



## 2014 ANNUAL REPORT

# Preschool Special Education Audit Initiative

DECEMBER 2014



**NEW YORK STATE OFFICE OF THE STATE COMPTROLLER**  
Thomas P. DiNapoli, State Comptroller  
DIVISION OF STATE GOVERNMENT ACCOUNTABILITY

## Contact

[www.osc.state.ny.us](http://www.osc.state.ny.us)

Office of the State Comptroller  
Division of State Government Accountability  
110 State Street, 11th Floor  
Albany, NY 12236

[StateGovernmentAccountability@osc.state.ny.us](mailto:StateGovernmentAccountability@osc.state.ny.us)

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## A MESSAGE FROM THE COMPTROLLER

Special education programs fulfill a great need across New York State, but too often taxpayers are paying for more than they should. Our audits have found that while many private special education providers use public funds conscientiously and in accordance with State rules, other providers evade the rules and abuse taxpayer funds.

Over the last decade, this office has found a pattern of mismanagement, waste and even fraud by numerous private providers of preschool special education. Our audits have found flaws in the system of oversight that enable some private providers to misuse public funds intended for preschool children with disabilities, diverting the money for their own personal benefit. As a result, children needing special education services have been shortchanged by private providers who are cutting corners and reaping the benefits of lax State oversight.

We all have a responsibility to protect taxpayer dollars and to make sure that these programs adhere to State guidelines.

The State Legislature has responded to this pattern of abuse by passing legislation requiring my office to audit the expenses submitted to the State Education Department (SED) by all preschool special education providers by March 31, 2018, and to report annually on the findings of our audits to the Governor and the Legislature. This report is the first such annual report.

We take our audit responsibilities very seriously, and have launched a comprehensive effort to implement this initiative. We have hired, trained and assigned additional staff to conduct these audits. We have also reassigned existing staff to this important endeavor. As a result, we are now engaged in audits across the State which will continue to uncover improper and fraudulent activities.

We have also embarked upon a cooperative venture with the State Education Department, the New York City Department of Education, the New York State Association of Counties and the counties themselves, as well as individual private providers of preschool special education, to improve the oversight and management of this important sector. We have begun by providing training to county officials and private providers to explain the importance of this initiative, and to discuss fraud prevention and detection techniques, the findings of our audits, and the need for strong internal controls.

These efforts have already begun to bear fruit. We are seeing a strong commitment from a wide range of stakeholders to ensure that this process works more efficiently and effectively. My office will continue to provide leadership and to emphasize the importance of needed internal controls and responsible external oversight.

With effective collaboration and determination we can make a difference in the management of this program and ensure that preschool children with disabilities receive the services that they need. They deserve no less from us.



**Thomas P. DiNapoli**  
New York State Comptroller



## EXECUTIVE SUMMARY

New York State has a longstanding history of providing special education services to students with disabilities. State Education Law makes school districts responsible for the provision of services to students with disabilities, including preschool students, and authorizes them to contract for necessary educational services with private providers. Currently, the New York State Education Department (SED) reports that about 81,000 preschool students with disabilities receive services in New York annually at a cost of more than \$1.4 billion to the State and its localities.

Unlike in other states, preschool special education services in New York are predominantly provided by private providers (both for-profit and not-for-profit) rather than the school districts themselves. These providers must be approved by SED, which annually develops rates for programs operated by approved providers based on actual costs reported to SED. These rates are used to reimburse providers for eligible costs which must be in compliance with comprehensive guidance promulgated by SED. There are currently about 320 approved private preschool special education providers in the State.

For more than a decade, the Office of the State Comptroller (OSC) has conducted dozens of audits of expenses submitted by special education providers to SED which focused on provider compliance with SED cost-reporting guidance and the accuracy and appropriateness of self-reported program costs. These audits identified a widespread pattern of unsupported expenditures, expenses claimed from other programs, personal expenses included with program expenses, no-show jobs, less-than-arm's-length transactions, and ineffective boards of directors. OSC concluded that stopping fraudulent, wasteful and abusive practices by preschool special education providers required a more comprehensive approach.

In June 2012, Comptroller DiNapoli announced a new special education audit initiative, which involved a broader, sector-wide perspective as well as multiple simultaneous individual audits, and proposed legislation to improve the oversight of preschool special education providers. As a result, Chapter 545 of the Laws of 2013 was signed into law on December 18, 2013 and became effective immediately. The law requires the State Comptroller to audit the expenses reported to SED by every program provider of special education services for preschool children with disabilities at least once by March 31, 2018, subject to the funding made available by the Legislature for such purpose. The law also requires the Comptroller to report annually to the Governor and the Legislature in December of each year regarding the audits of expenses submitted to SED by preschool special education providers conducted during the preceding twelve months.

As of December 2014, OSC has completed 40 audits of expenses submitted to SED by preschool and/or school age special education providers over the last decade, including 19 completed in 2014. These audits have cumulatively identified almost \$42 million in disallowances, or 7.6 percent of the total claimed expenses of \$544 million for the audit period. OSC also conducted an audit of SED's fiscal and program oversight of special education providers and issued an audit report thereon in December 2012.

Recent audits have continued to find patterns of mismanagement and abuse similar to the audits completed in previous years. As a result of the leadership of this Office and the combined commitment of all responsible parties, these audits have already begun to have a far-reaching impact on the State's efforts to strengthen the management and oversight of preschool special education providers in New York.

# OVERVIEW

## Background

New York State's longstanding commitment to providing special education services to students with disabilities predates federal mandates. Initially enacted in 1975, the federal Education of All Handicapped Children Act (now known as the Individuals with Disabilities Education Act, or IDEA) requires that all students with disabilities be provided with a free appropriate public education in the least restrictive environment possible. Prior to IDEA, parents of children with disabilities in New York State petitioned the Family Court and their county of residence to receive services under the Family Court Act of 1962.

In 1989, legislative changes were enacted to add a new Section 4410 to the State Education Law to bring New York into compliance with Part B of IDEA pertaining to preschool children. As a result of this legislation, school districts became responsible for services to preschool students with disabilities aged three and four. Because of the previous involvement of the counties and the Family Court in determining approved services, counties were required to continue to pay for special education services for preschoolers while receiving partial reimbursement from the State.

