

April 2009

RECOVERY ACT

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



GAO

Accountability * Integrity * Reliability



Highlights of [GAO-09-580](#), a report to Senate and House Committees on Appropriations, Senate Committee on Homeland Security and Governmental Affairs, and House Committee on Oversight and Government Reform

Why GAO Did This Study

The American Recovery and Reinvestment Act of 2009 (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. The Recovery Act requires GAO to do bimonthly reviews of the use of funds by selected states and localities. In this first report, GAO describes selected states' and localities' (1) uses of and planning of Recovery Act funds, (2) accountability approaches, and (3) plans to evaluate the impact of funds received. GAO's work is focused on 16 states and the District of Columbia—representing about 65 percent of the U.S. population and two-thirds of the intergovernmental federal assistance available through the Recovery Act. GAO collected documents from and interviewed state and local officials, including Governors, "Recovery Czars," State Auditors, Controllers, and Treasurers. GAO also reviewed guidance from the Office of Management and Budget (OMB) and other federal agencies.

What GAO Recommends

GAO makes a number of recommendations, which are discussed on the next page. In general, OMB concurred with the overall objectives of our recommendations and plans to work with GAO to further accountability for these funds.

View [GAO-09-580](#) or [key components](#). For more information, contact J. Christopher Mihm at (202) 512-6806 or mihmj@gao.gov.

RECOVERY ACT

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What GAO Found

Uses and Planning for Recovery Act Funds

About 90 percent of the estimated \$49 billion in Recovery Act funding to be provided to states and localities in FY2009 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). The funding notifications for Recovery Act funds for the 16 selected states and the District of Columbia (the District) have been approximately \$24.2 billion for Medicaid FMAP on April 3, \$26.7 billion for highways on March 2, and \$32.6 billion for SFSF on April 2.

Increased Medicaid FMAP Funding

Fifteen of 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 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. For the most part, states 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, 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.

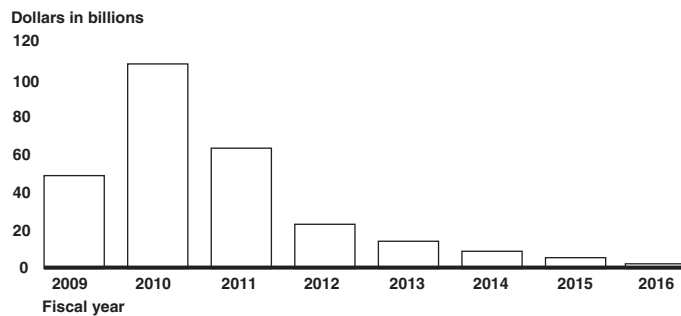
State Fiscal Stabilization Fund

The states and D.C. 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.

This report contains separate appendixes on each of the 16 states and the District that discuss the plans and uses of funds in these three major programs as well as selected other programs that are receiving Recovery Act funds.

Planning continues for the use of Recovery Act funds. The figure below shows the projected timing of funds made available to states and localities.



Source: GAO analysis of CBO and FFIS data.

State 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

GAO found that the selected states and the District are taking various approaches to ensuring that internal controls 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

Two of the several objectives of the Recovery Act are to (1) preserve existing jobs and stimulate job creation and (2) 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.

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United States Government Accountability Office
Washington, DC 20548

April 23, 2009

Report to Congressional Committees:

The Nation faces what is generally reported to be the most serious economic crisis since the Great Depression. In response, the American Recovery and Reinvestment Act of 2009 (Recovery Act)¹ was enacted to promote economic recovery, make investments, and to minimize and avoid reductions in state and local government services. The Congressional Budget Office (CBO) estimated that the Recovery Act's combined spending and tax provisions will cost \$787 billion over ten years, of which more than \$580 billion will be in additional federal spending. 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.

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.² Accordingly, our objectives for this report were to describe (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.

To address these objectives, we selected a core group of 16 states and the District of Columbia (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,

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

²Recovery Act, div. A, title IX, §901.

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, we visited a non-probability sample of about 60 localities within the 16 selected states.³

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, legislative proposals, and other state legal materials.

We based our selection of the programs to review for this initial report on Recovery Act funding and potential risks associated with receipt of additional funds for these programs. An estimated 90 percent of fiscal year 2009 Recovery Act funding provided to states and localities will be for health, transportation and education programs. The three largest programs in these categories are the Medicaid Federal Medical Assistance Percentage (FMAP) awards, the State Fiscal Stabilization Fund, and highways. These three programs are therefore highlighted throughout this report. 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 I.

³This total includes two entities in the District of Columbia which received direct federal funding that was not passed through the District government.

We conducted this performance audit from February 17, 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.

Background

Recovery Act funds are being distributed to states, localities, other entities, and individuals through a combination of formula and competitive grants and direct assistance. Nearly half of the approximately \$580 billion associated with Recovery Act spending programs will flow to states and localities affecting about 50 state formula and discretionary grants as well as about 15 entitlement and other countercyclical programs. As noted above, three of the largest streams of funds flowing to states and localities are (1) the temporary increase in FMAP funding which will provide states with approximately \$87 billion in assistance; (2) the State Fiscal Stabilization Fund, which will provide nearly \$54 billion to help state and local governments avert budget cuts, primarily in education; and (3) highway infrastructure investment funds of approximately \$27 billion.

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. The amount of federal assistance states receive for Medicaid service expenditures is known as the FMAP. Across states, the FMAP may range from 50 to no more than 83 percent, with poorer states receiving a higher federal matching rate than wealthier states.

Under the Recovery Act, states are eligible for an increased FMAP for expenditures that states make in providing services to their Medicaid populations.⁴ The Recovery Act provides eligible states with this increased FMAP for 27 months between October 1, 2008, and December 31, 2010. On

⁴See 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).

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.⁵ 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 the FMAP for the 16 states and the District ranged from 7.09 percentage points in Iowa to 11.59 percentage points in California. (See table 1.)

Table 1: FMAP Changes from Fiscal Year 2008 to the First Two Quarters of Fiscal Year 2009, for 16 states and the District

State	Fiscal Year 2008 FMAP	Fiscal Year 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, as of April 16, 2009.

⁵Although 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.

Highway Infrastructure Investment

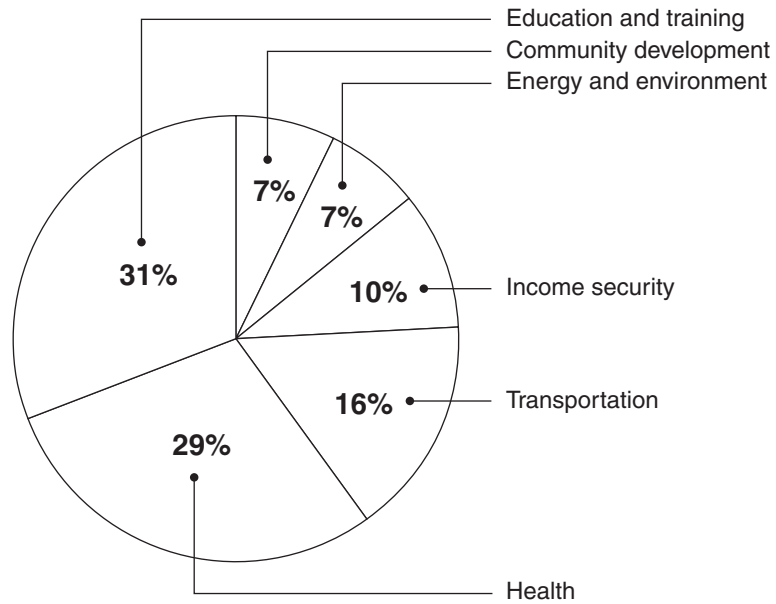
The Recovery Act provides approximately \$48 billion to fund grants to states, localities, regional authorities and others for transportation projects of which the largest piece is \$27.5 billion for highway and related infrastructure investments. The Recovery Act largely provides for increased transportation 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 grant programs mostly funded by formula, administered by the Federal Highway Administration (FHWA) in the U.S. Department of Transportation.

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 Recovery Act requires that the Secretary of Education 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. After reserving these and certain other funds, the remaining 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 Recovery Act specifies that 81.8 percent (about \$39.5 billion) of these remaining funds are 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 public safety and other government services including for educational purposes. 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.

Figure 1 shows the distribution of Recovery Act funds to states by broad functional categories over the next several years.

