The New York City Department of Education ("NYCDOE") Office of Auditor General ("OAG") management takes the position that all concerned benefit when Approved Special Education Programs ("ASEP" or "Agency") administrators familiarize themselves with the rules and regulations against which claims for reimbursement will be tested and are armed with sufficient information to assess their agency's compliance with that guidance and correct deficiencies as required. In keeping with their practice of informing the field of pertinent audit findings and compliance issues, the New York City Department of Education ("NYCDOE") Deputy and Assistant Auditors General accepted an invitation to speak at the Annual New York State Alliance for Children with Special Needs One-Day Conference. The substance of the presentation, which drilled into expenditure and audit protocols, and explained the NYCDOE's approach to approving ASEP's use of section 611/619 funds, is outlined below.

SECTION 4410 AUDIT PROGRAM

As ASEPs are aware, the relatively recent, well-publicized negative findings connected with the New York State Comptroller's audits of section 4410 programs have occasioned significant drops in rates, and, in some cases, termination of NYCDOE contracts, criminal prosecutions and civil action. As such, the state and New York City have been exploring how best to approach their oversight roles. In the case of New York City, management within the New York City Mayor's office promoted an enhanced audit presence as one path to encouraging programs' adherence to rules that regulate ASEPs' fiscal activities, thereby minimizing the city's exposure to losses attributable to downward rate adjustments. With that as the objective, the NYCDOE Office of Auditor General has sought and obtained approval of its section 4410 audit program from the New York State Education Department ("NYSED"),[1] received resources from the city sufficient to expand its preschool special education audit unit, and identified section 4410 programs that will be audited this fiscal year. Findings related to the audits will be reported to the NYSED Rate Setting Unit ("RSU") for its consideration in setting or adjusting tuition/session rates.

OAG's NYSED-approved audit program consists of tests of revenue, expenses, enrollment and adequacy of internal controls that will be applied to the ASEP's most recently or two most recently filed Consolidated Fiscal Reports ("CFR"). Testing, which is conducted on a sample basis, is accomplished through interviews of managers/consultants responsible for the agency's program and fiscal administration and review of agency records. As to the latter, unless stated otherwise, the ASEP is expected to produce original records of its fiscal transactions for on-site review. During the site visits, it should be expected that the auditors also will want to see

[1] http://schools.nyc.gov/oag/4410/4410AuditPgm.pdf

evidence that inventory is maintained in accordance with the Reimbursable Cost Manual ("RCM").

Lack of documentation supporting reported expenditures, or delay in making documentation available, exposes the agency to audit disallowances and expansion of the scope of audit, including an increase in sample size and/or the addition of years subject to review.

SELECTION OF PROGRAMS FOR AUDIT

To date, selection of programs for audit has been based on various considerations which include the following:

- CFR submissions that are late or have triggered requests by NYSED for supporting documentation
- Concerning data patterns identified through review of CFRs and financial statements
- Discrepancies between FTEs reported to the NYCDOE for payment and to NYSED for rate setting purposes

PREPARING FOR AN AUDIT

Past missteps cannot be cured retroactively. That, however, should not dissuade administrators from taking a proactive approach to assessing current conditions. Taking the long view and getting the operational house in order will prove to be an effective way to achieve efficiencies and "audit-proof" the agency going forward.

Auditors will look for the following and then draw conclusions about the soundness of the agency's fiscal practices.

- **Adequate fiscal support.** OAG has found that agency administrators generally are conversant with the rules around service delivery. It is striking, however, that those same agencies do not have managers on board who demonstrate an understanding of the RCM and other fiscal guidelines and can show the auditors how the rules are applied to the agency's day-to-day operations. Since it sends the wrong signal when only the agency's off-site consultant can address financial operations with the auditors, it is recommended that the operational assessment include review of the staffs' skill sets and responsibilities so that both service and operational oversight and implementation are covered adequately.

- **Strong internal controls**. "Internal controls are systems to protect the assets of an organization, create reliable financial reporting, promote compliance with laws and regulations, and achieve effective and efficient operations."[2] The ASEP's controls must cover both program and fiscal compliance and be subject to annual risk assessments. As examples:
    - In determining whether the agency has adequate controls over recording reimbursable costs, management should assess whether the agency has procedures that drive documenting approval of purchases and their receipt, and assure that the costs incurred are classified accurately, properly identified as reimbursable under the terms of the RCM, and fairly allocated.
    - The NYCDOE pays providers on the basis of the agency's certification of student enrollment on the Certified Monthly Roster ("CMR") and expects that pains have been taken to avoid certifying information that has not been vetted properly. As such, agency administrators should review current procedures to ensure that staff responsible for submitting the CMR are relying on *current*, accurate information which is the product of a process for documenting and verifying students' first and last dates of attendance or legal absence.