Currently, the New York State Education Department (SED) reports that about 81,000 preschool students with disabilities receive services throughout the State annually.

The cost of these services is substantial. SED reports that more than \$1.4 billion is spent annually by the State and its localities on services for preschool special education students aged three and four. Unlike in other states, preschool special education services in New York are predominantly provided by private providers (both for-profit and not-for-profit) rather than public school districts. These providers must be approved by SED in order to deliver special education services to children. SED annually develops rates for programs operated by approved providers based on actual costs reported to SED. These rates are used to reimburse providers for eligible costs, which must be in compliance with comprehensive guidance provided through the Consolidated Fiscal Reporting and Claiming Manual (CFR Claiming Manual) and additional guidance provided by SED through the Reimbursable Cost Manual (RCM). There are currently about 320 approved private preschool special education providers in the State.

For more than a decade, the Office of the State Comptroller (OSC) has conducted dozens of audits of expenses submitted to SED by preschool special education providers which focused on compliance with SED cost-reporting guidance and the accuracy and appropriateness of self-reported program costs. These audits identified a pattern of unsupported expenditures, expenses claimed from other programs, personal expenses included with program expenses, no-show jobs, less-than-arm's-length transactions, and ineffective boards of directors. OSC concluded that stopping fraudulent, wasteful and abusive practices by preschool special education providers required a more comprehensive approach.

In June 2012, Comptroller DiNapoli announced a new special education audit initiative which involved a broader, sector-wide perspective as well as multiple simultaneous individual audits, better coordination with SED and the New York City Department of Education (DOE), input from various interested parties, use of data analysis and risk analysis, and use of fraud and forensic auditing techniques. Comptroller DiNapoli also proposed legislation to improve the oversight of preschool special education providers.

## Legislation

Initially submitted by Comptroller DiNapoli as a program bill, Chapter 545 of the Laws of 2013 was signed into law on December 18, 2013 and became effective immediately. The law requires the State Comptroller to audit the expenses reported to SED by every program provider of special education services for preschool children with disabilities at least once by March 31, 2018, subject to the funding made available by the Legislature for such purpose. The law requires that the priority and frequency of such audits shall be based upon a risk assessment process and shall include reviews of financial documents as well as other records of providers. The statute also requires the State Comptroller to “inform and advise the Governor and the Legislature in December of each year regarding its audits of expenses reported to the Department by program providers of special education services for preschool children with disabilities conducted during the preceding twelve months and regarding any other pertinent information the Comptroller deems appropriate.” This report fulfills the statutory reporting requirement under Chapter 545 for December 2014.

Chapter 545 also directed SED to conduct a comprehensive study of alternative systems of reimbursement methodologies and monitoring protocols for preschool special education services; the results of this study shall be published no later than one year from the date of enactment (i.e., December 18, 2014). In compliance with Chapter 545, SED submitted its study of preschool special education tuition methodologies and monitoring protocols on December 18, 2014. The law also strengthened other aspects of the program by requiring that Executive Directors of providers be fully engaged and qualified for their positions and by requiring that a school district Committee on Preschool Special Education (CPSE) consent in writing and notify the Commissioner of Education whenever the CPSE places a preschool student with a disability in a program operated by the same provider that evaluated that student.

## OSC Implementation Activities

To begin the implementation of the provisions of Chapter 545, OSC requested startup funding to hire 34 new staff members, which was provided in the 2014-15 enacted State budget. To date, all of the new staff have been hired, trained and assigned to audits. OSC has also assigned existing staff to conduct audits of preschool special education providers in addition to the number of staff performing special education audits prior to the initiative (8.9 full-time equivalents [FTE] in 2013). OSC has provided specialized training to all staff engaged in the audit initiative. In order to meet the legislative mandate to audit the expenses submitted to SED by all preschool special education providers (currently more than 300) by March 31, 2018, additional resources will be requested for the 2015-16 State fiscal year.

As required by Chapter 545, OSC developed a risk assessment process to prioritize the preschool special education audits to be undertaken pursuant to the initiative. A new OSC data analysis team analyzed several years of cost information reported to SED by providers on their annual Consolidated Fiscal Reports (CFRs) to identify high-risk indicators. These indicators were used to assist management with the identification of high-risk special education providers and the development of a comprehensive audit plan for the initiative.

OSC also developed standard audit protocols and a specialized audit template to ensure consistency in the preschool special education audits and incorporated these protocols into staff training. As part of this effort, OSC has developed protocols to refer any findings of fraud, abuse or other conduct

constituting a crime which are uncovered during an audit to its own internal investigations unit as well as to external agencies with appropriate legal jurisdiction.

In conjunction with the New York State Association of Counties (NYSAC), OSC has conducted specialized training for county audit staff on the audit initiative, including the audit process and audit protocols. More than half the State's 62 counties have participated in the training, which has included information about the history of the special education audit initiative and the findings in the special education audits that OSC has undertaken to date.

OSC has also conducted training for preschool special education providers that addresses fraud detection and prevention as well as implementing the audit initiative, including the audit process, audit protocols and audit findings. As part of this training, providers have been given information on the steps in the OSC audit process (starting with the issuance of an engagement letter through the release of a final audit report) and what is expected of providers regarding familiarity with State CFR guidance and required documentation.

Additionally, OSC has collaborated with SED, the counties, the New York City DOE, NYSAC and other external groups to provide regular updates on OSC implementation activities. To facilitate this collaboration, OSC has established a dedicated electronic mailbox to communicate with external stakeholders.

## AUDIT FINDINGS

As of December 2014, OSC has completed 40 audits of expenses submitted to SED by preschool and/or school age special education providers over the last decade. These audits have cumulatively identified almost \$42 million in disallowances, or 7.6 percent of the total claimed expenses of \$544 million for the audit period. OSC also conducted an audit of SED's fiscal and program oversight of special education providers and issued an audit report thereon in December 2012. There are currently 17 additional audits of expenses submitted to SED by preschool special education providers in progress.

OSC audits of expenses submitted to SED by special education providers have identified widespread mismanagement and blatant abuse of funds intended for the education of children with disabilities, as well as outright fraud. These findings touch on virtually every aspect of the audited expenses ranging from costs for services provided directly to children to administrative functions. Not only do these findings provide evidence of financial waste and abuse, but such diversion of funds threatens the health and well-being of the children whose education and care are being compromised. As a result of these findings, legal investigations related to these audits have resulted in multiple criminal convictions and the recovery of more than \$5 million in stolen public funds.

