



**U.S. Department of Education
Office of Inspector General**



American Recovery and Reinvestment Act of 2009

**Systems of Internal Controls over Selected
Recovery Act Funds in Puerto Rico**

Audit Report



Puerto Rico Capitol Building



UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

Audit Services
Region IV

December 16, 2010

Hon. Luis G. Fortuño
Governor of Puerto Rico
Office of the Governor
P.O. Box 9020082
San Juan, Puerto Rico 00902-0082

Hon. Jesús Rivera Sánchez
Secretary
Puerto Rico Department of Education
P.O. Box 190759
San Juan, Puerto Rico 00919-1759

Dear Hon. Fortuño and Hon. Rivera Sánchez:

This **final audit report**, Control Number ED-OIG/A04K0001, presents the results of our review of the designed systems of State-level internal control over American Recovery and Reinvestment Act funds in Puerto Rico for the Governor's Office and the Puerto Rico Department of Education.

Statements that managerial practices need improvements, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determinations of corrective actions to be taken, including the recovery of funds, will be made by the appropriate Department of Education officials in accordance with the General Education Provisions Act.

If you have any additional comments or information that you believe may have a bearing on the resolution of this audit, you should send them directly to the following Education Department officials, who will consider them before taking final Departmental action on this audit:

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It is the policy of the U. S. Department of Education to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, receipt of your comments within **30 days** would be appreciated.

In accordance with the Freedom of Information Act (5 U.S.C. § 552), reports issued by the Office of Inspector General are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

Sincerely,

/s/

Denise M. Wempe
Regional Inspector General for Audit

Abbreviations/Acronyms Used in This Report

AP	Accounts Payable
ARRA	American Recovery and Reinvestment Act
ASSE	Associate Secretariat of Special Education
C.F.R.	Code of Federal Regulations
CFDA	Catalog of Federal Domestic Assistance Number
CMIA	Cash Management Improvement Act of 1990
CMU	Compliance Monitoring Unit
COOP	Continuity of Operations Plan
Computer Automation	Computer Automation Systems, Inc.
CPO	Central Procurement Office
Department	U.S. Department of Education
ESF	Education Stabilization Fund
FMU	Fiscal Monitoring Unit
GDB	Government Development Bank
Governor's Office	Office of the Governor
GSF	Government Services Fund
Hacienda	Departamento de Hacienda (Puerto Rico Department of Treasury)
IDEA	Individuals with Disability Education Act, Part B
MOE	Maintenance of Effort
MU-OFA	Monitoring Unit of the Office of Federal Affairs
OESE	Office of Elementary and Secondary Education
OIG	Office of Inspector General
OIPS	Office for Improvement of Public Schools
OMB	Office of Management and Budget
OSERS	Office of Special Education and Rehabilitative Services
PRDE	Puerto Rico Department of Education
PRIFA	Puerto Rico Infrastructure Financing Authority
RMU	Regional Monitoring Unit
SER	Sociedad de Educación y Rehabilitación de Puerto Rico (Society of Education and Rehabilitation)
SFSF	State Fiscal Stabilization Fund
SIFDE	Sistema Información Financiera del Departamento de Educación (Financial Information System of the Department of Education)
SEA	State Educational Agency
Title I	Title I, Part A of the Elementary and Secondary Education Act
TSA	Treasury State Agreement
UPR	University of Puerto Rico
U.S. Treasury	U.S. Department of the Treasury
VRA	Vocational Rehabilitation Administration

PURPOSE

The American Recovery and Reinvestment Act of 2009 (ARRA) places a heavy emphasis on accountability and transparency, and in doing so, increases the overall responsibilities of agencies impacted by the Act. The U.S. Department of Education (Department) is responsible for ensuring that the education-related ARRA funds reach intended recipients and achieve intended results. This includes effective implementation and control of funds at the Federal level, as well as ensuring that recipients understand requirements and have proper controls in place for 1) administering and reporting ARRA funds, and 2) promptly identifying and mitigating instances of fraud, waste, and abuse of the funds.

The purpose of our review was to determine whether agencies charged with responsibility for overseeing ARRA funds have designed systems of internal control that are sufficient to provide reasonable assurance of compliance with applicable laws, regulations, and guidance. Proper internal controls are essential for ensuring ARRA funds are adequately administered and used in ways that coincide with the intent of ARRA. This report provides the results of our review of the Puerto Rico Department of Education (PRDE), the Commonwealth of Puerto Rico's Office of the Governor (Governor's Office), and three of the Governor's Office's subgrantees.¹ We focused our review on the design of State-level controls over data quality, cash management, subrecipient monitoring, and use of funds. These controls cover the key aspects for proper administration of ARRA funds for Title I Part A of the Elementary and Secondary Education Act (Title I); Individuals with Disability Education Act Part B (IDEA);² and the State Fiscal Stabilization Fund (SFSF) programs.

Because ARRA was in its early stages when we started our review in June 2009, the Governor's Office requested additional time before we started our review of controls related to the SFSF program. The Governor's Office stated that it had established general controls to provide reasonable assurance that SFSF funds would be used in accordance with the requirements governing ARRA; however, it was waiting to receive the grant award notifications to implement more specific controls. Therefore, we focused our first ARRA audit in Puerto Rico on the designed systems for the Vocational Rehabilitation Administration's (VRA) controls over those funds. The results of our work at the VRA were presented in a report issued on December 14, 2009.³ In October 2009, we started our review of controls at the Governor's Office and three of its subgrantees, including PRDE as both subgrantee of SFSF and grantee of Title I and IDEA funds.

RESULTS IN BRIEF

In our assessment of the designed systems of internal control,⁴ we found that officials from the Governor's Office and its subgrantees, including PRDE, were working diligently and proactively to ensure proper administration of ARRA funds. Specifically, the Puerto Rico Government created a Task Force to oversee ARRA administration in Puerto Rico. The Task Force operates through the Puerto Rico Infrastructure Financing Authority (PRIFA), which was legally designated to provide support and guidance to government agencies, public corporations, and municipalities managing ARRA funded

¹ PRDE, the Puerto Rico Infrastructure Financing Authority, and the University of Puerto Rico.

² IDEA includes only Grants to States.

³ The Puerto Rico Recovery Act Audit, Vocational Rehabilitation Administration Audit Report, ACN: A04J0009 can be found at: <http://www2.ed.gov/about/offices/list/oig/areports.html> under the Office of Special Education and Rehabilitative Services.

⁴ We reviewed planned systems of internal controls for ARRA funds at PRDE, for the Title I and IDEA programs, and at the Governor's Office for the SFSF.

projects and programs. The Governor's Office (1) created a Web site⁵ to provide information to the public about the uses of ARRA funds, and (2) provided training to subgrantees on ARRA compliance. In addition, a government-wide database was created to collect data from all government agencies to facilitate the compilation and review of information, as well as to assist in making the data available to the public. Agencies receiving ARRA funds were required to submit monthly reports to the Governor's Office to be reviewed by Task Force personnel. This review was intended to ensure reported data were accurate and reliable before grantees of ARRA funds submitted quarterly reports to the Federal reporting Web site in accordance with Section 1512 of ARRA. The Governor's Office's quarterly report included information for all of its subgrantees. We commend PRIFA for its invoice review process and its immediate actions to address and resolve violations of the Davis Bacon Act. As discussed in the *Other Matters* section of this report, PRIFA's review identified violations of the Davis Bacon Act and it took immediate actions to address the issue.

Despite the positive efforts taken thus far on ARRA, we found that the Governor's Office and its subgrantees, including PRDE, needed to strengthen systems of internal control to ensure ARRA funds are properly administered. Specifically, we found that –

- The Governor's Office had insufficient controls over cash management;
- PRDE and the Governor's Office did not sufficiently monitor their use of ARRA funds and subgrantees to ensure adequate oversight;
- PRDE was not effectively monitoring the procurement process;
- PRDE lacked documentation to support payments made with IDEA ARRA funds and compliance with the contract awarding requirements included in Section 1554 of ARRA;⁶ and
- PRDE and the Governor's Office, including PRIFA, had insufficient internal controls for safeguarding information.

Because our review was limited to assessing the design of the internal controls over data quality, cash management, subrecipient monitoring, and use of funds, there may be weaknesses in other areas not reviewed.

In response to the preliminary audit report, the Governor's Office disagreed with our findings and recommendations and PRDE disagreed in part with our findings and recommendations. However, both responses included proposed corrective actions to resolve the findings, comply with the requirements of ARRA, and/or improve operations.

Based on the comments and the additional documentation received, we converted the Preliminary report Finding 1 related to the Governor's Office and two sub-sections in the Preliminary Finding 3 related to PRDE – “No Written Procedures – Calculating and Remitting Earned Interest Timely” and “No Written Procedures – Verifying Payments Before Requesting Reimbursement” to the *Other Matters* section in the report; and renumbered the Preliminary report Findings 2, 3, 4, 5, and 6 – Finding 2 was moved to

⁵ www.buengobiernopr.com.

⁶ ARRA Section 1554 requires that ARRA funded contracts be awarded as fixed price contracts through the use of competitive procedures.

Finding 5 and Findings 3 – 6 are now Findings 1 – 4. In addition, we revised the renumbered Findings 2, 3, and 4 as follows.

- Finding 2 (Preliminary Finding 4) and the related recommendations to reflect PRDE’s responsibilities to monitor grant and subgrant supported activities to ensure compliance with applicable Federal requirements;
- Finding 3 (Preliminary Finding 5) to clarify Article 81 of PRDE’s Procurement Policies and Procedures; and
- Finding 4 (Preliminary Finding 6) and the related Recommendations 4.1 and 4.2 to emphasize that PRDE did not provide sufficient documentation to support that services were rendered in accordance with any agreement established between PRDE and Computer Automation Systems, Inc. (Computer Automation), and that PRDE complied with Section 1554 of ARRA.

The comments are summarized at the end of each finding. The entire narrative of the Governor’s Office and PRDE’s comments are included as Enclosures to this report.

BACKGROUND

ARRA was signed into law on February 17, 2009, in an unprecedented effort to jumpstart the American economy. ARRA has three immediate goals: (1) create new jobs and save existing ones, (2) spur economic activity and invest in long-term growth, and (3) foster unprecedented levels of accountability and transparency in government spending. To ensure transparency and accountability of ARRA spending, recipients are required under Section 1512 of ARRA to submit quarterly reports on ARRA awards, spending, and jobs impact. According to the Office of Management and Budget (OMB), the reports, which contain specific detailed information on the projects and activities funded by ARRA, will provide the public with an unprecedented level of transparency into how Federal dollars are being spent. They will also help drive accountability for the timely, prudent, and effective spending of ARRA funds.

Puerto Rico is expected to receive \$1.3 billion in education-related ARRA funds. Data in Table 1 and Table 2 are restricted to funds related to the Title I, IDEA, and SFSF programs as the audit scope is limited to the review of these programs. On April 1, 2009, the Department released 50 percent of the ARRA funds for the Title I and IDEA programs. The remaining funds were released on August 31, 2009. PRDE administered the Title I and IDEA grant funds and was allocated \$386.4 million and \$109.1 million, respectively (See Table 1).

Table 1 – ARRA Allocations to PRDE		
CFDA NO.	PROGRAM	AMOUNT (\$)
84.389A	Title I Grants to Local Educational Agencies	386,407,681
84.391A	Special Education State Grants	109,098,472
	TOTAL	\$495,506,153

In addition, the Governor’s Office was allocated \$647.6 million in SFSF funds, which included \$529.7 million (81.8 percent) for the Education Stabilization Fund (ESF) and \$117.9 million (18.2 percent) for the Government Services Fund (GSF) (See Table 2).

CFDA NO.	PROGRAM	AMOUNT (\$)
84.394A	Education Stabilization Fund	529,741,859
84.397A	Government Services Fund	117,864,326
	TOTAL	\$647,606,185

The Governor's Office identified six subrecipients for the \$647.6 million in SFSF funds received (See table 3).

