

July 2009

# RECOVERY ACT

## States' and Localities' Current and Planned Uses of Funds While Facing Fiscal Stresses (Arizona)



GAO

Accountability \* Integrity \* Reliability

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# Appendix I: Arizona

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## Overview

The following summarizes GAO's work on the second of its bimonthly reviews of American Recovery and Reinvestment Act (Recovery Act)<sup>1</sup> spending in Arizona. The full report on all of our work, which covers 16 states and the District of Columbia, is available at <http://www.gao.gov/recovery/>.

**Use of funds:** Our work in Arizona focused on eight federal programs, selected primarily because they have begun disbursing funds to states and includes existing programs receiving significant amounts of Recovery Act funds or significant increases in funding. Program funds are being directed to helping Arizona stabilize its budget and support local governments, particularly school districts, and are being used to expand existing programs. Funds from some of these programs are intended for disbursement through states or directly to localities. The funds include the following:

- **Increased Medicaid Federal Medical Assistance Percentage (FMAP) funds.** As of June 29, 2009, Arizona has received about \$535 million in increased FMAP grant awards, of which it has drawn down about \$513 million, or 96 percent. Arizona officials said the funds made available as the result of increased FMAP are critical in helping Arizona maintain its core Medicaid program and avoid systematic reductions in funding for other programs, such as the State Children's Health Insurance Program. Arizona is also planning on using state funds freed up as a result of the increased FMAP to offset the state budget deficit.<sup>2</sup>
- **Highway Infrastructure Investment funds.** The U.S. Department of Transportation's Federal Highway Administration apportioned \$522 million in Recovery Act funds to Arizona. As of June 25, 2009, \$262 million has been obligated for highway projects. Arizona's Department of Transportation and Arizona's Federal Highway Administration worked together to identify a priority list of transportation infrastructure projects that could be started quickly. ADOT has awarded 24 contracts for Recovery Act highway projects, largely involving pavement preservation, shoulder widening, and road repair.

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<sup>1</sup>Pub. L. No. 111-5, 123 Stat. 115 (Feb. 17, 2009).

<sup>2</sup>The increased FMAP available under the Recovery Act is for state expenditures for Medicaid services. The receipt of this increased FMAP may reduce the funds that states would otherwise have to use for their Medicaid program, and states have reported using these available funds for a variety of purposes.

As of June 25, 6 highway projects funded with Recovery Act dollars have begun construction. For example, the initial project under construction near Prescott involves making safety improvements and repairs to the roadway.

- **U.S. Department of Education State Fiscal Stabilization Fund (SFSF).** The U.S. Department of Education has awarded Arizona about \$832 million, or about 81.8 percent of its total SFSF allocation of \$1.017 billion. Arizona has not drawn down any of the funds as of June 30, 2009. Arizona is planning to use a portion of these funds to offset budget cuts, in such areas as education. For example, the state has allocated, for fiscal year 2009, \$250 million to be used for the K-12 program, and \$183 million for community colleges and universities. Remaining funds will be used for education, public safety, or other government services.
- **Title I, Part A, of the Elementary and Secondary Education Act of 1965 (ESEA) funds.** The U.S. Department of Education has awarded Arizona about \$97.5 million in Recovery Act ESEA Title I, Part A, funds, or 50 percent of its total allocation of \$195 million. Of these funds, Arizona has allocated to state local education agencies (LEA) about \$185 million. As of June 30, 2009, the state education agency had approved 24 applications for about \$6.7 million. The schools are encouraged to use the funds in ways that will build their long-term capacity to service disadvantaged youth, such as through providing professional development of teachers. For example, a school will acquire an instructional data system, which integrates curriculum mapping, assessment, reporting, and analysis tools, to identify trends in student learning and make improvements in classroom instruction, and contract for a system coordinator.
- **Individuals with Disabilities Education Act (IDEA), Part B and C funds.** The U.S. Department of Education has allocated about \$194 million in Recovery Act IDEA, Part B and C funds to Arizona. The Arizona Department of Education will receive about \$184 million in IDEA Part B funds and the Department of Economic Security will receive about \$10 million in IDEA Part C funds. On April 1, 2009, the U.S. Department of Education made available about 50 percent of the total allocation. The Arizona Department of Education has allocated about \$178 million and about \$6 million to state LEAs and preschools, respectively, in Part B funds. On June 22, 2009, Arizona opened the grant application process to support special education and related services for infants, toddlers, children, and youth with disabilities. For example, LEAs plan to use the funds to provide teachers with coaching

services for improving behavior management skills, and initiate an in-school program for students with autism and another for medically fragile students.

- **Weatherization Assistance Program funds.** The U.S. Department of Energy allocated about \$57 million in Recovery Act weatherization funding to Arizona for a 3-year period. Based on information available on June 30, 2009, Arizona has received \$28.5 million in weatherization funds. Arizona is using the initial funding allocation of \$5.7 million to hire and train program staff and has received an additional \$22.8 million of the Recovery Act weatherization funds. Arizona intends to use this money to begin to weatherize at least 6,400 homes.
- **Edward Byrne Memorial Justice Assistance Grant Program funds.** The U.S. Department of Justice's Bureau of Justice Assistance has awarded \$25.3 million directly to Arizona in Recovery Act funding. Based on information available as of June 30, 2009, about \$23.1 million (91 percent) of these funds have been obligated by the Arizona Criminal Justice Commission, which administers these grants for the state.<sup>3</sup> These funds coming to the state are being used mostly to supplement current state law enforcement and criminal justice efforts. For example, 36 projects have been approved for funding in such areas as drug forensics, drug and gang prosecution, rural law enforcement, and information sharing initiatives.
- **Public Housing Capital Fund.** The U.S. Department of Housing and Urban Development has allocated about \$12 million in Recovery Act funding to 15 public housing agencies in Arizona. Based on information available as of June 20, 2009, about \$1.7 million (14 percent) had been obligated by 11 of those agencies. At the five public housing authorities we visited, this money, which flows directly to the authorities, is being used for various capital improvements. For example, two projects underway in Tucson are using the funding to repair asphalt, to do roof repairs, and to remodel a kitchen and bathroom and to replace the hot water and air-conditioning units.

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<sup>3</sup>We did not review Edward Byrne Memorial Justice Assistance Grants awarded directly to local governments in this report because the Bureau of Justice Assistance's solicitation for local governments closed on June 17; therefore, not all of these funds have been awarded.

**Safeguarding and transparency:** Arizona has enhanced its accounting system to track Recovery Act funds by adding new accounting codes in order to segregate and track these funds separately from other funds that will flow through the state government. Arizona's General Accounting Office has issued guidance to state agencies on their responsibilities, including how they are to receive, disburse, tag or code funds in their accounting systems; track funds separately; and, to some extent, report on these federal resources. State department heads and program officials generally expect that they will also require subrecipients, through agreements, grant applications, and revised contract provisions, to track and report Recovery Act funding separately. The state comptroller and the state chief information officer are devising a methodology to integrate information gathered across the state agencies with the data in the state's accounting system, the Arizona Financial Information System, into an overall database or data warehouse for reporting on the use of Recovery Act funds for the entire state. Although the state has not completed a separate risk assessment for these funds, the state is in the process of administering a survey asking state agencies for a self-assessment of their internal controls that includes a risk assessment, to help safeguard Recovery Act resources.

**Assessing the effects of spending:** Arizona agencies have begun collecting information on jobs created and preserved, although different kinds of information are being submitted across programs. On June 22, 2009, OMB issued implementing guidance clarifying how states are to report the number of jobs created and preserved under the Recovery Act. Existing programs that are receiving Recovery Act funds are continuing to measure some results beyond jobs—such as program outcomes—through their existing program evaluations, but some programs are still awaiting guidance for how to assess outcomes from federal programs.

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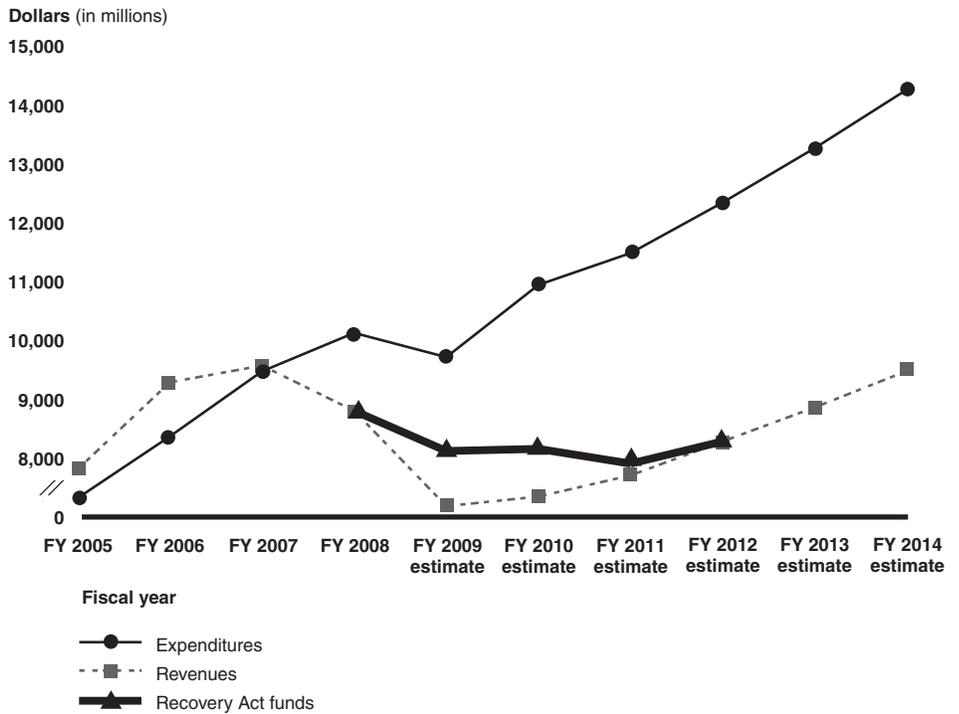
## Arizona Is Using Recovery Act Funds to Stabilize Budget and Support Programs and Infrastructure, but Expects Fiscal Challenges to Continue after Recovery Act Funds Expire

Arizona continues to face economic distress, which state officials expect will be partially relieved with Recovery Act funding. Arizona budget officials estimate that expenses to the state's general fund will exceed revenues by over \$10 billion for fiscal years 2009 through 2011, with minimal or no revenue increases projected through fiscal year 2011. The major cause of the widening budget gap is revenue collections, which continue to be significantly lower than officials had anticipated. For example, since May 2007, the state has experienced consistent revenue declines in income tax, corporate income tax, and sales tax revenue, according to state budget officials. To help reduce the budget shortfall, the state has imposed budget cuts on all areas of state government, including education, health care, environmental protection, behavioral health, and public safety. However, due to the severity of the state's economic situation, the state's budget office estimates that the state's general fund gap will continue to grow into fiscal year 2014 (see figure 1). Governor Jan Brewer recently approved legislation to address an even deeper fiscal year 2009 shortfall than expected and, as of June 30, is in negotiations with the state legislature to finalize plans to close an expected \$4 billion deficit in order to balance the fiscal year 2010 budget.<sup>4</sup> The Governor's plans to balance the fiscal year 2010 and 2011 budgets may include temporary increases in tax revenues as a means to avoid additional cuts. As of June 30, 2009, the state's fiscal year 2010 budget had not been passed.

