UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

Audit Services

May 20, 2013

FINAL ALERT MEMORANDUM

To: Michael Yudin
Acting Assistant Secretary
Office of Special Education and Rehabilitative Services

From: Patrick J. Howard /s/
Assistant Inspector General for Audit

Subject: California Department of Education's Administration of LEAs' Special Education Maintenance of Effort Compliance Requirement
Control Number ED-OIG/L09N0004

The purpose of this final alert memorandum is to highlight an issue of concern related to the California Department of Education's (CDE) administration of the special education maintenance of effort (MOE) compliance requirements applicable to local educational agencies (LEAs). These requirements are contained in the Individuals with Disabilities Education Act (IDEA), as amended. During our audit of LEAs' use of the IDEA MOE flexibility provision due to supplemental funds received under the American Recovery and Reinvestment Act of 2009, we determined that CDE is instructing LEAs to use local special education expenditure information from an improper year to demonstrate compliance with the LEA MOE requirement in certain circumstances.[1]

What Federal requirements apply to LEA MOE?

According to IDEA § 613(a)(2)(A), an LEA receiving IDEA funds must meet an annual MOE requirement to show that it has maintained the proper level of funding for educating children with disabilities. Specifically, an LEA must not use funds provided under Part B of the IDEA to reduce the amount of local funds the LEA spends on educating children with disabilities below the level of spending for the preceding fiscal year. This requirement is restated in U.S. Department of Education (Department) regulations under Title 34 of the Code of Federal Regulations, Section 300.203(a) (34 C.F.R. § 300.203(a)). Under its oversight responsibilities, a State educational agency (SEA) must determine whether each LEA complied with the annual MOE requirement. Consistent with Department guidance,[2] LEAs demonstrate compliance with this annual MOE requirement by spending, in total or per

[1] In California, LEAs receive State funding for special education programs in addition to funds from local sources. However, the issue of concern described in this alert memorandum refers only to the expenditure of funds obtained from local sources.

[2] U.S. Department of Education, Office of Special Education and Rehabilitative Services guidance, "Funds for Part B of the Individuals with Disabilities Education Act Made Available Under The American Recovery and Reinvestment Act of 2009," April 2009 and revised September 9, 2010.

capita (per student with disability), an equal or greater amount of local, or State and local, funds in each subsequent year. That is, LEAs may use any one of the following four options for demonstrating compliance with the MOE requirement:

1. The LEA's **total amount of local-only** funds spent on educating children with disabilities is equal to or greater than the total amount of local-only funds spent on educating children with disabilities in the preceding year.

2. The LEA's amount of **local-only funds spent per capita** is equal to or greater than the amount of local-only funds spent per capita in the preceding year.

3. The LEA's **total amount of combined State and local funds** spent on educating children with disabilities is equal to or greater than the amount of combined State and local funds spent on educating children with disabilities in the preceding year.

4. The LEA's amount of **combined State and local funds spent per capita** is equal to or greater than the amount of combined State and local funds spent per capita in the preceding year.

IDEA §§ 613(a)(2)(B) and 613(a)(2)(C), and Department regulations at 34 C.F.R. §§ 300.204 and 300.205, provide limited exceptions and adjustments that allow an LEA to reduce its local, or State and local, special education spending and remain in compliance with the MOE requirement. The exceptions that might allow an LEA to reduce spending from one fiscal year to the next are (1) if special education personnel leave voluntarily, (2) if fewer children with disabilities enroll, (3) if the LEA no longer needs to provide exceptionally costly special education services to a child with a disability (for example, if the child leaves the school district), and (4) if costly expenditures for long-term purchases have ended. An adjustment to the MOE requirement, known as "MOE flexibility," permits an LEA to reduce the level of local, or State and local, expenditures for special education programs and related services by up to 50 percent of any increase in their annual IDEA, Part B grant allocation if the SEA determines that the LEA has met the requirements of IDEA, which include providing a free and appropriate public education to all district students with disabilities.

If an LEA does not meet the MOE compliance requirement and cannot justify its actual spending reduction under the exception or adjustment provisions, the SEA must pay the Department the difference between the amount of funds the LEA spent and the amount it should have spent educating children with disabilities, using funds for which accountability to the Federal Government is not required.

