
Audit Report

Board of Cooperative Educational Services
Erie 2

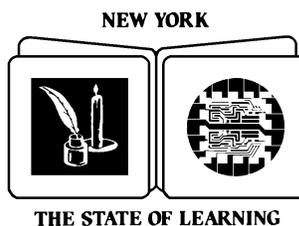
For the Period

July 1, 1995 through June 30, 1996

BOC-0397-10

February 8, 1999

The University of the State of New York
THE STATE EDUCATION DEPARTMENT
Office of Audit Services
Albany, New York 12234





THE STATE EDUCATION DEPARTMENT / THE UNIVERSITY OF THE STATE OF NEW YORK / ALBANY, NY
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February 8, 1999

Dr. Lionel Meno
District Superintendent of Schools
Erie 2-Chautauqua-Cattaraugus BOCES
8685 Erie Road
Angola, New York 14006

Dear Dr. Meno:

The following is our final audit report (BOC-0397-10) on the Erie 2 Board of Cooperative Educational Services for the period July 1, 1995 through June 30, 1996. The audit was conducted pursuant to Sections 305 and 1950 of the Education Law in pursuit of Goal #5 of the Board of Regents/State Education Department Strategic Plan: "Resources under our care will be used or maintained in the public interest."

It is the policy of the State Education Department to consider for review matters of significant disagreement which result from the issuance of final audit report. Appendix C describes the process to be followed in the event of such disagreement.

Ninety days from the issuance of this report, BOCES officials will be asked to submit a report on actions taken as a result of this audit.

I appreciate the cooperation and courtesies extended to the staff during the audit.

Sincerely,

Daniel Tworek

Enclosure

cc: Commissioner Mills
R. Cate
J. Kadamus
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Executive Summary

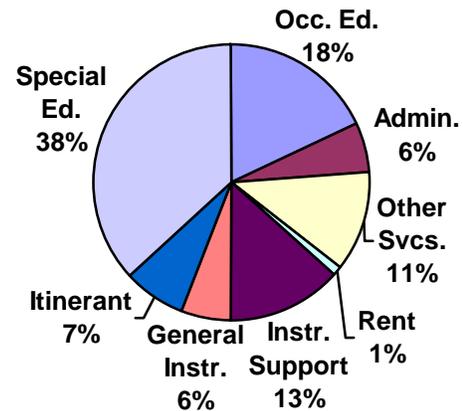
Erie 2-Chautauqua-Cattaraugus BOCES ranked 14th of the 38 BOCES in the State, in terms of total general fund expenditures, for the 1995-96 school year (\$34,537,252).

Background and Scope of the Audit

The audit examined financial management practices, records and documentation related to selected areas of Erie 2-Chautauqua-Cattaraugus BOCES (Erie 2) operations for the period July 1, 1995 through June 30, 1996. These areas included Administration, Occupational Education, Operations and Maintenance, the Employment Preparation Education program and other select CO-SERs. This was a financial related audit and the objectives were to: determine if cost allocations and transfers were accurate and reasonable; determine if services comply with Department approved specifications and provide measurable cost savings to school districts; verify that only reasonable and necessary costs were incurred; and, verify that the budgetary process provides control over the expenditure of funds.

Erie 2-Chautauqua-Cattaraugus BOCES

General Fund Expenses by Program
1995-96



Audit Results

Presented below is a summary of the audit findings developed in response to the audit's objectives.

- Several policies and procedures should be developed.
 - Miscellaneous refunds were not accounted for in the manner prescribed by the Office of the State Comptroller.
 - A periodic physical inventory should be conducted to verify the accuracy of the perpetual inventory system.
 - Personal use of an Erie 2 BOCES vehicle and non-overnight meal allowances should be accounted for as taxable income.
 - Some unnecessary expenses were incurred including board travel and food at an Erie 2 BOCES meeting.
 - There is an opportunity to reduce travel costs by adopting uniform travel reimbursement rates.
 - Documentation of credit card use was not adequate in some cases.
 - Documentation of the methodology used to allocate Operations and Maintenance costs to the CO-SERs was not adequate.
 - Documentation of EPE contact hours needs improvement.
-

Introduction

Background

Boards of Cooperative Educational Services (BOCES) are voluntary, cooperative associations of school districts that have joined to provide educational programs or services more economically than each could offer by itself and are authorized by Section 1950 of the Education Law. BOCES may provide such services as special education for students with disabilities, occupational education, academic and alternative programs, summer school, staff development, computer services, educational communications and cooperative purchasing. Today there are 38 BOCES in New York State and all but 13 of the 705 school districts in the State are members.

Each BOCES submits an annual Cooperative Services Application (CO-SER) to the State Education Department (Department) for approval of each program and service offered to districts. After the BOCES gains approval and determines budgeted program costs, it notifies the districts of available programs and the applicable rates.