CFDA NO.	PROGRAM	AMOUNT (\$)
84.394A (ESF)	1. Puerto Rico Department of Education	359,302,000
84.394A (ESF)	2. University of Puerto Rico of Puerto Rico	105,000,000
84.394A (ESF)	3. Conservatory of Music of Puerto Rico	1,583,000
84.394A (ESF)	4. School of Plastic Arts	798,000
	Leftover for obligation in fiscal year 2010-2011	63,058,859
84.397A (GSF)	5. Puerto Rico Infrastructure Financing Authority	86,786,326
84.397A (GSF)	6. Puerto Rico Police Department	31,078,000
	TOTAL	\$647,606,185

FINDINGS AND RECOMMENDATIONS

FINDING NO. 1 – Insufficient Controls Over Cash Management

Although the Governor’s Office had an acceptable payment system in place to meet its immediate cash needs and those of its subgrantees for ARRA funds, the Governor’s Office did not have written procedures for the payment process. Specifically, the Governor’s Office had no written procedures documenting the payment process, including requirements for the payment method (reimbursement or advance).

The Governor’s Office, as the prime recipient of ARRA SFSF, used the reimbursement method to fund its subgrantees under the SFSF. The Governor’s Office required its subgrantees to submit requests for reimbursement accompanied by supporting documentation of expenditures. The supporting documentation was reportedly reviewed by staff of the Governors’ Office before funds were drawn down from the U.S. Treasury and paid to the subgrantees. According to Article IV of the Memorandum of Understanding between the Governor’s Office and subgrantees, subgrantees must prepare and submit to the Governor’s Office a drawdown request indicating the exact amount of funds requested.

In our review of the Governor’s Office cash drawdowns as of October 2009, which consisted of 14 drawdowns totaling \$74.8 million, we found that 1 PRDE and 4 University of Puerto Rico (UPR) requests for cash drawdowns (as subgrantees) did not include adequate supporting documentation to provide reasonable assurance that payments had been made before the subgrantees requested reimbursement.

⁷ On May 27, 2009, the Department made available to the Governor’s Office \$433.9 million (67 percent of its total allocation) in SFSF, which included \$354.9 million in ESF and \$79 million GSF. On July 1, 2009, the Department made available remaining 33 percent in GSF (\$38.9 million). On September 27, 2010, the Department made available the remaining 33 percent in ESF (\$174.8 million) to the Governor’s Office.

Specifically, the requests did not include documentation indicating that the services for which the funds were requested had been provided and paid by PRDE and the UPR. PRDE's request included a document entitled "Reporting Information for the Puerto Rico Stabilization Fund." Although the document included important information,⁸ it did not include the purpose for which the funds were used and was not signed by an authorized official. UPR's request included a list of the positions and salaries, as the basis for the reimbursement; however, there was no evidence that the list had been reviewed and verified as accurate and complete. In summary, there was no evidence to indicate the Governor's Office reviewed subgrantees' documentation for accuracy and completeness prior to its reimbursement of reported expenditures.

According to 34 Code of Federal Regulations (C.F.R.) § 80.20(a),

...Fiscal control... must be sufficient to: (2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

Further, 34 C.F.R. § 80.21 states that

the payment system must consist of methods and procedures which minimize the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by the grantee or sub-grantee.

The regulations identify reimbursement as the preferred method of payment but allow for cash advances if the grant recipients demonstrate the willingness and ability to maintain procedures to minimize the time between receipt and disbursement of funds to pay program costs.

Officials in the Governors' Office acknowledged that subgrantees were orally instructed to submit supporting documentation with their requests for funds and that there were no written procedures to facilitate or document a review of subgrantee submissions. Without written guidance and procedures, we found that subgrantees did not submit documentation necessary to support reimbursement of incurred expenditures. Also, without written procedures for documenting the Governor's Office's review, subgrantees may not be adequately and consistently monitored. Documented procedures are necessary to establish and communicate controls to ensure consistent and effective processes and system continuity.

Recommendation

We recommend that the Assistant Secretary for OESE in conjunction with the Office of the Chief Financial Officer require—

- 1.1 The Governor's Office to develop written procedures for documenting its payment and review process to include detailing the type of documentation subgrantees need to provide to support a request for payment and to minimize the time elapsing between the receipt and payout of funds.

⁸ The document included the name of the agency, grant award number, CFDA, project name, Data Universal Numbering System, project grant period, award date, amount of award, the amount expended for the month, and the name of the Finance Director with no signature.

Governor's Office Comments

The Governor's Office disagreed with the finding, stating that it has written procedures for the ARRA payment process. Specifically, as part of the terms and conditions of the contracts with its subgrantees, the Governor's Office stated that Article IV Disbursement Duties requires that its subgrantees –

- Agree that the grant received from the Governor's Office will be managed separately from the rest of subgrantee's funds.
- Acknowledge that grant funds will not be disbursed until a drawdown request form is completed and delivered to the Governor's Office. The drawdown form will provide the Governor's Office with the exact amount of the disbursement to be made to the subgrantee and disbursement will not be authorized without delivery of a fully completed drawdown form.

The Governor's Office added that it has begun to strictly enforce the terms and conditions for disbursement contracts, including requiring documentation for the intended use of funds and official certification.

According to the Governor's Office, it follows the Puerto Rico Department of Treasury's (Hacienda)⁹ cash management and payment procedures when managing SFSF transactions. In addition, the Governor's Office stated that it has offered technical assistance to its subgrantees on the payment procedures and the SFSF-specific drawdown flowcharts. The Governor's Office added that the monitoring plan for the SFSF, Part C, dated March 10, 2010, explains the drawdown process. However, in response to the finding, the Governor's Office stated that it implemented an SFSF drawdown request review checklist and prepared written procedures detailing the drawdown process.

OIG Response

We determined that the response provided by the Governor's Office did not warrant a change to our finding and recommendations. In response to PRDE's comments, we moved two sub-sections of the finding to the *Other Matters* section of the report – "No Written Procedures – Calculating and Remitting Earned Interest Timely" and "No Written Procedures – Verifying Payments Before Requesting Reimbursement."

We acknowledge that the Governor's Office, as the prime recipient of ARRA SFSF, had established agreements with its subgrantees as required under Article IV of the Memorandum of Understanding. However, the disbursement requirements in those agreements established only that the grant received from the Governor's Office would be managed separately from the rest of the funds and that subgrantees needed to submit a complete drawdown request form. The agreements did not establish the requirements for the (1) payment method to be used to fund subgrantees (reimbursement or advance); (2) submission of supporting documentation for the reimbursement request to ensure costs were paid before requesting reimbursement from the Department; and (3) process to minimize the time elapsed between receipt and disbursement of Federal funds. Therefore, the Governor's Office lacked controls for the ARRA payment process, and the documentation submitted by the subgrantees did not provide reasonable assurance that payments had been made before the subgrantees requested reimbursement.

⁹ Hacienda is the abbreviation for the agency's name, "Departamento de Hacienda."

The Governor's Office stated that it is strictly enforcing the terms and conditions for disbursement contracts, including requiring documentation for the intended use of funds and official certification. It added that it has implemented an SFSF drawdown request review checklist and prepared written procedures detailing the drawdown process. We commend the Governor's Office for its immediate action to implement corrective actions.

FINDING NO. 2 – Insufficient Monitoring to Ensure Adequate Oversight of ARRA Funds

PRDE and the Governor's Office had not developed a sufficient plan to monitor and provide adequate oversight of the \$1.3 billion in education-related ARRA funds. Specifically, PRDE did not have a sufficient plan for monitoring its use of ARRA funds, and the Governor's Office monitoring plan and tool lacked key steps necessary to ensure ARRA compliance.

Insufficient Plan for Monitoring Prime Recipient's Use of ARRA Funds

We found that PRDE had not developed a sufficient plan for monitoring its use of ARRA funds to ensure compliance with the requirements governing ARRA funding. Specifically, PRDE had not modified the existing program monitoring guides to cover Title I and IDEA ARRA funds and did not have a sufficient level of adequately trained staff assigned to its monitoring units.

Incomplete Monitoring Guides

PRDE's Title I and the Associate Secretariat of Special Education (ASSE) monitoring units had not modified their monitoring plan and guides to provide reasonable assurance of compliance with ARRA requirements, including the new reporting requirements for the \$386.4 million in Title I and \$109.1 million in IDEA ARRA funds¹⁰ PRDE was expecting to receive. In addition, we found that the ASSE monitoring unit responsibilities did not include monitoring compliance with the Maintenance of Effort (MOE) requirements to ensure that Federal funds are used to provide additional educational services beyond those services normally provided by PRDE. To comply with MOE requirements, PRDE is responsible for meeting the State financial support requirement in 34 C.F.R. § 300.163. For State Educational Agencies (SEA), the comparison is the amount of State financial support provided (amount made available) for special education and related services from year to year, regardless of the amount actually expended.¹¹

PRDE officials believed there was no need to modify the monitoring guides because the Title I and IDEA ARRA funds would be used for the same activities for which regular funds are used. However, PRDE is responsible for the monitoring grant and subgrant supported activities to ensure compliance with applicable Federal requirements and achievement of performance goals, including ARRA goals.

The lack of complete monitoring guides reduces the effectiveness of PRDE's monitoring and oversight of Federal funds, including ARRA funds. As a result, PRDE could fail to identify instances of significant internal control weaknesses in programmatic and fiscal aspects which can lead to fraud.

¹⁰ These amounts refer only to CFDA numbers 84.389A (Title I Grants to Local Educational Agencies) and 84.391A (Special Education State Grants).

¹¹ Different programs calculate MOE differently as a condition of receiving Federal grant funds.

Insufficient Staffing

At the beginning of August 2009, the Coordinator of the Title I Compliance Monitoring Unit (CMU), the Coordinator of the Monitoring Unit of the Office of Federal Affairs (MU-OFA), and 89 Title I Auxiliary Superintendents and Regional Coordinators that comprised the Regional Monitoring Unit (RMU) were reassigned to fill school-level positions. As a result, the staffing of the units charged with monitoring the implementation of the Title I program at all levels was significantly reduced. It was not until February 2010 that the RMU resumed operations.

According to PRDE officials and a document entitled “Narrative to Accompany 2007 Compliance Agreement Plan Submission” that included the RMU’s monitoring and staffing plan, the RMU’s staffing plan consisted of one regional coordinator per region for a total of 7, 4 fiscal monitors per region for a total of 28, and 89 district superintendents for a total of 124. However, as of March 2010, these positions were not completely staffed and the personnel assigned had not received formal training on ARRA provisions. Although PRDE began filling the RMU’s positions, the RMU remains insufficiently staffed to effectively monitor Title I ARRA funds. Also, as of March 2010, the RMU’s composition had been reduced from the original staffing plan of 124 to 41 monitors. The new RMU no longer included district superintendents and fiscal monitors but was composed of 7 regional monitoring leaders and 34 monitors for a total of 41 as shown in Table 3.

Region	Regional Monitoring Leaders	Monitors
Arecibo	1	7
Bayamón	1	4
Caguas	1	5
Humacao	1	4
Mayaguez	1	5
Ponce	1	3
San Juan	1	6
Total	7	34

The monitoring plan states that a staffing plan will be developed to ensure that the regional units remain staffed at optimal levels and that the processes underlying the implementation of Title I programs are controlled. However, PRDE had not fully staffed the RMU after the reassignment of the Title I Auxiliary Superintendents and Regional Coordinators to school-level positions and had not provided ARRA related training.

In addition, the ASSE CMU Director stated that the CMU needed additional staff to effectively monitor the IDEA program. According to the Director of the ASSE’s CMU, the unit needed at least two more General Supervisors and two Specialists in Educational Research.¹² Although requests for additional staff had been made to previous¹³ Associate Secretaries of Special Education, no actions had been taken. In addition, assigned personnel had not received formal training on ARRA provisions. As of July 2010, the

¹² The personnel selected for these positions would be performing monitoring functions.

¹³ Associate Secretaries assigned before February 2010.

ASSE CMU consisted of five officials.¹⁴ Without a sufficient number of adequately trained personnel on ARRA provisions in both the RMU and CMU, PRDE cannot effectively monitor the use of ARRA funds.

Monitoring Plan and Tool Lacked Key Steps Necessary to Ensure ARRA Compliance

The Governor's Office developed a monitoring plan and tool to ensure subgrantee's compliance with the requirements governing ARRA funding and the proper use of funds. However, the monitoring plan and tool do not include key steps necessary to ensure compliance with ARRA requirements.