In addition to LEAs demonstrating that they have met the annual MOE compliance requirement based on the amount of funds actually spent in relation to the amount spent in the preceding year, LEAs must also demonstrate that they have met an annual MOE eligibility requirement to receive IDEA funds. According to 34 C.F.R. § 300.203(b)(1), for an LEA to be considered eligible to receive IDEA funds in a given fiscal year, an SEA must determine that the LEA has budgeted at least the same amount for educating students with disabilities (total or per capita) from either local or combined State and local sources as the LEA spent from the same source for the most recent prior year for which information is available. Additionally, 34 C.F.R. § 300.203(b)(2) states that, when establishing eligibility based on a comparison of local-only funds, the comparison should be made between the amount of local funds the LEA budgets for educating children with disabilities to the amount it spent for that purpose from local funds in the most recent fiscal year for which the LEA was determined eligible based on local-only

funds using the standard in § 300.203(b)(1). Therefore, to determine whether an LEA is eligible to receive IDEA for the upcoming year, the SEA compares the LEA's amount of budgeted funds to actual expenditures in a year that may not be the preceding fiscal year.

In its response to our draft alert memorandum, the Department stated that it has always interpreted the LEA eligibility standard in 34 C.F.R. § 300.203(b) to also apply to the compliance standard. Further, the Department stated that according to 34 C.F.R. § 300.203(b)(2), an LEA would use the same comparison year for the compliance standard as it used to meet the eligibility standard. The Department stated that an LEA would, using this application of the standard, compare local-only special education expenditures for the year to local-only special education expenditures from the most recent fiscal year for which information is available and the LEA met MOE based on local-only funds. However, the Department's position is not currently reflected in the Department's regulations or guidance. The Department also acknowledged that given the fluctuations in State and local funds, this position may not always result in the comparison year being the year in which the LEA spent the highest amount of local funds.

What is CDE doing that raises concern?

During our review we identified two instances in which CDE allowed LEAs to use the amount of local-only funds spent on special education programs and services from an improper year to demonstrate that they had met the MOE compliance requirement for fiscal year (FY) 2009–2010. Specifically, CDE allowed these LEAs to demonstrate MOE compliance by comparing their FY 2009–2010 local-only special education expenditures to FY 2006–2007 local-only expenditures instead of their preceding year's local-only expenditures. The LEAs used FY 2006–2007 as the comparison year for meeting FY 2009–2010 MOE because of the instruction in CDE's "Special Education MOE - Actual Versus Actual Comparison" template (MOE Comparison Template). The MOE Comparison Template instructed LEAs, under circumstances where an LEA could not demonstrate MOE compliance based on prior year's local-only or combined State and local special education expenditures, to compare local-only expenditures to the most recent fiscal year when the LEA met MOE compliance based on local-only expenditures. CDE's MOE Comparison Template further provided that if an LEA had not previously based MOE compliance on local-only expenditures, it could use a base year as early as 2006–2007 to demonstrate MOE compliance. LEAs enter their MOE data in CDE's MOE Comparison Template and then submit the completed template as a report (MOE Comparison Report).

As shown in the table below, neither Anaheim City School District (Anaheim) or Vacaville Unified School District (Vacaville) met the FY 2009–2010 MOE requirement using local-only, or combined State and local, expenditures in total or per capita when compared to the preceding year (FY 2008–2009). The fourth column, "FY 2009–2010 Increase or (Decrease)," shows that regardless of which of the four options the LEAs used to calculate their MOE compliance, they spent less in FY 2009–2010 than they spent in the preceding year.

Table: Special Education Expenditure Comparison

LEA Name	FY 2009–2010	FY 2008–2009	FY 2009–2010 Increase or (Decrease)	FY 2006–2007	FY 2009–2010 Increase or (Decrease)
Total Amount of Local-Only Funds Spent on Special Education Programs					
Anaheim	$13,292,770	$14,556,865	($1,264,095)	$9,550,740	$3,742,030
Vacaville	$9,613,666	$11,655,760	($2,042,094)	$7,971,841	$1,641,825
Local-Only Funds Spent Per Capita on Special Education Programs					
Anaheim	$6,007	$7,731	($1,724)	$4,361	$1,646
Vacaville	$6,911	$7,924	($1,013)	$5,423	$1,488
Total Amount of Combined State and Local Funds Spent on Special Education Programs					
Anaheim	$23,751,357	$25,214,694	($1,463,337)	(a)	Not applicable
Vacaville	$11,922,681	$13,055,713	($1,133,032)	(a)	Not applicable
Combined State and Local Funds Spent Per Capita on Special Education Programs					
Anaheim	$10,733	$13,391	($2,658)	(a)	Not applicable
Vacaville	$8,571	$8,875	($304)	(a)	Not applicable

Source: MOE Comparison Reports. We did not audit the reported amounts to expenditure detail.