Districts that belong to a BOCES are called component districts and are required to collectively pay the BOCES' administrative costs. Districts that actually use the programs offered by a BOCES, called participating districts, are required to pay for the costs of those programs. Costs charged to the districts are based on budgeted costs and are adjusted at the year-end to reflect actual costs. Typically, a refund is issued to the districts to reconcile differences.

Erie 2-Chautauqua-Cattaraugus BOCES (Erie 2) is headquartered in Angola, New York. Erie 2 serves 27 component districts, which enroll more than 47,000 students. During the 1995-96 school year, Erie 2 BOCES was ranked 14th of the 38 BOCES in the State with \$34,537,252 in general fund expenditures.

Objectives, Scope and Methodology

Pursuant to Sections 305 and 1950 of the Education Law, we audited management practices, records and documentation related to select operations of the Erie 2 BOCES for the period

July 1, 1995 through June 30, 1996. This was a financial related audit and the objectives were to:

- determine if cost allocations and transfers between funds and among CO-SERs are accurate and reasonable;
- determine if services (CO-SERs) comply with Department approved specifications and provide measurable cost savings to school districts;
- verify that only reasonable and necessary costs were incurred; and
- verify that the budgetary process provides control over the expenditure of funds.

To accomplish our objectives we reviewed applicable laws, regulations, policies and procedures; interviewed Department and Erie 2 BOCES management and staff; examined records and supporting documentation; sampled transactions on a non-statistical basis; and reviewed the Erie 2 BOCES audited financial statements.

There is no State or BOCES process to assess whether CO-SERs result in measurable cost savings to school districts. As a result, the audit was not able to complete this portion of the scope.

We conducted the audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operational records and applying other audit procedures considered necessary in the circumstances. An audit also includes assessing the estimates, judgments and decisions made by management. We believe that the audit provides a reasonable basis for our findings, conclusions and recommendations.

Comments of Erie 2 BOCES Officials

Erie 2 BOCES officials generally agreed with the findings and recommendations in this report. Their comments have been included where appropriate. Their response is included as Appendix B to this report.

Opportunities to Improve Management Processes

Management is responsible for establishing effective management processes or controls. Management controls include establishing the goals and objectives of the organization and the methods and procedures to ensure that the goals are met. These procedures include areas such as planning, organizing, directing and controlling program operations. They include systems for measuring, reporting and monitoring program performance. The audit reviewed several processes that it determined are significant to the audit objectives and identified several opportunities for improvement.

The areas in need of improvement include: establishing policies and procedures; accounting for miscellaneous refunds; maintaining an inventory of fixed assets; accounting for employee fringe benefits; developing travel policies; accounting for non-overnight meal allowances; documenting credit card usage; and allocating operations and maintenance costs.

Policies and Procedures

The Office of the State Comptroller's Financial Management Guide for Local Governments, Volume 2, Subsection 11.1010, (Guide) states that effective internal control systems are designed to ensure management that all resources entrusted to their care are used in accordance with all laws, regulations, policies and sound business practices, where applicable. A component of an effective internal control structure is "control procedures." An important aspect of control procedures is policies and procedures established by management.

A review of the Erie 2 BOCES policies and procedures manual revealed that it was incomplete and needed updating. Erie 2 BOCES officials stated that the manual was under revision at the time of the audit. As part of its updating, the following topics should be added to the revised policies and procedures manual: travel guidelines for employees and board members, personal use of Erie 2 BOCES telephones, use of Erie 2 BOCES credit cards, and the use of Erie 2 BOCES vehicles.

Erie 2 BOCES officials agree with the need to update the Board of Education policies and the organizational procedures. An effort to update was undertaken and went beyond the recommended topics. Policies and/or procedures have been completed for seven topics

and new policies and procedures were to be implemented by December 31,1998 for five additional topics.

Accounting for Miscellaneous Refunds

The Uniform System of Accounts for Boards of Cooperative Educational Services, issued by the Office of the State Comptroller, requires that a refund received before the end of the current fiscal year be credited to the expenditure account that was originally charged.

Erie 2 BOCES does not credit refunds to the expenditure account originally charged, but instead records such refunds as revenue. The audit noted the following example of the treatment of a refund by Erie 2 BOCES. On August 28, 1995, an Erie 2 BOCES dump truck popped out of gear, rolled down a slight incline and struck the Erie 2 BOCES facility in Fredonia, N.Y., causing \$15,747 in damages. The expense to repair the damages was charged to the Operations & Maintenance CO-SER (O & M). However, when the insurance reimbursement was received it was not credited to O & M but instead credited to the Administration CO-SER. The appropriate treatment of the refund would have been to credit the O & M CO-SER. As a result of the accounting treatment of the refund, the O & M expenditures reported on form SA-111 were overstated and the Administration revenues were overstated by \$15,747.

