New York State Office of the State Comptroller
Thomas P. DiNapoli

Division of State Government Accountability

Fiscal and Program Oversight of Special Education Providers

State Education Department

Report 2012-S-103 December 2012

Executive Summary

Purpose

To determine whether the State Education Department (SED) provides adequate onsite fiscal and program monitoring of special education providers. The audit covers the period from July 1, 2008 to November 2, 2012.

Background

SED oversees special education programs for students with disabilities between the ages of 3 and 21. In addition to services provided by local school districts, these programs include services delivered to about 75,000 preschool students by more than 300 for-profit and not-for-profit entities at an annual cost of approximately $1.3 billion. Fifteen State Comptroller audit reports of private special education providers have identified widespread fraud and abuse resulting in $13.2 million disallowances out of a total of $139.8 million examined costs which were funded by the State and local governments. In addition, six of these audits have been referred to law enforcement. In response to the audit findings, the New York State Board of Regents has directed SED to identify necessary program reforms.

Key Findings

- There has been no fiscal audit oversight of individual providers since 2007. There is also no system to ensure programmatic review of providers on any cyclical basis. In the past four years, only about one-third of providers have been reviewed. Other fiscal oversight is limited to the desk reviews of self-reported information contained in the Consolidated Fiscal Reports (CFRs) that providers submit annually.
- Because of the lack of other fiscal oversight, the Certified Public Accountants' (CPAs) role in certifying the CFR has become a critical control in the process. However, our audits have determined – and SED agrees - that CPAs are not fulfilling the responsibility and as a result the information is not sufficiently reliable. Still, prior to our audits, SED had no formal process to refer CPAs for professional discipline or to follow up on such cases.
- Not only is the reliability of the CFR information questionable, but the process itself is complicated and antiquated requiring many manual calculations and allocations, all of which increase the risk of human error and/or the opportunity for abusive manipulation.
- SED has not taken advantage of opportunities to use technology to replace many of the manual steps that staff must undertake. The 17 rate-setting staff work with CFR data from more than 700 providers who operate over 1,400 programs, each of which could require several different rate calculations and adjustments.
- Providers receive limited training and instructions from SED. Training is limited to an optional CFR preparation course offered twice each year. SED does give all providers manuals and periodic updates describing regulations, cost reimbursement rules and CFR claiming processes. However, it mainly relies on providers to ask questions if they don't understand something.
- CFRs are often filed late and are often rife with error. Existing penalty provisions do not function as an effective deterrent to these problems.
- Rates are usually not finalized until a year after services have been provided and paid for. However, when audit disallowances do occur, the State recovers its funding immediately by

reducing payments to the effected county, which is then left to handle any possible collection from the provider.
- Information sharing between SED and other funding agencies is ad-hoc at best. Cost adjustments do not result in a revised CFR available to other funding agencies. Although some sharing does occur through the CFR Interagency Committee in the case of large audit adjustments or suspected fraud, many programs funded by these other agencies are not cost-based and therefore not affected.

Key Recommendations

- Develop and implement a strategy, including necessary resources, for providing adequate onsite fiscal and program monitoring of special education providers.
- Establish a formal process for identifying and reporting CPAs who appear negligent in their certification of CFRs to the Office of the Professions.
- Coordinate with other State agencies to develop a system to ensure that CPAs certifying provider CFRs demonstrate appropriate training, competence and performance.
- Review the CFR and rate-setting processes to identify opportunities for streamlining operations, updating technology and reducing complexity and the occurrence of errors.
- Assess the feasibility of meaningful monetary penalties for providers failing to provide an accurate and timely CFR.
- Formalize policy and procedures for sharing identified provider problems with other State agencies that are also funding the provider.
- Reevaluate and enhance provider training requirements, including frequency, content and requirements for attendance.

Other Reports of Interest

IncludED Education Services, Inc.: Compliance With the Reimbursable Cost Manual (2010-S-59)
Achievements, PLLC: Compliance With the Reimbursable Cost Manual (2011-S-18)
Bilingual SEIT, Inc.: Compliance With the Reimbursable Cost Manual (2011-S-13)

Office of the State Comptroller
State of New York

Division of State Government Accountability

December 18, 2012

Dr. John B. King, Jr.
Commissioner
NYS Education Department
89 Washington Avenue
Albany, New York 12234

Dear Dr. King:

The Office of the State Comptroller is committed to helping State agencies, public authorities and local government agencies manage government resources efficiently and effectively and, by so doing, providing accountability for tax dollars spent to support government funded services and operations. The Comptroller oversees the fiscal affairs of State agencies, public authorities and local government agencies, as well as their compliance with relevant statutes and their observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations. Audits can also identify strategies for reducing costs and strengthening controls that are intended to safeguard assets.

Following is a report of our audit of the State Education Department: *Fiscal and Program Oversight of Special Education Providers*. This audit was performed pursuant to the State Comptroller's authority under Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

This audit's results and recommendations are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. If you have any questions about this draft report, please feel free to contact us.

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

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Background

In New York State, the State Education Department (SED) has primary responsibility for overseeing special education programs that provide services to students with disabilities between the ages of 3 and 21. Based on the individual needs of students, school districts arrange for services, which can be provided by public entities like Boards of Cooperative Educational Services (BOCES) and State-supported schools, or by private special education providers. While most school age students with disabilities receive educational services directly from public school districts, many (including preschool students) receive services from programs operated by private providers (both not-for-profit and for-profit entities). Presently there are over 300 private providers delivering preschool special education services to about 75,000 students at an annual cost of approximately $1.3 billion.

SED's Special Education Quality Assurance (SEQA) Office is charged with monitoring all public and private special education providers and for ensuring compliance with federal requirements under the Individuals with Disabilities Education Improvement Act. There are seven regional SEQA offices located throughout the State staffed by about 60 regional associates responsible for monitoring about 1,500 special education programs.