(a) CDE did not provide an option for LEAs to use a year other than the immediate prior year to meet the MOE requirement with combined State and local expenditures in total or per capita.

Despite this decrease in spending from the preceding year, CDE allowed the two LEAs to demonstrate that they complied with the MOE requirement by comparing local-only expenditures in FY 2009–2010 to local-only expenditures in the 2006–2007 base year. However, use of such a base year is not authorized in IDEA or current Department regulations or guidance. Neither LEA represented on the MOE Comparison Reports submitted to CDE that they were reducing special education expenditures under the exception provision in IDEA § 613(a)(2)(B) or the flexibility provision in IDEA § 613(a)(2)(C). Because the two LEAs reduced the amount of local funds spent educating children with disabilities below the level of spending for the preceding fiscal year and the reductions were not the result of authorized MOE exceptions or flexibility, they did not comply with the MOE requirement in IDEA.

Because CDE's FY 2009–2010 MOE Comparison Template states that LEAs that had not previously met the MOE compliance requirement with local-only expenditures may use a base year as early as FY 2006–2007, it is possible that additional LEAs in California incorrectly represented that they complied with the FY 2009–2010 special education MOE compliance requirement by also using an improper base year. Furthermore, LEAs may have incorrectly represented that they met the MOE compliance requirement in other fiscal years. We noted that CDE's FY 2010–2011 MOE Comparison Template similarly states that LEAs that had not previously met the MOE compliance requirement based on local-only expenditures may also use a base year as early as FY 2006–2007.

What are the actual or potential adverse effects of using an improper base year?

The two LEAs we discuss in this alert memorandum (Anaheim and Vacaville) spent less than they should have on special education programs in FY 2009–2010, but they were not penalized for doing so because CDE improperly allowed them to maintain this lower level of spending.

The reduced special education spending that CDE improperly allowed may have adverse impacts on LEAs' special education programs in subsequent fiscal years because LEAs may maintain this incorrect spending level as their base level to determine future years' expenditure levels. For example, if Anaheim set its local-only special education expenditure base level in FY 2010–2011 at $13,292,770, the amount that CDE improperly allowed as Anaheim's MOE in FY 2009–2010 as shown in the table above, it could have spent at least $1,264,095 less than it should have for special education programs and services in FY 2010–2011.[3] Further, unless Anaheim needed or chose to increase special education spending in the future, it could continue to underspend in subsequent fiscal years because it was improperly allowed to reduce spending in FY 2009–2010.

The improper spending reductions taken by LEAs in California could also have fiscal implications for CDE or the LEAs. According to Federal regulations, if an LEA does not meet the annual MOE requirement, the SEA must pay the Department, from funds for which accountability to the Federal Government is not required, the difference between the amount it spent and the amount it should have spent educating children with disabilities.

RECOMMENDATIONS

We recommend that the Acting Assistant Secretary of the Office of Special Education and Rehabilitative Services—

1. Revise the Department's regulations as needed and clarify guidance concerning the LEA MOE requirement to ensure that LEAs are not permitted to reduce the amount of local funds spent on educating children with disabilities below the level of spending for the preceding fiscal year, as required by the IDEA.

2. Instruct CDE to immediately modify its LEA MOE Comparison Template so that LEAs can no longer demonstrate whether they have met the MOE compliance requirement based on local-only funds from an improper fiscal year. In addition, CDE should be instructed to notify all LEAs that they can no longer use the improper base year option on the MOE Comparison Reports.

3. To the extent that LEA expenditure records are available, instruct CDE to identify all instances in which LEAs used an improper year to meet the MOE compliance requirement based on local-only funds and require these LEAs to revise their MOE Comparison Reports using the proper comparison year. LEAs should first identify the correct MOE base level that should have been used to determine MOE compliance and then recalculate MOE compliance for subsequent years using the correct MOE base. CDE should reassess the LEAs' compliance with the MOE requirement after the LEAs have revised their MOE Comparison Reports.

4. Determine the amount that CDE is required to remit to the Department as a result of LEAs in California using an improper base year to meet the actual MOE compliance requirement and determine whether a monetary recovery is warranted.

[3] We did not obtain Anaheim's or Vacaville's special education MOE actual versus actual comparison reports for FY 2010–2011 or later because it was beyond the scope of our MOE flexibility audit.