We found that the monitoring plan and monitoring tool developed did not include steps to ensure –

- Compliance with ARRA reporting including
 - the methodology employed to estimate the employment impact of ARRA funded work; and
 - adherence to the requirements of Section 1512 of ARRA and the reliability of subgrantees' data.
- Subgrantees have written policies and procedures for their accounting systems.
- Subgrantees' financial records are properly maintained, reviewed, and up-to-date.
- Subgrantees' accounting systems contain sufficient information and reflect proper accounting treatment of financial transactions, including
 - Bank account and cash balances;
 - Disbursement details, including date, payee, name, account, expense classification, and other relevant information;
 - Separate accounting for funds from different sources, including ARRA;
 - Comparison of outlays against budgets;
 - Initial recording and subsequent clearing of cash advances;
 - Accrual of expenditures to match cost to their proper award period; and
 - Subgrantees' financial statements audited by an independent public accountant.
- Subgrantees have a human resource/payroll system with clear and comprehensive policies and procedures, as well as, appropriate and adequate effort reporting systems, to include proper review and approval of time allocation.

A monitoring plan and tool provide assurance that controls are in place to reduce the risk of noncompliance. However, an insufficient monitoring plan and tool indicate that the programs may not be adequately monitored, which increases both the risk of noncompliance with requirements governing ARRA and the possibility of waste, fraud, and abuse.

Title 34 C.F.R. § 80.40(a) requires States to monitor subgrantees to ensure compliance with applicable Federal requirements. Specifically,

Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity.

¹⁴ There had been six officials in May 2010, but the Director retired at the end of June and the position has not been filled.

Recommendations

We recommend that the Assistant Secretary for OESE in coordination with the Assistant Secretary for OSERS require—

- 2.1 PRDE to ensure the RMU and the ASSE CMU are staffed and trained to effectively monitor the use of ARRA funds;
- 2.2 PRDE to revise the Title I and IDEA monitoring guides to include ARRA provisions to ensure that the use of funds is adequately monitored and in compliance with the requirements governing ARRA, including MOE requirements; and
- 2.3 The Governor's Office to expand the scope of its current monitoring plan and monitoring tool to address steps not included in the reporting, accounting, and financial areas to ensure that grant and subgrant activities comply with the requirements governing ARRA.

Governor's Office Comments

The Governor's Office disagreed with the finding, stating that the draft erroneously alleged that its monitoring plan and tool lacked key steps necessary to ensure ARRA compliance. According to its response, the Governor's Office provided the audit team with the preliminary draft of a monitoring plan, which was later revised after the Department issued its monitoring plan for the SFSF in February 2010. The Governor's Office stated that the monitoring plan was revised to incorporate all the components that the grantor would be using to monitor subgrantees, and that it will be using the same parameters established by the Department to monitor its subgrantees.

In March 2010, the Governor's Office submitted the final version of its monitoring plan. Although the monitoring plan is pending Department's approval, the Governor's Office stated that it proceeded to implement the monitoring plan with its subgrantees to ensure compliance with the requirements governing ARRA. The Governor's Office provided a copy of the revised plan and monitoring tools describing the monitoring process and necessary steps to ensure ARRA compliance.

PRDE Comments

Although PRDE disagreed with the finding related to its monitoring guides, PRDE acknowledged that it monitored Title I and IDEA ARRA funds using its regular Title I and IDEA monitoring procedures. PRDE stated that it currently monitors its ARRA Title I funds according to the Monitoring Procedures Manual for funds administered at the OFA. OFA's RMU monitors ARRA Title I funds according to the monitoring calendar, which was developed using a risk-based analysis. The RMU updated the Monitoring Procedures Manual to ensure that the use of both regular and ARRA Title I funds are adequately monitored in compliance with Federal requirements. PRDE stated that the manual is under review and final approval was expected by October 31, 2010.¹⁵

PRDE stated that it agrees with the draft's recommendation that additional staff are needed to assist the RMU with the programmatic monitoring visits. However, until additional staff are hired, the MU-OFA

¹⁵ As of November 3, 2010, PRDE had not provided evidence of final approval.

has provided, and will continue to provide, the necessary assistance to the RMU in its monitoring activities to comply with the 2010-2011 monitoring calendar.

According to PRDE, the Special Education Office or ASSE monitors its ARRA IDEA funds through its regular IDEA monitoring procedures and is planning on leveraging the OFA's system of fiscal monitoring through the creation of a Fiscal Monitoring Unit (FMU), administered by PRDE's Finance Division. ASSE will develop IDEA fiscal monitoring policies and procedures to be implemented by the FMU, or another unit responsible for monitoring IDEA funds. In the interim, the Finance Department is responsible for calculating and monitoring IDEA fiscal requirements, including maintenance of effort. PRDE added that it will ensure the RMU is properly trained to effectively monitor the use of ARRA funds and revise its Title I and IDEA monitoring guides to include monitoring the use of ARRA funds in compliance with Federal requirements.

In accordance with the draft's recommendation, PRDE stated that it is in the process of properly staffing and training the FMU and the RMU to effectively monitor the use of ARRA funds. PRDE added that it will conduct a needs assessment to determine how many employees are necessary for each of the monitoring units. According to PRDE, until the RMU is properly staffed, MU-OFA will continue to assist the RMU with its monitoring schedule and that OFA will train members of the RMU when the manual is finally approved.

OIG Response

In response to the Governor's Office and PRDE's comments and additional documentation submitted, we revised the finding to better reflect the requirements of 34 C.F.R. § 80.40(a) that requires States to monitor subgrantees to ensure compliance with applicable Federal requirements.

The first monitoring plan and tool provided for our review by the Governor's Office did not include key steps necessary to ensure compliance with ARRA requirements. The Governor's Office provided a revised monitoring plan and stated that it had been revised based on the Department's Monitoring Plan for the SFSF issued in February 2010. Although the revised plan and tool includes steps that would be necessary to ensure ARRA compliance, a monitoring plan and tool should be flexible enough to allow for modifications based on issues identified during use. Therefore, we encourage the Governor's Office to continue strengthening its monitoring plan and procedures as it monitors its subgrantees for compliance.

PRDE acknowledged that it monitored Title I and IDEA ARRA funds using its regular Title I and IDEA monitoring procedures. However, these monitoring procedures did not include the reporting requirements needed under Section 1512 of ARRA for transparency and accountability. As such, we maintain that PRDE's monitoring plans and guides should be revised to ensure that the use of ARRA funds is adequately monitored and reported. Regarding the ASSE's monitoring guides, PRDE stated that it would be developing fiscal policies and procedures to ensure fiscal aspects of the IDEA program are monitored, including compliance with the MOE and allowability of costs. However, we maintain that PRDE's ASSE should revise its IDEA program monitoring guides to include ARRA provisions.

FINDING NO. 3 – PRDE Is Not Effectively Monitoring the Procurement Process

PRDE had not fully established a monitoring unit or developed a monitoring plan and/or guidance to effectively monitor Purchasing Officers and the current and past performances of vendors. Additionally, PRDE had not reviewed its procurement procedures to ensure procurement processes funded under ARRA are conducted in accordance with the requirements governing ARRA.

In November 2007, the former PRDE Secretary issued a memorandum establishing the new structure for PRDE's Procurement Office. The purpose of the memorandum was to ensure a more efficient use of the assigned funds and to provide for improvements to strengthen PRDE's procurement process. As part of the effort, PRDE implemented the current financial system known as SIFDE to automate the procurement processes. In addition, PRDE established a new functional structure in the memorandum known as the Central Procurement Office (CPO). The proposed CPO included three components – the Acquisition Unit, the Contract Unit, and the Monitoring Unit. PRDE's CPO is responsible for establishing monitoring programs and processes to monitor Purchasing Officers and the performance of vendors to identify internal control weaknesses and administrative deficiencies.

PRDE's efforts in establishing the Monitoring Unit have not been sufficient to comply with the November 2007 memorandum nor its procurement policies and procedures. As of January 2010, more than 2 years after the memorandum was issued, we found that the Monitoring Unit component of the CPO had not been fully staffed. We also found that PRDE had not developed a monitoring plan nor had it developed guides to monitor Purchasing Officers and vendors. Further, PRDE had not revised its procurement procedures to ensure that procurement processes funded under ARRA were conducted in accordance with the requirements governing ARRA.

In January 2010, a consultant from one of PRDE's consulting firms¹⁶ was assigned to the Monitoring Unit to perform follow-up functions on vendors who had not submitted quotes requested by Purchasing Officers during the acquisition process, in addition to monitoring the quality of goods received and related complaints. However, the consultant's functions were not yet aligned with the main objectives of the Monitoring Unit. Also, as of September 8, 2010, the consultant was no longer working at the Monitoring Unit and PRDE had not yet assigned any staff to perform the functions previously delegated to the consultant. According to PRDE officials, they were in the process of evaluating the options¹⁷ to fully establish the Monitoring Unit. Without proper guidelines and sufficient staff, PRDE's efforts in maintaining an adequate level of monitoring over the Purchasing Officers and the performance of vendors could be affected.

Article 81 of PRDE's Procurement Policies and Procedures¹⁸ delegated Purchasing Officers the task of providing follow-up support to the payment process to avoid unnecessary delays. However, based on information provided by the Purchasing Officers, they had the responsibility for obtaining vendors' invoices and following up on the supporting documentation needed to prepare hard copy packages for each purchase order to send to the Accounts Payable (AP) Division. The task delegated to the Purchasing Officers could conflict with their duties because routine contact with outside vendors during both the

¹⁶ RMSROC & Company, Certified Public Accountants & Consultants were contracted to help in the implementation of PRDE's financial system, especially with the procurement module.

¹⁷ Specifically, PRDE is evaluating a contractor's proposal to perform the monitoring functions, as well as, another option to use PRDE's staff to perform the monitoring functions.

¹⁸ Dated October 5, 2005, as amended on August 6, 2008, to include the creation and responsibilities of the new CPO among other amendments.

procurement and the payment processes is inherent in these positions. As such, Purchasing Officers are at increased risk of potentially receiving inappropriate pressures from outside vendors to expedite their corresponding payments over the payments of other vendors. In addition, the added task to gather vendors' invoices and to follow up on supporting documentation, if not performed expeditiously, could result in the delay of payments to vendors. The potential conflict of interest situation was also identified by PRDE's Internal Audit Division in the 2007 Compliance Agreement Quarterly Progress Report for the period ended December 2009.

Title 34 C.F.R. § 80.40(a) states that

Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity.”

In addition, Article 19, section 19.11 of PRDE's Procurement Policies and Procedures²⁶ establishes as a responsibility of the CPO the implementation of monitoring programs and processes to monitor Purchasing Officers and vendors. The objective is to identify lack of adequate internal controls and administrative deficiencies.

According to 34 C.F.R. § 76.702,

[a] State and a sub-grantee shall use fiscal control and fund accounting procedures that insure proper disbursement of and accounting for Federal funds.

PRDE has not sufficiently complied with internal mandates for monitoring its procurement process. The lack of progress in establishing a Monitoring Unit with adequate monitoring guides prevents PRDE from effectively monitoring its Purchasing Officers and vendors. As a result, PRDE could fail to identify potential internal control weaknesses in its procurement process putting at risk funds used to procure services. In addition, the added task for Purchasing Officers to obtain vendors' invoices and to follow up on supporting documentation represents a potential conflict of interest. Specifically, the Purchasing Officers obtain all vendors' invoices and required supporting documentation in addition to fulfilling their duties as Purchasing Officers. The combination of duties assigned to Purchasing Officers does not allow for adequate segregation of duties, which could, at a minimum, delay payments, or worse, result in fraudulent payments.

Recommendations

We recommend that the Assistant Secretary for OESE in coordination with the Assistant Secretary for OSERS require PRDE to—

- 3.1 Adequately administer Federal funds, including ARRA funding, by providing staff who have appropriate training to CPO's Monitoring Unit to effectively monitor Purchasing Officers and vendors' performance;
- 3.2 Develop a monitoring plan and guides to effectively conduct monitoring of Purchasing Officers and vendors' performance; and

- 3.3 Revise procurement procedures to ensure that procurement processes funded under ARRA are conducted in accordance with the requirements governing ARRA.

PRDE Comments

PRDE disagreed in part with the preliminary report's recommendations regarding the monitoring of its procurement process. PRDE stated that it is committed to ensuring that its CPO effectively monitors the performance of Purchasing Officers and vendors and is in the process of establishing and staffing the proposed CPO Monitoring Unit. According to PRDE, a staffing level of three will satisfy this unit's needs. PRDE expects to contract these responsibilities out until it is able to create and hire the new positions.