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<sup>4</sup>The fiscal year in Arizona begins July 1 and ends June 30. In our April report we noted that state officials were working to close an estimated budget gap of about \$2.1 billion for state fiscal year 2009.

**Figure 1. Arizona General Fund Expenses, Revenues, and Federal Recovery Act Funding for Fiscal Year 2005 to Fiscal Year 2014 (in millions)**



Source: Arizona's Office of Strategic Planning and Budgeting.

Budget officials stated that Recovery Act funds will help to reduce the size of current and future general fund shortfalls but will not completely eliminate them. For example, the state used \$470 million made available as a result of the increased FMAP to help close a gap in the fiscal year 2009 budget, and plans to apply \$810 million of such funds in fiscal year 2010 and \$500 million in fiscal year 2011 for the same purpose. In addition, the state applied \$443 million in SFSF funds to the budget gap in fiscal year 2009 and plans to use \$390 million for that purpose in fiscal year 2010. Recovery Act funds used to close the budget gap total about \$2.6 billion across fiscal years 2009 to 2011—compared to the state's estimated general fund shortfall of over \$10 billion for that same period.<sup>5</sup>

<sup>5</sup>In our April 2009 report we noted that the state had depleted its budget stabilization fund, known as its rainy-day fund.

In addition to general fund stabilization, budget officials noted that Recovery Act funding enabled the state to, among other things, reduce the number of furloughs and layoffs, avoid some service reductions, maintain the level of state employee benefits, and prevent some contract delays and reductions that otherwise would have occurred. Budget officials noted that they intend to develop an exit strategy that will prepare the state for when Recovery Act funds are no longer available. To do so, they will work with agencies to minimize the funding cliff effect that could result once Recovery Act funds expire, but the officials said that such instructions have not yet been developed. The Governor has stated that the use of Recovery Act funds is not intended to grow the size of Arizona's government services to unsustainable levels once such funds are no longer available.

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**Arizona Requires Additional Management Capacity to Oversee Recovery Act Funds and Is Addressing This Gap with Federal Funding**

Budget officials stated that more staff are needed to implement the estimated \$6.3 billion in total Recovery Act funds that are to be received by Arizona. Currently, there are about 15 full-time staff within the state's Office of Economic Recovery, and other agencies have designated staff members who are primary contacts or who are called on an as-needed basis for Recovery Act funding issues. For example, the state comptroller has an internal staff of 3 that is responsible for communicating with the Governor's Office and state agencies, teaching the state agencies what is needed to comply with the Recovery Act requirements, and emphasizing the need for good internal controls. To assure that the state has the capacity to comply with Recovery Act provisions, officials estimated that they will need an additional 35 full-time staff and plan to complete an assessment of actual staffing needs by the end of July.

As part of the staff planning efforts, officials are drafting a budget that will use the option as announced by OMB in May 2009 to charge up to 0.5 percent of certain Recovery Act funds in indirect costs to provide additional staffing resources to entities responsible for the oversight, monitoring, and tracking of Recovery Act funds. The announcement by OMB has been very helpful, according to Arizona officials. The comptroller noted that the state is developing strategies and processes to estimate the state's indirect costs and plans to make subsequent adjustments to the estimated amounts after actual costs are incurred. In addition, some individual programs receiving Recovery Act funds allow agencies to use a share of these funds for administrative costs. For example, the Edward Byrne Memorial Justice Assistance Grant (JAG) Program, under the Recovery Act, allows up to 10 percent of funds to be used for such costs. Officials with the Arizona Criminal Justice

Commission, which oversees JAG funds for the state, estimated that the workload is likely to double as a result of receiving additional funds through the Recovery Act. They plan to use some of the state's administrative JAG funds to hire additional staff to help manage the heightened Recovery Act requirements and increased number of subrecipients.

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## Federal Assistance under the Recovery Act Is Helping Arizona to Maintain Its Medicaid Program and to Address Budget Deficits

Medicaid is a joint federal-state program that finances health care for certain categories of low-income individuals, including children, families, persons with disabilities, and persons who are elderly. The federal government matches state spending for Medicaid services according to a formula based on each state's per capita income in relation to the national average per capita income. The rate at which states are reimbursed for Medicaid service expenditures is known as the Federal Medical Assistance Percentage (FMAP), which may range from 50 to no more than 83 percent. The Recovery Act provides eligible states with an increased FMAP for 27 months from October 1, 2008 through December 31, 2010.<sup>6</sup> On February 25, 2009, the Centers for Medicare & Medicaid Services (CMS) made increased FMAP grant awards to states, and states may retroactively claim reimbursement for expenditures that occurred prior to the effective date of the Recovery Act.<sup>7</sup> Generally, for federal FY 2009 through the first quarter of federal FY 2011, the increased FMAP, which is calculated on a quarterly basis, provides for: (1) the maintenance of states' prior year FMAPs; (2) a general across-the-board increase of 6.2 percentage points in states' FMAPs; and (3) a further increase to the FMAPs for those states that have a qualifying increase in unemployment rates. The increased FMAP available under the Recovery Act is for state expenditures for Medicaid services. However, the receipt of this increased FMAP may reduce the funds that states would otherwise have to use for their Medicaid programs, and states have reported using these available funds for a variety of purposes.

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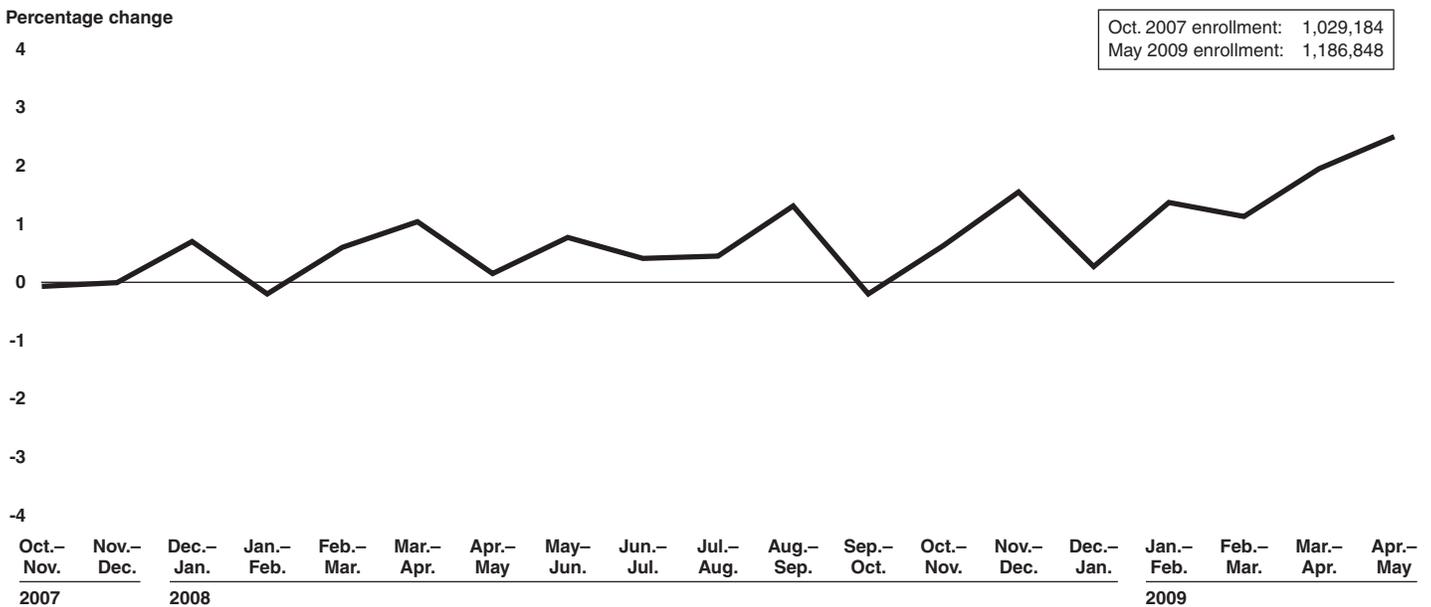
<sup>6</sup> See Recovery Act, div. B, title V, §5001.

<sup>7</sup> Although the effective date of the Recovery Act was February 17, 2009, states generally may claim reimbursement for the increased FMAP for Medicaid service expenditures made on or after October 1, 2008.

## Enrollment Growth in Arizona’s Medicaid Program Adding Pressure to State Budget

From October 2007 to May 2009, the state’s Medicaid enrollment increased from 1,029,184 to 1,186,848, an increase of over 15 percent.<sup>8</sup> Enrollment varied during this period—the largest enrollment increase occurred between April and May 2009, and there were several months where enrollment decreased (fig. 2). Most of the increase in enrollment was attributable to the population groups of (1) children and families, and (2) non-disabled non-elderly adults.

**Figure 2: Monthly Percentage Change in Medicaid Enrollment for Arizona, October 2007 to May 2009**



Source: GAO analysis of state reported data.

Note: The state provided projected Medicaid enrollment data for May 2009.

As of June 29, 2009, Arizona has drawn down almost \$513 million in increased FMAP grant awards, which is over 96 percent of its awards to date.<sup>9</sup> Arizona officials reported that they are planning on using funds made available as a result of the increased FMAP to offset the state budget deficit.

<sup>8</sup>The state provided projected Medicaid enrollment data for May 2009.

<sup>9</sup>Arizona received increased FMAP grant awards of almost \$535 million for the first three quarters of federal fiscal year 2009.

Arizona officials noted that the state's Medicaid program continues to experience substantial growth as the state continues to face difficult budget periods. Officials added that the funds made available as a result of the increased FMAP have been critical in helping Arizona maintain its core Medicaid program and avoid systematic reductions in funding for other programs, such as the State Children's Health Insurance Program (CHIP). Officials added that in the absence of funds made available as a result of the increased FMAP, funding for CHIP would have been particularly affected because the program does not have the same entitlement protections as the Medicaid program. In using the increased FMAP, Arizona officials reported that the Medicaid program has incurred additional costs related to developing new systems or adjusting existing reporting systems associated with these funds.

Since increased FMAP dollars became available, Arizona has raised a number of questions related to its ability to maintain eligibility for these funds. For example, on June 26, 2008, the state passed a law which changed the frequency of Medicaid eligibility determinations for childless adults who are not disabled from 12 months to 6 months. Because the Arizona constitution provides for a delayed effective date for non-emergency legislation, the change was not implemented until September 26, 2008. CMS determined that this change constituted a more restrictive eligibility standard, thus violating one of the maintenance of eligibility requirements under the Recovery Act.<sup>10</sup> As a result, on April 29, 2009, the Governor signed an emergency measure to amend the state's law to revert back to an annual redetermination process, which was effective June 1, 2009.<sup>11</sup> The state had suspended any additional draw downs of increased FMAP until this change was implemented. State officials reported that CMS has not indicated that the state would be required to repay any dollars.