To receive State funding, special education providers must submit a Consolidated Fiscal Report (CFR) on an annual basis. The CFR requirement applies to providers who operate programs for SED, as well as those who run programs administered by the Office of Alcoholism and Substance Abuse Services (OASAS), the Office of Mental Health (OMH) and/or the Office for People With Developmental Disabilities (OPWDD). Representatives of these agencies comprise the CFR Interagency Committee. Comprehensive guidance is provided to service providers through the Consolidated Fiscal Reporting and Claiming Manual (CFR Claiming Manual) which gives detailed instructions for each schedule that must be filed and is updated annually. SED's Reimbursable Cost Manual (RCM) provides further guidance to entities receiving public funds for educating students with disabilities, including both for-profit and not-for-profit providers. The RCM describes reimbursable costs in detail and also provides information on the methodology used to set rates.

Because the CFR data is self-reported, each special education program provider is required to have an independent certified public accountant (CPA) certify not only their financial statements, but also that the CFRs has been prepared in accordance with applicable instructions. The purpose of the CPA certifications is to ensure that the CFR data is reported consistently and can be relied upon. Special education program providers are allowed to claim CPA audit fees associated with CFR certifications as an expense on the CFR.

SED's Rate-Setting Unit (RSU) is responsible for establishing rates paid to special education providers. RSU uses information contained in the CFRs on revenues, expenses, staffing and enrollment to set reimbursement rates. These rates, as well as the rate-setting methodology, are subject to the approval of the Division of the Budget (DOB). As of November 2012, RSU had 17 employees to carry out this responsibility. For the 2011-12 school year, these staff used CFR data from 735 providers to develop rates for 1,470 special education programs.

Once rates are approved, SED uses its System to Track and Account for Children (STAC) to apply data on student counts and calculate the amounts to be paid to school districts and counties as reimbursement for the provision of services to students with disabilities. Preschool special education providers are paid in the first instance by counties based on invoices submitted. Counties then submit for reimbursement from the State. The State funds 59.5 percent of the cost of special education providers and the counties must fund the remaining 40.5 percent.

Although counties fund a significant portion of these costs, they have little input about what services will be provided. Instead, in consultation with parents, decisions about the nature and extent of special education services that students require are made by a committee composed of representatives from the school district and other educational professionals.

Audit Findings and Recommendations

Since 2003, our audits of special education providers have repeatedly uncovered increasingly serious deficiencies in fiscal management, including cases of outright fraud. (See Exhibit A.) The results of these audits have prompted this current audit which finds that SED's onsite fiscal oversight of private special education providers has been largely inadequate to ensure proper use of public funding, while its onsite programmatic oversight, which has been more substantial, is extremely limited. SED performs a limited number of program reviews of private special education providers and has no process in place to ensure all providers are reviewed on a cyclical basis. Without such monitoring, there is significant risk that providers may spend State and local funds inappropriately, operate inefficiently and lack long-term financial viability.

SED's fiscal oversight is limited to its rate-setting process, which uses self-reported information from each provider's CFR to establish the amount each provider will be paid for services. The CFR preparation process is complex, difficult for providers to understand and in many ways is outdated. The process relies on self-reported financial information and manual processes that leave substantial room for human error, as well as possible willful misrepresentation. Although rate-setting staff provides a thorough review of reported CFR information to develop rates, this process was never intended to scrutinize the accuracy of the information and it affords only limited capability to prevent and detect fraud. In addition, technology has not been used efficiently to keep pace with program growth and complexity.

Absent independent fiscal oversight, SED's requirement that all CFRs be certified by an independent CPA has become a critical control in the oversight process. However, our audits have shown – and SED recognizes – that many of these CPA certifications have not been reliable. Still, until very recently, SED has not had a process in place to refer CPAs it suspects of not having performed the necessary due diligence in certifying provider CFRs to its Office of the Professions for potential disciplinary action. In addition, there is no formal process in place for tracking, reporting and issuing warnings to CPAs exhibiting simple negligence in the certification of CFRs. Further, the Office of the Professions does not have a process to notify rate-setting staff of the disciplinary actions taken, if any, in cases where gross negligence has been found.

Lastly, training for CFR accounting and reporting is not required by current laws or regulation for special education providers, boards of directors, CPAs and any other persons in fiduciary roles. Furthermore, there are no deterrents or penalties to providers when financial reports contain significantly misstated information or are filed late.

Current Fiscal and Programmatic Monitoring Efforts are Insufficient

SED needs to significantly enhance its fiscal and program monitoring of private special education providers to help prevent mismanagement and abuse of public funds.

Fiscal Monitoring

Within SED, the Office of Audit Services (Audit Services) has primary responsibility for conducting audits of educational entities regulated by or receiving funds administered by SED, including private special education providers. Officials informed us that the unit with its current complement of 17 staff was originally created to audit service providers. In the course of the audit, we found that Audit Services has not conducted any fiscal or programmatic audits of private special education providers since 2007. Instead, its focus has shifted to local school districts and their compliance with certain federal requirements. This shift in focus has left a void in onsite fiscal monitoring of private special education providers.

Similarly, SEQA also does not provide any fiscal oversight of private special education providers. Regional staff are involved in the initial review of applications made by providers for new programs, but these reviews do not include evaluations of the appropriateness and accuracy of reported costs, and follow-up reviews are not performed to ensure fiscal viability. We did find some coordination with rate-setting staff who work with regional staff from the SEQA office during the initial approval process for a program and who also provide recommendations of providers for SEQA to review. Following such a review, a copy of the report is also given to RSU staff, who determine if any findings have rate-setting implications. Counties may also conduct their own audits of special education providers; however, relatively few counties have done so.

As a result, fiscal oversight by SED is largely limited to the rate-setting process for special education services, where staff perform desk reviews of CFRs to help ensure that providers have submitted allowable costs as described in the RCM. However, these reviews are limited to performing a series of error checks of the reported data and ensuring the providers' expenses do not exceed certain thresholds, known as cost screens. In some cases, RSU staff make inquiries and obtain limited source documentation from providers to help assure that reported costs are necessary, reasonable and appropriate. In addition, rate-setting staff has referred specific providers to our Office for potential audit based on their review of provider CFRs. RSU staff believes that regularly conducted audits would have a beneficial impact on the accuracy and appropriateness of costs reported on the CFRs.