PRDE stated that, although the proposed CPO Monitoring Unit has not yet been established and staffed, the CPO implemented an interim approach to handling its proposed responsibilities. Specifically, the CPO regularly monitors the workflow quantity and status of requisitions, delivery orders, and purchase orders, as well as the cumulative dollar amounts by purchasing category.

According to PRDE, the CPO is structured to ensure two levels of review of Purchasing Officer work. First, CPO Supervisors, located at both the central and regional levels, review all work completed by the Purchasing Officers. Second, the CPO Director spot-checks Purchasing Officer work already reviewed by the Supervisors. PRDE added that the CPO has monitoring procedures in place, which PRDE is scheduled to review and revise, as appropriate. PRDE stated that it will review its procedures to ensure procurement processes funded under ARRA are conducted in accordance with the requirements governing ARRA. If any necessary changes or additions are identified, PRDE will revise its procedures accordingly.

PRDE stated that it has completed a review of its policy regarding the handling of invoices by Purchasing Officers and has determined that those procedures maintain an adequate segregation of duties. PRDE maintained that the preliminary report's description of Article 81 of PRDE's Procurement Policies and Procedures misstates the role of the Purchasing Officers with regard to the receipt of invoices. Although Article 81 assigns Purchase Officers the task of providing follow-up support to the payment process to avoid unnecessary delays, Purchasing Officers are not responsible for obtaining vendors' invoices or preparing hard copy packages for each purchase order to send to the AP Division. According to PRDE, the AP Division is charged with receiving invoices and supporting documentation. For services, the invoices and supporting documentation are first received at the specific office contracted to receive the services. The invoices are reviewed, certified, and then forwarded to the AP Division. For goods, the invoices go directly to the AP Division from the vendor. The AP Division is responsible for notifying Hacienda to issue payment.

In response to the PRDE Internal Audit Report on the 2007 Compliance Agreement Quarterly Progress Report for the period ended December 2009, PRDE's CPO Director issued a letter dated January 14, 2010, clarifying the process and reinforcing the proper roles of the Purchasing Officers and the AP Division with regard to the receipt and review of invoices to ensure segregation of duties.

OIG Response

Although the CPO has monitoring procedures in place, the CPO's Monitoring Unit is part of the structure proposed by PRDE in its November 2007 memorandum and should be established accordingly. Although

PRDE's procurement procedures apply for all procurement activities, regardless of funding source, ARRA has specific requirements regarding procurement processes. Section 1554 requires that to the extent possible, contracts funded under the ARRA should be awarded as fixed price contracts through the use of competitive procedures. A summary of any contract not awarded as fixed price through the use of competitive procedures is required to be posted in a special section of the website established in accordance with section 1526 of ARRA.¹⁹ As such, PRDE should revise its procurement procedures accordingly.

Regarding the task of gathering vendors' invoices, PRDE is correct that Article 81 of PRDE's Procurement Policies and Procedures delegated Purchasing Officers the task of providing follow-up support to the payment process to avoid unnecessary delays and does not require them to prepare hard copy packages for each purchase order to send to AP Division. However, even though not required by Article 81, according to the Purchasing Officers, they were preparing hard copy packages for each purchase order. The task of gathering such documentation could conflict with their duties because routine contact with outside vendors is inherent in the position and outside vendors could exert pressure on Purchasing Officers to expedite their payments.

The potential conflict of interest situation was also identified by PRDE's Internal Audit Division in the 2007 Compliance Agreement Quarterly Progress Report for the period ended December 2009 and PRDE stated that the CPO Director had issued a letter clarifying the process and reinforcing the proper roles of the Purchasing Officers and the AP Division. The letter is dated January 14, 2010, with an effective date of March 1, 2010. At the time of our review, in January 2010, Purchasing Officers were still obtaining vendors' invoices. However, based on the guidance issued by the CPO Director clarifying the roles of the Purchasing Offices and the AP Division, we deleted from this audit report the preliminary draft report's recommendation related to the review of PRDE's policy regarding the handling of invoices by Purchasing Officers.

FINDING NO. 4 – Lack of Documentation to Support IDEA ARRA Fund Procurement and Compliance with Section 1554 of ARRA

PRDE made payments with IDEA ARRA funds without sufficient documentation to support that funds were used as intended and in compliance with ARRA requirements. Specifically, PRDE paid \$2,051,000 with IDEA ARRA funds for the purchase of an information technology system known as SEASweb or Special Education Automation Software and did not provide a contract related to the procurement. As such, PRDE provided no evidence to support that services were rendered in accordance with any agreement between PRDE and Computer Automation and that a reasonable price was obtained based on a competitive process in compliance with Section 1554 of ARRA. Section 1554 requires that to the extent possible, contracts funded under ARRA should be awarded as fixed price contracts through the use of competitive procedures. A summary of any contract not awarded as fixed-price through the use of competitive procedures is required to be posted in a special section of the Web site.

In 2006, PRDE acquired SEASweb through an agreement with the Society of Education and Rehabilitation (SER)²⁰ of Puerto Rico. The implementation was initially overseen by SER of Puerto Rico and subsequently taken over by PRDE. The system consisted of a special education management solution

¹⁹ Section 1526 of ARRA required the Recovery Accountability and Transparency Board to create and maintain a website to give user-friendly tools to the public to track how and where the ARRA funds are spent.

²⁰ SER is a not-for-profit organization that provides therapy and educational services to individuals with disabilities.

that would help PRDE manage the data²¹ of all special education students in Puerto Rico. On March 4, 2010, PRDE's ASSE allocated \$4.6 million²² to pay for a February 2010 invoice submitted by Computer Automation for the SEASweb annual license. The invoice referenced a proposal called SEAS Education Plans – Product and Services Proposal, dated December 16, 2009. However, PRDE paid \$2,051,000 to Computer Automation instead of the \$4.6 million originally allocated. PRDE officials stated that the proposal, for which the \$4.6 million invoice had been submitted, was not accepted. Because PRDE determined that it did not require the additional services Computer Automation was offering as a package, in addition to the annual software license, it purchased only the annual software license for \$2,051,000.²³

PRDE stated that the cost of the annual license was established based on Computer Automation's price sheet; however, the price sheet provided by PRDE in response to the finding was dated June 7, 2006, while the invoice referenced to the proposal was dated December 16, 2009. Therefore, we could not determine if payments made to Computer Automation were correct, reasonable, and/or justified.

Despite several requests for the information, PRDE was unable to provide us with a copy of the contract between PRDE and Computer Automation and/or the approved proposal cited in the invoice. Subsequently, we obtained a copy of the proposal, but PRDE officials could not confirm whether the proposal had been approved nor could it provide any other form of documentation or contracts to support the software license agreement between PRDE and Computer Automation.

Section 1554 Special Contracting Provisions of ARRA states that

To the maximum extent possible, contracts funded under this Act shall be awarded as fixed-price contracts through the use of competitive procedures. A summary of any contract awarded with such funds that is not fixed-price and not awarded using competitive procedures shall be posted in a special section of the website established in section 1526.

Also, 34 C.F.R. § 75.730 states that

A grantee shall keep records that fully show... (b) How the grantee uses the funds; (c) The total cost of the project... (e) Other records to facilitate an effective audit.

In addition, 34 C.F.R. § 80.20(a) states that

...Fiscal control... must be sufficient to: (2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

Further 34 C.F.R. § 76.702, a State should use fiscal control and fund accounting procedures that ensure proper disbursement of and accounting for Federal funds.

PRDE did not provide documentation to adequately support that services were rendered in accordance with any agreement between PRDE and Computer Automation, and that a reasonable price was obtained based on a competitive process in compliance with Section 1554 of ARRA. Therefore, we were not able to determine whether payments were in compliance with requirements governing ARRA. Without adequate documentation and fiscal controls in place to document and support payments for expenditures

²¹ Students' personal information, appointments, evaluations, eligibility and other data.

²² On February 25, 2010, Computer Automation billed PRDE \$4,662,000 for the annual license of the SEASweb software.

²³ A second invoice in the amount of \$2,051,000 was resubmitted on February 25, 2010, the same day the \$4.6 million invoice was submitted.

incurred, there is an increased risk that Federal funds, including ARRA funds, will not be administered properly and that payments could be made for unallowable services. In addition, without written agreements, there is no assurance that services were provided in accordance with grant objectives.

Recommendations

We recommend that the Assistant Secretary for OSERS require PRDE to—

- 4.1 Provide evidence that services were reasonable, justified, and rendered in accordance with an agreement established with Computer Automation to support the \$2,051,000 in payments or return the funds to the Department; and
- 4.2 Provide evidence of compliance with Section 1554 of ARRA, including documents supporting the type of procurement process conducted, and the approved contract and/or proposal establishing agreements for the recurring procurements of the SEASweb software license.

PRDE Comments

PRDE stated that it has supporting documentation for the procurement process resulting in the purchase of the annual software license from Computer Automation as well as documentation for the \$2,051,000 in payments made, including evidence that services were rendered in accordance with the agreement between Computer Automation and PRDE.

According to PRDE, Computer Automation is the owner of the SEASweb software, which PRDE uses for maintaining its special education data. To use this software, PRDE must purchase an annual software license from Computer Automation each year. The audit report cites an invoice and accompanying proposal that were submitted by Computer Automation to PRDE totaling \$4.6 million; however, PRDE never accepted this proposal nor entered into a contract with Computer Automation for the services detailed in that proposal. According to PRDE, it did not require the additional services Computer Automation was offering as a package in addition to the annual software license in said proposal. Accordingly, PRDE proceeded through the procurement process to purchase the annual software license for \$2,051,000 and no additional goods or services were acquired.

PRDE stated that the cost of the annual license was established based on Computer Automation's price sheet. PRDE's student count in SEASweb for 2009 was 121,339. The cost of the annual license is based on a usage fee of \$16 per student. Accordingly, the 2009 usage fee was \$1,941,424 (121,339 x \$16). PRDE also elected to purchase the SEASweb software annual maintenance plan for an additional fee of \$187,500. The total of the annual maintenance and the usage fee was \$2,128,924. PRDE received a discount of \$77,924 for its purchase of the annual maintenance plan. Thus, the adjusted total cost of the SEASweb annual license and maintenance was \$2,051,000. PRDE paid Computer Automation's invoice in two installments – \$594,790 paid on March 25, 2010, and \$1,456,210 paid on March 19, 2010.

OIG Response

Based on PRDE's comments and the additional payment documentation, we slightly modified the finding to consider its explanation for not accepting the \$4.6 million proposal and to exclude the statement that PRDE had provided partial documentation showing a payment in the amount of \$594,790. PRDE provided additional documentation showing payments in the amount of \$2,051,000. We also modified

Recommendation 6.2 in our preliminary audit report (currently Recommendation 4.1) and added Recommendation 4.2, requiring evidence of compliance with Section 1554 of ARRA, including documents supporting the type of procurement process conducted, and the approved contract and/or proposal establishing agreements for the recurring procurements of the SEASweb software license.

Although PRDE stated that it has supporting documentation of the procurement process resulting in the purchase of the annual software license from Computer Automation, it only provided an email dated October 18, 2010, as support. The e-mail from the President and CEO of Computer Automation briefly discussed the discount provided to PRDE for the 2009-2010 SEASweb annual license cost, an outdated pricing proposal components sheet dated June 7, 2006, and the evidence of payments made to Computer Automation. It does not provide support of PRDE's agreements with Computer Automation and its compliance with Section 1554. PRDE did not provide sufficient documentation to support that services were rendered in accordance with an agreement between PRDE and Computer Automation and that a reasonable price was obtained based on a competitive process in compliance with Section 1554.

FINDING NO. 5 – Insufficient Internal Controls for Safeguarding Information

PRDE and the Governor's Office, including PRIFA, had not established sufficient internal controls for safeguarding information, including developing, approving, and updating information system security policies and procedures. Specifically, PRDE, the Governor's Office, and/or PRIFA lacked policies and procedures to –

- ensure proper password and account management;
- reflect changes to their information systems and protect information against the latest security threats; and
- protect the physical access to its information system distribution and transmission lines.

Insufficient IT Policies and Procedures for Password and Account Management

PRDE had not updated its information system security policies and procedures to ensure proper password and account management. Although PRDE had established policies and procedures through Circular Letter 4-2008-2009, dated July 22, 2008, it did not adequately address proper password and account management. Specifically, PRDE was not enforcing the use of secure passwords throughout the organization and did not properly assign account rights and permissions. Additionally, we found that PRIFA had not established procedures to enforce the use of secure passwords throughout the organization.