Similarly, the officials said that the state has required political subdivisions—most typically counties—to contribute to the nonfederal share for Medicaid expenditures and that this contribution varied. Some

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<sup>10</sup>In order to qualify for the increased FMAP, states generally may not apply eligibility standards, methodologies, or procedures that are more restrictive than those in effect under their state Medicaid plans or waivers on July 1, 2008. See Recovery Act, div. B, title V, §5001(f)(1)(A).

<sup>11</sup>Officials reported that prior to CMS's ruling, the state drew down FMAP dollars totaling about \$286 million, which the state held but did not distribute.

officials have raised questions about how this practice relates to the maintenance of eligibility requirement in the Recovery Act.<sup>12</sup> For example, the largest contribution may have its annual sharing percentage change between the state and the counties. Other contributions made by counties to the state's acute care program are not subject to adjustments. However, state officials reported that the underlying laws, which require the counties to contribute to the non-federal share of expenditures, have not changed.

Regarding the tracking of the increased FMAP, state Medicaid officials indicated that Arizona changed its accounting system to include a new fund for tracking revenues and expenditures specific to increased FMAP and that the state will use existing reconciliation processes to assure the completeness and accuracy of tracked and reported data on increased FMAP dollars. However, the Medicaid officials noted that they and officials from Arizona's General Accounting Office are awaiting guidance from OMB about what steps auditors should follow when reviewing increased FMAP revenues and expenditures. The 2007 and 2008 Single Audits for Arizona identified no material weaknesses related to the data systems or other aspects of the Medicaid program.<sup>13</sup>

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<sup>12</sup>In some states, political subdivisions—such as cities and counties—may be required to help finance the state's share of Medicaid spending. Under the Recovery Act, a state that has such financing arrangements is not eligible for certain elements of the increased FMAP if it requires subdivisions to pay during a quarter of the recession adjustment period a greater percentage of the non-federal share than the percentage that would have otherwise been required under the state plan on September 30, 2008. See Recovery Act, div. B., title V, § 5001(g)(2). The recession adjustment period is the period beginning October 1, 2008 and ending December 31, 2010.

<sup>13</sup>The Single Audit Act of 1984, as amended (31 U.S.C. ch. 75), requires that each state, local government, or non-profit organization that expends \$500,000 or more a year in federal awards must have a single audit conducted for that year subject to applicable requirements, which are generally set out in Office of Management and Budget (OMB) Circular No. A-133, Audits of States, Local Governments and Non-Profit Organizations (June 27, 2003). If an entity expends federal awards under only one federal program, the entity may elect to have an audit of that program.

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## First Round of Arizona Recovery Act Highway Projects Under Way

The Recovery Act provides funding to the states for restoration, repair, and construction of highways and other activities allowed under the Federal-Aid Highway Surface Transportation Program, and for other eligible surface transportation projects. The Act requires that 30 percent of these funds be suballocated for projects in metropolitan and other areas of the state. Highway funds are apportioned to the states through existing federal-aid highway program mechanisms and states must follow the requirements of the existing program including planning, environmental review, contracting, and other requirements. However, the federal fund share of highway infrastructure investment projects under the Recovery Act is up to 100 percent, while the federal share under the existing Federal-aid Highway Program is usually 80 percent.

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## Arizona Selected Quick-Start Highway Projects to Help Comply with the Act and Received Contract Bids That Were Lower Than Estimated

As we previously reported, \$522 million was apportioned to Arizona in March for highway infrastructure and other eligible projects. As of June 25, 2009, \$262 million had been obligated (see Table 1). The U.S. Department of Transportation has interpreted the term obligation of funds to mean the federal government's contractual commitment to pay for the federal share of the project. This commitment occurs at the time the federal government signs a project agreement. As of June 25, 2009, no funds had been reimbursed by FHWA. States request reimbursement from FHWA as they make payments to contractors working on approved projects.

In anticipation of stimulus legislation, Arizona began planning for federal highway infrastructure investment before the Recovery Act was passed. Arizona's Department of Transportation (ADOT) and the Arizona Division of the Federal Highway Administration (FHWA) worked together to identify a priority list of transportation infrastructure investments from Arizona's Five Year Transportation Plan. Together, they identified projects that could be started quickly, focusing on projects that could be implemented in under 180 days, as well as projects that could be completed within a 3-year time frame. As a result, the initial Recovery Act funded projects advertised for bid are all short-term projects that require little lead time for planning and design, enabling contractors to begin work quickly. Many initial round projects were also chosen to coincide with the construction season, which, in the northern part of the state, excludes the winter months.

**Table 1: Highway Obligations for Arizona by Project Type as of June 25, 2009**

Dollars in millions

	Pavement projects			Bridge projects				Total
	New construction	Pavement improvement	Pavement widening	New construction	Replacement	Improvement	Other <sup>a</sup>	
	\$10	\$113	\$75	\$8	\$1	\$13	\$42	<b>\$262</b>
Percent of total obligations	3.7	43.3	28.6	3.1	0.4	4.8	16.1	<b>100.0</b>

Source: GAO analysis of Federal Highway Administration data.

<sup>a</sup>Includes safety projects such as improving safety at railroad grade crossings, transportation enhancement projects such as pedestrian and bicycle facilities, engineering, and right-of-way purchases.

ADOT has advertised 35 of the 41 statewide highway projects authorized by the FHWA’s Arizona Division. As of June 30, 2009, contracts for 24 of these projects have been awarded. Specifically:

- On May 15, 2009, ADOT awarded contracts for the first six projects to be undertaken using Recovery Act funds. Five of these six projects are pavement preservation projects and one is for shoulder widening and safety improvements. These six projects came in about \$3 million below ADOT’s initial estimates.
- On June 3, 2009, ADOT awarded an additional nine contracts that came in \$4.3 million below ADOT’s initial estimates.
- On June 19, ADOT awarded nine highway contracts that came in \$2.7 million below ADOT’s initial estimates.

ADOT officials believe that the bids coming in below estimates are caused by the current low levels of economic activity in the construction industry due to the state’s economic downturn, as well as lower prices for commodities like asphalt and oil. If the trend of bids coming in lower than ADOT estimates continues, ADOT officials told us that they are considering lowering bid estimates in the future. The savings from these low bids likely will be reinvested in additional Recovery Act projects.

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## Arizona Expects to Meet All Highway Spending Requirements under the Act

Funds appropriated for highway infrastructure spending must be used as required by the Recovery Act. The states are required to

- ensure that 50 percent of apportioned Recovery Act funds are obligated within 120 days of apportionment (before June 30, 2009) and that the remaining apportioned funds are obligated within 1 year.<sup>14</sup> The 50 percent rule applies only to funds apportioned to the state and not to the 30 percent of funds required by the Recovery Act to be suballocated.
- give priority to projects that can be completed within 3 years, and to projects located in economically distressed areas (EDA). EDAs are defined by the Public Works and Economic Development Act of 1965, as amended.
- certify that the state will maintain the level of spending for the types of transportation projects funded by the Recovery Act that it planned to spend the day the Recovery Act was enacted. As part of this certification, the governor of each state is required to identify the amount of funds the state planned to expend from state sources as of February 17, 2009, for the period beginning on that date and extending through September 30, 2010.<sup>15</sup>

Based on the progress to date, Arizona officials are reporting that they are on track to meet all three of their spending requirements under the Recovery Act. First, Arizona has met the Recovery Act requirement that 50 percent of their apportioned funds are obligated within 120 days. Of the approximately \$365 million that is subject to this provision 71.4 percent was obligated as of June 25, 2009.

Second, Arizona believes it will be able to expend most of the Recovery Act funds in 3 years because it has made it a priority to select projects that

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<sup>14</sup>The 50 percent rule applies only to funds apportioned to the state and not to the 30 percent of funds required by the Recovery Act to be suballocated, primarily based on population, for metropolitan, regional, and local use.

<sup>15</sup>States that are unable to maintain their planned levels of effort will be prohibited from benefiting from the redistribution of obligation authority that will occur after August 1 for fiscal year 2011. As part of the federal-aid highway program, FHWA assesses the ability of the each state to have its apportioned funds obligated by the end of the federal fiscal year (September 30) and adjusts the limitation on obligations for federal-aid highway and highway safety construction programs by reducing for some states the available authority to obligate funds and increasing the authority of other states.

could begin quickly and be completed within 2 years. State officials reported that, since the first projects are predominantly repaving projects, most are likely to be completed within 1.5 years of award. In addition, according to ADOT officials, all highway projects being undertaken with Recovery Act funds will be located in EDAs. To meet this requirement, ADOT officials developed a map of economically distressed areas in the state based on home foreclosure rates, unemployment rates, and data on disadvantaged business enterprises from the Department of Commerce. ADOT outlined its methodology for determining EDA in a letter to FHWA, which approved the methodology.

Third, on March 17, 2009, the Governor submitted Arizona's certification to the Department of Transportation certifying that the state would maintain its projected level of spending as required in the act. On April 20, 2009, the Department of Transportation responded that the state did not list all of the programs covered under the Recovery Act in the maintenance of effort certification and gave the state the opportunity to amend its certification with the correct information. On May 19, 2009, Arizona resubmitted its certification. According to Department of Transportation officials, the department has concluded that the form of the certification is consistent with the additional guidance. The Department of Transportation is currently evaluating whether the states' method of calculating the amounts they planned to expend for the covered programs is in compliance with the Department of Transportation guidance.

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## Arizona's Application for State Fiscal Stabilization Funds to Offset Budget Cuts Was Approved

The Recovery Act created the State Fiscal Stabilization Fund (SFSF) to be administered by the U.S. Department of Education (Education). The SFSF provides funds to states to help avoid reductions in education and other essential public services. The initial award of SFSF funding requires each state to submit an application to Education that provides several assurances. These include assurances that the state will meet maintenance of effort requirements (or it will be able to comply with waiver provisions) and that it will implement strategies to meet certain educational requirements, including increasing teacher effectiveness, addressing inequities in the distribution of highly qualified teachers, and improving the quality of state academic standards and assessments. Furthermore, the state applications must contain baseline data that demonstrate the state's current status in each of the assurances. States must allocate 81.8 percent of their SFSF funds to support education (education stabilization funds), and must use the remaining 18.2 percent for public safety and other government services, which may include education (government services

funds). After maintaining state support for education at fiscal year 2006 levels, states must use education stabilization funds to restore state funding to the greater of fiscal year 2008 or 2009 levels for state support to school districts or public institutions of higher education (IHE). When distributing these funds to school districts, states must use their primary education funding formula but maintain discretion in how funds are allocated to public IHEs. In general, school districts maintain broad discretion in how they can use stabilization funds, but states have some ability to direct IHEs in how to use these funds.