- **Sub Ledgers/Cost Centers.** CFR preparation is significantly hampered if the agency has not maintained sub ledgers that identify costs by program and function. Nonetheless, it has been OAG's unhappy experience that although CFRs had been submitted, when asked for the corresponding sub ledger in satisfaction of an audit request, many agencies cannot produce it. What that means is that even before any drilled down work begins, the agency has given the audit team cause for concern about how the CFR could have been prepared in the absence of program/function-specific cost assignment.

- **Cost allocation**. NYSED and NYCDOE understandably are concerned about ASEPs' appropriate allocation of costs among programs and entities that benefit from the agencies' expenditures. Therefore, where costs are incurred and cannot be attributed to only one program, ASEPs must:
    - Establish an allocation methodology that fairly and reasonably apportions costs; per the RCM, the allocation methods, as well as the statistical basis used to calculate allocation percentages, must be documented and retained for each fiscal year for review upon audit for a minimum of seven (7) years.
    - To the extent possible, develop the allocation methodology at the beginning of the school year – even before costs are incurred – and apply the methodology as expenditures are made.
    - Review allocation percentages on an annual basis and adjust them as necessary to reflect a reasonable cost distribution among programs. All records used to

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[2] http://www.oms.nysed.gov/rsu/Manuals_Forms/Manuals/RCM/CurrentYear/201213RCMFinalVersion73112.pdf at page 73.

update or select a new allocation methodology for a particular cost category must be maintained as well. Note that the allocation methodology can be based on the prior year's cost and revenue data. However, material changes in current year operating costs or revenue may require adjustments to the methodology. And, as a matter of good business practice, the methodology should be reviewed at year end to determine whether it is still sound.

- **Employee time records/consultant invoices**. Personal service and consultant costs generally represent the majority of the expenditures reported in an agency's CFR. And, since agencies are required to report not only the salary and associated fringe benefits for employees, but their title and full time equivalency, it is reasonable to expect that supporting time records, or detailed invoices in the case of consultants, would be maintained. Nonetheless, it has been OAG's experience that time records and consultant invoices often are missing or lacking in detail and required approval, conditions that may result in disallowance of inadequately supported costs.
    - Employee time records. The RCM requires payroll to be supported by employee time records that are prepared during, not after, the time period for which the employee was paid, completed at least monthly, and signed by the employee and a supervisor. If an individual works in two or more titles or jobs within the same organization or a related organization, the agency must maintain contemporaneous records for the time spent in each program or title. Auditors will test whether the records are in hand and account for the total activity for which each employee is compensated.
    - Consultant invoices. The RCM set outs a number of criteria for engaging consultants and maintaining adequate documentation, which "includes, but is not limited to, the consultant's resume, a written contract which includes the nature of the services to be provided, the charge per day and service dates." Payments to consultants can be made only for service actually provided. The invoice must be itemized and identify the service provided, and for each service, the date(s), number of hours on task, the fee per hour; and the total amount charged. "In addition, when direct care services are provided, the documentation must indicate the names of students served, the actual dates of service and the number of hours of service to each child on each date." (RCM Section III. 1.C. Consultants). Auditors will test whether the agency maintained required documentation and whether the invoices are sufficiently detailed and are consistent with the rates stated in the written contract. Additionally, if the contract specified deliverables, they will be sought and reviewed upon audit.

- **Classification of costs.** Many of the costs incurred in the operation of the agency are, on their face, not difficult to classify. We are surprised, then, when, for example, transportation costs are categorized as supplies or an executive director is classified as a consultant. Such situations bespeak either a lack of internal controls over entry of expenditures or an intention to “hide” expenses. Either case will color the audit findings and may impact reimbursement.

We do recognize, however, that there may be expenditures that do not readily fit into a particular cost category. In those cases, the agency should consult with its financial advisor before posting the expenditure to the ledger. If, upon a later review, the agency’s CPA recommends re-classification of such cost, the administrator should obtain a clear understanding of the rationale for that decision.

- **Less-Than-Arm-Length (LTAL) Transactions.** Generally, LTAL transactions are reimbursed using actual documented costs of the owner or vendor. Since an invoice from the related party will not be considered appropriate support of the ASEP’s actual cost, it is recommended that before engaging in the LTAL transaction, the ASEP consider whether the related party has maintained and is prepared to produce on audit a record of its costs at the time services/goods were purchased.