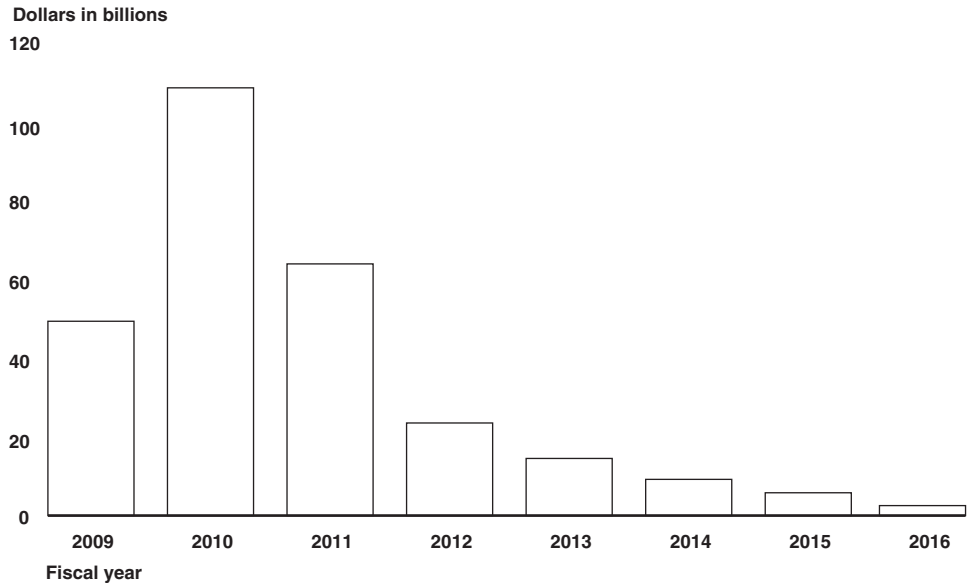
Figure 1: State and Local Recovery Act Funding by Broad Functional Category, Fiscal Years 2009-2019



Source: GAO analysis of CBO and FFIS data.

The timeline of Recovery Act spending has been a key issue in the debate and design of the Recovery Act because of the elapsed time between when policy changes are first proposed and actual spending begins to flow from enacted changes. Figure 2 shows the projected timing of state and local-administered Recovery Act spending.

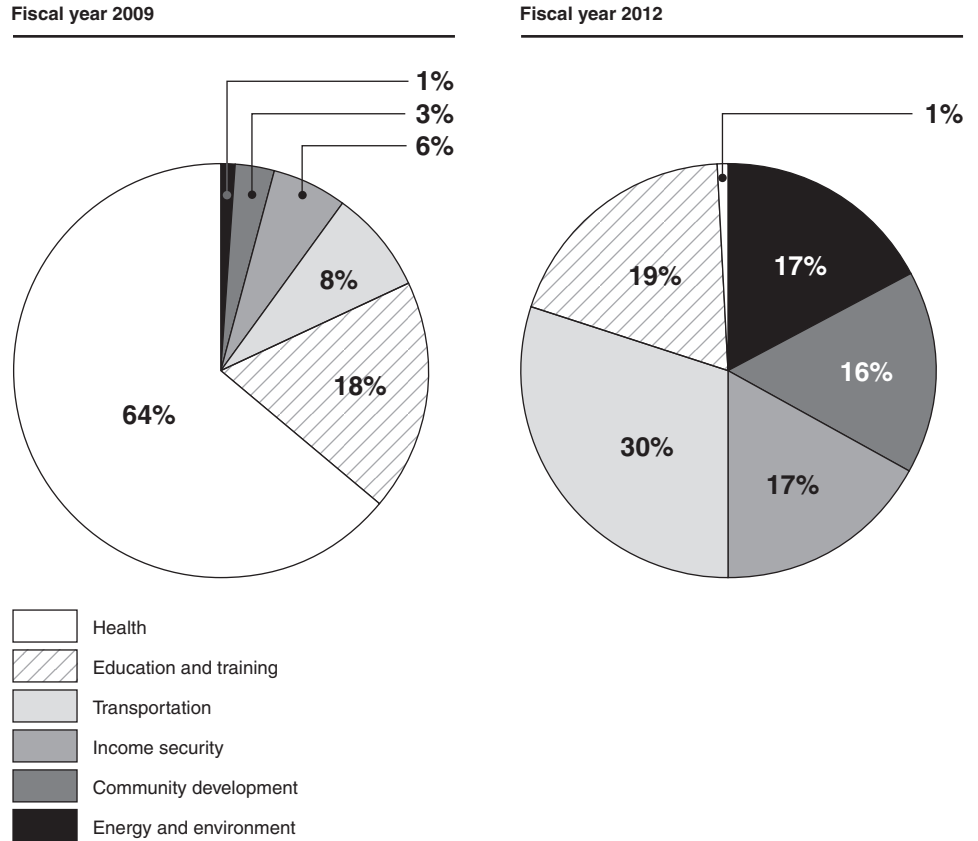
Figure 2: Projected Timing of Federal Recovery Act Funding Made Available to States and Localities by Fiscal Year



Source: GAO analysis of CBO and FFIS data.

Over time, the programmatic focus of Recovery Act spending will change. As shown in figure 3, about two-thirds of Recovery Act funds expected to be spent by states in the current 2009 fiscal year will be health related, 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 the 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 3: Composition of State and Local Recovery Act Funding, Fiscal Years 2009 and 2012



Source: GAO analysis of CBO and FFIS data.

The administration has stipulated that every taxpayer dollar spent on economic recovery must be subject to unprecedented levels of transparency and accountability. To that end, the Recovery Act established the Recovery Accountability and Transparency Board to coordinate and conduct oversight of funds distributed under the Act in order to prevent fraud, waste and abuse. The Board includes a Chairman appointed by the President, and ten Inspectors General specified by the

Act.⁶ The Board has a series of functions and powers to assist it in the mission of providing oversight and promoting transparency regarding expenditure of funds at all levels of government. The Board will report on the use of Recovery Act funds and may also make recommendations to agencies on measures to avoid problems and prevent fraud, waste and abuse.

The Board is also charged under the Act with establishing and maintaining a web site, www.recovery.gov, (Recovery.gov) to foster greater accountability and transparency in the use of covered funds. The website currently includes overview information about the Recovery Act, a timeline for implementation, a frequently asked questions page, and an announcement page that is to be regularly updated. The administration plans to develop the site to encompass information about available funding, distribution of funds, and major recipients. The website 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.⁷ Eventually, prime recipients of Recovery Act funding will provide information on how they are using their federal funds. Currently, Recovery.gov features projections for how, when, and where the funds will be spent, as well as which states and sectors of the economy are due to receive what proportion of the funds. As money starts to flow, additional data will become available. In addition to Recovery.gov, OMB has also issued guidance directing executive branch agencies to develop a dedicated portion of their web sites for information related to the recovery.

To ensure a high level of accountability, OMB has issued guidance to the heads of federal departments and agencies for implementing and

⁶The Recovery Accountability and Transparency Board is comprised of a chairperson appointed by the President; Inspectors General from the Departments of Agriculture, Commerce, Education, Energy, Health and Human Services, Homeland Security, Justice, Transportation, Treasury, and the Treasury Inspector General for Tax Administration; and any other Inspector General designated by the President from any agency that expends or obligates Recovery Act funds.

⁷Recovery Act, div. A, title XV, § 1527(c)(11)–(13).

managing activities enacted under the Recovery Act.⁸ OMB has also issued for comment detailed reporting requirements for Recovery Act fund recipients that include the number of jobs created and jobs retained as a result of Recovery Act funding.⁹ OMB's guidance documents are available on Recovery.gov. In addition, the Civilian Acquisition Council and the Defense Acquisition Regulations Council have issued an interim rule revising the Federal Acquisition Regulation (FAR) to require a contract clause that implements these reporting requirements for contracts funded with Recovery Act dollars.¹⁰

The Recovery Act also assigns GAO a range of responsibilities to help promote accountability and transparency. Some are recurring requirements such as providing bimonthly reviews of the use of funds made available under Division A of the Recovery Act by selected states and localities and reviews of quarterly reports on job creation and job retention as reported by Recovery Act fund recipients. Other requirements include targeted studies in several areas such as small business lending, education, and trade adjustment assistance. We completed the first of these mandates on April 3, 2009, by announcing the appointment of 13 members to the Health Information Technology Policy Committee, a new advisory body established by the Recovery Act. The committee will make recommendations on creating a policy framework for the development and adoption of a nationwide health information technology infrastructure, including standards for the exchange of patient medical information. On April 16, 2009, we issued a report completing a second mandate to report on the actions of the Small Business Administration (SBA) to, among other things, increase liquidity in the secondary market for SBA loans.¹¹

⁸See, 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.