CPA Certification of Provider CFR Submissions

As part of the CFR submission process, special education program providers are required to have independent CPAs express an opinion on their financial statements and certify that the CFR is prepared in accordance with applicable instructions. The purpose of the CPA certification is to ensure that the CFR data is reported consistently and can be relied upon by the RSU for the rate-setting process. Special education program providers are allowed to claim CPA audit fees associated with CFR certifications as an expense on the CFR.

CPAs are required to follow the audit guidelines contained in Appendix AA of the CFR Claiming Manual, which outlines the minimum testing procedures a CPA should use to certify a CFR. The guidance was originally developed by the CFR Interagency Committee with the assistance of a task force of the New York State Society of Certified Public Accountants. The objective of the guidance is to provide uniformity in the scope of work completed by independent accountants on the CFR Schedules.

About five years ago, the CFR Interagency Committee undertook an effort to make the audit guidelines more rigorous. According to RSU staff, the American Institute of Certified Public Accountants (AICPA) and the New York State Society of Certified Public Accountants (NYSSCPA) discussed and approved the language used in the certifying statements. However, RSU staff indicates that, based on their review of certified CFRs and recent OSC audits, testing procedures are not being consistently followed by CPAs. As a result, although RSU staff place significant reliance on CPA certifications, they recognize some are not reliable.

As part of the rate-setting process, RSU staff accountants review the program data reported on the CFR and compare it to information contained in the financial statements of the special education program provider, as well as student data from SED's STAC system. When reporting errors are found, RSU staff accountants make adjustments to the reported CFR data. As of September 25, 2012, RSU records indicated adjustments made for the 2009-10 reporting year included 733 adjustments totaling about $3.9 million for claimed program costs and another 361 totaling about $13.8 million for agency administrative costs. RSU staff stated that many of these adjustments would not have been necessary had CPAs performed the minimum testing required prior to certifying CFRs.

OSC audits have found numerous errors in cost reporting on CFRs that can be attributed to the lack of due diligence by CPAs hired by special education program providers. Examples include instances of no-show jobs, personal expenses included with program expenses, nepotism, less-than-arm's-length transactions, self-dealings and ineffective oversight by boards of directors. The audits also found reporting errors in allocation methodologies used to distribute program costs, as well as errors in accounting methodologies used for depreciation, amortization and accruals that led to additional disallowances. If the CPAs had performed testing procedures as required under the CFR guidelines/regulations, it is likely that many of these audit findings would have been discovered during the certification process.

CPAs can be subject to discipline by SED's Office of the Professions for failing to properly carry out their responsibilities associated with certifying special education providers' CFRs. According to the Office of the Professions, there are two categories of errors which can be made by CPAs: gross negligence and simple negligence. Gross negligence occurs when accounting or auditing standards are not followed and material errors result. Simple negligence occurs when errors are made which indicate a failure to use ordinary care. Under current statutory requirements, CPAs can face disciplinary action for exhibiting gross negligence in the certification of CFRs.

Although rate-setting staff suspect that some CPA certifications are not reliable, it is only recently that RSU began referring suspect firms for possible professional discipline, primarily as a result of recent OSC audits. To date, RSU staff has referred eight CPAs to the Office of the Professions for investigation. Office of the Professions staff confirmed that four of these CPAs are currently under investigation and another has already been disciplined. The other three CPAs were investigated, but staff determined no action was warranted. Although RSU now has procedures in place to refer suspect firms, there is still no internal process for the Office of the Professions to notify RSU of what actions, if any, were taken. In addition, there is no other formal process in place for tracking, reporting and issuing warnings to CPAs who may exhibit simple negligence in the certification of CFRs.

Our analysis shows that 11 out of 122 CPA firms hired by providers (9 percent) serve about 46 percent of the private special education providers in New York. One of these CPAs, hired by at least 13 providers, is on the list of firms that RSU referred to the Office of the Professions.

Particularly troubling is the fact that special education providers are allowed to claim audit fees as a reimbursable expense, even when RSU staff find significant reporting errors that result in cost adjustments to certified CFRs. In effect, New York State taxpayers are then paying for a service that is required by State regulations, but which does not result in reliable information for use by agency officials. RSU staff have suggested that SED, in cooperation with the other agencies that require CFR reporting, pre-approve a pool of CPAs authorized to certify providers' CFRs. This practice could significantly improve the quality of CFR data if uniform contractual standards are enforced.

Program Monitoring

SEQA regional staff assess local school district compliance with federal reporting requirements and annually report on 20 State performance indicators that assess program areas such as graduation rates, drop-out rates, complaints and suspension rates through several types of reviews. These State performance indicators are reported at the school district level and are aggregated statewide.

Once federal reporting requirements have been met, regional staff select some private special education providers for focused reviews. Focused reviews evaluate seven programmatic areas: implementation of Individualized Education Programs (IEPs), instructional practices, access to general education curriculum and assessments, behavioral intervention plans, health and safety, responsibilities to parents and maintenance of confidentiality, and discipline. Private special education providers are selected for reviews using a risk-based system which is based on complaints made by parents, school districts or other parties of interest; areas of non-compliance reported by providers in annual self-reviews; and recommendations made by RSU.

However, there is no process in place to ensure that all private special education providers are reviewed on a cyclical basis, including follow-up reviews of newly approved providers. During the four years covered by our audit, SEQA performed 114 focused reviews of 112 private providers; about one-third of the provider population. This included a review of one of the 15 special education providers covered by our prior audits listed in Exhibit A.

The lack of comprehensive program monitoring lessens the possibility of identifying early potential signs of agency risk which could then trigger a more in depth fiscal review or independent audit.

Current Reporting and Rate Setting Processes No Longer Meet Program Needs

SED's current process is complex and cumbersome, not designed to detect fraud or abuse, and results in financial risk to local governments.

Consolidated Fiscal Reporting Process

Our review found the CFR preparation process can be cumbersome, time-consuming and costly – both for filers and for the oversight agencies. Special education providers are generally required to submit nine separate schedules on the CFR. (Exhibit B presents a flow chart depicting the CFR reporting process). Revenues, expenses, staffing, enrollment and shared costs are all self-reported within these nine schedules, first in the aggregate and then allocated to each program administered by the provider. CFRs can become further complicated when shared costs must be allocated to programs reimbursed by different agencies. Providers must also reconcile their financial statements to the allowable costs reported on their CFRs. Finally, as noted earlier, providers are responsible for hiring CPA firms to certify that the CFRs were prepared in compliance with the current set of applicable instructions. Both the provider's executive director and the CPA must sign and certify to the validity of information contained in the completed CFR.