According to information system assessments, which were performed by an external contractor in October and November 2009, PRDE's password policy did not provide controls for defining and enforcing an adequate password-based authentication system. As a result, the passwords used could be easily decrypted. In addition, the external assessment reported that PRDE had improperly delegated rights and permissions to its information systems to contractors and users, which put the information at risk. Although our review did not cover transactions performed by contractors and users to determine whether access had been improperly used, the delegated rights and permissions, which were provided to contractors and users, allowed them to potentially change most of the configuration aspects.

Further, PRDE had not reviewed and updated its security policies and procedures to ensure that proper password and account rights and permissions were assigned according to the employees' functions and responsibilities. PRDE Information System officials stated that the issues addressed in those assessments had been communicated to PRDE's management and it had corrected the issue of inadequate rights and permissions. However, its administration, from the Secretary on down including the Information System Division, had been constantly changing; therefore, PRDE needs to ensure effective security policies and procedures are updated to provide business continuity regardless of changes in personnel and to avoid the risk of compromising the agency's information. Without adequate security policies and procedures, the data may be compromised both from within and outside the agency, potentially affecting the reliability of the information reported, including the nearly \$1 billion in ARRA educational funds²⁴ awarded to PRDE.

Insufficient Internal Controls for Safeguarding Information and Addressing Current Security Threats

The Governor's Office and PRIFA had not developed and approved information system security policies and procedures to reflect changes to their information systems and to take into consideration the latest security threats. As a result, the Governor's Office and PRIFA lacked sufficient internal controls for safeguarding its information against unauthorized access.

An information system assessment of controls conducted in PRIFA as part of its financial audit for the year ended June 2009 identified a series of control deficiencies that could jeopardize the security of the agency's information, including its financial data²⁵ and ARRA data. Specifically, the assessment reported that PRIFA did not –

- Document a formal policy regarding standard or minimum password criteria, including minimum length, complexity requirements, expiration intervals, and account lockout for operating systems and databases;
- Establish a formal policy or procedure for system and application owners to review the nature and extent of user access privileges to ensure that those privileges were pertinent to the user's functions;
- Document and test application software upgrades in a separate test environment instead of directly in the production environment;
- Perform formal information system risk assessments to determine what information resources exist that require protection and to understand and document potential risks from information system security failures that may cause loss of information confidentiality, integrity, and/or availability;
- Implement adequate environmental controls, such as fire detectors and suppression systems;²⁶ and
- Establish or develop a formal, documented set of policies, procedures, standards, and guidance regarding management and administration of information security and operations and change control for applications, databases, networks, and operating systems.

²⁴ PRDE was awarded the following ARRA funds – \$522,904,561 in Elementary and Secondary Education funds; \$117,449,619 in Special Education; and \$359,301,996 in SFSF received from the Governor's Office.

²⁵ The financial data included invoice processing, payment processing, and budget, among other related processes.

²⁶ Although a sprinkler system was maintained inside the room, other fire suppression mechanisms were not present.

Although the Governor's Office was in the process of developing a set of security policies and procedures as of October 18, 2010, the policies and procedures had not been completed. PRIFA had also developed a set of security policies and procedures;²⁷ however, they were still in draft and had not yet been approved. On August 6, 2010, PRIFA stated that it had performed a preliminary evaluation of its information system policies and procedures and was developing a plan to address the deficiencies found during our review. Additionally, we found that PRIFA did not have a Continuity of Operations Plan (COOP) to include an alternate site with the backup equipment necessary to continue operations if an emergency occurred and the primary equipment stopped working. Further, PRIFA relied on backups that had not been fully tested to confirm that all the information was being backed up to ensure the continuation of operations. As a result, the agency's operation was at risk in the event of a disaster.

The U.S. Department of Commerce National Institute of Standards and Technology Special Publication 800-53, revision 3, provides guidance for organizations to establish the necessary controls

to comply with security requirements defined by applicable Federal laws, Executive Orders, directives, policies, standards, or regulations (e.g., Federal Information Security Management Act, OMB Circular A-130). State, local, and tribal governments, as well as private sector organizations are encouraged to consider using these guidelines, as appropriate.

In addition, the Government of Puerto Rico established Law 151, known as "Ley de Gobierno Electrónico,"²⁸ which provides the Puerto Rico OMB with the authority to issue general directives to use adequate security controls that can guarantee the confidentiality, integrity, and availability of data to include security policies and procedures.

Insufficient Internal Controls for Protecting the Physical Access to Information System Distribution and Transmission Lines at the Governor's Office

The Governor's Office was not adequately protecting the physical access to its information system distribution and transmission lines. We found exposed distribution and transmission lines²⁹ in all the areas visited posing a risk to the security of the information as well as the security of the personnel adjacent to those areas. Additionally, we found that the exposed distribution and transmission lines had previously caused loss of connectivity which disrupted operations. The Governor's Office needs to strengthen the physical access to its information system distribution and transmission lines to provide a reasonable level of assurance that the information within its facilities and systems is secured.

As stated in the previous section, the U.S. Department of Commerce National Institute of Standards and Technology Special Publication 800-53, revision 3, provides guidance for organizations to establish the necessary controls to comply with Federal security controls. The Publication's Appendix F-PE-4 states that

physical protections applied to information system distribution and transmission lines help prevent accidental damage, disruption, and physical tampering. Additionally, physical protections are necessary to help prevent eavesdropping or in transit modification of unencrypted transmissions.

²⁷ The security policies and procedures were revised on October 7, 2009, but approval was still pending as of October 18, 2010. However, PRIFA expects to have the security policies and procedures in place by December 31, 2010.

²⁸ Electronic Government Law, dated June 22, 2004.

²⁹ Distribution and transmission lines may include cables, fiber optics, and satellite among other available means of communications; however, this finding refers to local area network cables.

Protective measures to control physical access to information system distribution and transmission lines include: (i) locked wiring closets; (ii) disconnected or locked spare jacks; and/or (iii) protection of cabling by conduit or cable trays.

Effective security policies and procedures minimize the risk of compromises to the agency's information and demonstrate due diligence to the individuals served. Also, physical protections applied to information system distribution and transmission lines help prevent accidental damage, disruption, and physical tampering. Without adequate security policies and procedures the data may be compromised both from within and outside the agency, potentially affecting the data reliability of the information reported. This information includes \$1.3 billion in education-related ARRA funds that the Government of Puerto Rico received, which includes the \$86.8 million in ARRA SFSF funds awarded to PRIFA by the Governor's Office. The ultimate objective is to implement information systems that are dependable in the face of threats.

Recommendations

We recommend that the Assistant Secretary for the Office of Elementary and Secondary Education (OESE) in coordination with the Assistant Secretary for the Office of Special Education and Rehabilitative Services (OSERS) require—

- 5.1 PRDE to update its information system security policies and procedures to enforce the use of secure passwords throughout the agency and to conduct periodic audits to ensure users have the correct level of access;
- 5.2 The Governor's Office to ensure PRIFA enforces the use of secure passwords throughout the agency;
- 5.3 PRDE and the Governor's Office, including PRIFA, to ensure that they develop a schedule for periodically updating their information systems security policies and procedures;
- 5.4 The Governor's Office and PRIFA to ensure that information system security policies and procedures are approved and that they incorporate information addressing the latest security threats to protect the agency's information, including ARRA data;
- 5.5 The Governor's Office to ensure that PRIFA evaluates the findings and recommendations made during the information system assessment and implement corrective actions as appropriate;
- 5.6 The Governor's Office to instruct PRIFA to conduct an information system risk assessment to determine how the agency will continue its operations when an emergency occurs and establish appropriate measures such as a COOP; and
- 5.7 The Governor's Office to ensure that physical access to distribution and transmission lines is strengthened to help prevent accidental damage, disruption, and physical tampering.

Governor's Office Comments

Although the Governor's Office disagreed with our findings and recommendations, it stated that it is in the process of developing and approving information system security policies and procedures taking into

consideration the latest security threats and changes in information systems. According to its response, the procedures are expected to be completed and approved by December 31, 2010. The Governor's Office added that it is in the process of identifying funding for protecting exposed information system distribution and transmission lines.

The Governor's Office also stated that, as a result of its preliminary evaluation of its information system policies and procedures, PRIFA developed a plan to correct the deficiencies in its internal controls for safeguarding information.

The Governor's Office added that it will instruct PRIFA to develop a schedule for periodically updating its information system security policies and procedures, and require PRIFA to conduct an information system risk assessment to determine how the agency will continue its operations in the event of an emergency. In addition, the Governor's Office stated that it will ensure PRIFA approves its information system security policies and procedures; incorporates information addressing the latest security threats to protect the agency's information, including ARRA data; and evaluates the findings and implements the recommendations made during the information system assessment, as appropriate.

PRDE Comments

PRDE disagreed with the finding that internal controls had not been established for developing, approving, and updating information system security policies and procedures. PRDE stated that it has established appropriate internal controls related to its information system security policies and procedures, including policies to ensure proper password and account management.

According to PRDE's response, it has information systems policies and procedures that outline the process to provide secure passwords throughout the organization, and assign account rights and permissions to the employees. PRDE stated that currently personnel from the Human Resources Department and the Information Systems Office are meeting on a weekly basis to cross-reference employee transfers and to monitor the appropriate password changes and access to information. PRDE added that it is in the process of updating its information systems new account procedures through implementation of "Oracle Identity Management and Access Management," which will provide the necessary tools to efficiently manage access protocols for PRDE's systems.

OIG Response

At the time of our review, the Governor's Office and PRIFA did not have information system policies and procedures in place for safeguarding information against unauthorized access. Although in its overall response to the preliminary audit report the Governor's Office did not agree with the findings and recommendations, its response to the finding acknowledged weaknesses in safeguarding information and addressing current security threats at the Governor's Office and PRIFA and included the corrective measures implemented to protect the information systems against unauthorized access.

In its response, PRDE stated that it currently has information system policies and procedures that outline the process to provide secure passwords throughout the organization and assign accounts rights and permissions. At the time of our review, PRDE's information system security policies and procedures, established through Circular Letter 4-2008-2009, did not adequately address proper password and account management. Specifically, we found that PRDE had not enforced the use of secure passwords throughout the organization for its local area network. PRDE did not properly assign account rights and permissions,

and improperly delegated rights and permissions to its information systems to contractors and users putting the information at risk. Although PRDE Information System officials stated that the issues related to the inadequate rights and permissions had been corrected, PRDE should continue conducting periodic audits to ensure that users have the correct level of access.

PRDE added that it is updating its information systems new account procedures through the implementation of “Oracle Identity Management and Access Management,” which will provide the necessary tools to efficiently manage access protocols for PRDE’s systems. We acknowledge that PRDE has updated its information system policies and procedures to outline the proper workflow approval process required to request, assign, and approve user accounts; as well as, to deny and inactivate user accounts.

OTHER MATTERS

Violation of the Davis Bacon Act

A PRDE contractor³⁰ did not pay nine of its employees the prevailing hourly wage in violation of the Davis Bacon Act. All Federal contractors are required to comply with the Davis Bacon Act, which provides wage rates for employees for given types of work. According to the Davis Bacon Act, the prevailing wage is \$7.25 per hour for the type of project³¹ included in the contract, but the contractor paid nine of its employees at the rate³² of \$6.00 and \$5.25 per hour. To its credit, through an established review process, PRIFA discovered the violation.

The specific violation related to a July 6, 2009, PRIFA award of \$23 million from its school renovation grant³³ to the Office for Improvement of Public Schools³⁴ (OIPS). OIPS is affiliated with PRDE to assist PRIFA in the renovation of 120 public schools. As a subgrantee of ARRA SFSF, PRIFA used the reimbursement method to fund its subgrantees and required its subgrantees to submit requests for reimbursement accompanied by supporting documentation of expenditures. The supporting documentation was reportedly reviewed for accuracy, compliance, and completeness by PRIFA staff before funds were disbursed to the subgrantees. During these reviews an accounting official noted that an invoice submitted by one of the OIPS contractors included supporting payroll documentation. The payroll documents for the period ending in August 2009 confirmed that payments for nine employees did not meet the Davis Bacon Act prevailing wage of \$7.25 per hour.³⁵ The documentation submitted showed payments at the rate of \$6.00 and \$5.25 per hour instead of \$7.25. After being notified of the violation, the contractor resubmitted its invoice with documentation correcting the payroll issue for three of the nine employees; however, the contractor stated that the \$5.25 rate per hour for the remaining six employees was the correct rate and, as such, did not adjust the hourly rate for those employees.