⁹OMB, "Information Collection Activities: Proposed Collection; Comment Request," 74 *Fed. Reg.* 14824 (Apr. 1, 2009).

¹⁰74 *Fed. Reg.* 14,639 (March 31, 2009).

¹¹GAO, *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).

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

Officials in the 16 selected states and the District indicated they have used certain Recovery Act funds and continue planning for the use of additional funds they have not yet received. States' existing intergovernmental programs—such as Medicaid, transportation, and education—have been among the first programs to receive Recovery Act funds. Planning continues for the use of Recovery Act funds for these and other program areas. States' planning actions include appointing Recovery Czars; establishing task forces and other entities, and developing public web sites to solicit input and publicize selected projects. In some cases, according to state officials, state legislation will be required to receive and expend funds or to make required changes to programs for eligibility prior to using the funds. States' approaches to planning for Recovery Act funds also vary in response to state legislative and budget processes regarding the use of federal funds and states' fiscal situations.

States' Use of Recovery Act Funds by Selected Program Areas

The three largest programs making funds available to the state and localities so far have been the Medicaid FMAP, highways funds, and the SFSF. Table 2 shows the breakout of funding available for these three programs in the 16 selected states and the District that GAO visited. Recovery Act funding for these 17 jurisdictions accounts for a little less than two-thirds of total Recovery Act funding for these three programs.

Table 2: Notification of Recovery Act Funds for GAO Core States and the District of Columbia for Select Programs (Dollars in thousands)

(Dollars in thousands)

State	Medicaid FMAP	Highways	States 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

(Dollars in thousands)			
State	Medicaid FMAP	Highways	States Fiscal Stabilization Fund
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.

Medicaid FMAP

Under the Recovery Act, states are eligible for an increased FMAP for expenditures that states make in providing services to their Medicaid populations.¹² The Recovery Act provides eligible states with an increased FMAP for 27 months between October 1, 2008 and December 31, 2010. 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.

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,

¹²See 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).

which represents almost 46 percent of the increased FMAP grants awarded for the first three quarters of federal fiscal year 2009 (Table 3).¹³

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 effect under their state Medicaid programs on July 1, 2008.¹⁴ In

¹³This amount includes funds drawn down by U.S. territories and the District.

¹⁴See Recovery Act, div. B, title V, § 5001(f)(1).

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.¹⁵ 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.¹⁶ 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.¹⁷
- **Percentage Contributions from Political Subdivisions:** In some states, political subdivisions—such as cities and counties—may be required to help finance the state’s share of Medicaid spending. States that have such financing arrangements are not eligible to receive the

¹⁵States 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).

¹⁶This provision only applies to claims received after February 17, 2009, the date of enactment of the Recovery Act.

¹⁷This prohibition does not apply to any increase in FMAP based on maintenance of the states’ prior year FMAPs.

increased FMAP if the percentage contributions required to be made by a political subdivision are greater than what was in place on September 30, 2008.¹⁸

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.¹⁹ 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.²⁰ 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. Similarly, New Jersey reported that the state used these funds to eliminate premiums for certain children in its State Children’s Health Insurance

¹⁸This prohibition does not apply to any increase in FMAP based on maintenance of the states’ prior year FMAPs.

¹⁹Recovery Act, div. B, title V, § 5001 (g)(1).

²⁰Recovery Act, div. B, title V, § 5001 (a)-(c), (h)(1).

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. In addition, 10 states and the District indicated that the increased funds made available would help offset deficits in their general funds. Pennsylvania reported that because funding for its Medicaid program is derived, in part, on state revenues, program funding levels fluctuate as the economy rises and falls. However, the state was able to use 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.

Finally, 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 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

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 and for other eligible surface transportation projects. 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 of Columbia, 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” certifications, which means that the certification was subject to conditions or assumptions, future legislative action, future revenues, or other conditions.²¹

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 apportionment by the Department of Transportation to the states (March 2, 2009), and specifically before June 30, 2009, 50 percent of the apportioned funds must be obligated.²² 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.

²¹The legal effect of such qualifications is currently being examined by the U.S. Department of Transportation and has not been reviewed by GAO.

²²For 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.

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 them 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 the Department of Transportation (DOT) on a list of projects reimbursement from DOT for these projects. States will then request reimbursement from DOT as the state makes payments to contractors 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 Washington D.C. 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.

In most states we visited, while they had not yet expended significant funds, they were planning to solicit bids in April or May. They 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.²³ 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

²³As of April 16, 2009, the U.S. Department of Transportation had obligated \$137.0 million for 32 Mississippi projects.

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 funds²⁴ 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 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 states and D.C. 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

²⁴According 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.

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. 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 funding formula found in Title I, Part A, of the Elementary and Secondary Education Act of 1965 (ESEA), commonly known as the No Child Left Behind Act. 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 their 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, they are 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, generally, state officials expect that SFSF recipients, such as local school districts, will 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.

Localities Report Limited Initial Use of Recovery Act Funds

In addition to funds for Medicaid, transportation, and SFSF which flow primarily directly to the states, the Recovery Act provided funds for other program areas ranging from housing to training to alternative energy. Localities' planning for the use of Recovery Act education funds varied according to both the status of federal guidance in place at the time of our review and individuals states' and localities' own planning process. New Jersey state education officials said they were initially limited in their ability to provide guidance to local institutions because they were awaiting guidance from the U.S. Department of Education. As a result, school district officials we interviewed in Newark and Trenton said they are waiting for state officials to tell them what their allocations are for each of the federal Recovery Act education programs. The timing of the federal and state guidelines for these funds are important as the local schools

districts are planning their upcoming fiscal year budgets and would like to know how the Recovery Act funds would complement their upcoming school spending. According to the governor's chief of staff, the state already funds local school districts with \$8.8 billion in state funds, so ensuring accountability for the use of state funds to so many school districts is not a new challenge to the state oversight agencies. On April 1, 2009, the U.S. Department of Education issued guidance to the states on how Recovery Act funds could be used for education. State officials are continuing to review the guidance, and on April 16, 2009, issued guidance to local school districts outlining each district's allocation of additional funds made available under the Recovery Act for programs authorized under Title I of the Elementary and Secondary Education Act (ESEA) and the Individuals with Disabilities Education Act. In Arizona, Tempe School District No. 3 plans to use the vast majority of the Recovery Act funding for ESEA Title I for existing programs, but it has tentative plans to use portions of it each year to hire two temporary regional facilitators and to fund five existing preschool programs, among other uses.

Officials from the selected states and the District said there were plans in place to apply for and use Recovery Act funds. For example, Michigan plans to apply for \$67 million in Recovery Act funds for crime control and prevention activities under the Department of Justice's Edward Byrne Memorial Justice Assistance Grants. Michigan Department of Community Health officials told us that about \$41 million of these funds will support, among other things, state efforts to reduce the crime lab backlog, funding for multi-jurisdictional courts, and localities' efforts regarding law enforcement programs, community policing, and local correctional resources. An additional \$26 million in Recovery Act funds will go directly to localities to support efforts against drug-related and violent crime. On April 13, 2009, Michigan began accepting grant applications for the Byrne program and will continue to accept them until May 11, 2009. In another example, officials in the District told us that as of April 3, 2009, the District Department of Employment Services had received about \$1.5 million for adult Workforce Investment Act (WIA) programs, about \$3.8 million for dislocated workers programs, and almost \$4 million for youth programs. They said that D.C. plans to use these Recovery Act funds in accordance with the U.S. Department of Labor's guidance stating the intent of the Recovery Act to use WIA Adult funds to provide the necessary services to substantially increased numbers of adults to support their entry or reentry into the job market, and that WIA Dislocated Worker funds be used to provide the necessary services to dislocated workers to support their reentry into the job market.

Recovery Act Funds Expected to Alleviate Some State Fiscal Pressures As States Continue to Adjust Budget Plans to Address Current and Emerging Challenges

Officials in all of the selected states indicated they were able to reduce or eliminate expected budget shortfalls through the inclusion of Recovery Act funds in their budget projections. In Texas, some representatives told us that absent the availability of Recovery Act funds, state agencies likely would have been asked to make cuts of about 10 percent for the state's fiscal year 2010-2011 biennial budget, in addition to the state drawing upon the rainy day fund. However, other officials representing the Texas Office of the Governor said that budget deficit situations do not necessarily result in the state using its rainy day fund. The officials stressed that—to meet the requirement to pass a balanced budget—a variety of other solutions could be considered, such as budget reallocations among state agencies and programs, as well as spending cuts. Colorado officials said Recovery Act funds will help prevent cuts to state programs such as transportation. Illinois officials said the state hopes to avert layoffs and create new jobs with Recovery Act funds.