The CFR Claiming Manual, RCM and CFR are all complex documents that can be difficult to understand, particularly for providers with less experienced staff. The reporting requirements and related guidance can also change from year to year as the oversight agencies in the CFR Interagency Committee determine that reporting modifications are necessary. For example, SED recently added a section to the CFR requiring greater detail about consultants in response to certain OSC audit findings about services provided by consultants.

CFR preparation includes several manual processes that can be unwieldy for providers to complete. For example, when multiple programs are administered from one location, shared costs such as utilities, depreciation and lease expenses must be allocated among the programs fairly. The CFR Claiming Manual and RCM each explain in detail how these allocations are to be made and reported on the CFR. However, performing these manual processes still leaves room for human error and possible willful misrepresentation of information.

Rate-setting staff use certified CFRs to set reimbursable rates and often note reporting errors during the rate-setting process. Reporting errors become time consuming and costly because RSU staff must contact providers to determine why the errors occurred and to obtain correct reporting amounts. Reporting errors can also be noted during OSC or county audits of providers, which can lead to the need for RSU to repeat the entire rate setting process.

The complexity of the CFR also contributes to problems with the timeliness of reporting. Providers must submit their CFRs no later than 120 days after the end of the reporting period; a 30-day extension beyond the initial due date is automatically granted to each provider requesting such an extension. Penalties may apply if CFRs are not filed on time. Penalties can include delaying reimbursements, reducing the amount of reimbursable interest expense that can be claimed as an allowable cost and freezing the reimbursement rate.

We found that penalties for late filing are inadequate to deter the practice. As of September 30, 2012, 24 providers had not yet filed their 2010-11 CFRs and were therefore ten months late, those reports having been due by November 30, 2011. Currently, potential penalties for late filers consist only of reductions in reimbursable amounts of interest expense, delayed payments and/or the freezing of rates at prior year levels. In some cases, it is possible that this initial rate could be higher than the final rate that would be calculated for a program, making the rate freeze an actual benefit rather than a penalty. Monetary fines are not currently used as penalties. RSU staff note that the use of penalties is discretionary and, in some cases, penalizing providers could lead to program closures and a loss of services for students.

Rate-Setting Process

Although RSU staff provide a thorough review of reported CFR information to develop rates, this review adds further complexity to the overall process. RSU staff do not conduct any onsite provider reviews. Instead, RSU conducts desk reviews which rely heavily on a combination of manual steps, electronic edit checks and threshold comparisons. The available technology is dated and is not being used efficiently. Source documents (such as invoices) are not routinely reviewed by RSU staff, but may be requested during follow-up discussions with providers. Furthermore, there are few controls in place to prevent and detect fraud. (See Exhibit B for a more detailed description of rate-setting activities and procedures).

Comprehensive manual checklists are maintained by staff to ensure that the CFR reviews are consistent and well-documented. Screens are applied to ensure that overall or specific costs are not excessive, specifically with respect to median salaries of executive staff, non-direct costs and total costs; screens also ensure that offsetting revenue is netted out from program costs. As part of this standard examination, SED reviews specific areas that are considered to be more likely to reveal weaknesses in legitimate costs, including:

- Related party information, which is not always disclosed and could indicate a less-than-arm's-length transaction;
- The five highest paid employees and five highest paid independent contractors;
- A comparison of executive salaries to the regional median salary;
- Whether providers also operate programs not reflected in the CFR, such as residential programs for the Office of Children and Family Services (OCFS); and

- Agency administration costs, which may include charges paid to the parent company of the program.

However, even though these reviews may result in adjustments to approved costs, the adjustments may not necessarily identify the specific source of a disallowance, but rather just the magnitude of the overage. For example, a recent audit OSC completed of IncludED Educational Services, Inc. (Report 2010-S-59 issued July 20, 2012) identified over $15,000 of inappropriate costs included in a CFR for the rental of an apartment in California for the son of the provider's owner. SED's cost screening process had already reduced the allowable portion of expense in this category by more than the amount of the inappropriate rent, but that adjustment was based entirely on the total amount of cost claimed, not on the knowledge that the costs were inappropriate or potentially fraudulent. As a result, while SED may have limited some of the disallowed costs because of the cost screens, the control is not an effective means of deterring fraud and abuse.

Audit Disallowances and Recoveries

For any audit that results in the identification of a program cost disallowance or adjustment, whether completed by OSC or a county, rate-setting staff generate an audited or final rate for each year in the audit scope period. Staff compare audit disallowances and/or adjustments to changes made to cost and program data reported by the provider during the initial CFR review and rate setting process. Any audit adjustments greater than any amounts previously disallowed by RSU staff through their costs screens are included in the final rate calculation. After RSU staff calculate the final rate, a rate-setting methodology packet, including a copy of the audit report, is sent to the Division of the Budget (DOB) for approval. Once approved by DOB, the provider's rates are adjusted on SED's system and the disallowance amount is generated.

SED immediately recoups audit disallowances from counties and school districts by adjusting the reimbursement rates on its system. The revised lower rate generates the disallowance amount that the county or school district owes back to SED. The next payment SED makes to the county or school district is then reduced by the State's share of the audit disallowance. The county or school district is then responsible for recouping the audit disallowance from the provider.

Some counties and school districts require providers to send them reimbursement checks while others reduce the next payment made to a provider. Some counties and school districts (including New York City) may allow a provider to pay back the disallowance over time rather than all at once. If a provider closes down before the county fully recovers any audit disallowances or other rate adjustments, the county incurs the financial loss. Other than the amount of the disallowance, no other fines or penalties are imposed on a provider.

Sharing of Significant Findings with Other State Agencies

The four State agencies that use the CFR all have access to the same information reported by providers on the CFR, as well as corresponding provider financial statements which are used to determine the provider's rate. However, agencies do not generally have access to amended or corrected CFR information, or to disallowances and adjustments that may have been applied by

SED. Furthermore, SED does not routinely notify other State agencies of any corrections to the CFRs or adjustments that have been identified. Similarly, while providers and counties may view revised rates online, there is no formal process in place to notify other agencies if a rate has been revised or why.