The Governor submitted an application to Education on May 21, 2009, for SFSF funds, which will allow the state to offset budget cuts. The application was approved on June 11, 2009. Arizona's SFSF allocation is \$1.017 billion. The state specified in its application that stabilization funds of \$433 million in fiscal year 2009 and \$399 million in fiscal year 2010 should help to offset Arizona's budget cuts to education. The state has allocated, for fiscal year 2009, \$250 million of the \$433 million be used for the K-12 program, and the remaining \$183 million for community colleges and universities. The state similarly allocated, for fiscal year 2010, \$223 million of the \$399 million for the K-12 program, and \$176 million for community colleges and universities. The application stated that the remaining 18.2 percent or \$185 million will be used at the Governor's discretion for education, public safety, or other government services.<sup>16</sup>

In terms of the \$433 million, in May 2009, the governor had to modify the state's spending for the current fiscal year, which ended June 30, 2009, to address a widening budget gap. The governor replaced \$250 million in general funds allocated for K-12 programs education and backfilled this amount with the education stabilization funds. Specifically, in fiscal year 2009 the education stabilization funds allocated to elementary and secondary education will replace about 5.9 percent of the general funds and the funds allocated to community colleges and universities will replace about 17 percent of the general fund. Similarly, it is estimated that the education stabilization funds will replace about the same amounts in fiscal year 2010. According to an official from the Governor's Office of Strategic Planning and Budgeting, no funds have been drawn down as of June 30, 2009.

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<sup>16</sup>Four categories of other expenditures were listed as "Allocation to Other Services" in an attachment to Arizona's application. The uses listed are (1) Education Reform; (2) Health Care and Children's Programs; (3) Public Safety; and (4) Innovation, Technology, and Economic Development.

The Governor stated that Arizona will not need to request a waiver from the Recovery Act requirement that states maintain the support for education programs at least at the level provided in fiscal year 2006. For example, the levels of state support for elementary and secondary education for fiscal years 2009 and 2010 (\$3.976 billion and \$3.926 billion respectively) exceed the fiscal year 2006 amount of \$3.464 billion and, therefore, comply with the maintenance of effort requirement. Budget officials said that they had no concerns about being able to effectively spend the general fund resources freed up as a result of the federal stabilization funds because of the significant budget deficits and resulting program cuts the state has faced since fiscal year 2007.

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## Local Education Agencies Are Beginning to Apply for ESEA Title I Part A Education Funds

The Recovery Act provides \$10 billion to help local educational agencies (LEAs) educate disadvantaged youth by making additional funds available beyond those regularly allocated through Title I, Part A of the Elementary and Secondary Education (ESEA) of 1965. The Recovery Act requires these additional funds to be distributed through states to LEAs using existing federal funding formulae, which target funds based on factors such as high concentrations of students from families living in poverty. In using the funds, LEAs are required to comply with current statutory and regulatory requirements, and must obligate 85 percent of its fiscal year 2009 funds (including Recovery Act funds) by September 30, 2010.<sup>17</sup> Education is advising local educational agencies to use the funds in ways that will build their long-term capacity to serve disadvantaged youth, such as through providing professional development to teachers. Education made the first half of states' ESEA Title I, Part A funding available on April 1, 2009, with Arizona receiving \$97.5 million of its approximately \$195 million total allocation.

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<sup>17</sup>LEAs must obligate at least 85 percent of their ESEA Title I, Part A funds by September 30, 2010, unless granted a waiver, and all of their funds by September 30, 2011. This will be referred to as a carryover limitation.

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## Arizona LEAs Are in the Process of Submitting Applications for ESEA Title I Funding Focusing on Improving Students' Academic Achievement

Arizona's State Department of Education has allocated \$185 million in ESEA Title I Recovery Act funds to date and is accepting applications from LEAs that outline how they will use these funds. The state is requiring that LEAs use the same grant process for requesting and reporting on ESEA Title I Recovery Act funds as they do for non-Recovery Act ESEA Title I funds. The process includes LEAs submitting applications that contain a detailed plan on how and when the funds will be used and State Education Agency (SEA) officials reviewing the application to ensure that spending plans comply with applicable laws and regulations. As of June 30, 2009, the SEA had approved 24 applications for about \$6.7 million. Also, another 73 LEAs have submitted its application for about \$33.2 million, but the applications have not been approved. In addition, another 165 LEAs have started the application process but have not formally submitted applications for approval. The additional applications total approximately \$115.5 million. According to SEA officials, they expect to approve all applications by September 30, 2009. Both the SEA and the five LEAs that we visited were confident that they could spend the funds in the next school year, especially given the program cuts they have experienced and expect to face. Although most LEAs have not submitted applications for grants, because it is the end of the school year and funds are not needed, they are developing plans for the use of the Recovery Act ESEA Title I funds for next year that focus on improving students' academic achievement.

During our fieldwork, we visited five Arizona LEAs including the four largest school districts. We found that one LEA had submitted an application for Recovery Act funds; three LEAs had drafted plans for the use of funds but had not submitted an application because it is the end of the school year and they have time to consider other projects before school begins; and one LEA had developed projects for its funding allocation, but is considering additional uses of its funds before submitting an application. The following examples show how the LEAs plan to spend Recovery Act ESEA Title I funds.

- The Phoenix Elementary School District No 1 plans to hire 36 specialists (three at each ESEA Title I school) to provide strategic and intensive reading intervention to students who are not meeting Arizona's reading standards. The LEA will also hire a reading curriculum resource specialist to oversee the ESEA Title I Recovery Act reading program. The LEA expects these positions to last only during the years of Recovery Act funding, although the LEA is hoping to make the resource specialist position permanent by looking for another source of funding.

- Another LEA, the Imagine Charter Elementary at Desert West, will 1) acquire an instructional data system, which integrates curriculum mapping, assessment, reporting, and analysis tools, to identify trends in student learning and make improvements in classroom instruction; and 2) contract for a system coordinator. The LEA piloted the system last year and determined that the system could improve student academic achievement, but that a full-time coordinator could enhance the effectiveness of the system by providing prompt feedback to the teachers regarding areas in which students need additional instruction. The Recovery Act funds will be used initially to contract for a coordinator, but the LEA plans to keep the coordinator after Recovery Act funds are terminated by reprioritizing its existing projects.

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### LEAs Will Seek Waivers So ESEA Title I Funds Can Be Used More Flexibly

LEAs we visited will likely seek waivers from requirements to provide funds for supplemental educational services (SES), such as tutoring, because they go unused and this waiver will provide more funding for other ESEA Title I projects. Specifically, three of the five LEAs we visited had schools in the district needing academic improvement and as a result are required to provide an amount equal to at least 20 percent of ESEA Title I funds transportation for public school choice and SES.<sup>18</sup> According to officials from the three LEAs, they will seek a waiver from Education from this requirement, which could allow the LEAs to use the funds for other ESEA Title I approved purposes. The LEA officials said the primary reason for requesting a waiver was that in the past, parents and students did not use the tutoring available through the vendors and the LEAs had to forfeit those funds. LEA officials explained that the tutoring services went unused because the district covers hundreds of square miles, and parents are unable to get students to approved vendors for tutoring. Furthermore, according to LEA officials, their discussions with parents showed that the parents would prefer to have their children's current teachers provide the tutoring, but they are not allowed to do so. Lastly, LEA officials said that since non-Recovery Act ESEA Title I funds already require a 20-percent expenditure and are not totally used, an additional expenditure from

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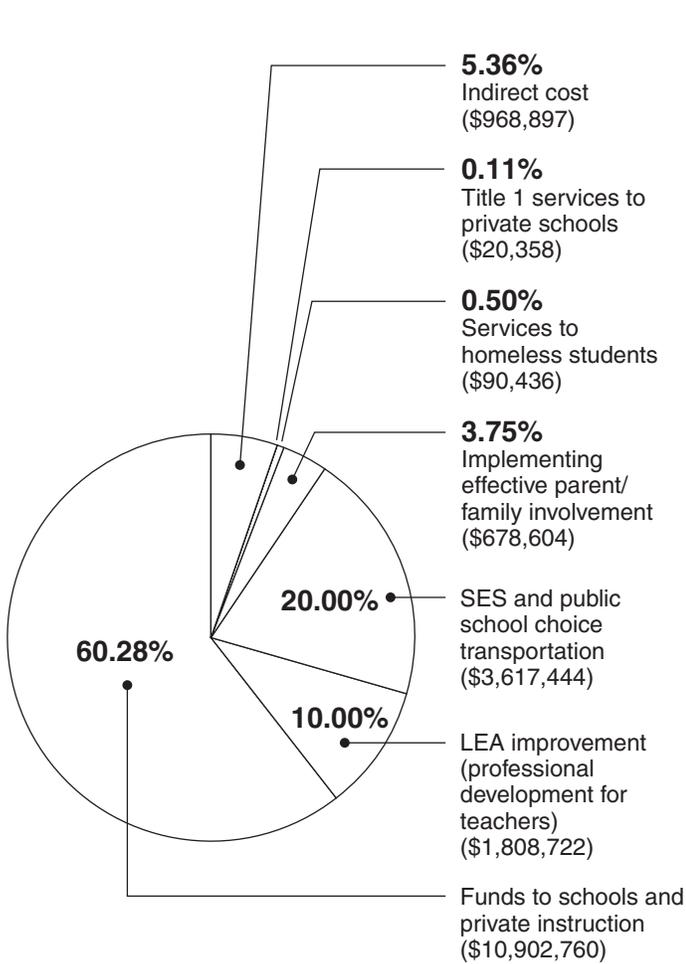
<sup>18</sup>Under ESEA Title I, states are required to establish performance goals and hold their ESEA Title I schools accountable for students' performance by determining whether or not schools have made adequate yearly progress (AYP). Schools that have not made AYP goals for 2 or more consecutive years are identified for improvement and must implement certain activities that are meant to improve student academic achievement. Districts with schools are required to provide an amount not less than 20 percent of their ESEA Title I, Part A allocation to cover school choice-related transportation costs and SES. Unless a waiver is granted, this requirement would apply to ESEA Title I Recovery Act funds also.