  A contract for the purchase of management, administration and staffing services will be evaluated to determine whether the transaction was economically beneficial to the reimbursable program and whether the arrangement resulted in duplication of functions within the ASEP. Where it appears that the ASEP derived minimum economic benefit and/or employed staff that largely performed the same function as the consultant(s), the costs charged to the program will be adjusted on audit.

  Finally, though hiring individuals who are related by blood or marriage is not prohibited by SED regulations, the ASEP will be required to produce those individuals’ qualifications, time records and work product.

- **Bonus/Merit Award.** This is a “non-recurring and non-accumulating . . . lump sum payment in excess of regularly scheduled salary which is not directly related to hours worked. A merit award may be reimbursed if it is based on merit as measured and supported by employee performance evaluations.” (FY 2013 RCM Section 13 (compensation for Personal Services) A. (10).) It is not available for consultants.

  Since payments made within this category without adherence to guidelines have resulted in significant audit disallowances, it is important that the agency implement the preconditions to making such awards even if the agency is only contemplating merit award distributions at this time. Those steps, as cited in the FY 2013 RCM are:

  - The provider’s governing entity must adopt a written employee performance evaluation policy and form that contains sufficient detail as to the criteria and methods used to determine each employee’s final evaluation rating.

- The written employee performance evaluation policy must also describe how the final evaluation rating will directly correlate to any amount of a merit award should funds be available for such an award.

Of course, the evaluations must then be conducted and memorialized in accordance with the policy.

Finally, new and notable in the most recent RCM is that merit awards must be paid within the year awarded or no later than 2 ½ months after the entity's year end.

- **Facility Costs.** When more than one related program operates in the same rented facility, the share of rental and related expenses allocated to the reimbursable program is based on reasonable and documented criteria, such as actual square footage utilization. Auditors will carefully review the floor plans, allocation methodology and supporting documentation. We can state, based on experience, that SEIT program facility costs that were allocated based on ratio value or the revenue of the respective programs have been adjusted downward on audit.

- **Audit Costs.** Costs incurred for legal/financial consultants who are engaged to assist with responding to audit requests will be evaluated to determine whether they are "reasonable, necessary, and directly related to the special education program." Before incurring such costs, the ASEP would do well to consult with RSU staff.

INDIVIDUALS WITH DISABILITIES EDUCATION ACT ("IDEA")

IDEA sections 611 and 619 funds are distributed by the NYCDOE to the ASEPs as vendor funds. In this relationship, the ASEP is essentially standing in for the NYCDOE in providing supplemental services/materials to the students assigned by the NYCDOE to the ASEP. As such, the NYCDOE has the final say on the types of services/materials that can be purchased with IDEA funds and exercises that responsibility fairly conservatively within guidelines promulgated by SED.

In reviewing an ASEP's budget and narrative, NYCDOE grant and program managers consider whether the NYCDOE would purchase the same items or services for its public school students. If not, it is unlikely that approval will be given. Reasonable people may disagree with the NYCDOE's decisions, but, in the end, the relationship is the NYCDOE's to manage. In the absence of a plan to spend the funds in furtherance of the program and/or a desire to undertake the required administration and recordkeeping, ASEPs are encouraged to give some thought to foregoing the request for funds.

With respect to the required budget and narrative, ASEPs should state specifically the nature of the expenditure that will be made with IDEA funds. As an example, the NYCDOE has sent back submissions that seek funds for $20,000-worth of "general supplies." Budgets for items that are clearly outside anyone's guidelines, such as a snow blower; high-level administrative salaries; HVAC system; and automobiles have also been rejected. The NYCDOE does not discourage a creative approach to IDEA-funded projects funded. That said, the best way to get the NYCDOE to agree with such a proposal is to keep costs reasonable and make a strong case in the narrative for how the proposed expenditure will benefit the students and supplement the program.

As for expending IDEA funds, ASEPs are advised of the following:

- ASEPs must comply with the RCM guidance pertinent to each particular approved cost category. As an aside, we note that not every category of expenditure within the RCM can be supported with IDEA funds.
- OAG audits will include tests of IDEA expenditures; OAG, in addition to other responsible DOE offices, may conduct targeted reviews.
- It is likely that wholesale "substitutions" of items that were not approved for those that were will be disallowed on audit even if the expenditure is documented and could have been approved if it had been requested in the budget. Such unfortunate outcomes can be avoided by submitting timely Form FS 10A for amendments to the budget.
- The NYCDOE plans to automate the IDEA funding process, thereby connecting budgets to expenditure reports. It is best to get used to maintaining records and expending funds within approved budgeted categories now.