SED indicates that because other State agencies generally do not use reported provider costs as a basis for reimbursement, adjustments it identifies often do not affect those other agencies. However, SED officials stated they do communicate with these other State agencies in cases of fraud or egregious misuse of funds by a provider. This communication generally occurs informally through bimonthly meetings of the CFR Interagency Committee. Officials stated they also communicate with other agencies that provide funding to the same provider, but do not use the CFR as a basis for reimbursement. For example, SED noted contact from time to time with OCFS, which does not use the CFR, concerning educational placements for residential students. SED indicates that contact with OCFS often occurs when there are discussions of major changes to a program and its rate. Finally, in recognition of its own lack of audit resources, for the past several years SED has referred specific providers to OSC for potential audit when they have identified risk areas that warrant closer scrutiny.

SED Can Improve the Quality of Data by Advancing Technology and Training

SED needs to take steps to modernize the existing process and increase provider training to make better use of resources and improve the quality of CFR information.

Utilizing Technology to Improve Current Processes

Technology is often used by agencies to perform their functions more efficiently. In situations where the same comparisons and calculations are done multiple times, using a database and automating these tasks can greatly improve efficiency. Database software can store, validate, compare and analyze data for trends and outliers. Through better use of available technology, RSU staff could become more efficient while performing a more thorough review of all CFR data.

RSU staff has software available to them that could be used to automate some of the steps in their review process, which could reduce the time spent manually verifying CFR information for completeness, accuracy and reasonableness. In addition, RSU staff could utilize database software to further expand and improve overall knowledge of each special education provider's characteristics, identifying providers that may need further review and attention.

Improving Special Education Provider Training

Because of the complexity of the CFR and rate-setting systems, outreach and training for providers and their staff is critically important to avoid potential reporting problems. We found SED's impact in this area has been limited, in large part due the fact that providers are not required to participate.

In conjunction with OASAS, OMH and OPWDD, SED does offer regular training sessions on the accounting and reporting requirements necessary for the completion of the CFR. The training is held twice a year at two or more locations, including New York City and at least one upstate site. SED indicates that training on CFR preparation is encouraged, but not required, for private special education providers. Participation is open to members of the providers' staff, boards of directors, executive directors, comptrollers, chief financial and operating officers, as well as contracted CPAs. Online training is also available on the use of the CFR reporting system software and one-on-one training can be arranged with SED staff upon request. In addition, new program applicants are encouraged to meet with SED's RSU staff before, during or after commencing programs.

However, because regulations do not require providers or their CPA firms to attend any training, SED's outreach program is still largely reliant on having providers make specific inquiries or ask for assistance with issues they do not understand. RSU staff does take some proactive steps to regularly communicate with providers about reporting requirements, changes in guidance and specific reporting information. Providers are encouraged to contact SED directly if they have questions regarding allowable and non-allowable expenses. RSU staff keeps track of frequently asked questions and coordinates responses through a point person to ensure consistency of guidance and whether subsequent clarification is needed in the annual updates of the CFR Claiming Manual and RCM.

Recommendations

1. Develop and implement a strategy, including necessary resources, for providing adequate onsite fiscal and program monitoring of special education providers.

2. Establish a formal process for identifying and reporting CPAs who appear negligent in their certification of CFRs to the Office of the Professions.

3. Coordinate with other State agencies to develop a system to ensure that CPAs certifying provider CFRs demonstrate appropriate training, competence and performance.

4. Review the CFR and rate-setting processes to identify opportunities for streamlining operations, updating technology and reducing complexity and the occurrence of errors.

5. Assess the feasibility of meaningful monetary penalties for providers failing to provide an accurate and timely CFR.

6. Formalize policy and procedures for sharing identified provider problems with other State agencies that are also funding the provider.

7. Reevaluate and enhance provider training requirements, including frequency, content and requirements for attendance.

Audit Scope and Methodology

The objective of our audit was to determine if SED is providing adequate fiscal and programmatic oversight of private special education providers. We also evaluated what steps, if any, need to be taken to remedy any oversight deficiencies. Our audit scope period was from July 1, 2008 to November 2, 2012.

To accomplish our objectives, we reviewed laws and regulations that identify SED's fiscal and program oversight responsibilities of private special education providers. We interviewed officials and staff from various offices and units within SED responsible for special education initiatives, including the Office of Audit Services, the Office of Special Education Quality Assurance, the System to Track and Account for Children Unit and the Rate Setting Unit. We reviewed the procedures used by these offices and units to obtain and evaluate program and fiscal information reported by the providers of special education programs. In addition, we reviewed the process used by SED to establish rates which reimburse providers for these program costs. We obtained evidence of any programmatic reviews completed by SED, which determine if private special education providers are providing adequate services and fulfilling program requirements. We also assessed the level of guidance available from SED to special education providers and the level of communication and sharing of information between SED and other State agencies.

We conducted our performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

Authority

The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

Reporting Requirements

We provided a draft copy of this report to SED officials for their review and formal comment. We considered their comments in preparing this report and have included them in their entirety at the end of it. In their response, SED officials fully agreed with five of our recommendations and partially agreed with two of our recommendations. Officials indicated the actions they will take to improve their oversight of special education programs. Also, our rejoinders to certain comments raised in SED's response are included as State Comptroller's Comments.

Within 90 days of the final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the State Education Department shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where the recommendations were not implemented, the reasons why.

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Vision

A team of accountability experts respected for providing information that decision makers value.

Mission

To improve government operations by conducting independent audits, reviews and evaluations of New York State and New York City taxpayer financed programs.