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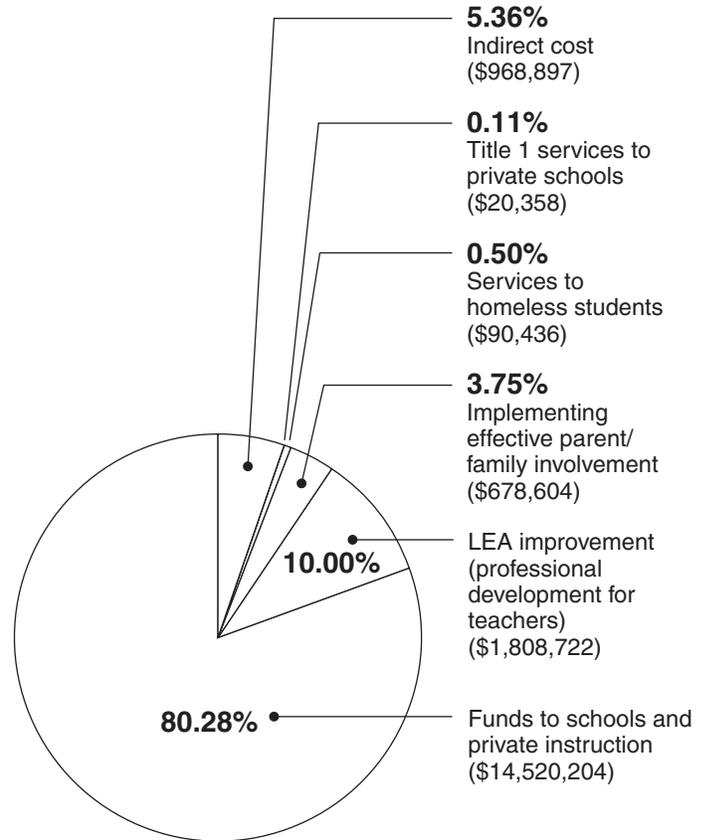
Recovery Act funds would exacerbate this situation. For example, as a result of receiving additional ESEA Title I Recovery Act funds, Phoenix High School must spend more than \$2 million for SES and \$1.7 million for other requirements, leaving \$6.5 million for spending on other ESEA Title I projects. If the waiver were granted, the LEA would be able to spend about \$8.6 million for other ESEA Title I projects, which is an increase of about 30 percent. Figure 3 shows how the Tucson Unified School District's funds to schools and private institutions would increase from \$10.9 million to \$14.5 million if the waiver were granted. SEA officials added that they have had discussions with LEAs on this subject and the state officials expect that many LEAs will seek a waiver. The state has also discussed this issue with the Department of Education although Education has not provided guidance on the process the SEA and LEAs are to use in seeking and approving waivers. According to state officials, Education may require each LEA to seek a waiver from Education or it may give the SEA authority to grant the waivers.

**Figure 3: Comparison of Tucson Unified School District Recovery Act ESEA Title I Budget Before and After an SES Waiver**

**Stimulus budget (total \$18,087,222)**



**Stimulus budget after school choice/SES waiver (total \$18,087,222)**



Source: Tucson Unified School District, June 2009.

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## Individuals with Disabilities Education Act Part B Funds Have Been Allocated to Local Education Agencies and Part C Funds Are Being Used to Offset Budget Reductions in Early Intervention Services

The Recovery Act provided supplemental funding for programs authorized by Part B and C of the Individuals with Disabilities Education Act (IDEA), the major federal statute that supports special education and related services for infants, toddlers, children, and youth with disabilities. Part B includes programs that ensure preschool and school-aged children with disabilities have access to a free and appropriate public education, and Part C programs provide early intervention and related services for infants and toddlers with disabilities, or at risk of developing a disability, and their families. IDEA funds are authorized to states through 3 grants—Part B preschool-age, Part B school-age, and Part C grants for infants and families. States were not required to submit an application to Education in order to receive the initial Recovery Act funding for IDEA Parts B and C (50 percent of the total IDEA funding provided in the Recovery Act). States will receive the remaining 50 percent by September 30, 2009, after submitting information to Education addressing how they will meet Recovery Act accountability and reporting requirements. All IDEA Recovery Act funds must be used in accordance with IDEA statutory and regulatory requirements.

The U.S. Department of Education has allocated about \$194 million in Recovery Act IDEA Part B and Part C funds to Arizona. The Arizona Department of Education will receive about \$184 million in IDEA Part B funds and the Arizona Department of Economic Security (DES) will receive about \$10 million in IDEA Part C funds. The Arizona Department of Education has allocated about \$178 million and about \$6 million to state LEAs and preschools, respectively, in Part B funds. On April 1, 2009, the U.S. Department of Education made available about 50 percent of the total allocation.

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## The SEA Recently Opened the LEA Application Process for IDEA Part B Funds

The state has allocated \$178 million of these funds among 544 LEAs. According to SEA officials, they plan to use the same grant process for Recovery Act IDEA funds that they use for non-Recovery Act IDEA funds. The process includes agreeing to the Recovery Act's reporting requirements, submitting an application that contains a detailed plan on how and when the funds will be used, and the SEA officials conducting a subsequent review to ensure that spending plans comply with applicable laws and regulations.

The SEA opened the application process for IDEA grants on June 22, 2009. The grant process was delayed while waiting for OMB guidance on reporting requirements for Recovery Act funds. The SEA opened the grant application process on the same day OMB issued the program reporting

requirement guidance.<sup>19</sup> As of June 30, 2009, the SEA had approved 2 applications for about \$18,000. Also, another 15 LEAs have submitted its application for about \$1.5 million, but the applications have not been approved. In addition, 129 LEAs have started the application process but have not formally submitted applications for approval. The additional applications total approximately \$107 million.

Although Arizona has recently opened the application process for Recovery Act IDEA Part B funds, the five LEAs we visited in early June have determined how they will use the funds. We found that the LEAs had many ideas for the use of the funds, including professional development and assistive technology that may help the student participate in school (such as special computer software or a device to assist in holding a pencil). Specifically:

- The Mesa Unified School District No. 4 plans to use the funds to provide teachers with coaching services for improving behavior management skills. The coaches will work with the general and special education teachers both on individual levels and in group settings to identify specific techniques to use to manage the behavior of special education students. These skills can be used to assist students in the classroom and to implement a student's individual education plan.
- The Phoenix Union High School District No. 210 plans to use the funds to initiate an in-school program for students with autism and another for medically fragile students. Approximately half of these funds will be used to purchase medical equipment and supplies, and the remainder will be used to employ or contract for nurses, aides, and teachers. School officials estimate that by moving these programs in house, the school district will save about \$210,000, which will be spent on sending students to outside vendors. The savings will result in increased services for IDEA Part B students in areas such as improving reading and math skills. However, the LEA stated that the application delay may prohibit the projects from starting in the fall, because soliciting bids and obtaining equipment takes weeks to accomplish.

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<sup>19</sup> In response to requests for more guidance on the recipient reporting progress and requiring data, OMB in consultation with a broad range of stakeholder issued additional implementing guidance for recipient reporting on June 22, 2009. See, OMB Memorandum, M-09-21, Implementing Guidance for the Reports on Use of Funds Pursuant to the American Recovery and Reinvestment Act of 2009.

- The Tucson Unified School District No. 1 plans to use part of the Recovery Act IDEA Part B funds to purchase, install, and pilot voice amplification systems in classrooms by collecting pre/post data at the elementary and middle school levels. The amplification system will make it easier for students to hear the teacher's voice over the background sounds and allows the teacher to speak more quietly and still be heard. After reviewing research during 2008 to 2009, the LEA determined that the system will benefit students with low hearing and students with attention deficit disorder and benefit teachers who will be able to teach all day without straining their voices. Data will be collected on student and teacher perceptions as well as academic achievement, learning behaviors, and staff absenteeism.

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### Arizona Is Using Initial IDEA Part C Funds to Support a Growing Caseload

IDEA Part C provides funds to states to implement statewide, comprehensive, multidisciplinary, interagency programs and make early intervention services available to children under age 3 with disabilities and their families. In Arizona, these services are provided by entities that contract with DES. Under the Recovery Act, DES is scheduled to receive a total of nearly \$10 million for IDEA Part C. On April 1, 2009, DES received nearly \$5 million and is scheduled to receive nearly \$5 million by September 30, 2009, after it submits for review and approval additional information addressing how it will meet the accountability and reporting requirements specified in the Recovery Act. DES officials maintain that these funds will be used to offset reductions in early intervention services and to enable DES to provide for an increase in its caseload.

Federal guidance states that the Secretary of Education does not have authority to grant waivers under IDEA for Part C's maintenance of effort requirement. Guidance also states that federal provisions require each lead agency to ensure that the total amount of state and local expenditures on early intervention budgeted for a particular fiscal year are at least the amount of such funds expended in the prior fiscal year. On April 22, 2009, Education sent a letter to DES officials to clarify Arizona's responsibilities under Part C of the IDEA, particularly with regard to service provisions and maintenance of effort requirements. The letter stated that the Office of Special Education Programs under Education had learned that DES had informed parents of over 2,200 children that their children would no longer be served under IDEA Part C because of cuts in state funding. DES officials explained that reductions in the IDEA Part C program (reflected in the Education letter) resulting from the severe, recession-driven budget challenges facing the state may have been necessary prior to the passage of the Recovery Act. But with the assistance of Recovery Act funds, DES

officials stated that they will be able to serve all individuals that had received services in the prior fiscal year, and therefore, will be able to meet the maintenance of effort requirements for receiving the funds.

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## Arizona's Edward Byrne Memorial Justice Assistance Grant Program Funding Will Support the State's Efforts to Control Drugs, Gangs, and Violent Crime in the State

The Edward Byrne Memorial Justice Assistance Grant (JAG) Program within the Department of Justice's Bureau of Justice Assistance (BJA) provides federal grants to state and local governments for law enforcement and other criminal justice activities, such as crime prevention and domestic violence programs, corrections, treatment, justice information sharing initiatives, and victims' services. Under the Recovery Act, an additional \$2 billion in grants is available to state and local governments for such activities, using the rules and structure of the existing JAG program. The level of funding is formula based and is determined by a combination of crime and population statistics. Using this formula, 60 percent of a state's JAG allocation is awarded by BJA directly to the state, which must in turn allocate a formula-based share of those funds to local governments within the state. The remaining 40 percent of funds is awarded directly by BJA to eligible units of local government within the state.<sup>20</sup> The total JAG allocation for Arizona state and local governments under the Recovery Act is about \$42 million, a significant increase from the previous fiscal year 2008 allocation of about \$3.1 million. The Arizona Criminal Justice Commission (ACJC) administers JAG funds for the state.

As of June 30, 2009, Arizona has received its full state award of about \$25.3 million.<sup>21</sup> ACJC officials explained that the state's direct Recovery Act funding enables them to continue to support drug taskforces and projects throughout the state, projects that were otherwise at risk of being reduced given a 66 percent decrease in fiscal year 2008 JAG funding as well as program budget cuts by the state legislature. Because of its geographic location, Arizona faces significant law enforcement challenges associated with drug and human trafficking along the border. From March 31 to April 24, ACJC officials solicited applications for funding from state criminal justice agencies. To ensure funding stability for projects given the short-term availability of Recovery Act funding, ACJC officials proposed a

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<sup>20</sup>We did not review these funds awarded directly to local governments in this report because the Bureau of Justice Assistance's solicitation for local governments closed on June 17.

