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# financial management of federal-state education programs

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## Introduction

Cooperative activities involving the States and the U.S. Office of Education have been a tradition since the establishment of the Office. In recent years the scope, extent, and magnitude of such programs have increased substantially. These programs provide grants for vocational education under the George-Barden and Smith-Hughes Acts, the Area Redevelopment Act, and the Manpower Development and Training Act; grants for rural library services; and grants for the improvement of science, mathematics, and foreign language instruction; guidance, counseling, and testing; and statistical services under the National Defense Education Act. The programs for assistance to schools in federally affected areas under Public Law 815 and Public Law 874 are excluded because they are not administered directly by a State agency under a State plan or agreement.

Federal support for education has been expanded over a long period of time under a variety of statutes. Operating procedures under these programs have developed on the basis of the circumstances prevailing at the time of their inception and in the light of specific legislative requirements. Despite the differing nature of their objectives, there is one element which is common to all of the various programs—the management of money. This bulletin summarizes some basic principles to be applied to the management of the funds involved in a program regardless of the purpose for which the funds are provided. Specific details concerning accounting classifications and the structure of accounting records for receipts and expenditures are contained in OE Bulletin 1957, No. 4, *Financial Accounting for Local and State School Systems* (Handbook II).

## Identification of Specific Programs

The history of Federal aid to States and local communities shows that Federal funds have been provided for particular purposes and objectives established by Congress. The degree of specific mention of these purposes and objectives has varied greatly. However, the Congress, in providing funds for roads, hospitals, water pollution, and education, has not intended that the aggregate of these funds be pooled and that recipients allocate the aggregate in whatever pro-

portion they desire. The administrative and financial structure within a State must therefore provide readily for separate identification of funds for each program in the accounts and records maintained by the State.

In providing Federal funds for education, Congress has identified specific educational objectives to be achieved by each program. It is therefore necessary that Federal funds for education paid to a State for use by the State and/or local agencies, be identified at State and local agency levels with the purposes for which the funds were provided.

The individuality of State and local agencies is the result of the differences in State and local statutes, regulations, needs, and desires. The principles summarized in this bulletin are based on sound business and professional practices found in actual operation in many States and local agencies.

## **Responsibility for Administration and Management of Federal Funds for Education Allotted to States**

Each statute authorizing a cooperative Federal-State program in education provides that the State agency designated by the State is the sole agency responsible for administering the program. Administration in all cases includes fiscal accountability of the Federal funds made available for the implementation of the authorized program.

The statutes also provide for a State plan or agreement which encompasses specific aspects of the program and financial administration activities of the responsible State agency. The plans and agreements provide for such administration in conformity with laws, rules, and regulations in effect in each State.

### **State Agency Activities**

#### **State Plan or Agreement**

The State plan or agreement is the basic document governing operations under each Federal-State program. One of the most important aspects in the management of State level activities is the periodic review of the State plan or agreement to insure that it is current in relation to State laws, policies, and procedures applicable to the receipt and expenditure of funds. This review should be conducted at least annually, and should include all statutes, court decisions, and administrative regulations issued since the last review.

## **Accounting Records**

Accounting records constitute the basis of financial management. It is essential that the accounting records for State agency activities provide the information needed to identify adequately the receipt and expenditure of all funds. The type and format of accounting records are matters which individual States decide on the basis of their own requirements. Within the type and format selected, it is essential that the receipts and expenditures be identified clearly with the specific program for which the Federal funds were appropriated. Within each specific program, receipts should be identified as Federal, State, local, or from some other source, such as a refund, contribution, etc. Expenditures for each program also should be classified by type of expenditure. Most States require an accounting system which identifies certain categories of expenditures, such as personal services, equipment, supplies, travel, etc. In almost all cases the normal classification used by the State will suffice for the usual Federal fiscal reports required. Under Federal programs which involve payments by the State agency to local agencies, the accounting records of the State should identify separately for each program the reimbursements and/or advance payments made to each local agency. The recording of the total amount of each payment to each local agency will be adequate; detailed classification by type of expenditure included in the payment is not necessary.

## **Supporting Documentation**

The accounting records for State level activities must be related to supporting documentation. It is essential that each entry in the accounting records refer to the documentation which supports the entry and that the documentation be filed in such a way that it can be readily located. Supporting documentation for purchases should include copies of the purchase order and/or purchase requisition, contracts, invoices, receiving reports, and canceled checks or warrants. In addition, inventory records should be maintained for equipment items purchased.