Office of Special Education and Rehabilitative Services Comments

We provided a draft of this alert memorandum to the Office of Special Education and Rehabilitative Services (OSERS) for comment. In its response dated February 28, 2013, OSERS partially agreed with the concern presented in our draft alert memorandum. OSERS stated that it shares our concern that CDE allowed LEAs that had not previously based MOE compliance on local-only expenditures to use a base year as early as 2006–2007 to determine compliance with the MOE requirement. OSERS noted that the regulation at 34 C.F.R. § 300.203 does not explicitly cover the situation where an LEA has never met MOE compliance based on local-only expenditures. Under these circumstances, OSERS believes that it is more appropriate to interpret the regulation to mean that the comparison year to be used is the immediate prior year, not another fiscal year that the State selects. However, OSERS also stated that it does not believe it was unreasonable for CDE to use a comparison year other than the immediate prior year. OSERS agreed that CDE's application of this standard allowed the two LEAs discussed in the alert memorandum to demonstrate MOE compliance in FY 2009–2010 by comparing the amount of local-only funds spent that year with the comparable amount spent in FY 2006–2007 (comparison year), even though the amount spent that year was less than the amount spent in FY 2008–2009 (preceding year).

OSERS did not agree with our position that CDE endorsed an improper base year for determining MOE compliance. OSERS stated that it has always interpreted the MOE eligibility standard at 34 C.F.R. § 300.203(b) as the basis for determining MOE compliance. According to OSERS, using the standard at 34 C.F.R. § 300.203(b) as the basis for determining MOE compliance provides clarity to LEAs because the comparison year for both the eligibility and compliance standards is the same.

OSERS also stated that using the eligibility standard at 34 C.F.R. § 300.203(b) as the basis for determining MOE compliance will ensure that LEAs will not reduce their expenditures for educating children with disabilities while also providing LEAs with flexibility in how they calculate MOE. OSERS stated that it believes that the "assumption underlying the literal language of the regulation was that it would lead to comparisons of local effort to the most recent fiscal year in which the LEA expended the highest amount of local funds." However, OSERS acknowledges that there may be no single approach that always results in the comparison year being the year that the LEA spent the highest amount of local funds.

OSERS did not specifically state whether it concurs with any of the recommendations in our draft alert memorandum but does not believe that a recovery of funds is warranted because the regulation and guidance are not specific to the situation addressed in the draft alert memorandum. OSERS proposed that it instead further analyze the California situation and offer technical assistance to CDE. OSERS also noted that it is currently seeking to clarify regulatory requirements associated with LEA MOE requirements and is analyzing proposed regulatory changes.

We have included the full text of OSERS' comments as an attachment to this memorandum.

Office of Inspector General Response

After considering the Department's comments to our draft alert memorandum, the Office of Inspector General maintains its position that the LEAs did not comply with the IDEA's MOE requirement that they not reduce the amount of local funds spent on educating children with disabilities below the level of spending for the preceding fiscal year. OSERS' application of the eligibility standard in 34 C.F.R.

§ 300.203(b) could create a situation in which LEAs are able to reduce their funding commitment to special education programs even though this action would not be permitted under IDEA. This could occur not only when an LEA uses an improper base year to demonstrate compliance with the MOE requirement, as was the case with Anaheim and Vacaville, but also when an LEA demonstrates compliance alternately based on local-only and combined state and local funds over multiple years such that local-only and combined state and local spending is decreased over time.

OSERS' own guidance and policy memoranda have consistently stated that for an LEA to meet the MOE compliance requirement, it must spend, from year to year, at least the same amount that it spent in the previous year. For example, OSEP Memorandum 10-5, December 2, 2009, states "[t]he LEA standard at 34 CFR § 300.203(b) requires that an LEA ... expend, from year to year, at least the same amount that it expended in the previous year. The comparison, for LEA MOE compliance, is expenditures from year to year." We did not identify any OSERS guidance or policy memoranda that permitted LEAs to use a comparison year other than the preceding year to demonstrate compliance with the MOE requirement. As a result, most States, LEAs, non-Federal auditors, and others may be unaware that the Department would permit LEAs to use a comparison year other than the preceding year to meet the MOE compliance requirement with local-only funds.

CDE's instructions for LEA compliance with MOE requirements were not consistent with IDEA, current Department regulations and guidance, or the Department's position that the LEA eligibility standard in 34 C.F.R. § 300.203(b) should be used to determine whether an LEA has complied with the annual MOE requirement. CDE's template instructs an LEA to demonstrate MOE compliance based on the prior year's combined State and local or local-only special education expenditures. If an LEA cannot demonstrate MOE compliance based on the prior year's combined State and local or local-only special education expenditures, then it has the option to compare local-only expenditures to the most recent fiscal year when the LEA met MOE compliance based on local-only expenditures. Further, if an LEA had not previously based MOE compliance on local-only expenditures, it can use a base year as early as 2006–2007 to demonstrate MOE compliance.