<sup>21</sup>Due to rounding, this number may not exactly equal 60 percent of the total JAG award.

budget that uses Recovery Act and non-Recovery Act JAG funds as well as the state's matching Drug and Gang Enforcement funds to sustain projects through fiscal year 2014.<sup>22</sup> From 52 applications received, ACJC officials selected 50 eligible projects for JAG funding, of which 36 will receive only Recovery Act JAG funding. These projects received final committee approval and funds were made available to the criminal justice agencies on July 1, 2009. These agencies proposed projects for funding such as drug forensics, drug and gang prosecutions, rural law enforcement, and information sharing initiatives. All approved projects support the seven JAG purpose areas defined by BJA,<sup>23</sup> as well as four priorities laid out in Arizona's statewide strategic plan to control and combat drugs, gangs, and violent crime in the state. In addition, officials plan to use 10 percent of the funds for administrative purposes, as permitted by BJA. (See figure 4 for estimated funding distributions.)

**Priority 1:** Multiagency, multijurisdictional drug, gang, and violent crime task forces, their tandem prosecution projects, and statewide civil forfeiture efforts;

**Priority 2:** Criminal justice information sharing projects;

**Priority 3:** Adjudication, forensic analysis, detention, and criminal justice system support services; and

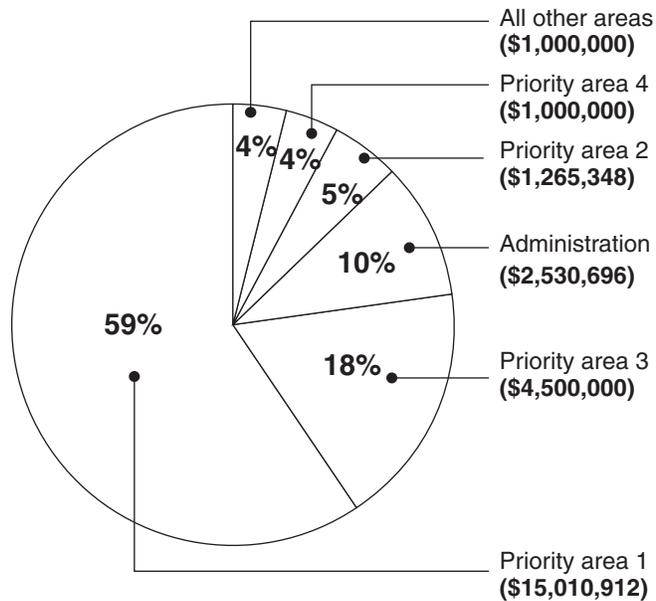
**Priority 4:** Proven substance abuse prevention and education programs.

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<sup>22</sup>The Drug and Gang Enforcement Account is within Arizona's criminal justice enhancement fund and its funds are used to enhance efforts to deter, investigate, prosecute, adjudicate, and punish drug offenders and members of criminal street gangs. Ariz. Rev. Stat. § 41-2402.

<sup>23</sup>The Bureau of Justice Assistance allows JAG funding for state and local initiatives, technical assistance, training, personnel, equipment, supplies, contractual support, and information systems for criminal justice, as well as criminal justice-related research and evaluation activities that will enhance the following seven areas: prosecution and court programs; crime prevention and education programs; corrections and community corrections programs; drug treatment and enforcement programs; program planning and evaluation, as well as technology improvement programs, and crime victim and witness programs.

**Figure 4: Estimated State Distribution of Recovery Act JAG Funds**



Source: GAO analysis of Arizona Criminal Justice Commission data.

Furthermore, officials stated that, without Recovery Act JAG funding, local subrecipients would have experienced additional staff reductions as has been experienced since fiscal year 2000 because of reductions in federal JAG funding and reduced state funding. With Recovery Act funds, subrecipients plan to be able to keep key law enforcement personnel in the task force; prosecutorial, court and probation personnel; and forensic analysis staff. Of the 36 projects with Recovery Act funding, ACJC officials estimate that 103 full-time equivalents will be created or preserved.

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## Arizona's Public Housing Agencies Receive Capital Formula Grants and Are Funding Priority Projects

The Public Housing Capital Fund provides formula-based grant funds directly to Public Housing Agencies to improve the physical condition of their properties; for the development, financing, and modernization of public housing developments; and for management improvements.<sup>24</sup> The Recovery Act requires the Department of Housing and Urban Development (HUD) to allocate \$3 billion through the Public Housing Capital Fund to public housing agencies using the same formula for amounts made available in fiscal year 2008. Recovery Act requirements specify that public housing agencies must obligate funds within 1 year of the date they are made available to public housing agencies for obligation, expend at least 60 percent of funds within 2 years of that date, and expend 100 percent of the funds within 3 years of that date. Public housing agencies are expected to give priority to projects that can award contracts based on bids within 120 days from the date the funds are made available, as well as capital projects that rehabilitate vacant units, or those already under way, or are included in the required 5-year capital fund plans. HUD is also required to award \$1 billion to housing authorities based on competition for priority investments, including investments that leverage private sector funding/financing for renovations and energy conservation retrofit investments. On May 7, 2009, HUD issued its Notice of Funding Availability (NOFA) that describes the competitive process for funding, criteria for applications, and time frames for submitting applications.<sup>25</sup>

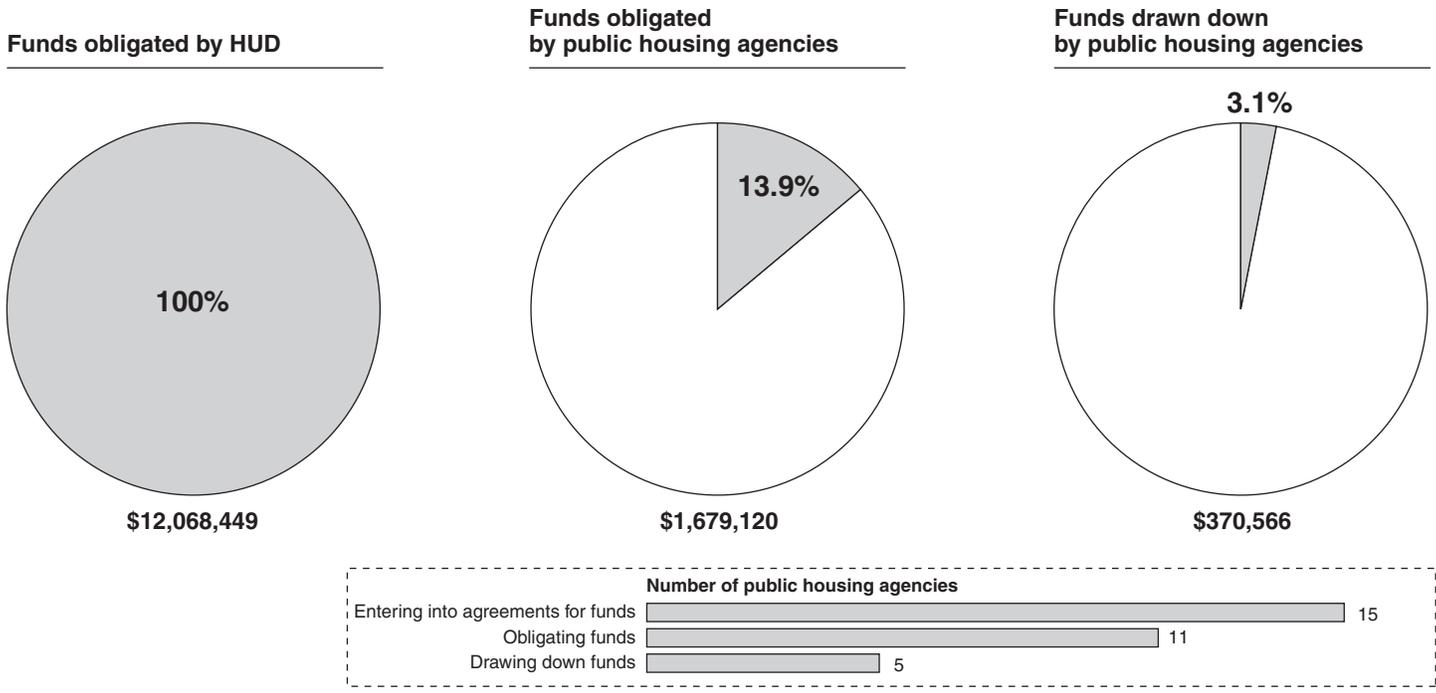
Arizona has 15 public housing agencies that have received Recovery Act formula grant awards. As described in figure 5, all these public housing agencies received \$12,068,449 from the Public Housing Capital Fund formula grant awards. As of June 20, 2009, only 11 public housing agencies have obligated \$1,679,120 or 13.9 percent and have drawn down \$370,566 or 3.1 percent of the total amount.

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<sup>24</sup>Public housing agencies receive money directly from the federal government (HUD). Funds awarded to the public housing agencies do not pass through the state budget.

<sup>25</sup>HUD released a revised NOFA for competitive awards on June 3, 2009. The revision included changes and clarifications to the criteria and timeframes for application, and to funding limits.

**Figure 5: Percentage of Public Housing Capital Funds Allocated by HUD that Have Been Obligated and Drawn Down in Arizona**



Source: GAO analysis of HUD data.

We visited five public housing agencies in Arizona: the City of Phoenix Housing Department, the City of Glendale Community Housing Division, the Housing and Community Development Department of the City of Tucson, the Housing Authority of Maricopa County, and the Pinal County Housing Authority. We selected these housing agencies based on the amount of funding they were allocated, the housing agency size as measured by the number of units the agency has, and if the authority may have received a recent HUD troubled designation.<sup>26</sup>

<sup>26</sup>HUD developed a Public Housing Assessment System (PHAS) to evaluate the overall condition of housing agencies and measure performance in major operational areas of the public housing program. These include financial condition, management operations, and physical condition of the housing agencies' public housing programs. Housing agencies that are deficient in one or more of these areas are designated as troubled performers by HUD and are statutorily subject to increased monitoring.

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## Housing Agencies Have Plans to Use Capital Funds for Rehabilitating Properties and Are on Track to Meet Recovery Act Time Frames

The five housing agencies that we visited in Arizona received a total of \$8.8 million in Capital Fund formula grants. Officials at each housing agency told us that they expect to obligate and expend their Recovery Act allocations within the required timeframes. As of June 20, 2009, these housing agencies obligated \$458,260, or about 5.2 percent of the total award, and had drawn down \$294,492. Officials at two housing agencies have planned four projects and have obligated or plan to obligate all of their funds and begin work in June. The other three housing agencies have obligated some funds to support a variety of projects and began some work in May. According to officials, drawdowns occur after funds have been expended; therefore, they expect to begin drawing down funds in July when invoices and receipts have been submitted for payment.

The five housing agencies are funding a total of 36 projects. The types of projects undertaken vary from remodeling the interior and exterior of a vacant single-family unit, to remodeling 51 kitchens within occupied units and replacing roofing or elevator and lobby glass in high-rise complexes to achieve greater energy efficiency. For example, one project under way in Phoenix will use \$30,163 to seal the roof surface of two large housing complexes, which will help maintain the integrity of the roof and promote energy efficiency. Two other projects under way in Tucson will use \$35,017 and \$46,700, respectively, to patch, repair, and seal the asphalt at 11 housing sites and to complete a major rehabilitation of a vacant single-family residence to include roof repairs; kitchen cabinet, window, hot water and air-conditioning unit replacements; bathroom remodeling; and painting. These three projects began in May 2009 and are expected to be completed by or in August 2009.

