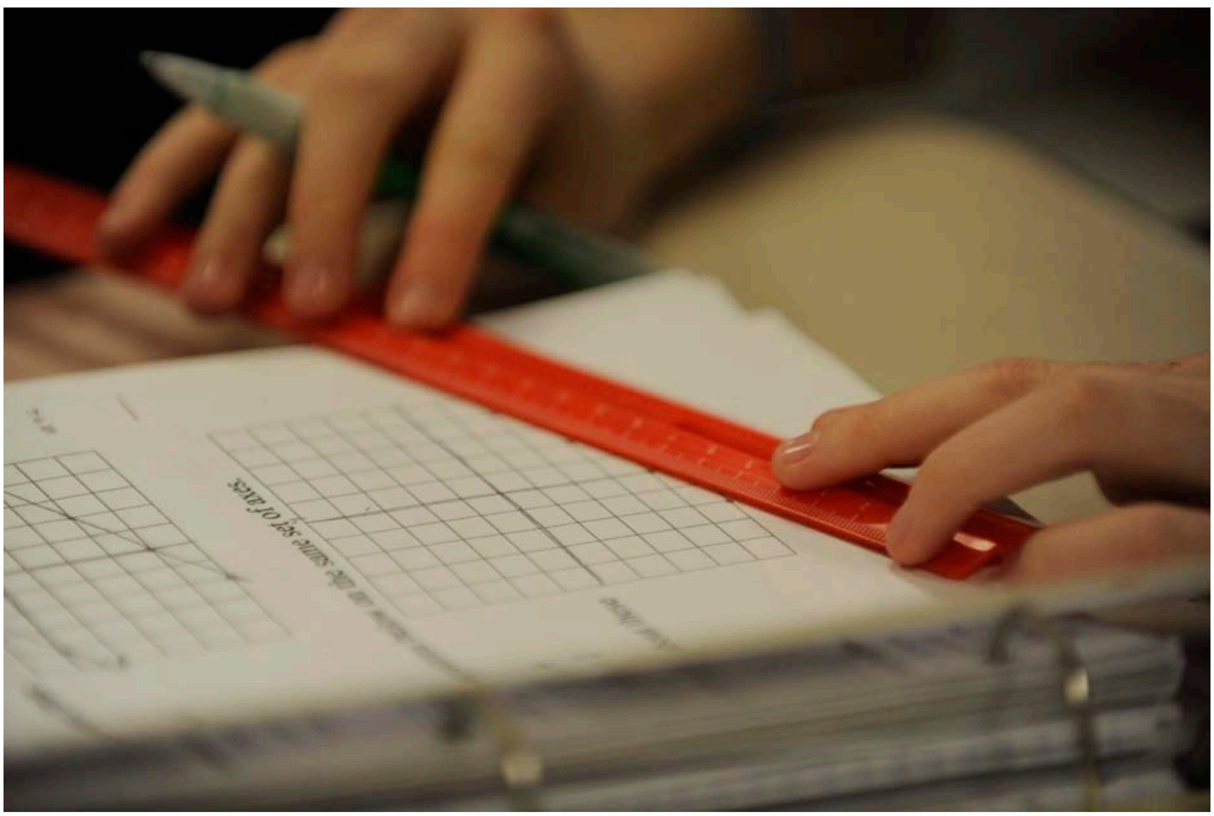
U.S. Department of Education
Office of Inspector General

American Recovery and Reinvestment Act of 2009

Potential Consequences of the Maintenance of Effort Requirements under the American Recovery and Reinvestment Act State Fiscal Stabilization Fund

Alert Memorandum



ED-OIG/L03J0011 **September 2009**

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

Audit Services

September 30, 2009

ALERT MEMORANDUM

To: Thelma Melendez de Santa Ana
Assistant Secretary
Office of Elementary and Secondary Education

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

Subject: Potential Consequences of the Maintenance of Effort Requirements under the ARRA State Fiscal Stabilization Fund
Control Number ED-OIG/L03J0011

The purpose of this alert memorandum is to highlight an issue of concern related to States' administration of the State Fiscal Stabilization Fund (SFSF) as part of the American Recovery and Reinvestment Act of 2009 (ARRA). The flexibility inherent in the maintenance of effort (MOE) requirements may be resulting in States reducing funding for public education. The consequence of this could adversely impact the achievement of the education reform objectives of the SFSF program. This came to our attention through our ARRA audit work and from complaints received through the Office of Inspector General (OIG) Hotline.[1]

We recommend that the U.S. Department of Education (Department) take action to address these potential consequences. The Department should track State funding for public education to determine the impact that the SFSF MOE requirements are having on levels of State support for public education. The Department should also use these data to ensure that States are complying with the MOE assurances made in their SFSF Phase I applications.