Exhibit A

OSC Audits of Special Education Providers
Reports Issued from June 2004 through November 2012
Summary of Disallowances and Categorization of Findings

Audit Number	Provider/Audit Name	Audited Program Costs Reported on CFR	Yrs in Scope	Total Disallowance	No Show Jobs	Evidence of Nepotism	Funds Diverted to Personal Use	Funds Used for Unallowable Items
Not For Profit Providers								
2003-S-3	Highbridge Advisory Council Family Services	$7,948,885	2	$2,524,991				X
2003-S-22	East Bronx Day Care Center	$5,044,373	3	$948,536				X
2004-S-14	Manhattan Center for Early Learning	$3,096,340	1	$617,109			X	X
2006-S-123	Leake & Watts Services, Inc.	$21,584,000	1	$646,066				X
2007-S-91	Pyramids Preschool	$2,130,601	1	$239,889	X	X	X	X
2008-S-68	A Starting Place	$3,379,270	1	$21,555				X
2010-S-59	IncludED Education Services, Inc.	$12,562,987	2	$2,634,511	X	X	X	X
For Profit Providers								
2004-S-81	Village Child Development Center	$6,196,965	2	$600,101			X	X
2006-S-65	Home Therapy Associates	$5,508,636	1	$1,063,623				X
2009-S-37	Integrated Treatment Services	$10,442,213	2	$511,615		X	X	X
2010-S-31	Special Ed Associates	$12,526,850	2	$670,857	X	X	X	X
2010-S-32	Important Steps, Inc.	$5,691,319	1	$244,874			X	X
2011-S-1	Capital District Beginnings	$12,075,675	2	$831,244	X	X	X	X
2011-S-13	Bilingual SEIT, Inc	$23,414,348	2	$1,474,924	X	X	X	X
2011-S-18	Achievements, PLLC	$8,183,952	5	$182,590		X	X	X
		$139,786,414		$13,212,485				
	Portion of Audited Costs Disallowed			9.45%				

Exhibit B

SED's Rate-Setting Process

RSU staff calculate several types of rates for individual programs depending on the timing of the data being used and constantly revises these rates based on updated information. RSU staff calculate a **prospective rate** for a program using two-year-old cost data first trended forward by the approved growth factor (No growth factor has been applied for the last three years). This rate is then subjected to a series of cost screens and other adjustments.

RSU staff calculate a **reconciliation rate** for a program after a CFR is filed for that program using reported actual data. Any adjustment made to reported data as a result of RSU's review, including the application of cost screens, is reflected in the revised reconciliation rate.

SED can also generate a **final rate** for a program if an audit of that program has a finding which would result in a cost adjustment; for example, if a position was reported as a direct care cost, but upon audit was discovered to actually be non-direct care.

A **corrected rate** can be generated at any time that an error is found.

Rate adjustments can also be made if, upon review, costs are not considered necessary or directly related to the operation of the program, cannot be substantiated with adequate documentation, have been incurred as a result of unsound business practices or have been incurred as a result of less-than-arm's-length transactions.

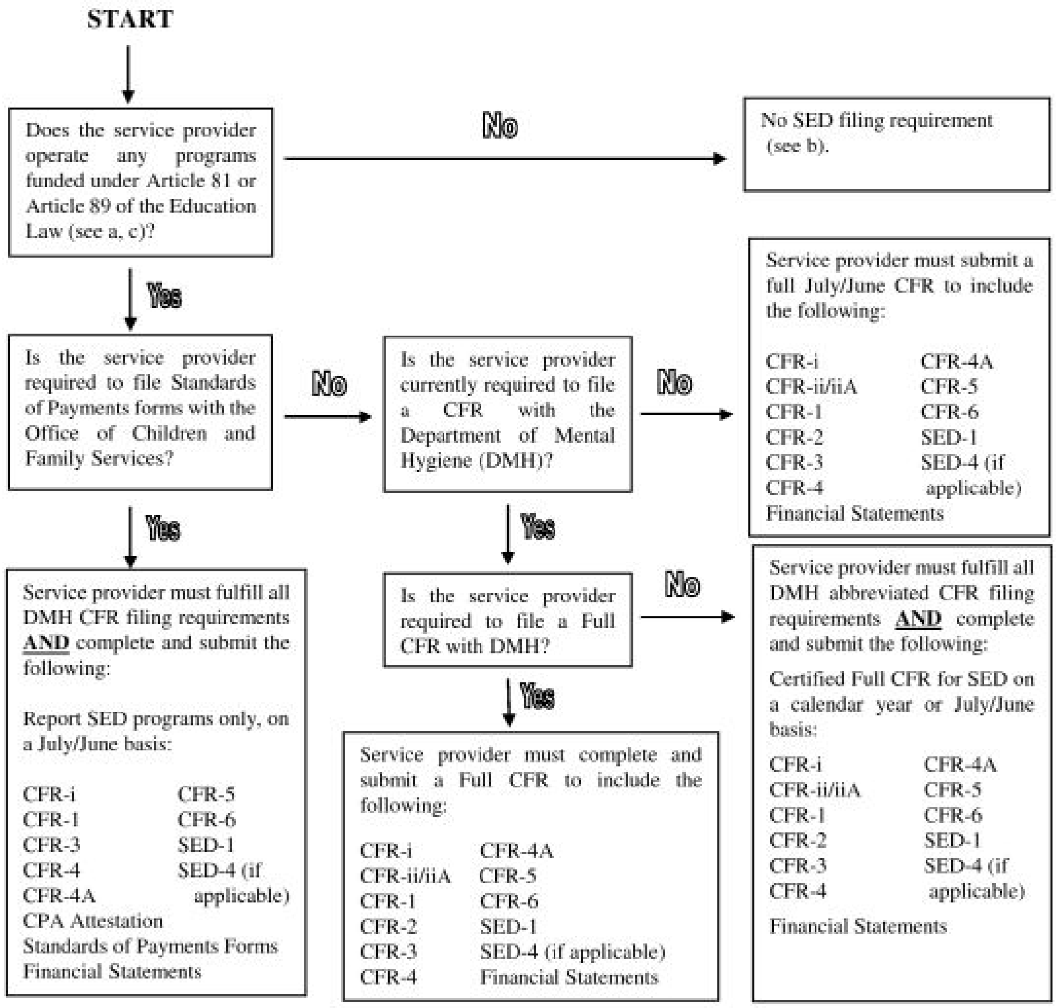
A **tuition rate appeal** can also lead to a rate adjustment if a program can demonstrate that the program would have insufficient resources to meet the educational needs of students being served without such an adjustment.