Generally, the public housing agencies we visited had high occupancy rates; therefore, they did not give priority to the rehabilitation of vacant units. Rather, they gave priority to larger, more costly, deferred projects in their 5-year plans that met Recovery Act requirements and that could be awarded within 120 days of when the funding was made available.<sup>27</sup> For example, Phoenix housing officials conducted a thorough evaluation of all projects contained in their 5-year plan; reviewed the scopes and types of work, and the potential for projects to have funds obligated within 120 days, be executed in a short time frame, and improve their HUD inspection scores; and selected some larger, deferred projects such as exterior

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<sup>27</sup> The 5-year plan addresses the housing agency's mission and their overall plan and priority list of projects to achieve their mission goals.

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painting, air-conditioning upgrades, and lighting improvements that were long overdue and could be efficiently approved through the city's procurement process. Phoenix, Maricopa, and Tucson housing officials specifically stated that they did not consider any major reconstruction projects because the time frame to process and approve the architectural designs and obtain permits for such projects would not meet Recovery Act obligation and expenditure requirements.

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### Lack of HUD Guidance Has Delayed Some Capital Fund Contract Awards

Officials from the five housing agencies we visited did not anticipate any challenges in accessing Capital Fund formula grants or in meeting the accelerated timeframes for using Recovery Act funds; however, they expressed concern over not having complete HUD guidance in advance of the funding being made available. Specifically, all housing officials stated that they are still awaiting guidance on

- what data should be measured to determine results achieved beyond the number of jobs created and preserved,
- the parameters of what is considered a job created or preserved, and
- the format on how to report the data and the entities who are to receive the reports.

On June 22, OMB issued implementing guidance that describes, among other things, how states are to report the number of jobs created and preserved under the Recovery Act as well as how they are to report these and other data. According to several housing and procurement officials, the lack of clear guidance has delayed the bidding and awarding of some contracts. This is because officials are obtaining clarification from local HUD and other city officials regarding specific metrics the housing agencies should require contractors to track and measure, as well as guidance on how to interpret and incorporate the Buy American provision,<sup>28</sup> and how to modify local procurement policies to adhere to federal Recovery Act requirements. For example, Tucson officials stated that because HUD has not provided any guidance on the Buy American provision, they have delayed the awarding of contracts so that city attorneys can research and provide guidance on how they should interpret and apply the Buy American provision, what changes need to occur to

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<sup>28</sup>The Buy American provision of the Recovery Act prohibits, with certain exceptions, the use of Recovery Act funds for the construction, alteration, maintenance, or repair of a public building or work unless all of the iron, steel, and manufactured goods used in the project are produced in the United States. Recovery Act, div, A, title XVI, § 1605

existing city procurement policies, and how to integrate changes into contracts. Furthermore, all of the housing authorities we met with stated that they are not aware of any quarterly report requirements nor have they received any guidance from HUD regarding the content of any quarterly reports, as well as how to measure jobs created or assess effects.

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### Housing Agencies Will Include Additional Data to Meet the Recovery Act's Reporting Requirements in Existing Financial Systems

All five housing agencies that we met with stated that they will be able to code, separately track, monitor, and report on the Recovery Act formula and competitive funds as well as add any new data that need to be tracked to each project activity as more guidance is provided on what metrics must be met. Currently, the number of jobs created or preserved is a requirement included in contracts and will be tracked in Davis-Bacon Act reports.<sup>29</sup> Furthermore, when asked about the Recovery Act requirement related to the application of prevailing wage rates as required by the Davis-Bacon Act, officials from the five public housing agencies we visited indicated that they are accustomed to meeting Davis-Bacon requirements and view meeting these wage levels as a seamless part of their contractual agreements with workers. All of the housing officials we met with stated that they would be able to track the number of jobs created or preserved through the Davis-Bacon reports; however, they are uncertain about what other data they should be tracking and how to assess impacts.

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<sup>29</sup>The Recovery Act requires all laborers and mechanics employed by contractors and subcontractors on Recovery Act projects to be paid at least the prevailing wages as determined under the Davis-Bacon Act. Recovery Act, div. A, title XVI, § 1606. Under the Davis Bacon Act, the Department of Labor determines the prevailing wage for projects of a similar character in the locality. 40 U.S.C. §§ 3141-3148.

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## Arizona Is One of the First Four States to Have Its Weatherization Plan Approved and Has Received the First Half of Recovery Act Weatherization Funds

The Recovery Act appropriated \$5 billion for the Weatherization Assistance Program, administered by the U.S. Department of Energy (DOE) through each of the states and the District of Columbia.<sup>30</sup> This funding is a significant addition to the annual appropriations for the weatherization program that have been about \$225 million per year in recent years. The program is designed to reduce the utility bills of low-income households by making long-term energy efficiency improvements to homes by, for example, installing insulation, sealing leaks around doors and windows, or modernizing heating equipment and air circulating fans. During the past 32 years, the Weatherization Assistance Program has assisted more than 6.2 million low-income families. According to DOE, by reducing the utility bills of low-income households instead of offering aid, the Weatherization Assistance Program reduces their dependency by allowing these funds to be spent on more pressing family needs.

DOE allocates weatherization funds among the states and the District of Columbia using a formula based on low-income households, climate conditions, and residential energy expenditures by low-income households. DOE required each state to submit an application as a basis for providing the first 10 percent of Recovery Act allocation. DOE will provide the next 40 percent of funds to a state once the department has approved its state plan, which outlines, among other things, its plans for using the weatherization funds and for monitoring and measuring performance. DOE plans to release the final 50 percent of the funding to each state based on the department's progress reviews examining each state's performance in spending its first 50 percent of the funds and the state's compliance with the Recovery Act's reporting and other requirements.

DOE has allocated to Arizona about \$57 million in funding for the Recovery Act Weatherization Assistance Program for a 3-year period, which represents a large increase in funding from previous years. Arizona received \$1.0 million and \$1.1 million for the weatherization program in 2007 and 2008, respectively. Arizona's Department of Commerce (DOC) Energy Office is responsible for administering the program. Arizona submitted its Weatherization Program Plan to DOE on April 28. DOE

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<sup>30</sup>DOE also allocates funds to American Samoa, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, Guam, the Virgin Islands, the Navajo Indian tribe, and the Northern Arapahoe Indian tribe.

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verified that Arizona’s plan met the requirements provided in its guidance and approved the plan on June 5.

On April 10, 2009, DOE provided the initial 10 percent allocation (approximately \$5.7 million) to Arizona. Since receiving these funds, DOC officials stated that they have been ramping up the program, including adding staff and obtaining additional field equipment such as tools, diagnostic equipment, and infrared cameras, because DOE guidance prohibits using any of the initial 10 percent for the actual weatherization production activities. However, on June 9, 2009, DOE issued revised guidance lifting this limitation to allow states to provide funds to local agencies for production activities that previously provided services and are included in state Recovery Act plans.

Once Arizona’s weatherization plan was approved, DOE provided an additional \$22.8 million for weatherization. Arizona expects to use Recovery Act funding to weatherize at least 6,400 homes. The state will begin funding applicants as soon as grants are received and approved.

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## Existing Internal Controls Will Be Used to Safeguard Recovery Act Funds at Various Levels in the State, Its Agencies, and Localities

According to the officials at the state level, with state agencies, and at the localities for the programs we visited, they will use their existing internal control processes for monitoring the receipt and spending of Recovery Act funds to help ensure compliance with the requirements of the Recovery Act. Since most of the funds will go through existing or long-standing programs, the procedures and controls that were in place for monitoring funding sources other than the Recovery Act have already been tested over the years. Overall, the controls are currently working well, according to the state officials. The State Comptroller’s comment that the key internal control is the attitude of management closely parallels a fundamental concept *Standards for Internal Control in the Federal Government* that states “managements sets the objectives, puts the control mechanisms and activities in place, and monitors and evaluates the control.”<sup>31</sup> Although, the state comptroller has a limited staff of 3 internal auditors, they are communicating with the Governor’s Office and state agencies as well as teaching the state agencies what is needed to comply with the Recovery Act requirements and emphasizing the need for good internal controls.

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

Although the state has not done a separate risk assessment of the internal controls for the programs receiving Recovery Act funds, the state Department of Administration<sup>32</sup> is in the process of administering a survey that includes asking each of the state agencies to complete a self-assessment of internal controls. Each of the state agencies was asked to complete the survey by April 30, 2009; however, additional follow up was needed and the analysis of the survey responses is expected to begin in July 2009. Additionally, in April 2009, the Arizona comptroller issued technical guidance directing state agencies to mitigate risk associated with Recovery Act funds. The guidance stated that, at a minimum, state agencies should do such things as ensure that qualified personnel oversee the administration of Recovery Act funds, maximize competitive awards, minimize improper payments, and conduct audits and investigations to identify and prevent wasteful spending. Later on May 27, 2009, the Arizona State Comptroller issued another technical bulletin stating that agencies receiving Recovery Act dollars should implement the management activities provided in guidance from the Association of Government Accountants Risk Assessment Monitoring Tool and Financial and Administrative Monitoring Tool. In general, these tools provide checklists and questions to assist the users, in part, with evaluating programmatic compliance risk and determining that federal grant purposes are being met. The State Comptroller stated that his bottom line is to mitigate risk and to get agency management to assess their programs and make choices based on an informed awareness of risks.

In addition, the state agencies and the localities that we met with have their own separate internal controls for safeguarding Recovery Act funds. For example, ACJC officials stated that they will use existing processes to safeguard the use of JAG funds. They used a peer-reviewed, risk-based scoring matrix to select subrecipients. Scoring criteria considered, among other things, the applicant's most recent Single Audit results; plans for evaluating the impact resulting from the use of such funds; ACJC funding history, including any past compliance issues; and evidence of the applicant's ability to meet Recovery Act requirements. ACJC officials stated that the 32 subrecipients selected to receive Recovery Act JAG funding have all received ACJC funding for the past several years and are all considered a low risk for noncompliance. Furthermore, officials stated that they are committed to working closely with subrecipients to ensure that they comply with the act. Once awards are granted, ACJC officials

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<sup>32</sup>The State Comptroller's office is in the Department of Administration.

stated that they have a compliance team of six staff that performs ongoing financial and programmatic compliance reviews to ensure that subrecipients comply with grant guidance. For example, program compliance staff reviews subrecipients' monthly and quarterly financial reports and identifies any areas of concern, such as if funds are drawn down too slowly or too quickly, if there are questionable expenses, or if monthly and quarterly reports do not agree. Financial compliance staff also performs annual onsite visits that include financial audits in addition to internal controls inspections of, among other things, the accounting system and key financial documentation. Noncompliance may be addressed through withholding funds, reducing funds, and placing the subrecipient on a high-risk list, although ACJC officials stated that subrecipients are often initially noncompliant as a result of error.