Other SEAs that were included in our audit of LEAs' use of the IDEA MOE flexibility provision due to supplemental funds received under the Recovery Act interpreted the LEA special education MOE compliance requirement to mean that LEAs had to demonstrate that they had spent at least as much as they had spent in the preceding year to comply with the requirement. For example, the Texas Education Agency's Web site described the four options for demonstrating compliance described earlier in this memorandum and stated that the comparison year was the "preceding fiscal year."

After reviewing OSERS' response, we modified this alert memorandum as follows:

- added information about the compliance requirement to a paragraph on page 1,
- added further discussion on page 2 regarding IDEA compliance and eligibility requirements,
- revised a paragraph on page 4 to further explain that CDE's instructions for LEA MOE compliance were inconsistent with Federal requirements, and
- added Recommendation 1 to address the Department's application of the eligibility standard in 34 C.F.R. § 300.203(b) to the IDEA MOE compliance requirement.

Administrative Matters

We conducted the work for this alert memorandum in accordance with the Office of Inspector General quality standards for alert memoranda.

Corrective actions proposed (resolution phase) and implemented (closure phase) by the Office of Special Education and Rehabilitative Services will be monitored and tracked through the Department's Audit Accountability and Resolution Tracking System.

This alert memorandum will be made available to members of the press and the general public to the extent information contained in the memorandum is not subject to exemptions in the Freedom of Information Act (5 U.S.C. § 552).

For further information, please contact Raymond Hendren, Regional Inspector General for Audit, Sacramento Audit Region at (916) 930-2399.

Electronic cc: Melody Musgrove, Director, Office of Special Education Programs
Ruth Ryder, Deputy Director, Office of Special Education Programs
Anthony White, Audit Liaison Officer, Office of Special Education Programs

Attachment

Attachment

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF SPECIAL EDUCATION AND REHABILITATIVE SERVICES

FEB 28 2013

To: Ray Hendren
Richard Rasa

From: Michael Yudin /s/
Acting Assistant Secretary, Office of Special Education and Rehabilitative Services (OSERS)

Subject: Draft Alert Memorandum, California Department of Education's Administration of Local Educational Agencies' (LEAs') Special Education Maintenance of Effort (MOE) Compliance, Control Number ED-OIG/L09N0004

We appreciate the work of the Office of Inspector General (OIG) related to the California Department of Education's (CDE's) administration of local educational agencies' (LEAs') compliance with the LEA maintenance of effort (MOE) provision in Part B of the Individuals with Disabilities Education Act (IDEA). The LEA MOE provision is important because it requires LEAs to maintain their level of financial support for the education of children with disabilities so that they can meet their obligation to provide the special education and related services that children with disabilities need to receive a free appropriate public education.

During an audit of LEAs' use of the IDEA MOE flexibility provision due to supplemental funds received under the American Recovery and Reinvestment Act of 2009 (ARRA), the OIG determined that "CDE is instructing LEAs to use local special education expenditure information from an improper year to demonstrate compliance with the LEA MOE requirement in certain circumstances." The OIG is proposing to issue an Alert Memorandum to highlight its concern and provided the U.S. Department of Education (Department) a copy of the Draft Alert Memorandum (Draft Memo). You have requested our comments on the Draft Memo. As outlined below, we appreciate this situation being brought to our attention, but we have some concerns with the analysis in the Draft Memo related to the comparison year (which OIG sometimes refers to as the "base year") an LEA must use if it demonstrates compliance with the MOE requirement based on local funds only.

OIG Findings in Draft Alert Memorandum

The OIG found during its review that in two instances CDE allowed LEAs to use the amount of local only funds spent on special education and related services from an improper year to demonstrate that they had met the MOE compliance requirement for fiscal year (FY) 2009-2010. The OIG stated that specifically, CDE allowed these LEAs to demonstrate MOE compliance by

comparing their FY 2009-2010 local-only special education expenditures to FY 2006-2007 local-only expenditures, instead of their prior year's local-only expenditure, as the OIG believes is required by IDEA.