The payroll records of the State agency usually will provide a form of documentation which will suffice for those employees engaged full time in a single activity. When employees' time is prorated, official personnel actions, job sheets, and/or official assignment schedules should support their assignment of time to two or more activities. These records should then be substantiated periodically by after-the-

fact time reports, supervisors' reports, time studies, or other formal evidence showing that the employees actually spent the prorated portion of their time on the assignments indicated.

### **Financial Statements**

An important aspect in the management of State level activities is the periodic review of financial statements by program administrators of the appropriate State agency. This review should be used by program administrators to

1. Relate program activity to funds expended
2. Relate funds expended to the budget
3. Provide the basis for future program plans and budget estimates.

Program administrators should communicate to financial personnel the type of information they need in order to manage programs effectively. Conversely, financial personnel should inform program administrators of the significant aspects of the information contained in financial statements. Financial management operations can contribute much to successful program operations, but this contribution depends upon frequent and effective communication between program personnel and financial personnel. Accounting is necessary to assure adequate control of funds, but it is also an effective tool of management. The degree of its effectiveness as a tool of management is dependent upon how management receives and uses such information.

### **Local Agency Activities**

The direct results of Federal-State grant programs are felt at the local agency level. It is there that the people for whom the programs were enacted are involved directly in activities designed to accomplish the objectives of the program.

It is also at the local agency level where most of the decisions are made on those specific items for which grant funds are expended. More importantly, the basic decisions on the use of the equipment and services acquired with grant funds are made at the local agency level.

### **Accounting Records**

The accounting records of local agencies are the basic records which reflect the decisions made on the expenditures of grant funds. Gen-

erally speaking, the accounting records at the local agency level should reflect the same kind of information required for State agency activities. Receipts and expenditures applicable to Federal programs should be identified separately by specific program. Expenditures should also be identified by type of expenditure, such as personal services, equipment, supplies, etc. In addition, expenditures should be referenced to each project or program approved for Federal participation. It is not uncommon for a local agency to submit two or more project applications during a fiscal year for participation in the same program or in two or more programs. Nor is it unusual for the same items to be purchased during the year under a project approved for Federal participation and to be purchased also as part of the regular program of the local agency. The identification of expenditures with each approved project or program simplifies the problem of identifying in the regular accounting records those expenditures applicable to the Federal program.

### **Supporting Documentation**

Supporting documentation for entries in the accounting records is very important at the local agency level as well as at the State agency level. In some programs the same problems of prorating employee time exist at the local agency level as at the State agency level, and the same general rules cited in the preceding section apply.

There are two aspects of documentation at the local agency level which warrant careful attention by local agency administrators. The first of these is the documentation of receipt of material and equipment purchased. Although in many cases formal receiving reports are not necessary, there should at least be a notation on the invoice, signed by an appropriate official, that the goods billed on the invoice were received in good condition and in the quantities indicated on the invoice.

The second aspect is the keeping of an equipment inventory. Although an inventory of equipment at the local agency level may not be required, such records are recommended as an effective tool in the management of the property of a local agency. They are useful to determine the level of casualty insurance; to support insurance claims; to plan a replacement program; to establish purchasing priorities; and to allocate equipment among two or more similar facilities.

### **State Agency Records of Local Agency Activities**

If all local agencies maintain detailed accounting records for individual transactions, there is no necessity for detailed accounting of local agency transactions by the State agency.

Two basic documents showing the financial relationship between the State and a local agency are (1) the local agency project or program application, and (2) the local agency claim for reimbursement.

It is important that the files of the State agency reflect its review and approval of local agency project or program applications. The amount of each approved application should be entered in a control record to provide necessary statistical data and to assure that applications are not approved in excess of the funds available for the particular program.

Local agency claims for reimbursement should be reviewed and compared in detail with the approved project or program application to assure that the claim for reimbursement does not include items which were not approved by the State. Although varying amounts of paperwork may be involved, State agencies should require that local agencies provide documentation, such as copies of purchase orders and receipted invoices, supporting the claim for reimbursement. This supporting documentation should include evidence that all pertinent legal requirements, such as bidding, installation permits, etc., have been met. This type of supporting documentation permits a reasonable preaudit of the claim for reimbursement, and facilitates comparison of the claim with the approved project or program application.

It may be argued that an effective postaudit of participating local agencies eliminates the need for supporting documentation to accompany a local agency claim for reimbursement. However, a postaudit by definition contemplates an audit at a date subsequent to the date that the reimbursement transaction occurred.

In many cases the postaudit may be as much as 3 years after the date the transaction occurred. Prudent and effective administration includes providing the administrator with as much information as possible at the time a decision is to be made. The decision on the amount of the reimbursement to a local agency can be made much more effectively and much more prudently if supporting documentation accompanies the local agency claim for reimbursement.