Specifically, the patterns of mismanagement and abuse can be summarized as follows:

### Payroll-Related Findings

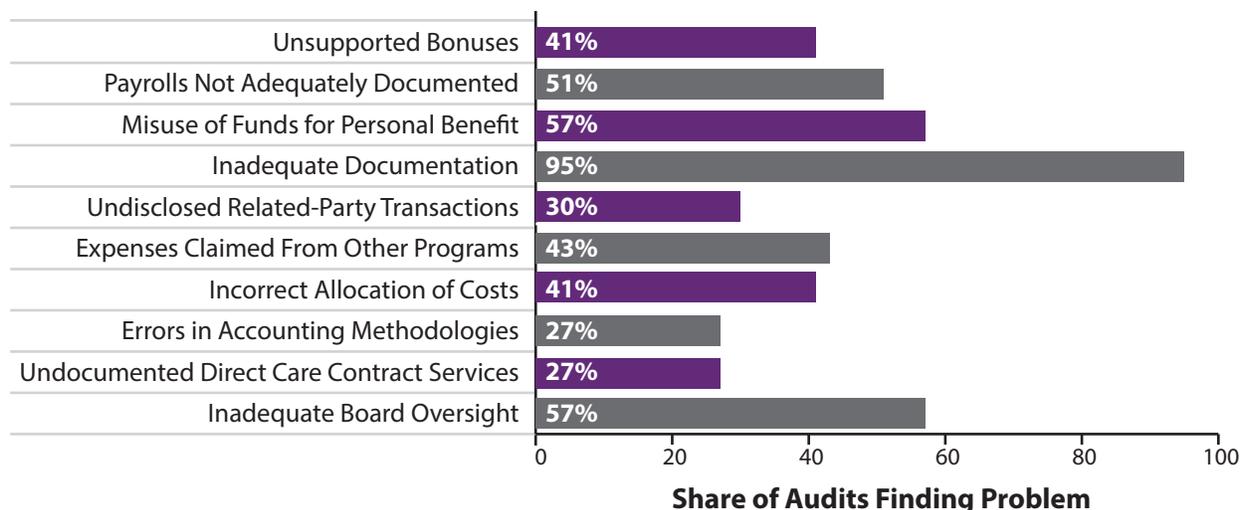
- **Unsupported bonuses** – SED guidance requires that salary bonuses must be based on merit and supported by performance evaluations to be eligible for reimbursement. More than a third of the audits (15 out of 37) found evidence of bonuses which were not in compliance with the RCM.

- **Payrolls not adequately documented** – SED guidance requires providers to base employee compensation on approved and documented payrolls which are supported by employee time and attendance records for all employees. Half of the audits (19 out of 37) found issues with the maintenance of payroll documentation in compliance with the RCM. In nine of those audits, disallowances of payroll expenditures resulted when employee compensation could not be substantiated by available time and attendance records (no-show or low-show jobs).

**Misuse of Public Funds for Personal Benefit** – More than half of the audited providers (21 out of 37) included personal expenses and purchases on their CFRs. Audits identified at least \$1.7 million of public funds diverted for personal use, including expenditures for:

- **Vehicles** – SED guidance allows for the reimbursement of vehicle costs as long as vehicle usage is program-related and documented in logs which include dates, times, purposes, destinations, mileage and names of travelers for individual vehicles. Several of the audits (13 out of 37) identified disallowances of vehicle-related expenses which were inadequately documented or otherwise ineligible for reimbursement.
- **Travel** – Travel costs must be program-related and appropriately documented to be eligible for reimbursement. Nearly half of the audits (17 out of 37) disallowed ineligible travel costs of staff, family members and/or non-employees.
- **Expenses of a personal nature** – Personal expenses are not eligible for reimbursement. In 21 out of 37 audits, personal expenses were disallowed for such purchases as apartment rentals, college tuition, jewelry, entertainment, food, cell phones, funeral expenses, and gifts for staff, family members and/or non-employees.
- **Capital improvements on personal residences** – SED guidance permits reimbursement for capital improvement expenditures that are program-related and preapproved by SED. In several instances, OSC audits identified capital improvement expenditures for personal residences which were claimed for reimbursement, including expenditures for renovations, landscaping, and furniture.

## Patterns of Mismanagement and Abuse Among Private Special Education Providers in New York State



**Inadequate Documentation** – SED guidance requires that expenditures must be reasonable, necessary, directly related to the program and adequately documented in order to be considered for reimbursement. In nearly all of the audited programs (35 out of 37), there were findings of ineligible expenses which were either not program-related or were unsupported by adequate documentation. These findings accounted for forty percent of all disallowances, a total of \$16 million, including more than \$760,000 for costs related to staff food and entertainment.

**Undisclosed Less-Than-Arm’s-Length (LTAL) Transactions** – SED guidance requires special education providers to disclose all less-than-arm’s-length (LTAL) transactions in their CFRs and in the notes to their financial statements. LTAL relationships exist between related parties that may influence each other’s business decisions due to the nature of their personal relationships (e.g., spouses who conduct business with each other). Disclosure of such relationships is necessary to help ensure the propriety of costs for reimbursement purposes. More than a third of the audits (13 out of 37) identified LTAL transactions totaling \$5.6 million which were not disclosed as required.

**Expenses Claimed from Other Programs and Incorrect Allocation of Costs** – SED guidelines require that any expenditure that cannot be charged directly to a specific program must be allocated across all programs and/or entities which benefit from the expenditure (e.g., general maintenance and overhead expenses). The RCM requires providers to maintain documentation of the methodologies used to allocate costs to the various programs which they operate. Almost half of the audits (16 out of 37) identified issues related to the allocation of costs among programs and/or the inappropriate claiming of expenses from other programs. Guidance also requires providers to correctly classify costs as either direct care costs (those associated with the provision of instruction and related services to students) and non-direct care costs (those attributable to the general administration of a program and/or the operation and maintenance of a program’s facilities). Over a third of the audits (15 out of 37) identified issues related to allocation of costs between direct and non-direct care. Some of these audits (7 out of the 37) identified issues with incorrect allocations of costs between preschool special education programs and Early Intervention (EI) programs. EI programs are overseen by the State Department of Health (DOH) for infants with disabilities from birth through age two and are fee-based rather than cost-based. In 2012, about half of the preschool special education providers (155 of 319) also offered EI programs.