Officials in Massachusetts also said that federal Recovery Act funds are critical to addressing the Commonwealth's immediate fiscal pressures. State officials expect to use a significant portion of funds made available as a result of their state-projected \$8.7 billion in Recovery Act funds (over 2 years) for budget stabilization. As of April 2009, the Commonwealth is addressing a budget shortfall of approximately \$3.0 billion, driven largely by lower-than-anticipated revenues. The combination of funds made available as a result of the increased FMAP and state rainy day funds—a reserve fund built up during more favorable economic conditions to be used during difficult economic times—will help the state avoid cuts in several areas, including health care, education, and public safety. Faced with declining revenue projections since fiscal year 2008, Pennsylvania officials believe that funds made available as a result of the Recovery Act are critical to help alleviate the immediate fiscal pressure and help balance the state budget. Based on February 2009 projections, Pennsylvania faces a \$2.3 billion shortfall in fiscal year 2009, largely because of lower-than-expected revenues.

Despite the infusion of Recovery Act funds into state budgets, some state officials reported that the current fiscal situation still requires action to maintain balanced budgets. These actions include budget reductions, fee increases and scaling back of state rebates of local property taxes. In Georgia, officials amended the state budget by reducing revenue estimates, using reserves, and cutting program funding. These actions were necessary despite the inclusion of additional Medicaid funds made available as a result of the Recovery Act. The largest budget cuts in New Jersey come from scaling back of state rebates of local property taxes by

\$500 million, and reducing state payments to the pension funds by \$895 million.

Officials in the selected states acknowledged the Recovery Act's contributions to easing immediate fiscal pressures but remain wary of continued fiscal pressures likely to remain after federal assistance ends. Officials in several states reported that their planning efforts focused on maintaining existing services rather than creating new programs or staff positions which could extend their state's financial liabilities beyond the end date for Recovery Act funds. Officials generally expected to use Recovery Act funds to fill gaps in existing programs rather than funding new initiatives. In the midst of program budget cuts, state officials acknowledged the challenge of ensuring that, where required to do so, they use Recovery Act funds to supplement and not supplant current state program funds.²⁵ For example, in Arizona, programs receiving Recovery Act funds may have a share of the state general fund reduced to help balance the fiscal year 2010 budget, thus demonstrating the state has met the prohibition on supplanting state funds could be a challenge. The Arizona Treasurer's Office estimated that even with Recovery Act funding, Arizona's expenditures were expected to exceed revenues through about 2014, and the state's "rainy day" fund has been depleted.²⁶

In California, even when the state Legislative Analyst's Office factors in the state's anticipated Recovery Act funding and a package of state budget solutions that will be voted on in a May 19, 2009 special election, it estimates an \$8 billion deficit in fiscal year 2009-10. Further, since the release of the governor's budget in January 2009, the state's economic condition continues to deteriorate, and the state legislature and governor may need to develop additional budgetary solutions to rebalance the 2009-10 budget following an update of the budget in May.²⁷

²⁵For certain programs, states may use Recovery Act funds to supplement but may not supplant current state program funds. Certain other programs are not subject to this restriction.

²⁶In addition, the Arizona state legislature passed a budget in January 2009 that closed an estimated shortfall of \$1.8 billion for fiscal year 2008 and \$2.1 billion for fiscal year 2009.

²⁷In January 2009, the fiscal year 2009-2010 Governor's Budget projected that the state would end the 2009-2010 period with a \$41.6 billion deficit if the state took no corrective actions.

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.²⁸

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 passed 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

²⁸Under Texas law, according to state officials, 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.

In contrast, officials in some 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 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 using 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 Act funds to help inform the public about the results of Recovery Act spending in Colorado.

States' Legislatures Approve Use of Recovery Act Funds

In many states we spoke to, officials reported that their planning efforts were affected by the need for the state legislature to approve state agencies' use of Recovery Act funds.²⁹ For example, in Florida, the state legislature must authorize the use of all Recovery Act funds received by the state; including those passed on to local governments. In Colorado, some Recovery Act funds, including those going to Child Care Development Block Grants (CDBG) and the Temporary Assistance to Needy Families (TANF) Emergency Contingency Fund, must be allocated by the Colorado General Assembly, which is in session only through early May. Mississippi officials also plan to use Recovery Act funds to address the state's fiscal challenges. Mississippi legislative officials we met with told us that the state legislature was considering adding escalation language to the current fiscal year's appropriations bills that would authorize state agencies to spend any Recovery Act funds received. The legislature normally conducts its regular session between the beginning of January and the end of March. However, the legislature recessed early during the 2009 regular session in part because of uncertainty regarding how Recovery Act funds that the state will receive should be spent. The legislature plans to reconvene in early May 2009 to complete its work on the state's fiscal year 2010 budget.

Selected States' and the District's Plans to Track Recovery Act Funds

The selected 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 can be 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 (i.e., tag), monitor, track, and report on the use of the Recovery Act funds they receive. The states and localities generally plan on using their current accounting system for recording Recovery Act funds, but many are adding identifiers to account codes to track recovery act funds separately. Many said this involved adding digits to the end of existing accounting codes for federal programs. In California for instance, officials told us that while their plans for tracking, control, and oversight are still evolving, they intend to rely on existing accountability

²⁹We 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.

mechanisms and accounting systems, enhanced with newly created codes, to separately track and monitor Recovery Act funds that are received by and pass through the state. Several officials told us that the state's accounting system should be able to track Recovery Act funds separately.

In one state, Arizona, officials told us that state agencies will primarily be responsible for administering, tracking, reporting on and overseeing Recovery Act funds for their respective programs because the state government is highly decentralized. The state's existing accounting system will have new accounting codes added in order to segregate and track the Recovery Act funds separately from other funds that will flow through the state government. Under Arizona's decentralized government, some larger agencies, and program offices within them, have their own accounting systems that will need to code and track Recover Act funds as well. The Arizona General Accounting Office has issued guidance to state agencies on their responsibilities, including how they were to receive, disburse, tag or code in their accounting systems, track separately, and to some extent report on these federal resources.

A concern expressed by state officials is that agencies within the state often use different accounting software making it difficult to ensure consistent and timely reporting. For example, Georgia officials stated that the majority of state agencies use the same software; however, some agencies do not use this software and others have greatly customized the software. Similarly, officials from the Illinois Office of the Internal Auditor said that the state is assessing an issue that could affect reporting — specifically that there are currently more than 100 separate financial systems used throughout the Illinois state government. Furthermore, Colorado state officials are concerned that their accounting system is outdated and said they faced challenges in meeting federal reporting requirements. Some state departments do not use the state financial system grant module and therefore manually post aggregate revenue and expenditure data. As a result, they may have to compile a list of Recovery Act funding received outside of their central financial management system. State officials are determining what approach they will use in tracking funds, and told us they plan to create an accounting fund and a centrally defined budget coding structure through which to track state agencies' use of Recovery Act funds.

State Concerns Over Accountability of Recovery Act Funds Going to Sub-Recipients or Directly to Localities and Other Non-State Entities

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 inability to track these funds with 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 from many of the 16 selected states and the District told us that they had concerns about the ability of sub-recipients, localities, and other non-state entities to separately tag, monitor, track, and report on the Recovery Act funds they receive. For example, in New Jersey officials noted that certain towns and cities, as well as regional planning organizations, can apply for and directly receive federal funds under the terms of the Recovery Act. According to the state Inspector General, the risk for waste, fraud and abuse increases the farther removed an organization is from state government controls. While some state officials said that they have statewide investigative authority, they would not be able to readily track the funding going directly to local and regional government organizations and nonprofits as a result of the funding delivery and reporting requirements set up in the Recovery Act. In addition, staff from the State Auditor's office noted that some smaller cities and towns in New Jersey are not used to implementing guidance from the state or federal government on how they are using program funds and this could result in the localities reporting using funds for ineligible purposes.

Officials in many states expressed concern about being held accountable for funds flowing directly from federal agencies to localities or other recipients. For example, officials in Colorado expressed concern that they will be held accountable for all Recovery Act funds flowing to the state, including those funds for which they do not have oversight or even information about, because some funds flow directly to non-state entities within Colorado (such as school districts and transportation districts).

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 the use of these funds and so they can coordinate Recovery Act activities. For example, Georgia officials do not expect to track and report on funds going directly to localities, but would like to be informed about these funds so that the state can coordinate with localities. They cited Recovery Act-funded broadband initiatives and health funding to nonprofit hospitals

as areas where a lack of coordination could result in a duplication of services or missed opportunities to leverage resources. Officials at the Colorado Department of Public Safety told us that, because Colorado and other states expressed interest in receiving data on localities' grant funding, the federal Bureau of Justice Assistance in the U.S. Department of Justice began providing data to the states on localities' funding.