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### Arizona's Agencies and Localities Will Use Existing Accounting Systems to Separately Track Recovery Act Funds

Arizona and its agencies, as well as the localities that are in our sample, are relying on existing accounting systems to separately track the financial data of the Recovery Act funds. Arizona officials we spoke with noted that they do not foresee that it will be difficult to track the Recovery Act funds separately. Arizona will track receipt and spending of the Recovery Act funds that the state receives using its existing accounting system, the Arizona Financial Information System (AFIS). According to the State Comptroller, the state agencies have the primary responsibility for the tracking of the receipt and spending of their Recovery Act funds and, due to the decentralized nature of Arizona government, accounting data are housed in a variety of different systems. On the other hand, the LEAs will use the existing state Department of Education's accounting systems for tracking Recovery Act financial data. Transactions for the state are on its accounting system, AFIS; and transactions for some of the state agencies, such as Arizona's Medicaid program and ADOT, are housed in their own separate accounting systems. For example, Arizona Medicaid officials indicated that for tracking of the increased FMAP, Arizona changed its accounting system to include a new fund for tracking revenues and expenditures specific to increased FMAP and that the state will use existing reconciliation processes to assure the completeness and accuracy of tracked and reported data on increased FMAP dollars. However, the Medicaid officials noted that officials from Arizona's General Accounting Office (AGAO) are awaiting guidance from OMB about what steps auditors should follow when reviewing increased FMAP revenues and expenditures.

The housing authorities that we visited each have separate accounting systems with some also being stand alone systems and others integrated into their city or county accounting system. For example,

- The City of Phoenix has an existing financial system that is used for all city programs, including the Housing Department. The system codes, separately tracks, monitors, and reports on the regular Capital Fund program by project, activity, and account numbers for revenues and expenditures. Once a transaction is entered into the financial system, the information is updated throughout the entire financial system and modifications can be made at any time to track new information.
- The Housing Authority of Maricopa County will use an existing financial system that according to Housing Authority officials will allow them to code, separately track, and monitor funds. Additionally, officials said that various internal controls are in place to compare the revenues and expenditures in monthly reconciliations conducted by five different officials tracking and monitoring each other's documentation.
- The City of Glendale Housing Authority will also be using their existing financial system. Housing Authority officials stated that the existing systems will code, separately track, monitor, and report on financial and program information. They will also rely on existing internal controls to manage the additional Recovery Act funds and metrics.

The state agencies using separate accounting systems periodically provided to the AGAO the data for inclusion in the state's accounting system, AFIS. To assist state agencies on the accounting for Recovery Act receipts and expenditures, the AGAO issued a technical bulletin on April 7, 2009, providing initial guidance on tracking receipts and expenditures. It directed state agencies to use specific codes for recording Recovery Act funds and for tracking receipts and expenditures in AFIS. It also stated that it is imperative that agencies that use systems other than AFIS also separately track and account for receipts and expenditures. In May 2009, we reviewed accounting structure information provided by the comptroller on AFIS and found that the system has an accounting code structure that includes separate codes for the agency, program, and organization, as well as distinct appropriation and grant codes. Additionally, the agencies have the discretion to assign another code as needed for their individual requirements. The Arizona comptroller will be able to query activity related to Recovery Act funds using these codes.

In April 2009, we reported that state officials were concerned that the state's accounting system was old and not designed with the reporting capacity needed to report the uses of Recovery Act funds.<sup>33</sup> The state comptroller and the state chief information officer (CIO) are investigating procuring new software with the capacity to extract data from AFIS and other agency systems and integrate it into an overall database or data warehouse. This will allow the state to analyze and manipulate the data in ways that they need to be able to meet the reporting requirements for Recovery Act funds. The CIO expected to have enough of the project implemented that the system will be able to satisfy the October reporting deadline under the act. The CIO also said that the project initially will address financial reporting requirements, but he hopes to be able to integrate reporting on program performance achieved with Recovery Act funds as well. While the project was undertaken to comply with the act, overall it will have benefits for reporting on other federal and state funding.

Arizona will continue to be challenged to track funds that go directly to localities. State officials expressed concern that they may not be able to track Recovery Act funds when the funds are received directly from federal agencies rather than through state agencies, such as housing authorities that receive Recovery Act funds directly from HUD.

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<sup>33</sup>GAO, *Recovery Act: As Initial Implementation Unfolds in States and Localities, Continued Attention to Accountability Issues Is Essential*, GAO-09-580 (Washington, D.C.: Apr. 23, 2009).

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## Arizona Plans to Use Single Audit Reports as a Source of Information on Internal Control Risks

The Single Audit reports for Arizona and the localities are a source of information on internal control risks.<sup>34</sup> According to the Arizona state comptroller and other agency and locality officials that we met with, they plan to use their respective Single Audit reports as a source of information about internal weaknesses for programs receiving Recovery Act Funds.<sup>35</sup>

The state comptroller's office has met with all the agencies that have Single Audit findings to address the 2007 findings (the fiscal year 2007 Single Audit report was the most recent report as of May 21, 2009). Additionally, the state comptroller's office and the agencies are assessing how any draft 2008 findings will affect the agencies.

However, for the last 2 years, the Single Audit report for Arizona has been late by approximately 2 months. The report for 2008 is expected to be issued June 30, 2009, or approximately 3 months after initial due date of March 30, 2009. According to the State of Arizona Office of the Auditor General's staff and the comptroller, the Department of Administration, which is responsible for consolidating all the financial data into the state's Comprehensive Annual Financial Report (CAFR), does not receive the financial information from the state agencies in a timely manner. As a result, the state cannot issue the CAFR and the Single Audit report will be issued late.

The lateness of Single Audit reports affects the usefulness of the information as a tool for monitoring the internal controls over Recovery Act funds.

However, some of the state officials said they use the report to identify and correct internal control weaknesses. Additionally, LEA officials plan to use their own Single Audit reports to identify and correct internal control weaknesses specific to their LEAs. The LEA officials explained

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<sup>34</sup>The Single Audit Act of 1984, as amended (31 U.S.C ch. 75), requires that each state, local government, or non-profit organization that expends \$500,000 or more a year in federal awards must have a single audit conducted for that year subject to applicable requirements, which are generally set out in Office of Management and Budget (OMB) Circular No. A-133, Audits of States, Local Governments and Non-Profit Organizations (June 27, 2003). If an entity expends federal awards under only one federal program, the entity may elect to have an audit of that program.

<sup>35</sup>For Arizona, the Auditor General serves as the state's auditor for the Single Audit; however, some of the audits are performed by the Auditor General but others are contracted out with independent accounting firms.

that their own Single Audit report is submitted by the contracted audit firm to the State of Arizona Office of the Auditor General, Arizona Department of Education, and the LEA simultaneously. Next, if an LEA's internal control weaknesses are significant, the LEA may receive a formal letter from the Auditor General's Office outlining the LEA's weaknesses contained in the report, stressing the importance of taking action to implement the reports recommendations, and giving the LEA a statutory 90 days to correct the weaknesses. Once the 90-day period has passed and if LEA officials notify the Auditor General that they have corrected the weaknesses, the Auditor General will conduct an on-site follow-up to determine if the deficiencies have, in fact, been corrected. If the Auditor General finds that the weaknesses are not corrected, the Auditor General will refer the LEA to the Arizona State Board of Education for action.

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## Arizona Is Developing Plans to Assess the Effects of Recovery Act Funds

On June 22, 2009, OMB issued implementing guidance for how states are to report the number of jobs created and preserved under the Recovery Act. Even before this guidance was issued, Arizona agencies began collecting information on jobs created and preserved although different kinds of information are being submitted across programs. For example, ACJC officials stated that they are capturing information on the number of jobs created and preserved using Recovery Act funds to the best of their ability. As part of this effort, potential JAG fund subrecipients were asked to provide the number of jobs that would be created and preserved as part of their application; in order to demonstrate jobs preserved, ACJC officials requested documentation of intended layoffs or hiring freezes.

Similarly, ADOT has written into all of its awarded contracts specific requirements that contractors will have to report monthly on the number of workers employed as a direct result of Recovery Act funded projects. FHWA worked with ADOT and a software vendor to create a custom software program through which ADOT can upload all indirect job creation from Arizona to FHWA. The vendor also developed the reports that can count the number of direct jobs created that will help ADOT meet reporting requirements under the Act.

Phoenix housing officials stated that they are able to track the number of jobs created and preserved and assesses the results of the Recovery Act-funded projects through weekly meetings and monitoring. However, they are uncertain as to how to assess the effects of their funded projects on the community and currently lack the administrative funding and manpower to routinely track more than what they are directed to track, let alone assess effects. Alternatively, according to City of Glendale Housing

Authority officials, besides tracking the number of jobs that will be created or preserved, they plan to track the amount of sales tax generated as well as administer a housing satisfaction survey to their tenants. Also, they are developing other social, economic, and physical tracking metrics that may provide more information on how various physical improvements and sources of funding, which includes Recovery Act funding, are making an impact on the City of Glendale. The officials added that while the existing initiative will account for some assessment of impacts, they are also uncertain about how to assess the effects of the Recovery Act spending without specific guidance from HUD.

Similarly, Arizona has a plan in place to monitor the dwellings that have been weatherized to ensure that the funding was spent in accordance with program requirements. The monitoring plan includes three components: (1) inspection of every completed weatherized home by the local Energy provider, (2) a review by the state Energy Office staff of 100 percent of the data submitted to the Arizona Weatherization Assistance Program Web-based reporting system, and (3) site monitoring visits by Energy Office staff to review job files and perform site monitoring on a minimum of 10 percent of the completed dwellings. A senior state Energy Office official believes that having this oversight plan in place will provide the necessary assurances that the program is operating according to federal requirements.

Because Arizona monitors its Recovery Act funds on an agency-by-agency basis, it will have to collect information on the number of jobs created and preserved on an agency-by-agency basis. Although some programs receiving Recovery Act funds, such as Federal Highways, have received some guidance on how to collect information on the number of jobs created and preserved from the federal agencies that they work closely with, others, such as public housing, have received no federal-level guidance on how to collect and report those data. As a result, Arizona has no central repository for collecting and disseminating data on the effects of the Recovery Act dollars, but as we previously discussed, Arizona's CIO noted that the state is updating its data reporting system in order to find a solution that will integrate gathered information across agencies. According to the Director of Arizona's Office of Economic Recovery, it will soon have a system and staff to collect, assess, and report Recovery Act data. Currently, the state's system mostly aggregates data from the disparate data sources, but the new system will provide the capability to report Recovery Act funds across the entire state. In addition, to the new state-wide tracking system described above, some agencies will track Recovery Act funds with their own in-house systems.

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## State Comments on This Summary

We provided the Governor of Arizona with a draft of this appendix on June 17, 2009. The Director of the Office of Economic Recovery responded for the Governor on June 23, 2009. Also, on June 24, 2009, we received technical comments from the State of Arizona Office of the Auditor General. In general, the state agreed with our draft and provided some clarifying information which we incorporated.

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