In November 2015, the Deputy and Assistant Auditors General for the New York City Department of Education ("NYCDOE") Office of Auditor General ("OAG") spoke at the annual conference hosted by The New York State Alliance for Children with Special Needs. The presentation addressed "practical" operational concerns, recent OAG audit findings, and the application of certain new SEIT requirements. Below is a summary of that discussion.

➢ PERSONNEL FILES

It is prudent to maintain three separate files:

1. **Personnel File**
   A general personnel file should be created for each employee on the date of hire. Most, but not all, important job-related documents should go in the file. A document should be in the employee's file if:
   - It is relevant to a supervisor who may review the file when making an employment decision.
   - It is related to the employee's performance, knowledge, skills, abilities or behavior.

   Examples of personnel file records
   - Job description for the position
   - Job application and/or resume
   - Offer/contract of employment
   - Signed "receipt" for items such as it hardware
   - Licenses/certificates and related records
   - Receipt or signed acknowledgment of employee handbook
   - Performance evaluations
   - Records of attendance at professional development workshops/training
   - Warnings and/or other disciplinary actions
   - Notes on attendance or tardiness
   - Documents relating to the worker's departure from the company (such as reasons why the worker left or was fired, unemployment documents, insurance continuation forms, and so on).
   - IRS Form W-4 (the Employee's Withholding Allowance Certificate)

   Personnel files should be reviewed periodically. During this review, the responsible manager should consider whether the documents in the file are accurate, up to date, and complete. For example, the reviewer should address the following:
   - Does the file contain every written evaluation of the employee?
   - Does the file reflect all of the employee's raises?
   - Does the file show every warning or other disciplinary action taken against the employee?
   - If the agency's policies provide that written warnings or other records of discipline will be removed from an employee's file after a certain period, have they been removed?

- If the employee was on a performance improvement plan, a probationary or training period, or other temporary status, has it ended? Has the file been updated to reflect the employee's current status?
- If the employee handbook has been updated since the employee started working, does the file contain a receipt or acknowledgment for the most recent version?
- Does the file contain current versions of every contract or other agreement between you and the employee?

2. **Confidential File**
   Personnel files should not be a repository for every record or note pertaining to the employee. Documents that contain sensitive information, such as, but not limited to, the following, should not go in the personnel file, but in a separate file for each employee. Access to that file should be limited.
   - Medical information
   - Marital status
   - Veteran status
   - Immigration status
   - National origin
   - Race
   - Gender
   - Religion
   - Sexual orientation
   - Dependent information
   - Child support/garnishments
   - Internal investigation records, though relevant disciplinary action, counseling or other direct communication are placed in the employee's personnel file.
   - Criminal history
   - Financial history
   - Worker's compensation claims
   - Subjective statements or accusations
   - Drug test results
   - Whistleblower complaints

3. **Form I-9 file**
   Employers must complete U.S. Citizenship and Immigration Services Form I-9 to document verification of the identity and employment authorization of each new employee (both citizen and noncitizen) hired after November 6, 1986 to work in the United States.

   All Form I-9s should be put into a single folder to avoid handing over employees' personnel or confidential files if government agents exercise their right to inspect I-9 forms during a site visit.

➢ WHISTLEBLOWER POLICY

Pursuant to RCM Section III (3): **"**All entities are required to have a Whistleblower Policy with the following requirements:

- The policy protects employees who report inappropriate behavior from retaliation.
- All employees are made aware of the Whistleblower policy through orientation or ongoing training opportunities.
- The policy is readily accessible to all employees (e.g., website, employee handbooks, and training materials)"

Although whistleblowers are not universally protected from employer retaliation by law, such protection may be conferred under specific statutes, among which is the New York False Claims Act,[1] which allows the Attorney General, a local government, or any person to file a lawsuit against a person or a company that obtains or withholds funds or property from the state or local government through false or fraudulent conduct. A person or company found liable under the act may be ordered to pay treble damages, civil penalties, litigation costs and attorneys' fees.

Any current or former employee, contractor, or agent of any private employer who is retaliated against for having acted under the law, may be entitled to relief, including reinstatement to the position the whistleblower would have had but for the discrimination; reinstatement of full fringe benefits and seniority rights; payment of two times back pay, plus interest; and compensation for special damages including litigation costs and reasonable attorneys' fees.