Maintenance of Effort Requirements

In accordance with the requirements in the ARRA, States must submit an application that includes a number of assurances in order to receive the first portion of their SFSF allocation. One assurance is that the State will maintain its support for elementary and secondary education, as well as public institutions of higher education (IHEs), at least at the level of such support for fiscal year (FY) 2006. States may also request a waiver from the MOE requirement if they meet certain criteria.[2] In addition to the MOE requirement, the ARRA stipulates that each State must first use the Education portion of its SFSF

[1] The OIG Hotline is a toll-free telephone number (1-800-MISUSED) and email box (oig.hotline@ed.gov) where individuals can report potential instances of fraud, waste, or abuse relating to Department programs.
[2] The percentage of the State's total revenues expended on education must be greater than or equal to the percentage expended in the fiscal year preceding the year for which the waiver is being requested.

allocation[3] to (1) restore State support for elementary and secondary education in FYs 2009, 2010, and 2011 to the greater of the FY 2008 or 2009 level and (2) restore State support for public IHEs in FYs 2009, 2010, and 2011 to the greater of the FY 2008 or 2009 level.

Another set of assurances that each State must provide in its application addresses the education reform objectives of the SFSF program. States must pledge that they will use the SFSF funds to advance the following education reforms:

1. increase teacher effectiveness and address inequities in the equitable distribution of highly qualified teachers,
2. implement statewide data systems that track pre-K-through-career progress and foster continuous improvement,
3. make progress towards rigorous standards and high-quality assessments, and
4. provide intensive support and effective interventions to struggling schools.

On July 29, 2009, the Department posted the proposed requirements, definitions, and approval criteria for Phase II of the SFSF program in the Federal Register. These requirements focus on the four education reform assurances. However, none of the proposed indicators or descriptors will ensure that States are complying with their MOE assurances in their Phase I application or address how levels of State funding are affecting States' progress toward the education reform objectives.

Potential Consequences of the MOE Requirements

The MOE assurances provide flexibility for States in various budget situations. A State facing a large deficit can avoid reductions in total education funding while a State with a stronger budget situation can increase total education spending to work toward the education reforms. However, we concluded that this flexibility may be resulting in a reduction in some States' funding for public education.

Some States' budget proposals would reduce State support for public education back to the FY 2006 levels and replace the State funds with their SFSF allocation to free up State resources for non-education budget items. Depending on the level of State resources, this could reduce the percentage of the State's revenue spent on public education. Although this reduction may be allowable under the law, it may adversely impact the achievement of the education reforms of the SFSF program.

Examples of the Consequences of the SFSF MOE Requirements

The following examples were obtained from ongoing work being conducted by the OIG in Pennsylvania and from our research relating to Connecticut and Massachusetts. These examples demonstrate how the SFSF MOE requirements are impacting these States' education budget decisions.

[3] The SFSF consists of the Education Stabilization Fund, which is 81.8 percent of the allocation, and the Government Services Fund, which is 18.2 percent of the allocation. (Public Law 111–5 § 14002)