Each year, RSU staff process information from CFRs submitted by providers in late fall, sets reconciliation rates in February and March and sends these rates to DOB around April 1st. In addition to approving individual rates by program, DOB also annually reviews and approves the rate-setting methodology. In accordance with this cycle, reconciliation rates for the 2011-12 school year will not be finalized until spring 2013.

The chart on the following page depicts the documentation flow for a CFR.

New York State Consolidated Fiscal Reporting and Claiming Manual	Subject: Submission Requirements	Section: 2.0	Page: 2.9
	Reporting Period: July 1, 2011 to June 30, 2012		Issued: 05/12

New York State Education Department (SED)
Consolidated Fiscal Report Document Submission Matrix
<u>For Service Providers Which Operate Only SED Programs</u>



Notes:

a) Municipalities that operate special education programs under Article 81 or Article 89 of the Education Law will be sent a cost center report under separate cover.

b) ACCES agencies that do not operate Article 81 or 89 programs <u>do not</u> need to submit a CFR to SED or cost out the ACCES programs separately. Instead ACCES programs for SED purposes are to be reported under the other column (col. 7) of the CFR-2 and in other programs on the CFR-3 line 48.

c) Agencies that ONLY operate Preschool Multidisciplinary Evaluation Programs have no SED filing requirements.

Agency Comments

THE STATE EDUCATION DEPARTMENT / THE UNIVERSITY OF THE STATE OF NEW YORK / ALBANY, NY 12234

DEPUTY COMMISSIONER
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December 6, 2012

Mr. John Buyce
Audit Director
Office of the State Comptroller
110 State Street, 11th Floor
Albany, NY 12236-0001

Dear Mr. Buyce:

I am responding to your letter of November 30, 2012 to Commissioner King regarding the Office of the State Comptroller's (OSC) draft audit report (2012-S-103) entitled "Fiscal and Program Oversight of Special Education Providers." I offer some overall comments on the contents of the report and then specifically address each of the seven recommendations.

As part of its general supervision activities, and its review of the Office of the State Comptroller audits of private special education providers, the Board of Regents initiated a comprehensive examination of the special education programs, services and costs associated with the providers at its September 6, 2012 meeting and directed Department staff to further explore and recommend specific measures to enhance existing provider oversight and accountability. Following a review and analysis of the current fiscal oversight and accountability provisions applicable to special education private providers, and to other providers in comparable sectors, a number of reform proposals were presented and adopted by the Board of Regents on November 5, 2012. Also at the November meeting, the Board of Regents approved the development of a budget priority request to support the implementation of the adopted reform proposals. Several of the Board of Regents reform proposals directly relate to the findings and recommendations outlined in the draft audit report and have the shared goal of strengthening the fiscal oversight and accountability measures of private special education providers in order to ensure that resources are being utilized effectively and appropriately.

The Department's specific response to the draft audit is organized to correspond to the specific recommendations.

__Recommendation 1:__

Develop and implement a strategy, including necessary resources, for providing adequate onsite fiscal and program monitoring of special education providers.

We partially agree with this recommendation. We agree that oversight provisions with respect to onsite review should be enhanced in order to strengthen the Department's existing fiscal and program monitoring of special education providers. However, we do not agree with certain key findings and statements made in the draft audit which undervalue the monitoring activities conducted currently by the Department and believe that the draft audit discounts the importance and functionality of a priority/risk-based approach to program oversight.[i]

* Comment 1

We agree that oversight provisions with respect to onsite review should be enhanced in order to strengthen the Department's existing fiscal and program monitoring of special education providers. Due to the reliance placed on the current external audit requirements of the private special education providers, the Board of Regents reform proposals would strengthen this accountability measure by requiring special education providers to select a CPA from a Department approved list for the purposes of certifying its Consolidated Fiscal Report (CFR) or financial statements.[ii]

The Board of Regents reform proposals also seek to increase the onsite fiscal audits of the private special education providers by continuing to support the current OSC audit initiative and by supporting additional resources for further audits, including both random audits and audits targeted to providers with specific risk-factors associated with fraud. The Board of Regents reform proposals also aim to assist the audit efforts of the counties by recommending an increase in the amount of overpayments that may be recovered by the county or municipality conducting the audit and recommending that a disincentive for municipal audits be eliminated through ending the state's recoupment of all of the disallowed funds from the municipality if the provider ceases operation and, after diligent efforts, the municipality is unable to recover the funds.

In addition, the Board of Regents reform proposals for enhanced oversight of the special education private providers include strengthening aspects of the programmatic supervision of both new and existing providers. For example, the Department has imposed a short-term moratorium on the approval of new providers and program expansions while it revises the approval application to include an in-depth review of: services, staffing and methodologies necessary to ensure provision of high-quality programs; program environment to ensure the health and safety of students with disabilities; appropriate agency background and qualifications to provide sound fiscal practices; and governance qualifications that will provide effective fiscal and program oversight.

The Department is also in the process of creating a new protocol for program monitoring reviews that will focus on service delivery structures and models, efficient use of staff, resources and instructional effectiveness, as well as regulatory compliance. The Office of Special Education has developed a plan to review increased numbers of selected preschool special education programs during the 2012-2013 school year utilizing the priority/risk-based approach to target certain providers based on the timely need for intervention.

In order to undertake a more cyclical review of existing special education providers, the Board of Regents reform proposals include a request for additional resources to support new staff dedicated to developing and implementing a rigorous program reapproval process for all preschool special

* See State Comptroller's Comments, on page 28.

education providers. This reapproval process would incorporate new measures of oversight and accountability and a cycle for implementation would begin with providers that exhibit specific risk-factors of concern, with those providers also receiving a greater level of scrutiny upon review (including onsite monitoring where appropriate).

We believe that the Board of Regents reform proposals for enhanced oversight of the special education private providers target appropriate areas for improved monitoring activities to be implemented by the Department and address many of the findings contained within the draft audit.

Recommendation 2:

Establish a formal process for identifying and reporting CPAs who appear negligent in their certification of CFRs to the Office of the Professions.

We partially agree with this recommendation. While the Office of Professions has a formal process for accepting all complaints relating to professional misconduct,[iii] we will review current internal communication practices between the rate setting unit and the Office of Professions and formalize the referral process between the two offices to ensure that CPAs who appear negligent in their certification of CFRs continue to be identified and reported where appropriate.