In another example, officials told us that the Ohio Administrative Knowledge System (OAKS) will allow the state to tag Recovery Act funding. However, they said in many cases state agencies will rely on grantees and contractors to track the funds to their end use. Because the state intends to code each Recovery Act funding stream separately and recipients typically manage more than one funding stream at a time, state officials said recipients should be able to track Recovery Act funds separately from other funding sources. However, state and local officials we interviewed raised concerns about the capacity of grantees and contractors to track funds spent by sub-recipients. For example, officials with the Ohio Department of Education said they can track Recovery Act funds to school districts and charter schools, but they have to rely on the recipients' financial systems to be able to track funds beyond that. An official with the Columbus City Schools said that while they could provide assurances that Recovery Act funds were spent in accordance with program rules; they could not report back systematically how each federal Recovery Act dollar was spent. Officials with the Columbus Metropolitan Housing Authority also noted limitations in how far they could reasonably be expected to track Recovery Act funds. They said they could track Recovery Act dollars to specific projects but could not systematically track funds spent by subcontractors on materials and labor. These officials added, however, that if they required the contractors to collect this information from their subcontractors, they would be able to report back with great detail. Still, they said, without additional guidance from the federal government on specific reporting requirements, they were hesitant to specify requirements for their contractors to collect the data.

Pennsylvania officials said that the state will rely on sub-recipients to meet reporting requirements at the local level. Recipients and sub-recipients can be local governments or other entities such as transit agencies. For example, about \$367 million in Recovery Act money for transit capital assistance and fixed guideway (such as commuter rails and trolleys) modernization was allocated directly to areas such as Philadelphia, Pittsburgh, and Allentown. State officials also told us that the state would not track or report Recovery Act funds that go straight from the federal

government to localities and other entities, such as public housing authorities.

Officials in several states indicated that either their states would not be tracking Recovery Act funds going to the local levels or that they were unsure how much data would be available on the use of these funds. For example, Massachusetts officials told us that the portion of recovery funds going directly to recipients other than Massachusetts state government agencies, such as independent state authorities, local governments, or other entities, will not be tracked through the Office of the Comptroller. While state officials acknowledged that the Commonwealth lacks authority to ensure adequate tracking of these funds, they also are concerned about the ability of smaller entities to manage Recovery Act funds, particularly smaller municipalities that traditionally do not receive federal funds and who are not familiar with Massachusetts tracking and procurement procedures, and recipients receiving significant increases in federal funds. In order to address this concern, the state administration introduced emergency legislation that, according to state officials, includes a provision requiring all entities within Massachusetts that receive Recovery Act money to provide information to the state on their use of Recovery Act funds. Nevertheless, two large non-state government entities we spoke with—the city of Boston and the Massachusetts Bay Transportation Authority (an independent authority responsible for the metropolitan Boston’s transit system)—believe that their current systems, with some modifications, will allow them to meet Recovery Act requirements. For example, the city of Boston hosted the Democratic National Convention in 2004 and officials said that their system was then capable of segregating and tracking a sudden influx of temporary funds.

This response was common among the selected states. For example, officials in Florida told us that the state’s accounting system will not track the portion of Recovery Act funds that flow directly to local entities from federal agencies. Officials in Michigan’s Auditor General’s Office told us that their oversight responsibilities do not include most sub-recipients that receive direct federal funding, so any upfront safeguards to track or ensure accountability have not been determined.³⁰ Mississippi officials also said that although special accounting codes will be added to the Statewide Automated Accounting System in order to track the expenditure

³⁰Some Michigan state departments are sub-recipients of other state departments and so these recipients are under the State Auditor General’s authority.

of Recovery Act funds, the system would not track Recovery Act funds allocated directly to local and regional government organizations and nonprofit organizations.

In Arizona, the portion of recovery funds going directly to recipients other than Arizona government agencies, such as independent state authorities, local governments, or other entities, may not be tracked by the state. State officials expressed concern that they may not be able to attest to localities' ability to tag, track, and report on Recovery Act funds when these entities receive the moneys directly from federal agencies rather than through state agencies. Department heads and program officials generally expected that they could require sub-recipients receiving funds from the state, through agreements, grant applications, and revised contract provisions, to separately track and report Recovery Act funding. For example, unemployment program managers said they were issuing new intergovernmental agreements with localities to cover new reporting requirements. However, several of the state officials did raise questions about the ability of some local organizations to do this, such as small, rural entities, boards or commissions, or private entities not used to doing business with the federal government. Furthermore, several of the state department officials acknowledged that either some state agency information systems have data reliability problems, which will have to be resolved, or they had sub-recipients who in the past had problems providing timely and accurate reporting, but said that they would work with these entities to comply, and also had sanctions to use as a last resort.

Officials in Arizona, Florida, Georgia, and New York, also expressed concern that the new requirement to provide reports on use of Recovery Act funds within 10 days after a quarter ends may be challenging to meet by both state and local entities. In some program areas, some state officials raised concerns that the Recovery Act requirement will create much shorter deadlines for processing financial data that local areas will have difficulty meeting.

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.

States' and Localities' Internal Controls Will Be Critical to Ensuring That Recovery Act Funds Are Used Appropriately

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.³¹

Control Environment

The control environment should create a culture of accountability by establishing a positive and supportive attitude toward improvement and the achievement of established program outcomes. Control environment includes the integrity and ethical values maintained and demonstrated by management, the organizational structure, and management's philosophy and operating style. As detailed earlier in this report, although the implementation has varied, many locations we reviewed have attempted to enhance their control environment through the appointment of a Recovery czar or the establishment of boards or working groups that focus on the Recovery Act. Also, as noted earlier, state officials expressed concerns about the reliability and accuracy of data coming from localities.

Risk Assessments

The second feature of strong internal controls is risk assessment—that is, performing comprehensive reviews and analyses of program operations to determine if risks exist and the nature and extent of risks have been identified. Some states told us that they are conducting such risk assessments and the existing body of work by state auditors and others provide a good roadmap for states to use to pinpoint key areas of concern and to strengthen internal controls and subsequent oversight. For example, the Illinois Office of Internal Audit is performing a risk assessment of all programs related to the Recovery Act, and North Carolina's Office of Internal Audit is assessing the risk of the state department's financial management system and internal controls. Michigan's major state departments are conducting self assessments of controls, including identification of internal control and programmatic weaknesses. In Georgia, the budget office is requiring state agencies to complete a tool that assesses risk as part of the budget process for the

³¹GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

Recovery Act funds. Selected states have thus far identified various risks that the Recovery Act funds and programs face, including Georgia officials identifying three state departments with increased risk—the Georgia Department of Labor that is on a different accounting system than other state departments, the Georgia Department of Transportation which had previously identified accounting problems and is currently being reorganized, and the Georgia Department of Human Resources, which is currently being divided into three parts, which increases risk. Additionally, Massachusetts’ fiscal year 2007 Single Audit report also identified deficiencies, especially in the Department of Education’s sub-recipient monitoring.

Officials in several of the selected states told us that risk assessment is being conducted to look at programs receiving Recovery Act funds. Officials in Texas’ State Auditor’s Office noted that relatively high risks generally can be anticipated with certain types of programs such as new programs with completely new processes and internal controls; programs that distribute significant amounts of funds to local governments or boards, and programs that rely on sub-recipients for internal controls and monitoring. Officials from New York, North Carolina, and Pennsylvania commented that the weatherization program was an example of a program at increased risk.

The results of recent audits are a readily available source of information to use in the risk assessment process. Material weaknesses and other conditions identified in an audit represent potential risks that can be analyzed for their significance and occurrence that will allow management and others to decide how to manage the risk and what actions should be taken. A readily available source of information on internal control weaknesses and other risks present in the states and other jurisdictions receiving Recovery Act funding is the Single Audit report, prepared to meet the requirements of the Single Audit Act, as amended (Single Audit Act) and OMB’s implementing guidance in OMB Circular No. A-133, Audits of States, Local Governments, and Non-Profit Organizations. The Single Audit Act adopted a single audit concept to help meet the needs of federal agencies for grantee oversight and accountability as well as grantees’ needs for single, uniformly structured audits. 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.³² 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 (SEFA); (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),³³ and (3) an audit and an opinion on compliance with applicable program requirements for certain federal programs. The audit report also includes the auditor's schedule of findings and questioned costs, and the auditee's corrective action plans and a summary of prior audit findings that includes planned and completed corrective actions. Auditors are also required to report on significant deficiencies in internal control and on compliance associated with the audit of the financial statements.