PRIFA officials stated that they referred the case to their Legal Division and that the Legal Division notified the Department of Labor and sought additional guidance. In addition, PRIFA informed the

³⁰ The contract was awarded for Public School renovation projects.

³¹ The type of project was classified as “Building.”

³² Three employees were paid at a rate of \$6.00 per hour and six employees at a rate of \$5.25.

³³ On July 2, 2009, the Governor’s Office awarded PRIFA two grants amounting to \$86.7 million, one in the amount of \$70 million for school renovation projects and the other in the amount of \$16.7 million for ARRA implementation costs.

³⁴ The OIPS is known in Spanish as “Oficina para el Mejoramiento de las Escuelas Públicas” and uses the OMEP acronym.

³⁵ The prevailing wage of \$7.25 is included in General Decision: PR20080001 dated July 31, 2009. General Decisions establishing the minimum wage were issued by the U.S. Department of Labor for each State and territories.

contractor that the amount retained as part of its contract agreements would not be paid until a final resolution was reached. As a result of the incident, PRIFA officials issued a memorandum to all affected officials communicating the requirements of the Davis Bacon Act and its applicability.

On August 6, 2010, we received comments from the Governor's Office stating that the violation of the Davis Bacon Act had been completely resolved. In its response, the Governor's Office stated that payments were withheld, legal affidavits were required, and corrective measures were imposed by PRIFA.³⁶ We commend the Governor's Office and PRIFA for their immediate actions to address the noncompliance and suggest continued monitoring of subgrantees and contractors for compliance with the Davis Bacon Act.

Improvements Needed in Communicating Fraud Reporting Requirements

The Governor's Office had not appropriately informed subgrantees of the requirements for reporting suspected cases of fraud to the Department's Office of Inspector General (OIG). Although the Governor's Office and subgrantees signed agreements that included a clause acknowledging that the OIG may at any time inspect subgrantees' documents and those of any related contractor, supplier, and vendor to ensure proper use of ARRA funds, the signed agreements did not include the requirement to report suspected fraud.

Consistent with OMB Memorandum M-09-15, titled "Updated Implemented Guidance for the American Recovery and Reinvestment Act of 2009," the Department included this reporting requirement as a condition to the SFSF award made to the Governor's Office, requiring that any cases of suspected fraud be referred to the Department's OIG. According to 34 C.F.R. § 80.37(a)(2), grantees are to ensure that subgrantees are aware of requirements imposed on them by Federal statute and regulation.

The Puerto Rico ARRA Implementation Guidelines 09-02 address the fraud reporting requirement. The guidelines, developed by PRIFA, are used by the Puerto Rico Government to oversee the administration of ARRA in Puerto Rico. Contrary to the Federal reporting requirement in the grant conditions, Puerto Rico's implementation guidelines state that cases of fraud or misconduct shall be referred to the Government ARRA Task Force and PRIFA, rather than reported to the Department's OIG. Without proper communication of the fraud reporting requirement, there is no assurance that subgrantees will refer cases of suspected fraud to the Department's OIG so that fraud and related cases of misconduct can be properly investigated.

In response to the preliminary audit report, the Governor's Office provided documentation that the requirement for reporting suspected cases of fraud to the Department's OIG was disseminated and communicated to its subgrantees. Specifically, the Governor's Office updated a poster that it had provided to its subgrantees, which contained information about the Recovery Act Fraud Hotline. The poster was updated in May 2010, to incorporate the OIG's telephone number in response to our audit finding. We commend the Governor's Office for its immediate action to update its poster and, in effect, address our finding by providing notification to its subgrantees to immediately report any instances of suspected fraud to the Department's OIG.

³⁶ On March 12, 2010, PRIFA submitted a memorandum to the General Manager of the OIPS stating the importance of complying with the Davis Bacon Act and requested evidence demonstrating compliance.

Noncompliance with Cash Management Requirements at the Prime Recipient-Level

As required by the Cash Management Improvement Act of 1990 (CMIA) as amended, the Commonwealth of Puerto Rico and the U.S. Treasury have a Treasury State Agreement (TSA) that documents the accepted funding techniques and interest calculations agreed upon by both parties. The CMIA was enacted to improve the transfer of funds between the Federal government and the States. However, the ARRA programs were not added into the TSA. The CMIA is intended to address two primary issues: States drawing down funds before they are needed and Federal agencies providing late grant awards to States. Based on the intent of the CMIA, the ARRA programs should have been added to the TSA to help protect Federal and State interests.

The threshold for a covered program in the current TSA between the Commonwealth of Puerto Rico and the U.S. Treasury is \$29,851,405. The threshold in the previous TSA that was in effect from July 1, 2009, through June 30, 2010, was \$26,674,140. Neither of these TSAs specifically lists SFSF, Title I, or IDEA ARRA funds as programs covered by the agreement. However, as of November 19, 2010, the Commonwealth of Puerto Rico had available balances for the SFSF, Title I, and IDEA ARRA grants of \$208 million, \$124 million, and \$77 million, respectively. U.S. Treasury regulations at 31 C.F.R. Section 205.7 stipulate that a State is responsible for contacting the U.S. Treasury to amend the TSA within 30 days of a change that would impact the existing TSA, including the addition or deletion of programs.

PRDE's policies and procedures for calculating and remitting to the Department excess interest earned on Federal cash advances required interest to be remitted only once a year in accordance with the TSA. Funds were disbursed by Hacienda, and as such, Hacienda calculated any interest earned that needed to be returned to the Department and notified PRDE of the amount required to be remitted to the Department only once a year. Although the Commonwealth of Puerto Rico's TSA allowed for annual calculation of interest earned, funds received through ARRA are not included in the TSA. As a result, the Commonwealth of Puerto Rico must comply with the Education Department General Administrative Regulations at 34 C.F.R. Sections 80.20(b)(7) and 80.21(i) for ARRA funds. These regulations require States to maintain proper cash management procedures, including calculating the interest earned on Federal funds drawn down in advance of need and remitting that interest to the Federal government at least quarterly. If the ARRA programs are included in the TSA, the Commonwealth of Puerto Rico will be able to calculate and remit interest for the covered programs annually in accordance with the TSA.

We suggest the Commonwealth of Puerto Rico notify the U.S. Treasury that ARRA programs should be added to the TSA if the available balance on the grant exceeds the Commonwealth of Puerto Rico's threshold for TSA coverage.

Inadequate Controls to Ensure Expenditures Are Paid Before Requesting Reimbursement

Although PRDE required the use of reimbursement procedures for certain expenditures, it did not ensure that expenditures were paid before requesting reimbursement from the Department. Without adequate controls in place to ensure costs are paid before requesting funds from the Department, PRDE could potentially use funds for unallowable expenditures. Although PRDE acknowledged that it may not have had adequate controls to ensure that ARRA costs were paid before PRDE requested reimbursement from the Department, it has strengthened its controls to ensure that costs are paid before requesting reimbursement.

SCOPE AND METHODOLOGY

Our review consisted of an assessment of the designed system of internal controls that PRDE and the Governor's Office planned to use in administering funds received under ARRA for the Title I, IDEA, and SFSF programs. For the SFSF program, we reviewed the designed system of internal controls at the Governor's Office and the three of its subgrantees that received the highest amount of funds.³⁷ We reviewed the controls related to data quality, cash management, subrecipient monitoring, and use of funds.

We reviewed the Governor's Office cash draw downs as of October 2009, totaling \$74.8 million of the \$647.6 million allocated in SFSF; and PRDE's draw downs as of May 7, 2010, amounting to \$180.5 million of the \$495.5 million in Title I and IDEA funds allocated. We observed the payment and accounting processes in place and conducted a limited review of certain ARRA related transactions processed at the time of our review.

To gain an understanding and assess the designed system of ARRA internal controls that PRDE and the Governor's Office planned at the time of our field work, we –

- Reviewed PRDE's Single Audit reports for the years ended June 30, 2007 and June 30, 2008, and reports issued by the Comptroller's Office related to PRDE during the years 2007 and 2008;
- Identified ARRA funds allocated to PRDE for Title I and IDEA and the Governor's Office for the SFSF program;
- Obtained and reviewed written policies and procedures of PRDE, the Governor's Office and its subgrantees related to data quality, cash management, subrecipient monitoring, and use of ARRA funds;
- Obtained and reviewed the monitoring instruments of PRDE and the Governor's Office for the Title I, IDEA, and SFSF program;
- Obtained and reviewed documentation related to data quality, cash management, subrecipient monitoring, and use of funds for Title I, IDEA, and the SFSF program;
- Observed payment and accounting processes for ARRA related transactions; and
- Interviewed PRDE and Governor's Office officials regarding controls for data quality, cash management, subrecipient monitoring, and use of funds for the Title I, IDEA, and SFSF program.

We conducted our work at PRDE and the Governor's Office from October 16, 2009, through June 15, 2010. We discussed the results of our review and recommendations in separate meetings with PRDE and with the Governor's Office on July 21, 2010.

We assessed the reliability of computer-processed data by (1) observing the processes used to account for ARRA related transactions within the financial systems used by PRDE, the Governor's Office, and the three subrecipients; (2) reviewing documentation supporting selected drawdowns of ARRA funds; and (3) reviewing documentation supporting selected payment transactions recorded in PRDE's financial system related to the purchase of SEASweb. We determined that the data was sufficiently reliable for the purposes of this report.

³⁷ PRDE, PRIFA, and the UPR.

We conducted this performance audit 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.

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Washington, DC 20024

Or e-mail:

oig_hotline@ed.gov

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Enclosure A

Governor's Office Comments

Puerto Rico Governor's Office
Response to Draft Audit Report: ED-OIG/A04K0001

Submitted to:
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The Puerto Rico Governor's Office ("PRGO") herein submits its response to the United States Department of Education's Office of the Inspector General Draft Audit Report (the "Draft") entitled *Puerto Rico Recovery Act Audit System of Internal Controls over Selected Funds*. The Draft includes four findings made to PRGO (findings 1-4). Finding 1 alleges improvements needed in communicating fraud reporting requirements, finding 2 alleges insufficient controls for safeguarding information, finding 3 alleges insufficient controls over cash management, and finding 4 alleges insufficient monitoring to ensure adequate oversight of ARRA funds.

PRGO has carefully reviewed the specific documentation, policies, and procedures at issue. Based on the results of our review to date, PRGO respectfully disagrees with the Draft's findings and requests that the Draft's findings and recommendations be reconsidered. Each finding is discussed in turn.

Finding No. 1 – Improvements Needed in Communicating Fraud Reporting Requirements

The Draft erroneously alleges that the PRGO has not appropriately informed subgrantees of the requirements for reporting suspected cases of fraud to the Department's Office of Inspector General (USDE-OIG).

The following steps taken provide evidence of the different communication means to disseminate and communicate among our subgrantees the requirement for reporting suspected cases of fraud to the USDE-OIG:

1. On February 2009, PRIFA developed the *Puerto Rico ARRA Implementation Guidelines 09-02* to address the fraud reporting requirement (Enclosure A).
2. On March 26, 2010 the Office of the Governor disseminated among its subgrantees a poster (Enclosure B).

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Governor's Office Comments

3. On May 19, 2010 an updated poster was disseminated to all subgrantees in which we changed the Hotline Phone Number to incorporate the USDE-OIG as recommended (Enclosure C).

As shown above the Office of the Governor has ensured an effective and updated communication process in which not only were the subgrantees informed but they were also instructed to place the posters in areas of visual access to employees and the public. Inclusive, we suggested to the subgrantees to place the poster in the same place of the EEO Federal Regulations Posters.

The above dissemination and communication means to the subgrantees on the requirement of reporting suspected fraud was fulfilled. Accordingly, we are in total compliance with 34 Code of Federal Regulations (CFR) 80.37 (a)(2) "... ensure that subgrantees are aware of requirements imposed on them by federal statute and regulation".

Finding No. 2 – Internal Controls for Safeguarding Information

PRGO is in the process of developing and approving information system security policies and procedures. They will take into consideration the latest security threats and changes in the information systems. PRGO is expecting to have these procedures approved by December 31, 2010.