* Comment 2

As described in the draft audit, the rate setting unit has used the existing process to refer CPAs to the Office of Professions for professional misconduct when it finds substantial errors in provider cost reporting. Of the eight referrals, three were made recently and were associated with CPAs who performed audit services for private special education providers audited by OSC. Although we disagree that a new process needs to be established, we agree that the Department should better ensure coordination between the rate setting unit and the Office of Professions so that this process is utilized to report CPAs for professional misconduct when warranted.

As part of the Board of Regents reform proposals, the Department will also disqualify a CPA who fails to follow the required procedures from the list of approved CPAs that may certify a CFR or financial statement on behalf of a special education provider.

Recommendation 3:

Coordinate with other State agencies to develop a system to ensure that CPAs certifying provider CFRs demonstrate appropriate training, competence and performance.

We agree with this recommendation. The reform proposals adopted by the Board of Regents to strengthen the fiscal oversight and accountability measures of the special education providers include the recommendation that CFR training would be mandatory for any individual who prepares or certifies the CFR of a special education provider, including the certifying CPA. Also, as previously mentioned, a CPA may be disqualified from certifying a CFR or financial statement on behalf of a provider if the Department's required procedures are not followed. It is anticipated that

* See State Comptroller's Comments, on page 28.

the development and implementation of these proposals would begin within the Department with the potential for more coordinated efforts with other agencies in the future.

Recommendation 4:

Review the CFR and rate-setting processes to identify opportunities for streamlining operations, updating technology and reducing complexity and the occurrence of errors.

We agree with this recommendation. The Department will review the information and findings outlined in the draft audit and identify opportunities as described in the recommendation.

Recommendation 5:

Assess the feasibility of meaningful monetary penalties for providers failing to provide an accurate and timely CFR.

We agree with this recommendation. The Department will review the information and findings outlined in the draft audit, examine the existing monetary penalties imposed for failing to timely submit the CFR and assess the feasibility of new monetary penalties both for late filing and for filing a CFR with significantly misstated information.

Recommendation 6:

Formalize policy and procedures for sharing identified provider problems with other State agencies that are also funding the provider.

We agree with this recommendation. As identified in the draft audit, the Department currently has an informal process for information sharing with other state agencies through bimonthly meetings of the CFR Interagency Committee and through meetings with OCFS to discuss changes to programs that concern both agencies. The Department welcomes discussions with the other state agencies in order to identify areas where more coordinated efforts for information sharing would prove beneficial.

Recommendation 7:

Reevaluate and enhance provider training requirements, including frequency, content and requirements for attendance.

We agree with this recommendation. The reform proposals adopted by the Board of Regents include a requirement for annual fiscal training relating to the CFRs submitted by the special education providers. As identified in the draft audit, the Department currently offers regular CFR training and, pursuant to the Board of Regents reform proposals, this training would be mandatory for any individual who prepares or certifies a CFR of a provider. Additionally, the Board of Regents propose to require members of the provider's governing body (board members or owners) to complete training regarding their legal, fiduciary, and ethical responsibilities. In order to monitor compliance with the new training requirements and other financial accountability measures, the Board of Regents proposals include requiring an annual attestation statement for board members and owners of the providers.

If you have any questions regarding this response, please contact James Conway at (518) 473-4516.

Sincerely,

Sharon Cates-Williams

Sharon Cates-Williams

c: Commissioner King
Valerie Grey
James Conway
James DeLorenzo
Doug Lentivech
Mary Kogelmann

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[i] The draft audit characterizes existing Department oversight as limited in many respects. Although we agree that improvement should be made to enhance existing oversight, as identified in the Board of Regents reform proposals, we respectfully believe that current monitoring practices should be given more significance. For example, the rate setting unit performs a thorough review of the financial reports submitted by the providers in order to analyze the appropriateness of the expenses and ensure that reimbursement claims are allowable pursuant to program funding standards. The rate setting unit will undertake an even more extensive review on a case by case basis (including obtaining source documentation for submitted claims) if their desk audit reveals problematic reporting. As noted in the draft audit, for the 2009-10 reporting year the rate setting unit review resulted in over 700 adjustments totaling nearly $4 million for claimed program costs and over 350 adjustments totaling nearly $14 million for agency administrative costs. The draft audit also identifies the in-depth focus reviews undertaken by the Special Education Quality Assurance Office, including the review of Individualized Education Programs (IEPs) implementation, instructional practices, access to general education curriculum and assessments, behavioral intervention plans, health and safety, responsibilities to parents and maintenance of confidentiality, and discipline. Utilizing a priority/risk-based approach, programs are monitored because they exhibit factors associated with non-compliance or there is a need for timely intervention. As the draft audit notes, the Special Education Quality Assurance Office conducted focused reviews of 117 private providers (about one-third of the provider population). We believe that the priority/risk-based approach to the selection of private special education providers to be monitored is appropriate with respect to the monitoring demands and available resources. This methodology also proved beneficial for both the Department and OSC when referring and identifying the special education providers for audit as part of OSC's current audit initiative.

[ii] The Department is in the process of developing a Request for Qualifications (RFQ) to approve CPAs that may certify a special education provider's CFRs or financial statements and a CPA may be disqualified if found to have certified a CFR or financial statement without following the Department's required procedures.

[iii] The Office of Professions has protocol within its Professional Misconduct Enforcement System which includes the process for filing a complaint, conducting an investigation, pursuing disciplinary action, and providing information regarding complaint status and final outcome. All complaints are investigated (members of the State Board for the profession may be consulted during the investigation) and if substantial evidence of misconduct is found, then disciplinary action is pursued. Cases that do not result in disciplinary action are confidential and cases where the Board of Regents takes disciplinary action may be searched, by name or by month, on the Department's website. In all cases, the individual who filed the misconduct complaint is informed of the status of the complaint and the final outcome.

State Comptroller's Comments

1. We acknowledge that the Department currently provides certain levels of program and fiscal oversight. However, these measures are not adequate to detect extensive fraud and abuse on a timely and comprehensive basis, as evidenced by our recent audits.
2. We recognize that a process currently exists, but it needs to be improved with more formal communication and coordination within the various units of the Department.