**Errors in Accounting Methodologies Used for Depreciation, Amortization and Accruals** – SED guidelines permit reimbursement of the depreciation of capital assets and the amortization of financing costs over the useful life of the assets or financing. Several audits (10 out of 37) found the inappropriate expensing of such costs, including bond refinancing costs of more than \$560,000 which should have been amortized over a period of 20 years but instead were expensed in a single year by a provider.

**Contracted Direct Care Services Not Provided or Inadequately Documented** – According to the RCM, all payments to contractors must be supported by itemized invoices that indicate the specific services actually provided and, for each service, the date, number of hours provided, and the fee per hour, as well as the total amount charged. In addition, when direct care services are provided to students, the documentation must indicate the names of the students served. In nearly a third of the audits (10 out of 37), disallowances resulted from the identification of evidence that direct care services either were not provided or were inadequately documented.

**Lack of Due Diligence by Certified Public Accountants** – As part of the CFR submission process, each provider is required to have an independent certified public accountant (CPA) express an opinion on its financial statements and certify that its CFR is prepared in accordance with SED guidance. The purpose

of the certification is to ensure that the CFR data is reported consistently and can be relied upon for the rate-setting process. OSC audits have found numerous errors in cost reporting in CFRs that can be attributed to the lack of due diligence by CPAs hired by special education providers. Examples include: instances of personal expenses included with program expenses; LTAL transactions; errors in allocation methodologies; and errors in accounting methodologies used for depreciation, amortization, and accruals.

**Inadequate Oversight by Boards of Directors** – Twenty-one of the 37 providers that were audited by OSC were overseen by boards of directors. OSC audits reported that those boards of directors did not provide adequate oversight at 12 of the 21 providers. Audits found that boards did not fully meet their fiduciary responsibilities, were not independent, did not meet at least twice annually, did not maintain accurate board minutes, and/or did not comply with conflict of interest policies; two audits also found that board members did not file annual disclosure statements as required.

## Special Education Provider Audits Completed in 2014

In 2014, OSC completed 19 audits of expenses submitted to SED by special education providers, including audits of the expenses submitted by three providers with school age only (SAO) programs and audits of the expenses submitted by 16 providers with preschool programs. These audits continued to find patterns of mismanagement and abuse similar to audits completed in previous years. Some specific findings from the audits completed in 2014 are detailed below.

- **All Services for Kids, Inc. (All Services) (2012-S-19)**, located in Queens, New York, is a private for-profit corporation that provides, in addition to other child-related services, special education itinerant teacher (SEIT) services to children with disabilities between the ages of three and five years. For the two fiscal years ended June 30, 2010, All Services claimed and received State and local government support totaling \$1.3 million. The OSC audit identified \$66,532 in disallowances which were not in compliance with the RCM, including:
  - ▶ \$53,546 in personal service expenses, including compensation paid to the husband of the Executive Director for services that he did not perform; and
  - ▶ \$12,986 in non-personal expenses, including inappropriately allocated rental expenses, cell phones used by the Executive Director's minor children, unaccounted-for equipment, and cable television expenses.
- **TheraCare Preschool Services, Inc. (TheraCare) (2012-S-21)** is a for-profit organization that provides special education services to children between three and five years of age who reside in New York City as well as Westchester, Nassau and Suffolk counties. The special education programs it provides include preschool SEIT services and preschool integrated special education. For the three fiscal years ended June 30, 2011, TheraCare reported program-related costs of about \$50.1 million; the OSC audit disallowed \$876,898 in costs which did not comply with the RCM, including:
  - ▶ \$474,080 in employee bonus payments which were not in compliance with RCM guidelines; and
  - ▶ \$76,766 in unnecessary and inappropriate South American recruitment-related costs.
- **LaSalle School (LaSalle) (2012-S-68)** is a not-for-profit school located in Albany, New York, that provides a range of community and campus-based programs, including residential and

day services, to male adolescents and their families. LaSalle is a school age only (SAO) program which offers both special education and regular education curricula for students in grades 6 through 12. For the three fiscal years ended June 30, 2011, LaSalle claimed a total of \$11.5 million in reimbursable expenses for the special education program audited. The OSC audit disallowed a total of \$433,968 in costs that were unnecessary, unallowable or not correctly reported on the CFR, including:

- ▶ \$375,240 in compensation for uncertified teachers;
- ▶ \$38,745 in other ineligible employee compensation; and
- ▶ \$11,450 in unsupported vehicle costs.

The audit also found that LaSalle's Board of Trustees failed to report less-than-arm's-length business arrangements on its CFR and did not comply with RCM requirements pertaining to the documentation of cost allocation methodologies and the preparation and maintenance of employee time and attendance records.

- **Churchill School and Center (Churchill) (2012-S-20)** is a private not-for-profit education corporation located in New York City which includes the Churchill School (Churchill), the Churchill Center (Center) and a Development Office. Churchill is a SAO program which provides special education services to children from kindergarten through 12th grade who are classified as having learning disabilities and/or speech-language impairments. The Center offers educational programs to non-Churchill students and professional development workshops. The Development Office administers fund-raising and related activities. For the three fiscal years ended June 30, 2011, the OSC audit disallowed \$3,023,220 (or 7.1 percent) of the \$42.8 million in program-related expenses claimed by Churchill, including:

- ▶ \$1,412,227 in compensation incurred by the Center and the Development Office, but charged to the Churchill School;
- ▶ \$439,527 in food, parties, gifts, rental of a personal apartment, and other ineligible, inappropriate and/or insufficiently documented expenses;
- ▶ \$429,729 in employee bonuses that did not comply with RCM requirements; and
- ▶ \$220,501 in unnecessary transportation costs incurred with a private bus company for the transportation of students to off-site activities during school hours which should have been handled at no additional cost by regular school buses made available for such purposes by school districts with students placed at Churchill.