Local agency claims for reimbursement must necessarily be recorded in the accounting records of the State agency since they represent a charge against Federal funds. These entries need be in total only for each claim under each project without itemization of the detail reflected in the claim. In addition, the claims should be recorded in statistical records to provide program information, including the difference between the estimated amount approved and the amount actually expended and reimbursed.

If Federal funds are paid to local agencies before the State receives documentation supporting local agency expenditures, such payments do not constitute expenditures of Federal funds. They are merely



advances which must be accounted for and supported by adequate documentation. If the local agency expenditures are less than the total amount advanced, a refund or other adjustment from the local agency must be made.

Another significant record which should be maintained at the State level is a copy of the audit report covering the local agency project or program. If the audit function is performed by the State agency which administers the program this usually poses no problem. When this is not the case, arrangements to secure copies of audit reports should be made with either the appropriate State agency or the local agencies.

## **Audits of State and Local Agency Activities**

### **General**

One of the overriding considerations in the development of audit programs for both State agency and local agency activities is that these audit programs must be consistent with State plan or agreement requirements and with general State requirements for audit activities. The audit programs should be developed in accordance with generally accepted auditing standards, with due consideration for Federal and State policies, procedures, and regulations applicable to each program.

For maximum benefit to the State agency, the audit program should provide that the audit report include separate financial schedules or statements identifying the receipts and expenditures applicable to each State-administered program in which the local agency participated. Receipts should include receipts for interest, sales proceeds, refunds, discounts, etc., which are related directly to the federally aided programs involved.

In order to avoid misunderstandings and to insure adequate audit coverage, the appropriate State officials should approve written State policies on the scope, extent, nature, and frequency of audits of State agency and local agency activities. There should also be an appropriate written statement identifying the individual or agency to whom the audit responsibility is assigned, and the individual or agency who is to perform the audits.

The audit instructions, audit programs, and audit workpapers for each audit should be available, upon reasonable notice, for review by appropriate State officials and by representatives of the U.S. Government. These documents should include the method and extent of tests, examinations, and other techniques used in making the verifications required by specific audit steps.

## **Specific Audit Steps**

For audits of local agencies, it is essential that specific audit instructions be developed to verify that

1. Funds disbursed by the State to the local agency were received and properly accounted for
2. Payments reported by the local agency were actually made to the vendors, contractors, and employees and that they conform to applicable laws and regulations, including procurement requirements
3. Refunds, discounts, etc., were properly credited to the specific programs as reductions of the gross expenditures
4. Payments are supported by adequate evidence of the delivery of goods or performance of services
5. Encumbrances or obligations included in the report of expenditures were actually incurred during the fiscal year for which the expenditure was claimed and, upon liquidation, were adjusted properly for any differences
6. The same item is not reported as an expenditure for 2 or more years, e.g., encumbrance in one year and payment in another
7. All expenditures claimed for federally supported projects were made for properly approved projects, are easily identifiable with these projects, and are the individual items adequately described in the approval and the claim for reimbursement
8. State and local agency rules applicable to equipment records and control are followed
9. Prorated expenditures, such as salaries, travel, etc., are divided correctly between two or more accounts, and that the basis of such division is reasonable, equitable, and substantiated
10. The type of funds expended for federally reimbursed projects are stated correctly; that Federal funds from one program are not used for matching purposes under another Federal program, except as specifically authorized; and that the same expenditures are not claimed for matching purposes under more than one Federal program
11. Unexpended or unearned Federal funds advanced or overpaid are returned promptly or otherwise correctly accounted for
12. If the local agency is on a fiscal year different from the Federal fiscal year, the audit report reflects outstanding obligations as of June 30 in sufficient detail to permit identification of subsequent payments with the applicable obligation and comparison with reports submitted by the local agency to the State agency.

## **Coordination of Preaudit, Program Review, and Postaudit Functions**

Three functions which provide a program administrator with information concerning the progress and development of a program are preaudit, program review, and postaudit. Previous sections of this bulletin have dealt with the importance of adequate supporting documentation which should be subject to a preaudit before expenditures are authorized. Program review functions have long been a regular part of State and local agency supervisory and consultative services. The scope and extent of program reviews vary greatly, and are governed principally by the nature of the program, the policies of the State and local agencies, the availability of staff, and the administrator's concept of the program. Postaudits also vary greatly in scope and extent and are affected principally by State and local statutory requirements and availability of staff. Program administrators should not unduly stratify each of these functions. Rather, program administrators should consider carefully all of the verifications and information necessary to them for the efficient operation of the program. Resources should then be allocated to these three functions in such a way that the program administrator will be assured of sufficient information and adequate verifications. In short, successful program operations require the constant coordination of preaudit, program review, and postaudit functions so as to provide maximum information and verification at a minimum cost and in a timely manner.