Connecticut

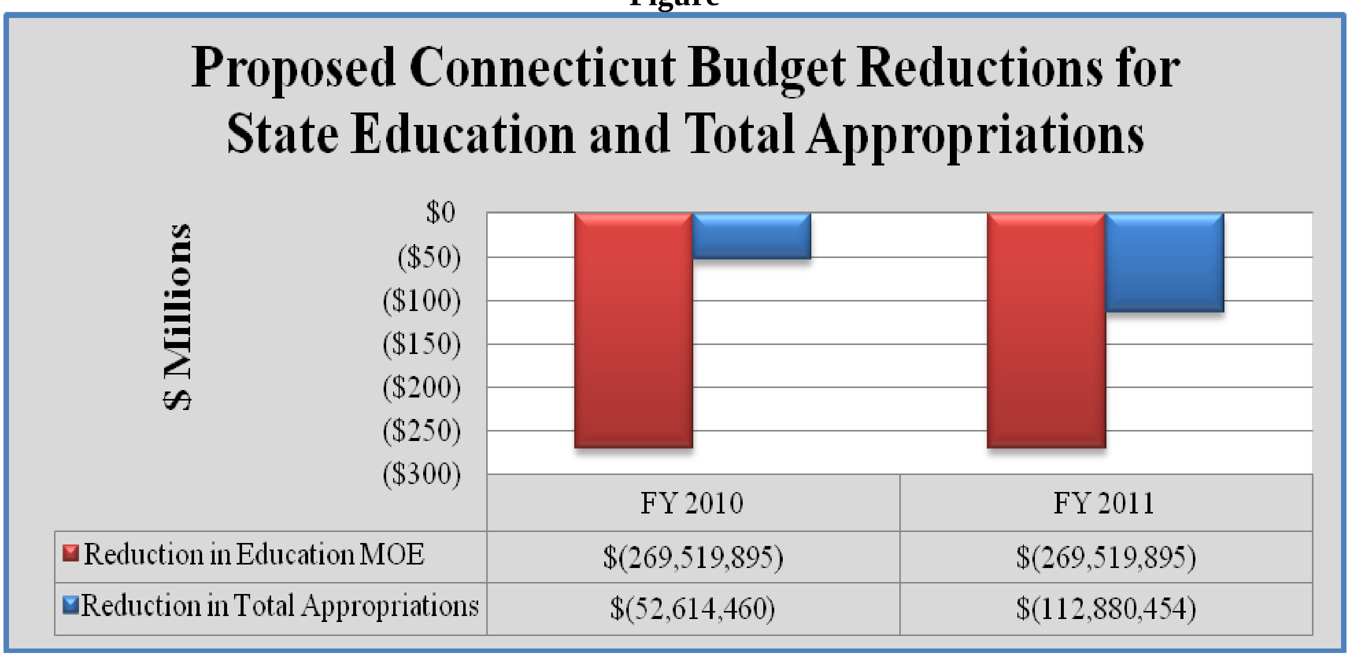
The Governor of Connecticut released her proposed FY 2010 through FY 2011 biannual budget on February 4, 2009. This budget proposed flat funding for the State's primary K-12 funding formula at $1.889 billion in FYs 2009, 2010, and 2011. These figures represent 10.3 percent, 10.02 percent, and 9.67 percent of the State's total appropriations in each of the respective FYs. After passage of the ARRA, the Governor submitted Connecticut's SFSF application to the Department on June 2, 2009. In the application, she reduced State funding for public education to the minimum amount of funding necessary to meet the MOE requirement, funding Connecticut's primary K-12 funding formula at $1.62 billion. This is the same funding as Connecticut's FY 2006 level of effort. Based on the State legislature's budget proposal from April 2009, the $1.62 billion will amount to 8.62 percent of the State's total FY 2010 appropriations ($18.794 billion) and 8.34 percent for FY 2011 ($19.42 billion). The application states that Connecticut plans to use SFSF funds to fill in the budget gap created by the reduction in State resources. The Table and Figure below further illustrate a proposed disproportionate reduction in education funding for both FY 2010 and FY 2011 (i.e. the State's primary elementary and secondary funding formula is being reduced by more than 14 percent while the total State budget is being reduced by less than one percent).

Table – Proposed Connecticut Budget Reductions for State Education and Total Appropriations

	FY 2010		FY 2011	
Proposed Appropriations	State Education	Total Appropriations	State Education	Total Appropriations
Before ARRA	$ 1,889,182,288	$ 18,846,580,428	$ 1,889,182,288	$ 19,532,652,321
After ARRA*	$ 1,619,662,393	$ 18,793,965,968	$ 1,619,662,393	$ 19,419,771,867
Budget Change	**$ (269,519,895)**	**$ (52,614,460)**	**$ (269,519,895)**	**$ (112,880,454)**
Percent Change	**-14.27%**	**-0.28%**	**-14.27%**	**-0.58%**

*State Education data are from the Governor's SFSF application while the Total Appropriations data are from the State legislature's April budget proposal.