- **Bilinguals, Inc. (Bilinguals) (2012-S-65)** is a non-public, for-profit special education institution based in Queens, New York that provides SEIT services and preschool integrated special education services to children between the ages of three and five. During the audit period, Bilinguals was affiliated with six other educational institutions owned by Bilinguals' Executive Director and her spouse, the Assistant Executive Director. For the three fiscal years ended June 30, 2011, Bilinguals reported \$13.3 million in reimbursable costs for the audited programs. The OSC audit identified \$875,729 (or 6.6 percent) of these reported costs as non-reimbursable, including:

- ▶ \$243,950 in compensation paid to 17 individuals who did not provide services to the audited programs during the audit period, including three individuals who worked for the Early Intervention (EI) program;

- ▶ \$218,682 in bonus payments that did not comply with the RCM;
- ▶ \$205,695 for international recruitment expenses for unqualified individuals and for individuals who did not come to work for the programs; and
- ▶ \$97,743 for ineligible expenses for the personal benefit of Bilinguals officials and staff, including costs for a Manhattan apartment, cell phones, college tuition, personal vehicles, gifts, parties and funeral expenses.

■ **Children’s Center for Early Learning (CCEL) (2011-S-21)** is a not-for-profit organization located in Brooklyn, New York which provides special education services to New York City-based children between three and five years of age. One of CCEL’s affiliates, the Children’s Center for Early Intervention (CCEI), is a for-profit organization which operates at the same Brooklyn location and provides early intervention services to children from birth to age three. Another affiliate, the Manhattan Children’s Center (MCC), is a non-profit private charter school which provides services to children between 3 and 12 years of age with autism spectrum disorders. For the three fiscal years ended June 30, 2009, CCEL reported \$10.7 million in reimbursable costs for the audited programs. The OSC audit identified \$797,438 (or 7.5 percent) of these reported costs as non-reimbursable, including:

- ▶ \$629,924 in salaries and fringe benefits paid to 27 individuals for costs chargeable to CCEL affiliates who did not provide services to the audited programs during the audit period, including 17 individuals who worked for the early intervention program;
- ▶ \$69,896 in compensation paid to seven employees for hours not worked;
- ▶ \$22,565 in undocumented and/or insufficiently documented payroll costs, including \$16,000 (eight payments of \$2,000 each) in salary expenses claimed on the 2007-08 CFR for a psychologist who had no time and attendance records for the period in question. CCEL officials claimed that they allowed this employee (the daughter of the Executive Director) to work from home between November 7, 2007 and March 28, 2008 while she was on maternity leave. However, there was no evidence that she performed any CCEL-related work during this period; and
- ▶ \$55,496 in ineligible expenses, including fees for undocumented professional services, income tax penalties, food purchases, and office-related expenses that should have been allocated to CCEI.

The audit also found that CCEL made interest-free loans to related parties using program moneys and failed to disclose those loans on its CFRs.

■ **Circle of Friends (2014-S-32)** is a for-profit organization with locations in Ravena and Delmar, New York which provides preschool special education services to children with disabilities between the ages of three and five years old from 12 school districts in three counties (Albany, Rensselaer, and Greene) in upstate New York. For the fiscal year ended June 30, 2013, Circle of Friends reported approximately \$1.1 million in reimbursable costs for the special education programs it operated. The OSC audit identified \$604 in non-reimbursable costs that were either undocumented or unnecessary.

■ **Metro Therapy, Inc. (2012-S-164)** is a proprietary business located in Suffolk County that provides SEIT services to children between the ages of three and five years in New York City and in Nassau and Suffolk counties. For the three fiscal years ended June 30, 2011, Metro Therapy

reported approximately \$7.1 million in reimbursable costs for its SEIT program. The OSC audit identified \$833,949 (or 11.7 percent) in non-reimbursable costs, including:

- ▶ \$357,063 in excessive allocations of salaries and fringe benefits;
- ▶ \$185,512 in compensation paid to five individuals who did not provide services to the SEIT program; and
- ▶ \$66,636 in parent company allocation expenses (including unreasonable travel expenses for corporate headquarters staff, such as corporate flight department salaries and fringe benefits, gas and oil charges, landing fees, corporate aircraft operating costs, and the rental and lease of equipment as well as other non-allowable expenses, such as charitable contributions and lobbying expenses) and \$62,138 in unrelated or undocumented non-personal service costs that were not in compliance with the RCM.

■ **Early Childhood Education Center (ECEC) (2014-S-35)** is a not-for-profit organization with locations in Albany, Guiderland and Troy, New York which provides preschool special education services to children with disabilities between the ages of three and five years. For the fiscal year ended June 30, 2012, ECEC reported about \$2.8 million in reimbursable costs for the preschool special education programs it operated. The OSC audit identified \$3,501 in costs that did not comply with SED's requirements for reimbursement, including expenditures for miscellaneous gifts to its employees, food for a board meeting and travel that lacked required documentation.

■ **Gateway-Longview, Inc. (Gateway) (2012-S-17)** is a not-for-profit organization located in Buffalo, New York that provides supportive, educational, housing and substitute care services for children, youth and families, including special education services to school-age and preschool children between 3 and 21 years of age. Gateway receives funding from multiple sources including SED, the Office of Children and Family Services (OCFS), the Office of Mental Health (OMH) and the Department of Health (DOH). For the three fiscal years ended June 30, 2011, Gateway received about \$68.6 million in revenue from government sources. The OSC audit disallowed a total of \$2.4 million, including:

- ▶ \$1,999,744 for the cost of related-party transactions with companies affiliated with members of Gateway's Board of Directors which were not competitively bid or documented to be fair and reasonable. Many of these costs lacked required supporting documentation; and
- ▶ \$378,946 for expenses that were inadequately documented or ineligible for reimbursement, including costs for food, flowers, personal expenses and gifts for staff. These disallowances also included \$64,110 in payments for car and cell phone allowances for Gateway's former Chief Executive Officer and other officials. The former CEO, for example, received personal benefits totaling \$39,138, including a \$600 monthly allowance for the purchase or lease of a vehicle, a cell phone allowance and reimbursement for membership fees to private social clubs. These costs were inappropriate, not properly documented and/or not reimbursable.