For example, in California, the most recent single audit conducted by the State Auditor for fiscal year 2007 identified 81 material weaknesses, 27 of which were associated with programs we reviewed for purposes of this report.³⁴ The State Auditor plans to use past audit results to target state agencies and programs with a high number and history of problems, including data reliability concerns, and is closely coordinating with us on these efforts. For example, the fiscal year 2007 State Single Audit Report identified 8 material weaknesses pertaining to the ESEA Title I program and the Individuals with Disabilities Education Act programs. The audit findings included a material weakness in the California Department of Education's management of cash because it disbursed funds without assurances from LEAs that the time between the receipt and disbursement of federal funds was minimized, contrary to federal guidelines. Education officials told us that they have addressed some of these material weaknesses and, in other cases, they are still working to correct them. If

³²If an entity expends federal awards under only one federal program, the entity may elect to have an audit of that program.

³³The 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.

³⁴State of California: Internal Control and State and Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2007 (June 2008 Report 2007-002).

these and other material weaknesses are not corrected, they may affect the state's ability to appropriately manage certain Recovery Act funds. The State Auditor's Office told us that it is in the process of finalizing the fiscal year 2007 State Single Audit Report and plans to issue the report within the next 30 days. In addition, the State Auditor's Office is summarizing the results of the single audit to identify those programs that continue to have material weaknesses. Finally, the State Auditor's Office plans to use the results of other audits it has conducted in conjunction with the single audit to develop its approach for determining the state's readiness to receive the large influx of federal funds and comply with the requirement regarding the use of those funds under the Recovery Act.

Arizona's fiscal year 2007 Single Audit report identified a number of material weaknesses related to the state Department of Education. The report identified a material weakness involving IDEA where the state department had not reviewed sub-recipients to ensure that federal awards were used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements. The Audit report also identified one financial reporting material weaknesses related to the state Department of Administration's ability to prepare timely financial statements, including its Comprehensive Annual Financial Report (CAFR). In fiscal year 2007, the CAFR was issued in June 2008, approximately 6 months after the scheduled deadline. According to the Auditor General's Office, the fiscal year 2008 CAFR will also be completed late as the last agency submitted its financial statement on March 9, 2008. According to the Auditor General's Office, this control deficiency affects the timeliness of financial reporting which affects the needs of users. It is especially important that Arizona try to address the timeliness issue with regard to financial statements given the number and strict reporting timelines that are imposed on states under the Recovery Act.

Control Activities

The third element of a comprehensive system of internal controls is that of control activities, which involve taking actions to address identified risk areas and help ensure that management's decisions, directives, and plans are carried out and program objectives met. Various control activities already exist and are also being put in place in the states related to the Recovery Act. Control activities for states and localities consist of the policies, procedures, and guidance that enforce management's directives and achieve effective internal control over specific program activities. Examples of such policies and procedures particularly relevant to the Recovery Act spending are (1) proper execution and accurate and timely recording of transactions and events, (2) controls to help ensure compliance with program requirements, (3) establishment and review of

performance measures and indicators, and (4) appropriate documentation of transactions and internal control.

Documented policies, procedures and guidance that are effectively implemented will be critical tools for states and localities management and staff as well as program recipients for achieving good management of Recovery Act programs. Control activities are also key in helping to achieve accurate, reliable reporting of information and results.

Effective control activities and monitoring are key to achieving this objective. Pennsylvania's Auditor General also found potential weaknesses and vulnerabilities in programs expected to receive Recovery Act funds.³⁵ For example, a recent Auditor General report found, among other things, weak internal controls, weaknesses in contracting, and inconsistent verification and inspection of subcontractor work in the state's Weatherization Assistance Program. States and localities that receive and administer the Recovery Act funds will be expected to minimize fraud, waste, and abuse in contracting.

According to Florida state officials, the state completed an initiative to strengthen contracting requirements several years ago. For example, the majority of state contracts greater than \$1 million are required to be reviewed for certain criteria by the Department of Financial Services' Division of Accounting and Auditing before the first payment is processed. The contract must also be negotiated by a contract manager certified by the Florida Department of Management Services, Division of State Purchasing Training and Certification Program. In another example of efforts to enhancing contracting processes and oversight, officials in New Jersey told us that the controls and reports will be put into place by the state's centralized purchasing department, the Division of Purchase and Property (DPP). The current accounting system will be able to account for and control the use of Recovery Act funds used for procurement because DPP will create special accounting codes for these funds. New Jersey officials stated that their accounting systems had the capability to track funds using special accounting codes and that they were confident no special enhancements were needed to their accounting software, although they would monitor the accounting system to ensure it was functioning

³⁵ Other audits the office performs include: financial audits of counties, and state aided and owned institutions; performance audits of state agencies, programs and state owned institutions; financial and compliance audits of school districts; special investigations; and audits of the operations of welfare county assistance offices.

properly. DPP will also publicly advertise bids for projects funded with Recovery Act funds, include terms and conditions in each request for proposals and contract for these projects stating detailed reports required by the Act, and will post contract award notices for Recovery Act-funded projects.

Information and Communication

Information should be communicated to management and within the entity to enable accountable officials and others throughout the entity to carry out their responsibilities and determine whether they are meeting their goals of accountability and efficient use of resources. The states have undertaken a variety of information and communication methods. For the Recovery Act, internal state communication is being conducted through newly created task forces or working groups such as those in California and the District, implementation teams such as in Florida and Georgia, and state offices such as in North Carolina. Texas also uses a periodic forum of the internal audit staff of Texas state agencies for another statewide communication method. Various officials are developing guidance related to the Recovery Act and dispensing the information to state agencies.

Monitoring

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 boards and entities, and internal and external auditors. Monitoring enables stakeholders to determine whether the internal control system continues to operate effectively over time. It also improves the organization's overall effectiveness and efficiency by providing timely evidence of changes that have occurred, or might need to occur, in the way the internal control system addresses evolving or changing risks.

Many of the boards or offices discussed in the control environment above have responsibilities related to monitoring the Recovery Act funds. States have undertaken various other activities to monitor Recovery Act funds, including Arizona's budget director meeting with the heads of programs potentially receiving Recovery Act funds to gauge each programs' preparedness; Arizona's Comptroller conducting a survey to inventory current internal controls at state agencies to help ensure controls are in place to limit the risk of fraud, waste, abuse and mismanagement of Recovery Act funds; California's Governor appointing the state's first Inspector General specifically to oversee Recovery Act funds as they are disbursed in the state; Massachusetts' legislature creating the Joint Committee on federal Recovery Act Oversight with the goals of ensuring compliance with federal regulations and reviewing current state laws, regulations and policies to ensure they allow access to Recovery Act funds

and streamline the processes to quickly stimulate the economy; and Texas State Auditor's Office plans to hire 10 additional staff.

An important aspect of monitoring Recovery Act funding includes sub-recipient monitoring. As noted, significant concerns exist regarding sub-recipient monitoring, as this is an area where limited experience and known vulnerabilities exist. Some state auditors do not have authority to monitor local operations of internal controls. For example, in Pennsylvania, officials from the Auditor General's office have different views about what authority they have to audit federal money that flows directly to localities, such as housing authorities and municipalities.

In Texas, the State Auditor's Office made a recommendation regarding the monitoring of sub-recipients in its most recent audit of the Texas Education Agency.³⁶ The audit report did not find that sub-recipients were improperly spending federal funds or were not meeting federal requirements, however the report did note that the agency had "a limited number of resources available to monitor fiscal compliance." The audit report recommended that the Texas Education Agency continue to add resources, within its budget constraints, to increase the amount of federal fiscal compliance performed. According to the State Auditor, following the audit in February 2009, the Texas Education Agency created a comprehensive correction plan to address this resource issue, which the agency is implementing.

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.

³⁶State Auditor's Office, *State of Texas Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2008*, SAO Report No. 09-330 (Austin, Tex., Feb. 2009). The audit was performed by an independent public auditing firm under contract to the State Auditor's Office.

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.³⁷ 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. 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 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:

³⁷The 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.

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- 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.³⁸

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 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 expressed concerns regarding the lack of funding provided to state oversight entities in the Recovery Act 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 management and oversight staff—limiting states’ ability to ensure proper implementation and management of Recovery Act funds. To the extent that states’ management infrastructures were already strained due to resource issues, risks will be exacerbated by increased workloads and new program implementation. While the majority of states indicated that they lack the necessary resources to conduct additional management and oversight related to the Recovery Act, some states indicated that they are taking

³⁸The 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.

measures to either hire new staff or reallocate existing staff to ensure adequate oversight of Recovery Act funds.