According to the information in the Draft Memo, CDE's MOE Comparison Template (Template) permitted LEAs to first determine if they could demonstrate MOE compliance based on the prior year's local-only or combined State and local expenditures. Second, if an LEA could not demonstrate MOE compliance based on that standard, CDE's Template instructed LEAs to compare local-only expenditures to the most recent fiscal year when the LEA met MOE compliance based on local-only expenditures. Third, CDE's Template further provided that if an LEA had not previously based MOE compliance on local-only expenditures, it could use a base year as early as 2006–2007 to demonstrate MOE compliance. The OIG indicates that by providing an MOE Comparison Template to LEAs that included the option for LEAs to compare local-only expenditures to a year other than the immediate prior year, CDE endorsed an improper base year for determining LEA MOE compliance that conflicted with the requirements of IDEA. The analysis below explains why we have concerns with the first and third steps in CDE's Template. However, our analysis also explains why the OIG's conclusion, that MOE determinations based on local funds only must be made on the basis of prior year expenditures by an LEA, is not fully accurate

Current Statutory and Regulatory LEA MOE Provision

Under section 613(a)(2)(A)(iii) of the IDEA, except as provided in section 613(a)(2)(B) and (C), Part B funds provided to an LEA must not be used to reduce the level of expenditures for the education of children with disabilities made by the LEA from local funds below the level of those expenditures for the preceding fiscal year.

Under 34 CFR §300.203(a), except as provided in 34 CFR §§300.204 and 300.205, funds provided to an LEA under Part B of the Act must not be used to reduce the level of expenditures for the education of children with disabilities made by the LEA from local funds below the level of those expenditures for the preceding fiscal year. Under 34 CFR §300.203(b)(1), except as provided in paragraph (b)(2), the State educational agency (SEA) must determine that an LEA complies with paragraph (a) for purposes of establishing an LEA's eligibility for an award for a fiscal year, if the LEA budgets, for the education of children with disabilities, at least the same total or per capita amount from either local funds only or a combination of State and local funds, as the LEA spent for that purpose from the same source for the most recent prior year for which there is information available. Under 34 CFR §300.203(b)(2), an LEA that relies on local funds for any fiscal year must ensure that the amount of local funds it budgets for the education of children with disabilities in that year is at least the same, either in total or per capita, as the amount it spent for that purpose in the most recent fiscal year for which information is available and local funds only were used to establish the LEA's compliance with the MOE requirement. (Emphasis added)

Guidance in OSERS' April 2009 Guidance on Funds for Part B of the IDEA Made Available under ARRA[1]

As noted in the Draft Memo, OSERS stated in response to question H-6 of the ARRA Guidance on the LEA MOE requirement that, if an LEA relies on a combination of State and local funds or local

[1] The April 2009 ARRA Guidance was revised on April 13, 2009, July 1, 2009, and September 9, 2009.

funds only to meet the MOE requirement, the comparison year is the prior year. This provided some basic guidance that was likely to apply to many LEAs.

History of LEA MOE in the IDEA

Prior to 1997, IDEA included a requirement that LEAs use IDEA Part B funds to supplement, not supplant, State and local funds. The Department's IDEA Part B regulations in effect prior to 1999 required LEAs to meet the supplement not supplant requirement by expending at least the same amount of the total amount of State and local funds expended the prior year for the education of children with disabilities. This was consistent with legislative history indicating that the intent of the supplement not supplant provision was that "[Federal] funds do not reduce the level of expenditures made by States or local educational agencies in the previous fiscal year." S. Conf. Rep. 94-455 (1975).

In 1997, IDEA was amended to include the requirement in section 613(a)(2)(A)(iii), that LEAs must not use Part B funds, except as provided in subparagraphs (B) and (C), to reduce the level of expenditures for the education of children with disabilities made by the LEA from local funds below the level of those expenditures for the preceding fiscal year. The legislative history of the IDEA Amendments of 1997 indicates that Congress included a specific LEA MOE requirement for the first time in order to address LEA concerns that they not be required to increase expenditures from local funds if the amount of State funds were reduced. In other words, LEAs wanted to have the option of meeting MOE through local funds only. *See* Sen. Rep. 105-17 (1997) and H. Rep. 105-95 (1997). *See also* Comments and Analysis to 1999 Regulations, 64 Fed. Reg. 12405, 12571 (March 12, 1999).

In response to the proposed regulation in the Notice of Proposed Rulemaking (NPRM) implementing the new LEA MOE provision in the IDEA Amendments of 1997, which addressed local funds only, some commenters expressed concern that the proposed regulation would mean that even in years when State legislatures increased State appropriations to offset financial expenditures of LEAs, those funds could not be included in making determinations as to whether the MOE provision had been met. The Department acknowledged in the analysis and comment section of the 1999 final Part B regulations that:

"if a State assumes more responsibility for funding these services, such as when a State increases the State share of funding for special education to reduce the fiscal burden on local government, an LEA may not need to continue to put the same amount of local funds toward expenditures for special education and related services in order to demonstrate that it is not using IDEA funds to replace prior expenditures from local funds."