Best Practices

- Have the employee sign that the whistleblower policy was received.
- Add discussion of the policy to a training agenda.
- Post the policy where it can be seen.
- Identify an agency compliance officer.

➢ WORKING CAPITAL LOANS – INTEREST EXPENSE (RCM Section II (28)).

This topic was included inasmuch as audits/reviews have identified a significant number of instances where essential RCM criteria have not been followed, particularly in the areas of demonstrating need for the loan and complying with related party loan documentation of need and interest rate limitations. In those cases, the auditors have recommended disallowance of reported interest costs.

Conditions for Working Capital Interest Reimbursement. "Working capital interest is defined as interest paid on loans that are secured for operational expenses."[2] Loan

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[1] New York City has enacted a False Claims Act as well.

[2] OAG has rejected the argument that where the Provider is one among several related entities the Provider need demonstrate only that the entire operation was cash-strapped, rather than that the Provider's cash flow situation necessitated the loan.

transactions will be evaluated on "an overall level of reasonableness." Fees incurred in procuring the loans are not reimbursable.

The RCM identifies criteria that must be met if working capital loan interest expense is reported. Among the requirements is that the provider must demonstrate that the loan is warranted. The RCM identifies documentation relevant to establishing need for the loan, including:

- "Documentation of cash flow needs including receipts and disbursements."
- "Documentation indicating that tuition billings or their equivalent were submitted to the appropriate funding sources in a timely manner in accordance with a written contract or schedule of payments and at least one follow-up notice was sent to delinquent sources."

Arm's-Length Interest Expense. Interest paid on arm's-length loans is reimbursable "provided *the interest rate is not in excess of the prime rate plus one percent* of the lending institution at the time the loan was made. Interest expense will be reimbursed on loans in excess of the prime rate plus one percent in cases where the entity can establish that it was unable to secure a rate of prime plus one percent or lower despite its good faith efforts to do so. An entity shall demonstrate good faith efforts through documentation supporting annual attempts to obtain the most competitive rate available by requesting quotes from at least three lending institutions."

Less-Than-Arm's-Length Interest Expense. Interest incurred in a LTAL transaction "will be reimbursed only with the *prior written approval of the Commissioner* upon *establishment of the necessity and cost effectiveness of the transaction*. A cost effective transaction relating to interest expense on capital indebtedness or on working capital loans is one in which *the interest rate charged by the LTAL lender is less than or equal to the prime rate available from lending institutions and is greater than the actual cost of the capital rate to the lender*. The borrowing LTAL entity must demonstrate that through a *competitive bidding process from at least three arms-length lending institutions* this LTAL transaction was necessary as a last resort to acquiring monies and that the interest rate charged by the lending LTAL entity was more favorable than could be obtained in the market place and that rate of interest must be demonstrated to be at prime or less from available lending institutions at the time the loan was incurred." (Emphasis added).

➢ PROVIDERS AS LENDER OF PUBLIC FUNDS

While the RCM has multiple guidelines for reporting interest expense, it does not provide guidance for reporting revenue earned as interest on loans of program and/or IDEA vendor grant funds. We take the view that the RCM's silence with respect to such loans made by a Provider to another entity is a clear indication that such commerce with public funds is not sanctioned. That position applies even if the loan agreement is in writing; even if interest is charged on the loan; and, even if that interest is added to reported revenue.

➢ PIERCING THE CORPORATE VEIL

General rules:

- A corporation exists independently of its owners, who are not personally liable for its obligations.
- Individuals may incorporate for the express purpose of limiting their liability.

However: In New York, the legal protection afforded by the corporate structure may be lifted, and personal liability may be imposed on the owners for the acts of the corporation—that is, the corporate veil may be pierced—where it is "demonstrate[d] that the owners of the corporation exercised complete domination over it in the transactions at issue and, in doing so, abused the privilege of doing business in the corporate form."[3] Courts have recognized the following conditions, among others, as providing support for piercing the corporate veil.

- Use of corporate funds for personal use
- The corporation has been so dominated by an individual and its separate entity so ignored that it primarily transacts the dominator's business instead of its own and can be called the other's alter ego
- Commingling of assets
- Inadequate capitalization

As a cautionary note, we are advising that, where audits have uncovered evidence that the corporate structure has not been respected, the New York City Law Department has instituted civil law suits seeking monetary relief on behalf of the NYCDOE against both the corporation (including 501(c)(3) organizations) and its high-level managers in their individual capacity. It should also be noted that the New York State Attorney General may be asked to review audit findings and consider appropriate action in the case of fiscal wrongdoing within the structure of a 501(c)(3) organization.