On your recent revision of July 21, 2010, you referenced under the criteria: "The National Institute of Standards and Technology from the U.S. Department of Commerce, Special Publication 800-53, revision 2." We have accessed this document and forwarded it to the corresponding offices for their lecture and input. We will have a formal meeting with the stakeholders in order to attend these criteria (Enclosure D).

Under this finding, reference is also made to Law 151 known as "Ley de Gobierno Electrónico" of 2004. Under Article 5 –Functions (3 L.P.R.A. sec. 993) states the following: "*(i) Develop the infrastructure to guarantee effective controls related to security of the information system that sustain the operations and governmental actives. (m) Project the utility of the information technologies to prevent accidents and prepare contingency plans that permit the government to act adequately in cases of crisis for the reestablishment of systems and data in cases of disasters within the less time possible.*" Both of these functions are in alignment with the finding related to the Government policy on safeguarding the information (Enclosure E).

We have contacted the Office of the Chief Information Officer (CIO) of the Governor's Office, who has provided us with Public Policy number TIG-003 revised September 12, 2007, referenced as Security on the Information Systems (Enclosure F). Also, we are enclosing the most recent presentation of the Office of the CIO on Risk Mitigation Plan of the Governmental Information (Enclosure G).

In addition, in response to this finding, the Puerto Rico Infrastructure Financing Authority (PRIFA) has performed a preliminary evaluation concerning its information system policies and

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Governor's Office Comments

procedures and insufficient internal controls for safeguarding information. As a result of such evaluation, PRIFA's staff has developed a plan to correct deficiencies brought to its attention.

- Use of strong passwords – PRIFA circulated a memo to all personnel requiring new passwords to consist of at least six (6) characters containing no less than three (3) of the following: (i) capital letters; (ii) lowercase letters; (iii) numbers (0-9); and (iv) non-alphabetical characters (e.g., @#\$%). Passwords will be required to be changed every sixty (60) days. (Enclosure H).
- User Access Privileges – PRIFA will establish a formal policy or procedure for system and application owners to review the nature and extent of user access privileges and to ensure that those accesses and privileges were pertinent to the users' functions by December 31, 2010.
- Testing and Documenting Software Upgrades – PRIFA acquired a new server to create a separate virtual environment to document and test any changes and/or upgrades before they are applied to the live servers.
- Information system's risk assessments – These tests will be performed to document and understand any potential risks present in PRIFA's information systems. They will be performed before establishing the Continuity of Operations Plan ("COP").
- Adequate Environmental Controls – PRIFA is considering investing on a FM-200 fire suppression system. This type of system is specialized for use inside server rooms.
- Information system security policies and procedures and security threats – PRIFA expects to have the information system security policies and procedures and the security threats policies and procedures in place by December 31, 2010.
- PRIFA currently receives monitoring alerts from the Puerto Rico Office of Management and Budget ("OGP", by its Spanish acronym), including other main applications (e.g., exchange, windows servers, etc.). PRIFA will modify its current incident report policies to also include new threats security procedures. PRIFA's personnel will perform the necessary procedures to correct this finding by December 31, 2010.
- COP – OIG considers that PRIFA's COP is not adequate because an alternate site with the equipment necessary to continue their operations in case of an emergency or equipment failure does not exist. As mentioned above: (i) PRIFA is acquiring a new server to create a separate virtual environment to document and test any changes and/or upgrades before they are applied to the live servers; and (ii) PRIFA is considering investing on a FM-200 fire suppression system. This type of system is specialized for use inside server rooms. Also, it is worth mentioning that PRIFA has already purchased the software that will be necessary for the implementation of the COP.

The PRGO will instruct PRIFA to develop a schedule for periodically updating their information systems security policies and procedures, and to conduct an information system risk assessment

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Governor's Office Comments

to determine how the agency will continue its operations when an emergency occurs and establish appropriate measures. The PRGO will ensure PRIFA approves their information system security policies and procedures and incorporates information addressing the latest security threats to protect the agency's information, including ARRA data; and, PRIFA evaluates the findings and recommendations made during the information system assessment and implement as appropriate.

Also, PRGO is in the process of identifying funds to finance the cause for protecting information system distribution and transmission lines.

Finding No. 3 – Insufficient Controls over Cash Management

The Draft incorrectly alleges that PRGO lacked sufficient controls for the ARRA payment process, specifically, that the PRGO did not have written procedures for the payment process.

As part of the terms and conditions of the contracts with our subgrantees, the PRGO requires under Article IV Disbursement Duties, the following:

4.1 SUBGRANTEE hereby agree that the Grant received from the OFFICE will be managed separately from the rest of SUBGRANTEE'S funds.

4.2 SUBGRANTEE acknowledges that Grant funds will not be disbursed until a draw down request form ("Draw down FORM") is completed and delivered to the OFFICE. The Draw Down Form will provide the OFFICE with the exact amount of the disbursement to be made to SUBGRANTEE and disbursement will not be authorized without delivery of fully completed Draw Down Form. A Sample of the Draw Down Form applicable to the Grant is included as Annex III and may be sent to the OFFICE via email. The OFFICE may turn the Draw Down Form into a web based process. Upon implementation of a web based draw down process, SUBGRANTEE shall make all requests in compliance with the procedure established by the OFFICE.

We have taken a corrective action on implementing strictly the Terms and Conditions of Contract for Disbursement which must include the intended use of funds and certified by an authorized official.

PRGO follows PR Treasury Department cash management and payment procedures when managing SFSF transactions. In addition, PRGO has offered technical assistance through meetings, online communication, and formal communications to its sub recipients to discuss the payment procedures and the SFSF-specific draw down flowcharts. As part of the standard procedure, PRGO always reviews draw down requests to ensure they are appropriate and contain all required information.

The Monitoring Plan for the State Fiscal Stabilization Fund in Puerto Rico of March 10, 2010; Part C states the following Draw Down Process:

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Governor's Office Comments

1. Review each draw down request to ensure it incorporates the backup documentation specified in the memoranda of understanding, as well as any additional documentation required by the PRGO.
2. Request documentation after draw down that certifies sub-recipient disbursement within the specified dates.
3. Maintain all draw down requests and back up at the PRGO.
4. Check "Expected Disbursement Schedule" for each sub recipient regularly to detect and clarify possible deviance from the plan.

Also, in response to this USDE-OIG Finding, PRGO has implemented a SFSF Draw Down Request Review Checklist (Enclosure I) and prepared a written procedure detailing the steps previously contained in the flowcharts (Enclosure J). These documents will be provided to the USDE-OIG to back up our corrective action plan.

Finding No. 4 – Insufficient Monitoring to Ensure Adequate Oversight of ARRA Funds

The Draft erroneously alleges that PRGO's monitoring plan and tool lacked key steps necessary to ensure ARRA compliance.

Upon approval of the State Fiscal Stabilization Fund program on May 2009, the PRGO was completely aware of the responsibility of developing a Monitoring Plan. As acknowledged on Finding #1 "*The Governor's Office developed a monitoring plan and tool to ensure subrecipient's compliance with requirements governing Recovery Reinvestment Act (ARRA) funding and the proper use of funds*"...

On the visit of the OIG in October 2009, the Office of the Governor provided the USDE-OIG Monitoring Team with the preliminary draft of a Monitoring Plan. This draft Monitoring Plan was later revised after the USDE published on February 2010 their Monitoring Plan for the State Fiscal Stabilization Fund (SFSF) Program. The intention was to incorporate to our original plan, all the components that the Grantor will be using to monitor us as grantees. We will use the same parameters to monitor our subgrantees.

On March 2010, the Office of the Governor submitted to the USDE the final version of the Monitoring Plan for consideration and approval. This version is pending for approval by the USDE (Enclosure K). We are confident that the USDE will approve this Monitoring Plan soon. Nevertheless, we have proceeded to implement the Monitoring Plan with our subrecipient's to ensure compliance with the requirements governing the American Recovery Reinvestment Act (ARRA).

Enclosure B

PRDE Comments

Puerto Rico Department of Education
Response to Draft Audit Report: ED-OIG/A04K0001

Submitted to:
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The Puerto Rico Department of Education (“PRDE”) herein submits its response to the United States Department of Education’s Office of the Inspector General Draft Audit Report (the “Draft”) entitled *Puerto Rico Recovery Act Audit System of Internal Controls over Selected Funds*. The Draft includes five findings against PRDE (findings 2 -6). Finding 2 alleges insufficient controls for safeguarding information, finding 3 alleges insufficient controls over cash management, finding 4 alleges insufficient monitoring to ensure adequate oversight of ARRA funds, finding 5 alleges ineffective monitoring of the procurement process, and finding 6 alleges lack of documentation to support payments made with IDEA ARRA funds.

PRDE takes allegations of this nature very seriously and has carefully reviewed the specific documentation, policies, and procedures at issue. Based on the results of our review to date, PRDE respectfully disagrees in part with the Draft’s findings and requests that the Draft’s findings and recommendations be reconsidered. For recommendations in which PRDE agrees, PRDE has outlined its corrective action plan. Each finding is discussed in turn.

Finding No. 2 – Internal Controls for Safeguarding Information

PRDE disagrees with the Draft’s finding that PRDE had not established internal controls for developing, approving and updating information system security policies and procedures. Specifically, the Draft states that PRDE lacked policies and procedures to ensure proper password and account management. PRDE has established appropriate internal controls related to its information system security policies and procedures, including policies to ensure proper password and account management.

Password and Account Management

PRDE has information systems policies and procedures that outline the process to provide secure passwords throughout the organization and assign account rights and permissions to the requisite employees. Before an employee is issued a password providing access to secure modules, the employee’s supervisor must submit the request to the Information Systems Office

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PRDE Comments

for a approval. Once a approved, a password is assigned. If the employee is transferred, the previous password is invalidated and the new supervisor must submit a new request for access to appropriate secure modules. The Information Systems Office meets weekly to cross-reference employee transfers with the Human Resources Department and to monitor the appropriate password changes and employee access to information.

The information systems policies and procedures also outline the process to provide secure passwords to contractors that require access to certain modules. Generally, contractors are provided access only to those systems or applications that are necessary. However, in very limited circumstances, there is a legitimate need to provide certain contractors administrative rights. This practice is constantly being reviewed and controlled. The Information Systems Office addresses this issue in its weekly meeting.

Several controls are in place to ensure proper security of PRDE information systems. PRDE currently uses the security system Oracle Applications. Username and password are required before any employee may access secure systems. Access to transaction entry, view, posting or adjustment of information is determined by defined roles and responsibilities within the applications. Roles and responsibilities are assigned to each user based on the approved tasks to be performed by the user. There is a minimum length requirement and alphabetical, numerical and special characters may be used to ensure passwords are not easily decrypted. In addition, all secure passwords must be changed every three months. Users are automatically logged out as a result of inactivity. Further, after five minutes of failed attempts to submit the correct password, the employee's computer goes into an automatic lock-down and cannot be unlocked until verification by the Information Systems Office that the access is allowable.

PRDE is in the process of updating its information systems new account procedures through implementation of Oracle Identity Management and Access Management. These new security systems will provide PRDE with the necessary tools to efficiently manage access protocols for PRDE's SIFDE, PCE and Active Directory systems. The new account procedures will outline the proper workflow approval processes required to request, assign and approve user accounts, as well as deny and inactivate user accounts. The new account protocols will be implemented in conjunction with the new security systems.

Accordingly, PRDE's information system security policies and procedures ensure the use of secure passwords throughout the agency and ensure users have the correct level of access. The Information Systems Office regularly monitors use of secure systems to ensure users have the correct level of access. Additionally, PRDE periodically reviews and updates its information systems policies and procedures to reflect changes to the information systems.

Finding No. 3 – Controls over Cash Management

PRDE disagrees with the Draft's finding that PRDE lacked sufficient controls for the ARRA payment process. PRDE currently has controls in place to ensure that costs under the schoolwide program are paid before requesting reimbursement from the U.S. Department of Education (ED) and that earned interest is properly calculated and timely returned to ED.

Verifying Payments Before Requesting Reimbursement

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PRDE Comments

According to the Draft, PRDE did not have adequate controls to ensure ARRA costs under schoolwide programs are paid before PRDE requests reimbursement from ED. PRDE acknowledges that this may have been an issue for a very small portion of its ARRA costs related to schoolwide programs. However, PRDE has eliminated this risk by updating its SIFDE system to allow for daily processing of reimbursement requests based on actual expenditures. As noted in the Draft, PRDE experienced some delays in its work with the external contractor to develop this automated system, however the contract was resumed and the contractor finished the new system. Implementation of the new automated system began this week. Testing of the new system is expected to be finished by the end of October, with full implementation to be complete by November 1, 2010.