■ **Bright Start Pediatric Services (Bright Start) (2014-S-34)** offers a range of services to children with disabilities from birth through age five in Monroe, Ontario and Wayne counties. For the fiscal year ended June 30, 2013, Bright Start reported reimbursable costs of \$442,638 for its SEIT program. The OSC audit identified \$4,798 in costs charged to the SEIT program that did not comply with SED requirements for reimbursement.

- **Aspire of Western New York (Aspire) (2014-S-36)** is a not-for-profit organization that provides a range of services to children with disabilities from birth through age 21 in six counties in western New York. For the year ended December 31, 2012, Aspire reported approximately \$3.8 million in reimbursable costs for its programs. The OSC audit identified \$7,501 in costs charged to preschool programs that did not comply with SED requirements for reimbursement, including costs for consultant services and other than personal service costs such as entertainment and food expenses.
- **Dynamic Center Inc. (Dynamic) (2014-S-3)** is a for-profit corporation located in Florida, New York that provides a range of preschool special education services to children between the ages of three and five in Orange County. For the fiscal year ended June 30, 2012, Dynamic claimed about \$1.1 million in reimbursable costs for its SEIT program. The OSC audit identified \$420,953 (37.6 percent) in reported costs that did not comply with RCM requirements, including:

  - ▶ \$279,020 in personal service expenses that were not supported by time sheets or other documentation; and
  - ▶ \$104,933 in other than personal service costs that were either unsupported, not program-related, personal in nature, or incorrectly calculated or allocated, including gifts, food for staff, and holiday parties. Among the personal items were travel, laundry, and car repair costs as well utility costs for the Executive Director's residence.
  - ▶ The audit also identified several record-keeping weaknesses corresponding to the expenses reported by Dynamic on its CFR.
- **The Child School (School) (2012-S-67)** is a not-for-profit organization located on Roosevelt Island, New York which provides special education services to children in New York City between 6 and 21 years of age. For the three fiscal years ended June 20, 2011, the School reported about \$26 million in program-related costs. The OSC audit identified \$992,765 in reported costs that were ineligible for reimbursement, including:

  - ▶ \$435,471 in personal service costs, including overstated salaries and fringe benefits, health insurance premiums paid for former employees during the audit period, ineligible bonuses and non-program-related expenses;
  - ▶ \$557,294 in other than personal service costs that were either unsupported, not program-related, unnecessary or unreasonable. Among the disallowances were \$180,073 for a less-than-arm's-length contract for building maintenance and cleaning services that was not competitively procured and \$72,856 for vehicles purchased and leased for the School's Executive Directors.
- **Functional MDS (MDS) (2014-S-1)** is a family-owned, for-profit organization that provides Special Education Itinerant Teacher (SEIT) services and integrated therapeutic preschool special education programs to children with disabilities between the ages of three and five in New York City. MDS shares services, building space and staff with a not-for-profit entity, Functional Life Achievement, which is owned by the same family that owns MDS and provides Early Intervention services to children from birth to age three. For the fiscal year ended June 30, 2013, MDS claimed approximately \$3.5 million in reimbursable costs. According to SED, MDS ceased providing SED-funded special education programs as of September 2014. The OSC audit identified \$794,219 (22.5 percent) in reported costs that did not comply with SED requirements for reimbursement, including:

- ▶ \$373,200 in compensation to 11 employees for which there was no evidence that they worked for MDS;
- ▶ \$198,888 in executive compensation that was improperly allocated to MDS; and
- ▶ \$109,187 in other than personal services costs that were unsupported by appropriate documentation or were ineligible for reimbursement, including costs for food, travel, equipment that should have been depreciated, and international recruitment, as well as five air conditioning units, which we determined were for the MDS Executive Director's personal use. (We note that the invoice for the air conditioners that MDS officials provided to support their claim had been altered, with the delivery address deleted. A copy of the original invoice from the vendor indicated the units were installed in the bedrooms of the Executive Director's residence.)

■ **Institutes of Applied Human Dynamics (IAHD) (2014-S-39)** is a not-for-profit organization based in Tarrytown, New York that provides preschool special education programs to children with disabilities between the ages of three and five years at the IAHD facility in the Bronx. For the fiscal year ended June 30, 2013, IAHD reported about \$2.3 million in reimbursable costs on its CFR. The OSC audit identified \$456,292 in reported costs that did not comply with RCM requirements, including:

- ▶ \$228,479 in salaries and fringe benefits for 30 employees that were improperly allocated to SED programs;
- ▶ \$113,088 in unapproved costs for salaries and fringe benefits for nursing services; and
- ▶ \$57,146 in building expenses which were not properly allocated in accordance with RCM guidelines.

## SED Fiscal and Program Oversight of Special Education Providers (2012-S-103)

Released in December 2012, this audit's highlights include:

- There has been no fiscal audit oversight of individual providers by SED since 2007, nor is there a system to ensure programmatic review of providers on any cyclical basis; fiscal oversight is limited to desk reviews of self-reported information that providers submit annually.
- Because of the lack of fiscal oversight by SED, the role of Certified Public Accountants (CPAs) in certifying CFRs is a critical control in the process. OSC audits have determined that CPAs are not fulfilling this responsibility and, as a result, cost information is not sufficiently reliable.
- Not only is the reliability of CFR information questionable, but the rate-setting process itself is complicated and antiquated, requiring many manual calculations, all of which increase the risk of error and manipulation.
- Providers receive limited training and instructions from SED.
- CFRs are often filed late and are often rife with errors; existing penalty provisions do not serve as an effective deterrent to these problems. For example, more than half of the preschool special education providers who submitted CFRs to SED for the 2011-12 school year (171 out of 312) filed them after the December 1st extended due date.

## RELATED AUDIT FINDINGS

Eleven private schools in New York State receive operating aid directly from the State to provide special education services for certain types of students with disabilities. These schools, known as 4201 schools in reference to the section of State Education Law which authorizes them, have historically been funded through a separate State appropriation rather than via the rate-setting process used for other private special education providers. Over the last decade, OSC conducted audits of eight of the eleven 4201 schools and, similar to the findings cited in the preschool special education expense audits, found widespread patterns of weak internal controls, inadequate board oversight, failure to follow competitive procurement procedures, and lack of documentation at these schools. Follow-up audits conducted by OSC found that most of these schools have made significant progress in correcting the problems identified in the initial audits, but that some improvements are still needed.