Erie 2 BOCES officials have implemented procedures to assure the appropriate accounting treatment of refunds. They indicated that since January 1, 1998, two similar situations have occurred and in both cases the insurance recovery payments were accounted for correctly.

Inventory of Fixed Assets

The Guide, Volume 1, Subsection 3.2010, states that it is important to maintain adequate fixed asset records to meet the requirements of Generally Accepted Accounting Principals (GAAP), and as a valuable tool for controlling fixed assets and planning replacements. The Guide, Volume 2, Subsection 11.0101, also states that effective internal control systems are designed to ensure management that all resources entrusted to their care are used in accordance with all laws, regulations, policies and sound business practices, where applicable. In addition, all resources should be safeguarded against waste, loss and misuse. Effective internal controls include maintaining accurate accounting and inventory

records and performing a periodic comprehensive physical inventory of its assets.

Erie 2 BOCES maintains a master fixed asset inventory list which identifies equipment and includes the location (center, program and room), description, model, BOCES number, serial number, purchase cost and acquisition date. The master inventory list is updated when there is an acquisition, deletion or transfer of equipment. BOCES officials indicated that in recent years they have not conducted a periodic comprehensive physical inventory of assets. In order to verify the accuracy of the inventory list, Erie 2 BOCES needs to develop a process to periodically inspect the inventory and verify its existence.

Erie 2 BOCES officials agreed that there is a need to conduct physical inventories of equipment.

Accounting for Employee Fringe Benefits

The Internal Revenue Service (IRS) requires employers to include fringe benefits, such as the personal use of a car provided to an employee, in the employee's gross income. The IRS rules used to value this benefit are found in Publication 535. The benefit is subject to income and employment taxes. This is true even if the employee's personal use of the vehicle is limited to commuting or de minimis use (such as a stop for a personal errand on the way between the workplace and the employee's home).

Erie 2 BOCES did not include as a fringe benefit, the value of the vehicle provided for the personal use of the District Superintendent, specifically the miles commuting to and from work. Therefore, the annual compensation reported on the District Superintendent's W-2 appears understated.

Erie 2 BOCES officials have corrected this oversight and are now reporting the appropriate compensation on the W-2. The District Superintendent maintains a log showing all personal miles, which is turned in to the business office at the close of the calendar year.

Travel Guidelines

The Guide, Subsection 8.1025, notes that the local government board “should promulgate specific rules and regulations concerning the reimbursement of expenses.” Further, it notes that “the rules and regulations should set forth the type of expenses which will be reimbursed, the procedures and

documentation necessary to support the reimbursement and any reasonable dollar or time limits which the board may wish to set.”

The Guide also provides some examples of rules and regulations the board could adopt, such as establishing reasonable maximum reimbursement rates to cover actual lodging and meal expenses. Also, the board should adopt a procedure for reimbursement of expenses in excess of the ceiling amounts when properly justified.

During the audit period Erie 2 BOCES did not have a policy establishing specific rules and regulations concerning the reimbursement of travel expenses. However, audit testing did reveal that Erie 2 BOCES tried to minimize travel expenses whenever possible, e.g., when the District Superintendent traveled to Albany, N.Y. he stayed at an economy hotel costing less than the per diem rates allowed for State and Federal employees.

Subsequent to the audit period, travel policies were implemented. The Board adopted a three-tier policy which establishes maximum receipted reimbursement rates depending on the employment status of the traveler.

Erie 2 BOCES has an opportunity to reduce travel costs by lowering the maximum receipted lodging and meal reimbursement rates established by policy. The audit recommends that the level at which to lower the rates would be the per diem amount that is established for State and federal government workers. The table below illustrates the difference between the maximum reimbursement rate under Erie 2 BOCES policies and the per diem rates established for federal and State employees.

Table 1
Comparison of Maximum Travel Reimbursement Rates
Established by Erie 2 with State and Federal Employees
Per Diem Rates

Location		<u>State and Federal Employees</u>	<u>Erie 2 Policy</u>	<u>Difference</u>
Albany	Meals	\$38	\$76	\$38
	Lodging	\$68	\$125	\$57
New York City	Meals	\$42	\$110	\$68
	Lodging	\$198	\$250	\$52

Source: OAS comparisons of Erie 2 policies regarding travel reimbursements.

The audit recognizes that there may be times when the per diem rate used by federal and State employees may be insufficient to provide suitable lodging for the traveler. The Erie 2 board should define a process for granting a waiver under these circumstances.

As table 1 shows, there is a potential under Erie 2 policies for travelers to receive greater reimbursements than would be payable under the State per diem. Erie 2 BOCES should monitor travel costs and consider adopting the rates used by all Federal and State employees as well as establishing a procedure for reimbursement in excess of ceiling amounts when properly justified.