➢ SEIT

All SEIT Providers are aware by now that payment for SEIT services are made only upon actual delivery of a direct service to student or an indirect service to the student's teacher if indirect service is recommended in the IEP. The NYCDOE has designed a new electronic billing system, the Certified Monthly Invoice ("CMI"), to accommodate fee-for-service billing. Although the CMI has been operational since July 2015, NYCDOE managers intend to make adjustments that will align better with SEIT Provider and NYCDOE needs and add new edits.

Also of note is that, in October 2015, the New York State Education Department ("NYSED") issued a Special Education Field Advisory ("Advisory"). Among other topics

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[3] See 2013 NY Slip Op 51345(U); Millennium Constr., LLC v. Loupolover, 44 AD3d 1016.

related to the provision of SEIT, the Advisory offers clarification in the area of make-up sessions. Although SEIT Providers are strongly encouraged to read the October 2015 Special Education Field Advisory in its entirety,[4] we offer the following highlights:

- Location of service. The Non-Exclusive Requirements Agreement for the Provision of Services for Preschool Students with Disabilities ("Agreement") is operative in all respects except in those that are at variance with NYSED guidance. As a significant case in point, the Agreement permits SEIT Providers to serve a student in a location agreed to by the parent if the early child program in which the student receives SEIT service is closed for a school holiday other than a national or New York State holiday and the SEIT Provider is not closed. (Agreement Section 10(c)(3)(L)). That section, however, has been superseded by the Advisory that was issued post-Agreement implementation, in that SEIT sessions, including make-up sessions, can be provided only at a site identified in the student's IEP.

- **Make-up sessions.** SEIT Providers
  - *Must* arrange to provide students with make-up sessions when the missed sessions were missed due to staff absence.
  - *May*, as *appropriate* to the individual student's needs, make-up any *excused student absences.*
  - *May, but are not required to,* make-up sessions for *unexcused student absences.*

➢ AUDITS

The potential impact of an audit conducted by OAG is tied to the type and scope of review.

- **Full-scope audit.**[5] The primary objective of a full-scope audit is to test the information reported in the Consolidated Fiscal Report. It is likely to cover at least two years' filings and will result in a report that is shared with NYSED for its consideration in setting audited rates.
- **Field review.** The field review, which is conducted largely in real time, is designed to obtain an understanding of the Provider's internal controls and current fiscal conditions with the objectives of minimizing the risk that expenses that do not meet RCM guidelines will make their way into the CFR and, where remediation is warranted, to allow steps to be taken to avoid replicating poor operational practices. The report of field review findings will be shared and discussed with the Provider and may be submitted to NYSED for its consideration in setting the Provider's reconciled rates.

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[4] http://www.p12.nysed.gov/specialed/publications/2015-memos/documents/SpecialEducationItinerantServicesforPreschoolChildrenwithDisabilities.pdf

[5] OAG's NYSED-approved audit program is available on-line:http://schools.nyc.gov/oag/4410/4410AuditPgm.pdf

- **IDEA review.** The objective of this targeted review is to determine whether the reported use of Section 611/619 vendor grant funds was consistent with the approved budget and in conformity with RCM guidelines. The report is shared with NYCDOE's internal offices for further appropriate action, which may include a demand for the return of disallowed funds to the NYCDOE.

- If the Provider is selected for an audit/review
  - Fiscal and program staff should be involved at the beginning of the audit/review.
  - Comply with requests for records fully and timely.
  - Since the auditors will rely on the information contained in the records produced by the Provider, if those records require clarification or explanation, it is best to offer such with the submission. In the same vein, the auditors may ask for particular records that the Provider does not have available or that may not provide a complete picture of the transaction. In those cases, the Provider should make a timely offer of any other or additional records that may be pertinent.
  - The administrators should know when and how it is determined that an expense is reimbursable and how non-reimbursable transactions are recorded in the general ledger.

➢ **Recent audit findings.**

- In violation of NYSED guidance and the Agreement, the Provider had only one set of general ledger accounts to record revenue and expenses for multiple programs.[6] Since that Provider reported costs for each approved program, the reliability of cost distribution becomes subject to question.