Figure



Pennsylvania

In the Commonwealth of Pennsylvania, the Governor and the State legislature, at the time of this memorandum, were in budget discussions over State support for public education. The Governor's office proposed using Pennsylvania's SFSF allocation to increase the State's basic education subsidy[4] by $418 million in FY 2010 and $735 million in FY 2011. The State legislature proposed reducing State support for education and using the SFSF funds to maintain the FY 2010 and FY 2011 basic education subsidy at the FY 2009 level. Pennsylvania currently has a $753 million rainy-day fund. The Governor's proposal would use $250 million of this money in FY 2009 and $375 million in FY 2010 to help close the gap between revenue and expenses. The State legislature's proposal does not use the rainy-day fund. On June 18, 2009, the U.S. Secretary of Education, in a letter to the Governor of Pennsylvania, noted that States' education budget decision could impact future funding opportunities. The letter states that, "If a State has disproportionately reduced its education budget and/or if a State has done nothing more than backfill budget holes with these dollars when the State had other resources available to it, such as a rainy-day fund, the State's competitive position to receive Race to the Top funds and/or other competitive grants may be negatively impacted." As of September 10, 2009, the differences between the budget proposals had not been resolved.

Massachusetts

The Commonwealth of Massachusetts website shows that the Governor's original budget proposal for FY 2009 included a $223.2 million increase to the State's primary K-12 funding formula, Chapter 70 education aid.[5] In October of 2008, the Governor announced reductions to the State budget to address revenue shortfalls, but Chapter 70 funding was unaffected. In January of 2009, the Governor proposed more reductions for FY 2009, but Chapter 70 funding remained intact. In May of 2009, after the passage of the ARRA, the Governor announced a plan to reduce the FY 2009 Chapter 70 appropriation by $412 million and use $412 million from the State's SFSF allocation to fill this gap. This plan was implemented through a reduction in the State's June 30, 2009, Chapter 70 local aid payments as well as instructions for school officials to identify eligible expenses previously charged to the general fund and to initiate journal entries to charge them to the Federal SFSF grant.

In the Governor's SFSF application, signed on May 20, 2009, Massachusetts applied for a waiver of the MOE requirements for public IHEs in FY 2010 and FY 2011, asserting that the State will be unable to fund public IHEs at the FY 2006 level. In order to meet the requirements for the MOE waiver, a State must show that it is spending at least as much State money on education, as a percentage of total revenues, as it did in the previous year. Massachusetts is able to meet this requirement because of its $412 million reduction in the FY 2009 Chapter 70 appropriations, which reduced the percentage of State revenue spent on public education in FY 2009. This reduction in State funding was replaced with SFSF funds. The reduction also allowed Massachusetts to reduce State support for public IHEs below the FY 2006 level for FYs 2010 and 2011 while maintaining the percentage of State revenue spent on public education at least at the FY 2009 level.

[4] Pennsylvania's basic education subsidy is the State's primary fund for basic elementary and secondary education costs.
[5] The Chapter 70 program is the major program of State aid to public elementary and secondary schools in Massachusetts. In addition to providing State aid to support school operations, it also establishes minimum spending requirements for each school district and minimum requirements for each municipality's share of school costs.

Potential Consequences in Other States

The OIG Hotline has received complaints from several States relating to this issue through August 3, 2009.[6] Although we have not performed follow-up research on all of the complaints, they may indicate that the issue could affect additional States, and therefore, could be having a larger impact on the education reforms.

Recommendations

Our audit work and research indicates that the flexibility permitted in the SFSF MOE requirements may be leading to a reduction in State support for public education. Reducing State funding for education and replacing it with SFSF funds, rather than using SFSF to increase support for education, could adversely affect the achievement of the education reform objectives of the program.

In order to address this, we recommend the Department:

1. Implement a process to track State support for elementary and secondary education as well as for public institutions of higher education, as defined in State SFSF applications, to determine the extent to which State funding on public education is being reduced.

