other programs.

There are a number of ways that the needed methodologies could be developed. One option would be to establish a working group of federal, state and local officials and subject matter experts.

Given that governors have certified to the use of funds in their states, state officials are uncertain about their reporting responsibilities when Recovery Act funding goes directly to localities. Additionally, they have concerns about the capacity of reporting systems within their states, specifically, whether these systems will be capable of aggregating data from multiple sources for posting on Recovery.gov. Some state officials are concerned that too many federal requirements will slow distribution and use of funds and others have expressed reservations about the capacity of smaller jurisdictions and non-profits to report data. Even those who are confident about their own systems are uncertain about the cost and speed of making any required modifications for Recovery.gov reporting or further data collection.

Problems also have been identified with federal systems that support the Recovery Act as well. For example, questions have been raised about the reliability of www.USASpending.gov (USASpending.gov) and the ability of Grants.gov to handle the increased volume of grant applications. OMB is taking concerted actions to address these concerns. It plans to reissue USASpending guidance shortly to include changes in operations that are expected to improve data quality. In a memorandum dated March 9, OMB said that it is working closely with federal agencies to identify system risks that could disrupt effective Recovery Act implementation and acknowledged that Grants.gov is one such system. A subsequent memorandum on April 8, offered a short-term solution to the significant increase in Grants.gov usage while longer-term alternative approaches are being explored. GAO has work underway to review differences in agency policies and methods for submitting grant applications using Grants.gov and will issue a report shortly.

OMB addressed earlier questions about reporting coverage in its April 3 guidance. According to OMB there are limited circumstances in which prime and sub recipient reporting will not be sufficient to capture information at the project level. OMB stated that it will expand its current

model in future guidance. OMB guidance described recipient reporting requirements under the Recovery Act's section 1512 as the minimum which must be collected, leaving it to federal agencies to determine whether additional information would be required for program oversight.

We Recommend: In consultation with the Recovery Accountability and Transparency Board and States, the Director of OMB should evaluate current information and data collection requirements to determine whether sufficient, reliable and timely information is being collected before adding further data collection requirements. As part of this evaluation, OMB should consider the cost and burden of additional reporting on states and localities against expected benefits.

Administrative Support and Oversight

At a time when states are experiencing cutbacks, state officials expect the Recovery Act to incur new regulations, increase accounting and management workloads, change agency operating procedures, require modifications to information systems, and strain staff capacity, particularly for contract management. Although federal program guidelines can include a percentage of grants funding available for administrative or overhead costs, the percentage varies by program. In considering other sources, states have asked whether the portion of the State Fiscal Stabilization Fund that is available for government services could be used for this purpose. Others have suggested a global approach to increase the percentage for all Recovery Act grants funding that can be applied to administrative costs. As noted earlier, state auditors also are concerned with meeting increased audit requirements for Recovery Act funding with a reduced number of staff and without a commensurate reduction in other audit responsibilities or increase in funding. OMB and senior administration officials are aware of the states' concerns and have a number of options under consideration.

We Recommend: The Director of OMB should timely 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.

Communications

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 consistent procedure for ensuring that the appropriate officials in states and localities are notified. According to OMB, agencies must

immediately post guidance to the Recovery Act web site and inform to the “maximum extent practical, a broad array of external stakeholders.” In addition, since nearly half of the estimated spending programs in the Recovery Act will be administered by non-federal entities, state officials have suggested opportunities to improve communication in several areas. For example, they wish to be notified when funds are made available to prime recipients that are not state agencies.

Some of the uncertainty can be attributed to evolving reports and timing of these reports at the federal level as well as the recognition that different terms used by federal assistance programs add to the confusion. A reconsideration of how best to publicly report on federal agency plans and actions led to OMB’s decision to continue the existing requirement to report on the federal status of funds in the Weekly Financial and Activity Reports and eliminate a planned Monthly Financial Report. The Formula and Block Grant Allocation Report has been replaced and renamed the Funding Notification Report. This expanded report includes all types of awards, not just formula and block grants, and is expected to better capture the point in the federal process when funds are made available.

We Recommend: 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 state-wide interest in this information, and (3) all non-federal recipients, on planned releases of federal agency guidance and, if known, whether additional guidance or modifications are expected.

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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