See Comments and Analysis to 1999 Regulations, 64 Fed. Reg. 12405, 12571 (March 12, 1999). In response to these comments, the final regulation on local MOE was changed to permit LEAs to meet MOE by expending the required amount of local funds only, or a combination of State and local funds, for the education of children with disabilities. The final regulation also included the provision at issue in this draft memorandum, that if an LEA relies on local funds only for any fiscal year, the LEA must ensure that the amount of local funds it budgets for the education of children with disabilities in that year is at least the same, either on a total or per capita basis, as the amount of local funds it spent for that purpose in the most recent fiscal year for which information is available and the LEA established its compliance with 34 CFR §300.203 using local funds only. The basic MOE requirement did not change in the IDEA Improvement Act of 2004.

Analysis of LEA Current MOE Regulation and Issues Raised in OIG Draft Memo

The regulation in 34 CFR §300.203 includes both a standard to be used as a part of determining an LEA's eligibility for an IDEA Part B subgrant (eligibility standard) and a separate standard for determining whether an LEA in fact spent as much local or State and local funds as required on the education of children with disabilities (compliance standard). While 34 CFR §300.203(b) only addresses the eligibility standard, the Department has always interpreted the standard set out in 34 CFR §300.203(b) to also apply to the compliance standard. The preamble of the NPRM implementing the IDEA Improvement Act of 2004 states that the standard for determining whether an LEA is complying with the LEA MOE requirement would be in proposed 34 CFR §300.203(b). See 70 Fed. Reg. 35782, 35795 (June 21, 2005). Therefore, the Department interprets 34 CFR §300.203(b)(1) as permitting LEAs to use the total or per capita amount of local funds only, or a combination of State and local funds, when calculating MOE for the purpose of meeting the compliance standard, as well as the eligibility standard. This interpretation ensures that LEAs will not reduce their level of expenditures for the education of children with disabilities, while giving LEAs the flexibility to calculate MOE based on one of four methods-local only, per capita; local only, total amount; State and local, per capita; and State and local, total amount. The Department also interprets the provision in 34 CFR §300.203(b)(2) to apply to the compliance standard. This interpretation provides clarity for LEAs because the comparison year for the eligibility standard is the same as the comparison year for the compliance standard.

Our first concern is with step one of CDE's Template, which permits an LEA to demonstrate compliance with the MOE requirement by comparing the amount of local-only expenditures for the education of children with disabilities to the amount of local-only expenditures in the prior year. While the immediate prior year is the comparison year that applies when an LEA demonstrates compliance based on a combination of State and local funds, the immediate prior year is not the comparison year that applies when an LEA is relying on local funds only to establish compliance. We recognize that the ARRA guidance put an emphasis on using the prior year as the comparison year, even when an LEA relies on local funds only. However, the regulation in 34 CFR §300.203(b)(2) specifies that the comparison year that applies when an LEA demonstrates compliance based on local funds only is the most recent fiscal year for which information is available and local funds only were used to establish the LEA's compliance with the MOE requirement. The specific language of the regulation is what applies to all situations and governs in this situation. Therefore, we do not agree with the OIG's statement that "by providing an MOE Comparison Template to LEAs that included the option for LEAs to compare local-only expenditures to a year other than the immediate prior year, CDE endorsed an improper base year for determining LEA MOE compliance that conflicted with the requirements of IDEA."

We interpret the provision in 34 CFR §300.203(b)(2) to mean that if an LEA relies on local funds only to establish eligibility or compliance, the proper comparison year is the most recent fiscal year for which information is available and the LEA met MOE based on local funds only, even if the LEA also met the MOE compliance standard based on State and local funds.[2] The comparison year

[2] The Department does not interpret the regulation to mean that the comparison year is the most recent fiscal year the LEA actually established its compliance with MOE based on local funds only, because that interpretation would make it very difficult for an LEA to determine the proper comparison year to use in order to meet the MOE requirement. An LEA often provides expenditure information to a State and may not know on what basis the State determined that the LEA met MOE for a particular fiscal year.

includes not only a year in which the LEA met only the local only test; but also a year in which the LEA met both the State and local test and the local only test. Even in a year in which an LEA meets MOE based on both tests, the LEA could have established compliance on the basis of local funds only, which is consistent with the literal language of the regulation. We believe that the assumption underlying the literal language of the regulation was that it would lead to comparisons of local effort to the most recent fiscal year in which the LEA expended the highest amount of local funds. However, given the fluctuations in State and local funds, there may be no one approach that would always result in the comparison year being the year in which the LEA expended the highest amount of local funds.