2. Establish and implement a process to ensure that States have met the MOE requirements and assurances prior to awarding additional SFSF funding.

Office of Elementary and Secondary Education (OESE) Response

A preliminary copy of this memorandum was provided to OESE for comment. In its response, OESE stated that as the Department began implementing the SFSF program, it became aware that the statutory provision allowing States to comply with the MOE requirements in ARRA by reducing the amount of fiscal support for public education to the FY 2006 level could potentially result in States reducing the amount of such support in FYs 2009 through 2011. The Department took steps to discourage States from reducing such support. For example, in the proposed application requirements for the Race to the Top program, States would be required to show whether and to what extent the percentage of the State's total revenues were used to support public education for FY 2009 as compared to FY 2008.

OESE also stated that it believes that the recommendations in our alert memorandum are reasonable and would further assist in addressing the concerns expressed in the memorandum.

OESE's response is included in its entirety as an Attachment to this memorandum.

[6] All of the OIG Hotline complaints were referred to the Department.

Corrective actions proposed (resolution phase) and implemented (closure phase) by your office will be monitored and tracked through the Department's Audit Accountability and Resolution Tracking System (AARTS).

Alert memoranda issued by the Office of Inspector General will be made available to members of the press and general public to the extent information contained in the memorandum is not subject to exemptions in the Freedom of Information Act (5 U.S.C. § 552).

For further information, please contact Bernard Tadley, Regional Inspector General for Audit, at (215) 656-6279.

Attachment

Electronic cc: Joseph Conaty, Director, Academic Improvement and Teacher Quality Programs
Joanne Weiss, Director, Race to the Top Fund
Phil Maestri, Director, Risk Management Services
Phil Rosenfelt, Deputy General Counsel, Office of General Counsel
Delores Warner, Audit Liaison Officer, Office of Elementary and Secondary Education

ATTACHMENT

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF ELEMENTARY AND SECONDARY EDUCATION

SEP 28 2009

MEMORANDUM

DATE:

TO: Keith West
Assistant Inspector General for Audit

FROM: Thelma Meléndez de Santa Ana, Ph.[redacted]
Assistant Secretary

SUBJECT: Response to Alert Memorandum on the Maintenance of Effort Requirements under the State Fiscal Stabilization Fund
Control Number ED-OIG/L03J0011

The Office of Elementary and Secondary Education (OESE) appreciates the work of the Office of the Inspector General in preparing the Alert Memorandum entitled *Potential Consequences of the Maintenance of Effort Requirements under the American Recovery and Reinvestment Act of 2009*. As Department staff began implementing the State Fiscal Stabilization Fund (SFSF) program, they became aware early in the implementation process that the statutory provision allowing States to comply with maintenance of effort requirements in section 14005(d) of the American Recovery and Reinvestment Act of 2009 by maintaining fiscal support for elementary and secondary education, and postsecondary education at the fiscal year 2006 level could potentially result in States reducing the amount of such support in fiscal years 2009, 2010, and 2011. The Department took steps to discourage States from reducing such support. For example, on July 29, 2009, the Department published a Notice of proposed priorities, requirements, definitions, and selection criteria in the Federal Register for the Race to the Top program. In that Notice, the Department proposed as an application requirement that a State provide financial data to show whether and to what extent the percentage of the total revenues available to the State (as defined in this notice) that were used to support elementary, secondary, and public higher education for FY 2009 increased, decreased, or remained the same compared to FY 2008. The Department also wrote to the Governor of Pennsylvania discouraging such reductions.

OESE appreciates the opportunity to comment on the OIG's Alert Memorandum and believes that the recommendations are reasonable and would further assist in addressing the concerns expressed in the Alert.

Anyone knowing of fraud, waste, or abuse involving U.S. Department of Education funds or programs should call, write, or e-mail the Office of Inspector General.

Call toll-free:
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1-800-MISUSED (1-800-647-8733)

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U.S. Department of Education
Office of Inspector General
400 Maryland Avenue, SW
Washington, DC 20202-1500

Or e-mail:
oig.hotline@ed.gov

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