## AUDIT RECOMMENDATIONS

OSC audits have made several recommendations to improve the efficiency and effectiveness of the private preschool special education providers. These recommendations fall into two main categories: (1) SED oversight of private providers, including the accuracy of tuition rates set by SED; and (2) the appropriateness and accuracy of costs claimed for reimbursement by the providers themselves.

**Recommendations to SED in the provider expense audits** can be summarized as follows:

- Review recommended audit disallowances, make appropriate adjustments to costs reported on the CFRs, and make appropriate adjustments to reimbursement rates;
- Recover past overpayments from providers and reduce future payments as appropriate;
- Work with providers to help them comply with RCM guidance, including providing better CFR training and requesting ethics training for boards of directors and senior management;
- Review program matters pertaining to student-to-staff ratios and the certification of teachers as identified in the audits and help providers develop remedial action plans as warranted;
- Consider banning certain providers from participation in State-funded programs; and
- Perform follow-up field site visits to providers to verify that audit recommendations have been implemented.

**Recommendations in the SED oversight audit** can be summarized as follows:

- 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 SED 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 accurate and timely CFRs;
- Formalize policies and procedures for sharing identified provider problems with other State agencies that are also funding the provider; and
- Re-evaluate and enhance provider training requirements, including frequency, content and requirements for attendance.

**Recommendations to preschool special education providers** can be summarized as follows:

- Ensure that costs reported on the annual CFRs are accurate, complete and in compliance with RCM requirements;
- Ensure that reported program costs are based on actual expenditures and are supported by adequate documentation;
- Ensure that all staff providing special education instruction are properly qualified and certified;
- Remediate organizational and procedural weaknesses related to effective internal controls, including board governance issues, time and attendance records, performance evaluations, conflict of interest policies, LTAL business arrangements, hiring of contractors and equipment inventory controls;
- Ensure that all costs are reported correctly as either direct care or non-direct care costs; and
- Comply with SED guidance regarding the allocation of costs among programs and required SED preapprovals (e.g., for facility renovations).

## IMPACT OF AUDITS: AGENCY RESPONSES AND ACTIONS TAKEN

### State Education Department

SED has agreed to implement all the recommendations in the OSC special education expense audits. Specifically, SED has reviewed recommended disallowances, made adjustments to reimbursable costs, recalculated tuition rates as appropriate and recovered any overpayments resulting from such recalculations. In addition, in response to the OSC special education expense audits and the oversight audit of SED itself, SED undertook a comprehensive examination of preschool special education programs, services and costs and explored specific measures to enhance its oversight and monitoring of private providers. As a result of this examination, SED has taken numerous actions to strengthen the fiscal oversight and accountability measures of preschool special education providers, including the following:

- **Special Education Financial Advisory Workgroup** – The New York State Board of Regents created a Special Education Financial Advisory Workgroup to allow all interested stakeholders

to provide input on the current tuition rate-setting structure for special education providers and discuss recommendations to maximize the efficient and effective use of State and local resources.

- **Enhanced Program Monitoring and Program Reapproval Process** – SED developed a comprehensive approach to improve its oversight of existing preschool special education providers, including developing a revised monitoring review protocol, conducting at least 50 onsite preschool program reviews annually, using program reviews as the basis for official program reapproval determinations, and initiating a cyclical schedule for the review and reapproval of all existing private preschool special education providers.
- **Revised Approval Process for New Programs and Program Modifications** – SED revised its special education provider approval application process to include an in-depth review of all program elements to ensure that high quality services are delivered in an environment that protects the health and safety of students with disabilities, and that the provider has the appropriate background and qualifications to provide effective program and fiscal oversight. While the revised approval application was being developed, SED imposed a short-term moratorium on the approval of new providers and program expansions, which was subsequently lifted when the revised application was released. SED also formed a new Preschool Unit within the Office of Special Education to manage the provider application process, address preschool legislative and regulatory issues, provide policy guidance, provide technical assistance to providers and other external parties, and liaison with other SED units to coordinate internal efforts to improve the oversight of preschool special education services.
- **Required CFR Training** – Beginning with the submission of CFRs for the 2012-13 school year, SED is requiring that individuals signing the CFR certification statements, namely Executive Directors and CPAs, either attend an interagency CFR training offered annually at one of six locations across the State or complete an online CFR training course. SED is tracking and verifying that individual providers have completed the required training.
- **Increased Fiscal Audits of Special Education Providers** – In addition to continued cooperation with OSC audits, SED has supported additional resources for further audits (both random audits and audits targeted to providers with specific risk factors associated with fraud) and has supported measures to remove disincentives for municipalities to audit preschool special education providers by increasing the share of overpayments that may be recovered by a municipality conducting an audit and proportionally reducing the State's share of such disallowed funds. As a result, the enacted State budget for the 2013-14 school year (Chapters 53 and 57 of the Laws of 2013) included provisions to: (1) authorize counties to retain 100 percent of recoveries identified in preschool provider audits; (2) direct SED to establish audit guidelines and protocols for such audits (SED has subsequently issued updated guidance to municipalities and revised regulations on preschool provider audits); (3) authorize SED to award grants to municipalities to enhance their oversight of preschool providers; and (4) direct SED to develop a data collection and analysis system to improve the oversight capacity of the State, school districts, and municipalities regarding preschool special education providers.
- **Review of Provider's Approval Status Following Fiscal Audit** – SED has enhanced its criteria and developed a process for revocation of a provider's approval based on fiscal concerns and/or misuse of public funds identified in audits; as a result, SED has taken action to terminate the approval of at least four preschool special education providers.

- **Strengthened Existing External Audit Requirement** – SED has enhanced its internal processes for referring CPAs to the Office of the Professions for professional misconduct based on substantial errors that are contained in a provider’s CFR that has been certified by a CPA and in cases where an audit of a provider contains findings of fraudulent spending or other intentional misuse of public funds.
- **Revised SED Regulations** – To implement the provisions of Chapter 545 of the Laws of 2013, SED has adopted regulations requiring that: (1) Executive Directors of private preschool special education providers must be qualified and fully engaged in their positions; and (2) a school district CPSE must consent in writing and notify the Commissioner of Education whenever the CPSE places a preschool student with a disability in a program operated by the same provider that evaluated that student.