Even before the system was updated, however, PRDE ensured the vast majority of the costs under schoolwide programs were paid before PRDE requested reimbursement from ED. At least 90% of the ARRA costs related to schoolwide programs went to payroll. Payroll disbursements go out on the 15th and 30th of each month by direct deposit. PRDE requests reimbursement from ED for schoolwide expenditures at the end of each month, after PRDE disburses its payroll costs. Therefore, for at least 90% of disbursements, controls existed to ensure that expenditures were paid before PRDE requested reimbursement.

For the remaining 10%, the request for reimbursement may have come before payment had been disbursed, for example, in circumstances where a check issued by PRDE for payment of a schoolwide expense remained outstanding at the time PRDE requested reimbursement from ED at the end of the month. However, PRDE adequately ensured the funds were used only for allowable expenditures because of the strong internal controls in place. For example, several layers of reviews and authorizations by different offices are required before federal funds, including ARRA funds, may be expended. Thus, even if a reimbursement request preceded the actual expenditure, several controls ensured that the funds were expended in accordance with federal requirements.

In conclusion, PRDE has established adequate controls to ensure ARRA costs under schoolwide programs are paid before requesting reimbursement for ARRA drawdowns from ED.

Calculating and Remitting Earned Interest Timely

The Draft mistakenly asserts that PRDE lacked written policies and procedures to ensure that earned interest is properly calculated and timely returned to ED. PRDE calculates and remits interest earned on advances to ED annually, rather than quarterly, in accordance with an agreement between the Puerto Rico Department of Treasury (PR Treasury) and the U.S. Department of Treasury, Office of Finance Management Service (FMS), included as Attachment A. ED has routinely allowed such arrangements in other states, including, for example, California.

PR Treasury enters into an agreement each year with FMS on behalf of all Puerto Rico government agencies that allows annual calculation and remittance of interest earned on federal advances. The policies and procedures describing this process are stated in the circular letter issued by the PR Treasury and included as Attachment B.

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PRDE Comments

Accordingly, PRDE has the required policies and procedures to calculate and remit excess interest earned on federal funds, including ARRA funds, and PRDE in fact calculates and remits excess interest in a timely manner.

Finding No. 4 – Monitoring to Ensure Adequate Oversight of ARRA Funds

PRDE disagrees with the Draft's finding that PRDE did not have a sufficient plan for monitoring its use of ARRA funds to ensure compliance with the requirements governing ARRA funding. The Draft states that the program monitoring guides covering Title I and IDEA were not modified to include Title I and IDEA ARRA funds. Further, the Draft states that PRDE does not have a sufficient level of adequately trained staff assigned to its monitoring units.

Monitoring Guides

PRDE currently monitors its ARRA Title I funds according to the Monitoring Procedures Manual for funds administered at the Office of Federal Affairs (OFA), included as Attachment C. OFA's Regional Monitoring Unit (RMU) monitors ARRA Title I funds according to the monitoring calendar, which was developed using risk-based analysis, included as Attachment D. The RMU updated the Monitoring Procedures Manual to ensure that the use of both regular and ARRA Title I funds are adequately monitored and in compliance with federal requirements. The revised manual is under review; final approval is expected to be obtained by October 31, 2010.

PRDE agrees with the Draft's recommendation that additional staff is needed to assist the RMU with the programmatic monitoring visits. Until the additional staff is hired, the OFA Monitoring Unit has provided and will continue to provide the necessary assistance to the RMU in its monitoring activities under the Monitoring Procedures Manual in order to comply with the 2010-2011 monitoring calendar.

PRDE's Special Education Office (SAEE) monitors its ARRA IDEA funds through its regular IDEA monitoring procedures. PRDE agrees with the Draft's recommendation that SAEE develop appropriate IDEA fiscal monitoring procedures and assign responsibilities to effectively monitor the fiscal aspects of the IDEA program. SAEE is planning on leveraging OFA's system of fiscal monitoring through the creation of a Fiscal Monitoring Unit, administered by PRDE's Finance Division. SAEE will develop IDEA fiscal monitoring policies and procedures to be implemented by the proposed Fiscal Monitoring Unit, or through another unit responsible for monitoring IDEA funds. In the interim, PRDE's Finance Department is responsible for calculating and monitoring IDEA fiscal requirements, including, for example, maintenance of effort. Further, strong internal controls are in place to adequately ensure all IDEA expenditures, including ARRA IDEA expenditures, comply with federal requirements. For example, each payment request must go through several layers of review and approval from different offices before the payment is allocated to ARRA or regular IDEA funds.

Thus, PRDE will ensure the RMU is properly trained to effectively monitor the use of ARRA funds and revise its Title I and IDEA monitoring guides to include monitoring the use of ARRA funds in compliance with federal requirements. Further, PRDE will develop IDEA fiscal monitoring policies and procedures to be implemented by IDEA fiscal monitors to better-ensure

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the fiscal aspects of the IDEA program are monitored (such as maintenance of effort and allowability of costs).

Staffing

In accordance with the Draft's recommendation, PRDE is in the process of properly staffing and training the Fiscal Monitoring Unit (FMU) and the RMU to effectively monitor the use of ARRA funds. PRDE will conduct a needs assessment to determine how many employees are necessary for each of the monitoring units. Until the RMU is properly staffed, OFA's Monitoring Unit will continue to assist the RMU with its monitoring schedule. As mentioned above, the RMU Monitoring Procedures Manual addresses both regular and ARRA Title I funds. OFA will train members of the RMU on the Monitoring Procedures Manual once the manual is approved.

PRDE SAEF also remains committed to effectively staffing the program monitoring unit. The Draft alleges that the SAEF needs additional staff to effectively monitor the IDEA program. Specifically, the Draft states that two general supervisors and two specialists in education research are needed. The SAEF completed a needs assessment and determined only two additional employees are needed to adequately monitor the IDEA program. One of the positions has been contracted and SAEF is actively searching to fill the single remaining open position. Additionally, as mentioned above, SAEF is also developing appropriate fiscal monitoring policies and procedures (covering both regular and ARRA funds) and will soon have IDEA fiscal monitors in the proposed Fiscal Monitoring Unit, or as part of another unit responsible for monitoring IDEA funds. PRDE's Finance Division will train the FMU monitors on the SAEF-developed IDEA fiscal monitoring policies and procedure once finalized and approved.

Finding No. 5 – Monitoring the Procurement Process

PRDE disagrees in part with the Draft's recommendations regarding the monitoring of its procurement process. The Draft states that PRDE has not fully established a monitoring unit or developed a monitoring plan and/or guidance to effectively monitor Purchasing Officers and the current and past performance of vendors. Further, the Draft alleges PRDE has not reviewed its procurement procedures to ensure procurement processes funded under ARRA are conducted in accordance with the requirements governing ARRA.

PRDE is committed to ensuring its Central Purchasing Office (CPO) effectively monitors the performance of Purchasing Officers and vendors and is in the process of establishing and staffing the proposed CPO Monitoring Unit. PRDE has determined a staffing level of three will satisfy this unit's needs. PRDE expects to contract these responsibilities out until it is able to create and hire the new positions.

While the proposed CPO Monitoring Unit has not yet been established and staffed, the CPO has implemented an interim approach to handling the responsibilities proposed to be managed by the CPO Monitoring Unit. The CPO regularly monitors the workflow quantity and status of requisitions, delivery orders, and purchase orders as well as the cumulative dollar amounts by purchasing category. The CPO issues weekly reports on these figures which are analyzed and discussed during weekly CPO staff meetings. Based on these reports, necessary

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follow-up activities are conducted to ensure delivery and receipt of procured items. CPO leadership monitors the data by region and by individual buyer to identify outliers or otherwise concerning statistics. Where concerns are identified, appropriate follow-up action is taken.

Additionally, in terms of monitoring the Purchasing Officers, the CPO is structured to ensure two levels of review of Purchasing Officer work. CPO Supervisors are the first level of review of Purchasing Officer work. The supervisors are located at both the central and regional levels, and each supervisor oversees three Purchasing Officers. The supervisors review all work completed by the Purchasing Officers. The CPO Director constitutes the second level of review, and spot checks Purchasing Officer work already reviewed by the Supervisors. This double layer of review helps ensure all purchasing orders are properly completed and approved.

The CPO has monitoring procedures in place, which PRDE is scheduled to review and revise, as appropriate, the monitoring procedures prior to the end of the calendar year. PRDE's established procurement procedures apply for all procurement activities, regardless of funding source. PRDE will review its procedures to ensure procurement processes funded under ARRA are conducted in accordance with the requirements governing ARRA. If any necessary changes or additions are identified, PRDE will revise its procedures accordingly.

PRDE has completed a review of its policy regarding the handling of invoices by Purchasing Officers and has determined said procedures maintain an adequate segregation of duties. First, the Draft's description of Article 81 of PRDE's Procurement Policies and Procedures misstates the role of the Purchasing Officers with regard to the receipt of invoices. Article 81 does assign Purchase Officers the task of providing follow-up support to the payment process to avoid unnecessary delays; however, contrary to the Draft's interpretation, Purchasing Officers are not responsible for obtaining vendors' invoices or preparing hard copy packages for each purchase order to send to the Accounts Payable (AP) Division. Rather, the AP Division is charged with receiving invoices and supporting documentation. In the case of services, the invoices and supporting documentation are first received at the specific office contracted to receive the services. The invoices are reviewed, certified, and then passed on to the AP Division. In the case of goods, the invoices go directly to the AP Division from the vendor. The AP Division is responsible for notifying Hacienda to issue payment.

In response to the PRDE Internal Audit Report on the 2007 Compliance Agreement Quarterly Progress Report for the period ended December 2009, and to ensure segregation of duties, the PRDE Director of the Procurement Office issued a letter clarifying the process and reinforcing the proper roles of the Purchasing Officers and the AP Division with regard to the receipt and review of invoices. This letter, dated January 14, 2010, is included as Attachment E.

Finding No. 6 – Documentation to Support Payments Made with IDEA ARRA Funds

PRDE has supporting documentation of the procurement process resulting in the purchase of the annual software license from Computer Automation Systems, Inc. (CAS) as well as documentation for the \$2,051,000 in payments made to CAS, including evidence that services were rendered in accordance with the agreement between CAS and PRDE.

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CAS is the owner of SEASweb software, which PRDE uses for maintaining its special education data islandwide. In order to use this software, PRDE must purchase an annual software license from CAS each year. The Audit Report cites an invoice and accompanying proposal that were submitted by CAS to PRDE totaling \$4.6 million; however, PRDE never accepted this proposal nor entered into a contract with CAS for the services detailed in that proposal. PRDE determined that it did not require the additional services CAS was offering as a package in addition to the annual software license in its proposal. Accordingly, PRDE proceeded through the procurement process to purchase the annual software license, and no additional goods or services, from CAS for a total cost of \$2,051,000. A copy of the invoice submitted by CAS to PRDE for the annual license reflecting this price is included at Attachment F. The description section of the invoice details that the purchase is for the SEASweb Special Education Management Systems Annual License. The final cost for the stand alone annual license is higher than the costs included in the proposal because CAS was offering a discounted price on the license if PRDE were to purchase a larger package of goods and services from CAS.

The cost of the annual license was determined based on CAS's price sheet, included as Attachment G. PRDE's student count in SEASweb for 2009 was 121,339. The cost of the annual license is based on a Usage Fee of \$16 per student. Accordingly, the 2009 Usage Fee was \$1,941,424 ($121,339 * 16$). PRDE also elected to purchase the SEAS Software Annual Maintenance for an additional fee of \$187,500. The total of the Annual Maintenance and the Usage Fee was \$2,128,924. PRDE received a discount of \$77,924 for its purchase of the Annual Maintenance, as evidenced by the written statement from CAS, included as Attachment H. Thus, the adjusted total cost of the SEASWeb Annual license and maintenance was \$2,051,000.

This purchase of the annual software license granted PRDE access to and use of the SEASweb program for the period October 20, 2009 through September 19, 2010. PRDE paid CAS invoice in two installments: (1) \$594,790 paid on March 25, 2010 and (2) \$1,456,210 paid on March 19, 2010. A copy of PRDE's accounting records for these two payments is included at Attachment I. PRDE received access to the SEASweb program for the period governed by the license.