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 administrative cuts during a past economic downturn in an attempt to maintain program delivery levels.

In Massachusetts, the task forces the Governor convened in December 2008 concluded that it is critical the Inspector General and State Auditor have resources to audit Recovery Act contracts and management of Recovery Act funds, as well as recommended that the Attorney General's office be provided with the resources to promptly and effectively pursue fraud and abuse. Massachusetts officials explained that the oversight community is facing budget cuts of about 10 percent at a time when increased oversight and accountability is critically needed. To illustrate the impact of the impending budget situation, the Inspector General stated that his department does not have the resources to conduct any additional oversight related to Recovery Act funds. This significantly affects the Inspector General's capacity to conduct oversight since the budget is almost entirely comprised of salaries, and any cuts in funding would result in fewer staff available to conduct oversight. In addition, the Massachusetts State Auditor described how their department has had to resort to staff being furloughed already for 6 days and is anticipating further layoffs before the end of fiscal year 2009. Similarly, 94 percent of their department's budget is labor and any cuts in funding generally result in cuts in staff. Much like Colorado and Massachusetts, Arizona and Florida state officials report significant declines in oversight staff. The Florida Auditor General told us that the office has not been hiring new staff for over a year and has about 10 percent of the office's positions unfilled. In addition, the Office of Policy Analysis and Government Accountability officials also told us their respective staffs have decreased

by 10 percent in the past two years. State officials stated that these staff resource constraints may lead them to reassess priorities and reallocate staff to ensure adequate oversight of Recovery Act funds.

Officials within Arizona state executive offices that are coordinating oversight activities—such as the Office of Strategic Planning and Budgeting, the Office of Economic Recovery, and the Comptroller’s Office—stated that they will need additional people to help ensure compliance with Recovery Act funding requirements, but that the state has a hiring freeze to help address budget deficits. For example, the General Accounting Office within the state Department of Administration has experienced a reduction from 74 to 50 staff, posing challenges to its increased oversight responsibilities, and the state Department of Economic Security that manages workforce investment programs had 8,214 staff on furloughs of five or nine days, depending on pay grade, and has laid off about 800 staff members as well. Similarly, a state Department of Housing official stated that the office currently has a vacancy rate of about 15 percent because of the hiring freeze. Furthermore, the state Auditor General reported that its staffing levels are nearly 25 percent below the authorized staffing level of 229 full time equivalents.

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 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.

In addition, officials from Ohio’s Office of Budget and Management (OBM) stated that its Office of Internal Audit plans to increase its internal audit staff from 9 (current) to 33 by transferring internal audit personnel from other state agencies and hiring new staff by July 2009. OBM officials say that the increase in Office of Internal Audit staff will provide the needed resources to implement its objectives and ensure that current safeguards are in place and followed as the state manages its Recovery Act funded programs. Additionally, some Georgia state officials that directly

administer programs stated that overseeing the influx of funds could be a challenge, given the state's current budget constraints and hiring freeze. For example, the State Auditor, whose fiscal year 2009 budget was cut by 11 percent, expressed concerns about the lack of additional funds for Recovery Act oversight. The Georgia State Auditor noted that, if state fiscal conditions do not improve or federal funding does not become available for audit purposes, additional budget and staffing cuts may occur within the department. In some cases, state officials told us that they planned to use Recovery Act funds to cover their administrative costs. Meanwhile, other state officials want additional clarity on when they could use program funds to cover such costs.

Hiring Freezes May Limit Some States' Capacity to Provide Effective Management and Oversight

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 Act 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.

Michigan officials reported that the state's hiring freeze may not allow state and local agencies to hire the additional staff needed to increase Recovery Act oversight efforts. For example, an official with the state's Department of Community Health said that because it has been downsizing for several years through attrition and early retirement, it does not have sufficient staff to cover its current responsibilities and that further reductions are planned for fiscal year 2010. However, state officials told us that they will take the actions necessary to ensure that state

departments have the capacity to provide proper oversight and accountability for Recovery Act funds.

In contrast, two states indicated that they have or will have sufficient levels of existing personnel to track funds. Texas state officials noted that state agencies plan on using existing staff to manage the stimulus funds. Agency officials will monitor the situations and, as need arises, will determine whether additional staff should be hired to ensure adequate oversight of the state Recovery Act funds. Additionally, in preparation of the infusion of Recovery Act funds, the Illinois Governor is seeking approximately 350 additional positions state-wide in the fiscal year 2010 budget to help implement Recovery Act programs, according to officials from the Governor's Office of Management and Budget.

Local Oversight Capacity

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 for some programs.

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.³⁹ OMB has also issued for public comment detailed proposed standard data elements that federal agencies will require from all (except individuals) recipients of Recovery Act funding.⁴⁰ 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, 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. In addition, the Civilian Acquisition Council and Defense Acquisition Regulations Council have issued an interim rule revising the Federal Acquisition Regulation (FAR) to require a contract clause that implements these reporting requirements for contracts funded with Recovery Act dollars.⁴¹

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. 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.

³⁹See, 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.

⁴⁰OMB, *Information Collection Activities: Proposed Collection; Comment Request*, Federal Register – 74 Fed. Reg. 14824 (Apr. 1, 2009).

⁴¹74 Fed. Reg. 14639 (March 31, 2009).

Preserving existing jobs and stimulating job creation and promoting economic recovery are among the Recovery Act's key objectives.⁴² 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. 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,⁴³ 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.

State officials that we spoke with are pursuing a number of different approaches for measuring the effects of Recovery Act funding. For example, Florida's state workforce agency is encouraging recipients of Recovery Act funds throughout the state to list jobs created with the funds in the state's existing online job bank. The Iowa Department of Transportation tracks the number of worker hours by highway project on the basis of contractor reports and will use these reports to estimate jobs created. In New Jersey, state and local agencies will collect or estimate data on the number of jobs created or retained as a result of Recovery Act funds in different ways. For example, the Newark Housing Authority will use payroll data to keep track of the exact number of union tradesmen and housing authority residents employed to turn damaged vacant units into rentable ones. In contrast, New Jersey Transit is using an academic study that examined job creation from transportation investment to estimate the number of jobs that are created by contractors on its Recovery Act-funded

⁴²Recovery 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.

⁴³Indirect jobs are jobs created as a result of demand for goods and services generated by direct funding from the Recovery Act.

construction projects.⁴⁴ Beyond employment issues, some Michigan state universities and the state's economic development department are expected to participate in analyses of the potential impact of Recovery Act funds.

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 and in the Federal Acquisition Regulation, as well as by guidance issued by federal departments. For example, OMB provided 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 direct recipients of Recovery Act funding. OMB plans to update this guidance again within 30 to 60 days of its April 3, 2009 issuance. Some federal agencies have also provided guidance to the states. The U.S. Departments of Education, Housing and Urban Development, Justice, Labor, Transportation, the Corporation for National and 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 the Broadband Deployment Grants, are awaiting issuance of implementation instructions.

⁴⁴The study estimated that for every \$1 million of transportation infrastructure investment, 11 jobs are created, 70 percent of them are directly related to the investment and 30 percent are indirectly related. (Rutgers University Edward J. Bloustein School of Planning and Public Policy, "Economic Impacts of Planned Transportation Investments in New Jersey" Camden, New Jersey, April 2008.)

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 Would Recommend: To provide additional leverage as an oversight tool for Recovery Act programs, the Director of OMB should adjust the current audit process to:

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- 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 Would 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;
- 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.

State and Federal Data Collection

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.

Administrative Support and Oversight

We Would 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.

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 Would 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 Would 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.

Agency Comments and Our Evaluation

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.

We are sending copies of this report to the Office of Management and Budget and relevant sections to the selected states and the District.

The report will also be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staffs have any questions about this report, please contact me at (202) 512-5500. Contact points for our offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix III-XX.

Sincerely,

A handwritten signature in black ink that reads "Gene L. Dodaro". The signature is written in a cursive style with a large, prominent "D" and a long horizontal stroke at the end.

Gene L. Dodaro
Acting Comptroller General of the United States

List of Congressional Committees

The Honorable Daniel K. Inouye
Chairman

The Honorable Thad Cochran
Ranking Member
Committee on Appropriations
United States Senate

The Honorable Joseph I. Lieberman
Chairman

The Honorable Susan M. Collins
Ranking Member
Committee on Homeland Security and Governmental Affairs
United States Senate

The Honorable David R. Obey
Chairman

The Honorable Jerry Lewis
Ranking Member
Committee on Appropriations
House of Representatives

The Honorable Edolphus Towns
Chairman

The Honorable Darrell Issa
Ranking Member
Committee on Oversight and Government Reform
House of Representatives

Appendix I: Objectives, Scope, and Methodology

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. As a result, our objectives for this report were to describe (1) selected states' and localities' uses of and planning for Recovery Act funds, (2) 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 have received to date.