## Preschool Special Education Providers

Preschool special education providers have typically agreed with OSC audit recommendations (36 out of 76 recommendations), have occasionally disagreed (14 times) and have often had no comments on the recommendations (26 times), although they may have disagreed with specific findings or submitted additional information regarding a specific issue (such as reasons for hiring non-certified teachers). Some issues related to special education expense audits include:

- **Need for Clear Guidance** – Although providers did not generally disagree with audit recommendations to comply with SED guidance, some providers indicated that written guidance from SED was not always clear. SED makes revisions annually to the RCM to clarify its guidance on various issues and has made specific modifications as a result of the OSC audits. For example, in the 2013-14 RCM, SED clarified the eligibility criteria for the costs of recruiting personnel to specifically address the costs of foreign recruitment efforts; providers must now document that significant domestic recruitment efforts to hire staff with similar credentials have taken place, recruited staff possess the required credentials to perform in the position for which they were hired, and the costs for staff that do not remain employed in the organization for at least a year will not be reimbursed.
- **Reported CFR Costs and SED Rate-Setting Methodology** – One issue raised by providers relates to the fact that reported CFR costs are not amended even if certain costs are excluded by the SED rate-setting methodology as ineligible for reimbursement. Because OSC audits use CFR information as reported, it is possible that the SED rate-setting process had already accounted for some of the amounts identified in the OSC audit findings. Nevertheless, the SED rate-setting process may only have identified dollar *amounts* above established thresholds which were subsequently excluded from the tuition rates rather than the *reasons* for such exclusions. For example, the SED rate-setting methodology may have excluded an amount above the percentage permitted for non-direct care costs, whereas an OSC audit may have identified that same amount for an inappropriate purchase (e.g., a home entertainment center). Providers are not penalized for this dual identification as rate adjustments would take both considerations into account.
- **Training on Audit Initiative and CFRs** – Many preschool special education providers have participated in training sessions conducted by OSC on fraud detection and prevention as well

as the audit initiative, including the audit process, protocols and findings. To date, about 70 providers have attended OSC training. In addition, about 200 Executive Directors, administrative staff and CPAs of providers have participated in CFR training conducted by SED.

## CONCLUSION

As New York continues to strengthen its oversight of preschool special education providers, State policy makers must find ways to encourage the long-term commitment of all stakeholders to make this important sector of the education system work more efficiently and effectively. Accordingly, this Office will continue to take a leadership role and to emphasize the importance of vital internal controls and responsible external oversight.

## APPENDIX A

# OSC Special Education Provider Audits to Date

	Provider/Audit Name	County	Audited Program Costs Reported on CFR	Number of Years in Scope	Total Disallowance
1	Institutes of Applied Human Dynamics	Westchester	\$6,856,777	3	\$456,292
2	Functional MDS	New York	\$3,525,591	1	\$794,219
3	The Child School*	New York	\$25,970,231	3	\$992,765
4	Dynamic Center Inc.	Orange	\$1,118,222	1	\$420,953
5	Aspire of Western New York	Erie	\$3,754,374	1	\$7,501
6	Bright Start Pediatric Services	Monroe	\$442,638	1	\$4,798
7	Gateway-Longview, Inc.	Erie	\$70,933,993	3	\$2,378,690
8	Early Childhood Education Center	Albany	\$2,752,836	1	\$3,501
9	Metro Therapy, Inc.	Suffolk	\$7,131,870	3	\$833,949
10	Circle of Friends	Albany	\$1,142,676	1	\$604
11	Children's Center for Early Learning	Kings	\$10,698,809	3	\$797,438
12	Bilinguals, Inc.	Queens	\$13,339,403	3	\$875,729
13	Churchill School and Center*	NYC	\$42,848,386	3	\$3,023,220
14	LaSalle School*	Albany	\$10,018,493	3	\$433,968
15	TheraCare Preschool Services, Inc.	NYC	\$50,075,064	3	\$876,898
16	All Services for Kids, Inc.	Queens	\$1,293,070	2	\$66,532
17-19	Audits Pending Investigation**	N/A	\$32,741,416	N/A	\$1,776,434
20	Island Child Development Center***	Queens	\$27,548,176	5	\$12,400,000
21	John A. Coleman School	Westchester	\$27,330,627	3	\$639,338
22	The Norman Howard School*	Monroe	\$11,304,496	3	\$208,305
23	Westchester School for Special Children	Westchester	\$47,782,346	4	\$802,912
24	Kids Quality Care, Inc.	New York	\$2,771,256	2	\$237,926
25	Kids & the Training Institute, Inc	New York	\$3,310,645	2	\$287,952
26	Achievements, PPLC	Albany	\$8,183,952	5	\$182,590
27	IncludED Education Services, Inc.	Nassau	\$12,562,987	2	\$2,634,511
28	Bilingual SEIT, Inc.	Queens	\$23,414,348	2	\$1,474,924
29	Capital District Beginnings	Rensselaer	\$12,075,675	2	\$831,244
30	Important Steps, Inc.	Bronx	\$5,691,319	1	\$244,874
31	Special Education Associates, Inc.	Kings	\$12,526,850	2	\$670,857
32	Integrated Treatment Services, Inc.	Kings	\$10,442,213	2	\$511,615
33	A Starting Place	Rockland	\$3,379,270	1	\$21,555
34	Pyramids Preschool	Clinton	\$2,130,601	1	\$239,889
35	Leake & Watts Services, Inc.	Westchester	\$21,584,000	1	\$646,066
36	Home Therapy Associates	Westchester	\$5,508,636	1	\$1,063,623
37	Village Child Development Center	Bronx	\$6,196,965	2	\$600,101
38	Manhattan Center for Early Learning	New York	\$3,096,340	1	\$617,109
39	East Bronx Day Care Center	Bronx	\$5,044,373	3	\$948,536
40	Highbridge Advisory Council Family Services	Bronx	\$7,948,885	2	\$2,524,991
<b>TOTAL (40 providers)</b>			<b>\$544,477,809</b>		<b>\$41,532,409</b>

\* School Age Only Program

\*\* Three audits were completed during 2014 and are pending further investigation; audit findings are not included in the text of this report.

\*\*\* Disallowances are based on audit work completed in 2012 and 2014.

Audits completed during 2014

Investigation completed during 2014