This interpretation is also consistent with the purpose of the MOE provision, because it prevents an LEA from using, as a comparison year, a year in which the LEA met the compliance standard based on local funds only (and not State and local funds) and in an intervening year increased the amount of local funds expended and met the compliance standard based on local funds and State and local funds. For example, in year one an LEA met MOE based on local funds. In year two, the LEA increased the amount of local funds it expended and met MOE based on local funds and, because State funding also increased, it also met MOE based on State and local funds. In year three, the LEA meets MOE based on local funds only by spending the amount of local funds it expended in year two; it cannot use year one as a comparison year, because the amount of local funds expended in that year was less than the amount of local funds expended in year two.

We share OIG's concern with the third step of CDE's Template, which permits an LEA that had not previously based MOE compliance on local-only expenditures to use a base year as early as 2006–2007 to demonstrate MOE compliance. It is not clear from the information provided why CDE chose 2006-2007; it may have been the last year the State had what it considered to be reliable data on local funds. (CDE's application of this standard permitted the two LEAs identified in the Draft Memo to demonstrate compliance with the MOE requirement in FY 2009-2010 by comparing the amount of local funds they spent in FY 2006-2007, which was less than the amount of local funds they spent in FY 2008-2009.) The regulation in 34 CFR §300.203 does not explicitly address the situation where an LEA has never demonstrated compliance based on local funds only. However, both the statutory and regulatory LEA MOE provisions set out two comparison years for the purposes of LEA MOE compliance: the immediate prior year; or if the LEA relies on local funds only, the last year the LEA met MOE based on local funds only. Therefore, if an LEA has never met MOE based on local funds only,[3] we believe the better interpretation of the regulation is that the comparison year is the immediate prior year, rather than a fiscal year that the State selects.

Response to Recommendations

OIG Recommendations

OIG is recommending that OSERS: (1) instruct CDE to: immediately modify its LEA MOE Comparison Template so that LEAs can no longer demonstrate whether they have met the MOE compliance requirement based on local-only funds from an improper fiscal year; (2) instruct CDE to identify all instances in which LEAs used an improper year to meet the MOE compliance standard based on local-only funds and require these LEAs to revise their MOE Comparison

[3] As noted above, prior to the enactment of the IDEA Amendments of 1997, there is was no LEA MOE requirement.

Reports using the proper year's data; and (3) determine whether the Department should seek a fiscal recovery.

OSERS' Response to the three OIG Recommendations

The LEA MOE regulation in 34 CFR §300.203 is a complex requirement and the Department has not issued guidance on the comparison year that applies when an LEA relies on local funds only to establish eligibility and compliance. As explained above, we interpret the provision in 34 CFR §300.203(b)(2) to mean that if an LEA relies on local funds only to establish eligibility or compliance, the proper comparison year is the most recent fiscal year for which information is available and the LEA met MOE based on local funds only, even if the LEA also met the MOE compliance standard based on State and local funds. The specific circumstance raised in the draft memo, the proper comparison year if an LEA has never demonstrated compliance based on local funds only, is not addressed specifically in the regulation. While we agree that the better interpretation of the regulation may be to require an LEA in that circumstance to use the immediate prior year as the comparison year, it arguably was not unreasonable for CDE to use a year other than the immediate prior year.

Because the regulation and guidance is not specific on all aspects of a situation like this, we do not believe that a recovery of funds would be appropriate at this time. As you know, the Department is currently seeking to regulate to clarify the LEA MOE provision in 34 CFR §300.203 and currently is conducting additional data analysis with respect to the proposed regulatory changes. The audit work that you have done will assist us as we identify all of the circumstances that will need to be addressed to clarify the LEA MOE standard. We will also do further analysis of the California situation, and offer to provide further technical assistance to the State educational agency. Therefore, while we very much appreciate the work you have done and the way in which you brought this to our attention, and share some of your concerns, it is our view that the draft recommendations should be modified appropriately, and the Department should continue its work on providing further guidance in this area, and provide technical assistance to California, and if necessary, other States on the comparison year that applies when an LEA relies on local funds only to establish eligibility and compliance.

Please let us know if you have questions or want to discuss this matter.