Selection of States

To address our objectives, 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 selected states are Arizona, California, Colorado, Florida, Georgia, Iowa, Illinois, Massachusetts, Michigan, Mississippi, New Jersey, New York, North Carolina, Ohio, Pennsylvania, and Texas. 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. These states and D.C. contain about 65 percent of the U.S. population and are estimated to receive about two-thirds of the intergovernmental grant funds available through the Recovery Act. Furthermore, they strike a balance between covering a significant portion of Recovery Act funding and obtaining a mix that reflects the breadth of circumstances facing states and localities throughout the country.

Selection of Programs

To focus our analysis, we examined a set of programs receiving Recovery Act funding that are administered by states and localities. To do this, we reviewed analysis and estimates of Recovery Act funds flowing to states and localities that were done by state and local associations including the National Governors Association, the National Conference of State Legislatures, and the Federal Funds Information for States (FFIS). We also analyzed data from congressional appropriations committees and the Congressional Budget Office (CBO) on the distribution, allocation, and spend out rates of Recovery Act funding.

The programs we selected were streams of Recovery Act funding flowing to states and localities through increased Medicaid Federal Medical Assistance Percentage (FMAP) grant awards, funding for highway infrastructure investment, and the State Fiscal Stabilization Fund (SFSF). Together, they are expected to account for about 91 percent of fiscal year

2009 Recovery Act spending by states and localities. For the FMAP grant awards, we conducted a web-based inquiry, asking the 16 states and D.C. to provide data and information on enrollment, expenditures, and changes to their Medicaid programs and to report their plans to use state funds made available as a result of the increased FMAP. We reviewed states' responses for internal consistency and conducted follow-up with the states as needed. We also spoke with individuals from the U.S. Department of Health and Human Services regarding the changes to the FMAP and the disbursement of increased FMAP funds. In addition, we spoke with individuals from the Centers for Medicare & Medicaid regarding their oversight and guidance to states. For highways infrastructure investment, we reviewed status reports and guidance to the states and discussed these with the U.S. Department of Transportation (DOT) and Federal Highways Administration (FHWA) officials. To understand how the U.S. Department of Education is implementing the SFSF, we reviewed relevant laws, guidance, and communications to the states and interviewed Education officials. Our review of related documents and interviews with federal agency officials focused on determining and clarifying how states, school districts, and public Institutions of Higher Education would be expected to implement various provisions of the SFSF.

We considered programs with large amounts of funding, programs receiving significant increases in funding, new programs, and those with known risks. For example, the Medicaid program is on the GAO high risk list. In addition, we consulted with our internal program experts and outside experts including federal agency inspectors general, state and local auditors, and state and local government associations.

Approach in States and Localities on Uses and Plans for Recovery Act Funds

Our teams visited the 16 selected states, localities within those states, and D.C. during March and April 2009 to collect documentation on the plans, uses, and tracking of Recovery Act funds and to conduct interviews with state and local officials. The teams met with a variety of state and local officials from executive-level offices including Governors and their key staff, Comptrollers' Offices, Treasurers' Offices, State Auditors' Offices, Recovery Czars, Inspectors General, senior finance and budget officials, and local officials such as from housing authorities, school districts, police departments, and other key audit community stakeholders to determine how they planned to conduct oversight of Recovery Act funds. The teams also met with state and local agencies administering programs receiving Recovery Act funds, including state Departments of Education, Transportation, and Health and Human Services, and with selected legislative offices in the states. In support of these interviews, we

developed a series of program review and semi-structured interview guides that addressed state plans for management, tracking, and reporting of Recovery Act funds and activities. These guides focused on identification of risk, risk mitigation, contracting, the internal control environment and safeguards against fraud, waste, and abuse. While in the 16 states and D.C., the teams also met with and interviewed a number of local government officials, whose offices are identified in Appendix 2.

Assessing Safeguards and Internal Controls

To determine how states and localities plan to track the receipt of, planning for, and use of Recovery Act funds, the state and D.C. teams asked cognizant officials to describe the accounting systems and conventions that would be used to execute transactions and to monitor and report on expenditures. In addition, to assist in the planning of the audit work and for inclusion in their risk assessment framework, we provided the state and D.C. teams with fiscal year 2007 single audit summary information, which was the most recent single audit information available. Single audit information was obtained from the Federal Audit Clearinghouse (FAC) single audit data collection forms and the single audit reports. The single audit summary information provided included : (1) total federal awards expended; (2) whether there were questioned costs; (3) the financial statement audit opinion, number of material weaknesses, and a brief description of each material weakness; and (4) major federal program audit opinion, number of material weaknesses, and a brief description of each material weakness. We examined the Single Audit reports to identify these issues and used that information when interviewing state officials in order to ascertain how they have addressed or plan to address the weaknesses. We also asked auditors to address how they planned to monitor and oversee the Recovery Act funds and whether or not they felt their offices had sufficient capacity to handle any new or increased responsibilities related to the Recovery Act.

Recovery Act Reporting Requirements

To understand the reporting requirements of the Recovery Act, we reviewed the guidance issued by OMB on February 18 and April 3, 2009 and selective federal agency guidance related to grants and to states and localities. We also reviewed an interim rule amending the Federal Acquisition Regulation containing interim reporting requirements for the Recovery Act, issued March 31, 2009.¹ Additionally we studied the OMB issued Information Collection Requirements: Proposed Collection (April 1,

¹74 Fed. Reg. 14,639.

2009) that contains the data elements for the quarterly recipient reports specified in Section 1512 of the Recovery Act. Each of the states and D.C. provided information on its plans to provide assessment data required by Section 1512.

We conducted this performance audit from February 17, 2009, through 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. Data on states' and localities' plans, uses, and tracking of Recovery Act funds was provided during interviews and follow-up meetings with state and local officials. Given that much of the Recovery Act funding had not yet reached the states and localities, we could not validate nor test the accuracy of the statements made by these officials regarding their accounting and tracking systems. Overall, we determined that the data were sufficiently reliable for the purposes of providing the background information on Recovery Act funding for this report. Our sample of selected states is not a random selection and therefore cannot be generalized to the total population of state and local governments.

Appendix II: Localities Visited by GAO in Selected States

Table 5: States and Localities Visited by GAO

States and the District of Columbia	Localities (or Associations Representing Localities)
Arizona	Regional Public Transportation Authority, Maricopa Association of Governments, City of Phoenix Public Transit Department, City of Phoenix Housing Department, City of Glendale Housing Department, Tempe School District, Peoria Accelerated High School, Maricopa Workforce Connections, City of Phoenix Workforce Connection Division
California	Sacramento Housing and Redevelopment Agency
Colorado	Denver Mayor's Office, Denver City Auditor, Denver Housing Authority, Denver Office of Economic Development
District of Columbia	District of Columbia Housing Authority, Washington Metropolitan Area Transportation Authority
Florida	Florida Association of Counties, Workforce Plus (a regional workforce board for Leon, Gadsden, and Wakulla Counties), Tallahassee Housing Authority, Florida Association of School District Superintendents
Georgia	Atlanta Housing Authority, Atlanta Regional Workforce Board
Iowa	City of Des Moines
Illinois	Chicago Transit Authority
Massachusetts	City of Boston, Massachusetts Bay Transportation Authority
Michigan	City of Detroit Mayor's Office, City of Lansing Mayor's Office, City of Detroit Office of Auditor General, Detroit Public Schools, Lansing School District
Mississippi	Central Mississippi Planning and Development District, The Housing Authority of the City of Jackson
New Jersey	Newark Mayor's Office, New Jersey Transit in Newark, Newark Housing Authority, Newark Public Schools, Trenton Mayor's Office, Trenton Police Department, Trenton Housing Authority, Trenton Board of Education
New York	New York City's Mayor's Office, New York City Budget Director, New York City Comptroller
North Carolina	City of Raleigh, Wake County, North Carolina Association of County Commissioners, North Carolina League of Municipalities
Ohio	Columbus Metropolitan Housing Authority, Franklin County Government, City of Columbus, Columbus City Schools, Local WIA
Pennsylvania	Harrisburg Housing Authority, South Central Workforce Investment Board
Texas	City of Austin Office of the City Auditor, City of Austin-Financial & Administrative Services Department, The Housing Authority of the City of Austin

Source: GAO.