### **Common Problem Areas**

#### **Expenditures**

Difficulties frequently arise because administrators, accountants, and auditors do not always have the same understanding of what is meant by "expenditure." It is important that all persons engaged in cooperative Federal-State programs have a clear and common understanding of this term. The definition of an "expenditure" must be related to a specific fiscal year within each individual State. An "expenditure" under a federally supported program must be consistent with the rules established within a State to define the "expenditure" of State and local funds. Following are examples of variations in the definitions of the term "expenditure" in different States and local agencies:

1. In some States an "expenditure" is made when funds are paid to the individuals who furnished the services, materials, or equipment. (Cash basis of accounting.)

2. In some States an "expenditure" is made when goods have been delivered or services have been performed. (Accrual basis of accounting.)
3. In some States an "expenditure" is made when a purchase order is issued or a contract is signed. (Obligation basis of accounting.)
4. In some States, funds appropriated for a specific fiscal year are considered to be expended when a requisition is formally issued during that fiscal year to the State's centralized purchasing department, even though a purchase order may not be actually issued before the end of the fiscal year.

Consistent application of the accounting basis determined by the definition of "expenditure" is essential. This consistency must be reflected in the accounting records, financial reports, and audit reports from year to year.

It should be pointed out that in those cases where State and local rules provide for expenditures to include orders placed with vendors, the State agency should receive a detailed report of such obligation or encumbrance items from each local agency as of the end of the Federal fiscal year (refer to specific audit steps 5, 6, and 12 on p. 8).

If the fiscal year for a State and/or its local agencies is different from the Federal fiscal year, the State and/or local rule which defines an expenditure for a fiscal year must be applied as of June 30 in the preparation of expenditure reports for Federal programs. For example, a State may have a fiscal year ending March 31 and State rules permit the definition of expenditures to include purchase orders outstanding as of March 31, if they are paid for within 30 days from issuance. This same 30-day rule must apply to purchase orders outstanding on June 30 in order to include such purchase orders in an expenditure report for Federal programs.

It is important to note that approval by the State of a project or program submitted by a local agency does not constitute an expenditure at the time of approval. Similarly, a payment to a local agency in advance of expenditure action by the local agency is not an expenditure at the time the advance is made.

### **Audit Exceptions:**

An audit exception is a determination by an appropriate authority that an item questioned by the auditor as not properly chargeable to the program should be disallowed. The U.S. Commissioner of Education is the official who determines the allowance or disallowance of items in U.S. Office of Education programs which are questioned by the auditor.

Audit exceptions should be recorded promptly and appropriate adjustments of State and/or local agency records should be made. To the extent that State and local rules and regulations permit such a practice, audit exceptions should be cleared by actual cash transactions between the local agency, the State, and the U.S. Office of Education. This practice is recommended because it usually provides the simplest method for handling audit exceptions as well as adequate supporting data in the accounting records for these exceptions. If audit exceptions are cleared by a deduction from subsequent payments, the accounting records and supporting documentation should reflect fully all of the factors considered in the computation of the net payment.

### **Federal Audit Programs**

The audit of Federal grants to States for education is the responsibility of the Division of Grant-in-Aid Audit of the U.S. Department of Health, Education, and Welfare. This Division reports administratively through the Office of Field Administration to the Secretary; audit reports are submitted to the heads of operating agencies in the Department for disposition of audit findings.

The activities of the Department of Health, Education, and Welfare, including the Office of Education, are in turn audited by the General Accounting Office, an independent agency in the legislative branch of the Federal Government reporting directly to the Congress. Under the authority of various laws (31 U.S.C. 53; 31 U.S.C. 67), the General Accounting Office examines the manner in which Federal agencies discharge their financial responsibilities.

Where federally aided programs are administered at several levels—Federal, State, and local—the General Accounting Office examinations may include audits at the State and local levels to ascertain the effects of the Federal agency administration at these levels. While the General Accounting Office examinations are independent of those conducted by the Department, appropriate consideration is given to the effectiveness of the Department's audits as well as audits performed by State and local agencies.

The U.S. Office of Education has a central Fiscal Advisory and Audit Section whose staff is available to program personnel of the Office of Education as well as to program and administrative personnel of State and local agencies for technical advice and assistance in the areas of fiscal control, accounting, and audit. It is the purpose of this Section to be of assistance in the formulation of sound financial management practices which will enable agencies handling Federal funds to account readily for such funds and to minimize fiscal adjustments resulting from Federal postaudits.