- The Provider failed to post transactions to the general ledger contemporaneously.

- The Provider misclassified costs. For example, plumbing service costs were recorded as instructional supplies. Among the reasons for the misclassification were the use of bank statements to record expenses and reliance on

[6] The Provider "shall adhere to all record development, maintenance and retention requirements under this Agreement and to all expenditure and record-keeping rules, regulations and official advisements of SED, including, but not limited to the Reimbursable Cost Manual and Regulations of the Commissioner Part 200, section 200.9, which requires that Center-based Providers maintain accounts in accordance with generally accepted government auditing standards; that Center-based Providers use the accrual basis of accounting; that accounting books of original entry include asset, liability and fund balance or equity accounts, as well as expenditure and revenue accounts; that subsidiary revenue and expenditure accounts be maintained for each approved program requiring a tuition rate, for preschool evaluation costs, and for each government grant administered by the Commissioner, including the federal Individuals with Disabilities Education Act ("IDEA") grant from which the Center-based Provider may receive funds as a vendor to the Board." (Agreement Section 18 (a)(1)). (Emphasis added).

consultants who did not have sufficient information to record the transaction correctly.

- Personal Service costs failed to meet the requirements of NYSED guidance and the Agreement.
  - Compensation was not supported with time records.
  - Time records did not cover all activities performed during the workday when employees worked for multiple programs/related entities.
  - Time records did not evidence supervisory review.
  - Bonus payments were reported but, after at least two years had passed, no payments had been made. The RCM requires that bonuses be paid within the year awarded or no later than 2 ½ months after the Provider's fiscal year.
  - The Provider could not produce employment agreements or agreements that included the pay scale.
  - Fringe benefits were paid for an individual who was not an employee, but a consultant.
  - OAG has accepted electronic time records as long as "time in" and "time out" are captured contemporaneously and the system requires supervisors' review; tracks the employees' and supervisors' electronic signatures (approvals); and prevents changes to the data once the time record has been approved.

- Other-than-Personal-Service ("OTPS") costs failed to meet the requirements of NYSED guidance and the Agreement.
  - Consultant expenses were not properly supported in that consulting agreements has not been executed and/or invoices were missing details of work performed, dates of service, hours on task and/or rates.
  - Reimbursement made to employees for expenses they incurred was not supported with original invoices.
  - Expenses were reported before they had accrued. Expenses accrue when the benefit has been realized, thereby triggering the obligation to pay. It is receipt of the benefit rather than the receipt of the invoice that controls when the expense accrues.
  - Excessive rent was charged to the program. In reviewing facility costs, the auditors will consider whether:
    - costs are incurred only for space necessary to operate the program
    - costs are reasonable
    - costs are for sites that have been approved by SED
    - costs are fairly and appropriately allocated, if space is shared.
  - Related party (less-than-arm's-length) transactions were not charged at actual cost.
  - Expenditures of a personal nature (e.g., trips, restaurant charges and theater tickets) were charged to the program through their classification as agency administration.

- Executive directors and other administrators often rely solely on accountants and bookkeepers for accurate recording of revenue and expense transactions and for maintenance of supporting documentation. Since administrators are responsible for the operation of the approved program and for certifying that costs have been reported in the CFR accurately, it is recommended that administrators:
  - Obtain and thorough understanding of the process used by the accounting staff to record transactions and assign costs.
  - Periodically sample transactions from the general ledger and determine whether they are reported in the correct cost category, assigned to the appropriate program if multiple programs are operated[7] and supported with RCM-compliant records.

- The audit/review tests enrollment and attendance outreach. Following are examples of findings.
  - Students' start and end dates reported in the CMR were different from the students' first and last attend dates of enrollment recorded in the register of attendance.
  - The Provider had no mechanism for tracking SEIT students' absences. Since there are many NYSED rules and Agreement obligations around conducting make-up sessions and reporting excessive absences, SEIT Providers are well advised to prepare and maintain accurate records of student attendance.
  - Providers failed to comply with the Agreement in that RDNA forms were not filed when required. In some instances, although the Provider stated that there had been communication with the CPSE by telephone, neither a written acknowledgement of the conversation nor an RDNA could be produced upon the auditors' inquiry.

[7] In the case of multiple programs, if a cost benefits *all* programs and that cost cannot be directly assigned to each program, then and only then, should the cost be recorded as agency administration.