Non-Overnight Meal Allowance

Volume XI, Section 8.0120, of the New York Accounting System User Procedure Manual (Manual) states that the IRS requires employers to report and withhold income and employment taxes from meal allowances for non-overnight travel (day trips). The specific IRS rule states that a taxpayer traveling on business may only deduct meal allowances if the trip requires the person to stop for "sleep or rest." Meal allowances, which are not deductible, are subject to withholding of income and employment taxes and must be reported on employee W-2s.

A discussion with Erie 2 BOCES officials revealed that Erie 2 BOCES is not complying with the Manual and IRS rules regarding non-overnight meal expenses. Erie 2 BOCES did not treat these expenses as income as required. Erie 2 BOCES officials indicated that their independent auditor has advised them that they are in compliance with IRS guidelines. They further state that the practice of providing a meal allowance for non-overnight travel

was a limited practice and beginning July 1, 1998 will be terminated.

Documentation of Credit Card Use

The Guide, Volume 2, Subsection 11.0101, states that effective internal control systems are designed to ensure management that all resources entrusted to their care are used in accordance with all laws, regulations, policies and sound business practices, where applicable. Also, all resources should be safeguarded against waste, loss and misuse. Components of an effective internal control structure include "Accounting System and Control Procedures," that is maintaining accountability for the related assets and having established policies and procedures.

Erie 2 BOCES provides an American Express credit card (AMEX) to four employees for use in relation to official Erie 2 BOCES business. The documentation supporting the monthly payments to AMEX did not always contain the vendor receipts. In the absence of receipts, the reconciliation and verification of the charges as official Erie 2 BOCES business are impossible. The audit testing included an examination of the March and April 1996 statements. The statements revealed \$3,523 in charges with only \$164 (4.64 percent) of the charges being supported by actual vendor receipts.

Erie 2 BOCES officials have implemented new procedures for reconciling monthly bills on the four AMEX credit cards. The procedure describes the use of the credit cards and requires each cardholder to acknowledge that any charge shown on a monthly statement is true, correct and a bona fide expenditure of Erie 2 BOCES. In addition, the cardholder will review the quarterly statement issued by AMEX and designate the business purpose of the charge. This statement will be filed in the Erie 2 BOCES offices.

Allocations

The Guide, Volume 1, Subsection 1.1040, states that in order to provide "full cost" information, methods must be devised to allocate indirect costs to the benefited areas. Sound business practices dictate that any method that produces an equitable cost distribution and is adequately documented is acceptable. The documentation would be of a nature that a prudent person, familiar with functions of the organization, could determine that the methods and the underlying basis for allocation are reasonable and consistent.

Erie 2 BOCES officials stated that the allocation of \$2,842,743 in O & M was based upon the square footage of the buildings used by each CO-SER. The audit was also told that the allocation basis is not current and may not reflect the actual square footage currently used by each CO-SER. In addition, the allocation percentages were modified to reflect specific CO-SER use. However, the basis for these revisions was not adequately documented. Therefore, the audit was unable to determine the reasonableness of the O & M allocations or allocation methodology. The absence of documentation of the method used to allocate costs to individual CO-SERs makes the appropriateness of that portion of the costs questionable. Erie 2 BOCES has taken corrective action to resolve this issue. Beginning with the 1998-99 budget, Erie 2 BOCES will maintain records of square-footage space allocations for every program annually. O & M will be budgeted by building, with allocations of costs made to programs based upon square-footage usage of programs housed within each building. Allocations that employ or are modified by other assumptions will be documented in new worksheets and processes.

Recommendations

1. Develop and implement policies on travel guidelines, personal use of telephones, use of credit cards, and Erie 2 BOCES vehicles.
2. Develop and implement a policy to appropriately account for miscellaneous refunds.
3. Implement a policy to periodically conduct physical inventories of fixed assets.
4. Account for the value of the personal use of Erie 2 BOCES vehicles as income to the employee.
5. Consider establishing travel reimbursement rates for board members and staff at the same level as federal and State employees.
6. Treat non-overnight meal allowances as income to the recipient employees.
7. Improve claims processing procedures to ensure that credit card expenses are sufficiently documented.

8. Develop a methodology to equitably allocate operations and maintenance expenses to the CO-SERs. Maintain documentation of the methodology.

Comments of Erie 2 BOCES Officials

Erie 2 BOCES officials agreed with these recommendations.

Administration

Each component district is responsible for a proportionate share of the costs included in the Administrative Budget, irrespective of its participation in the elective services that it may request. The Administrative Budget includes expenditures related to the District Superintendent's office, general costs of administration, expenditures of the Board, needs and assessment planning, central support for operations, and other activities as approved by the Commissioner of Education. Appropriations may also be included for the rental of facilities, payments to the Dormitory Authority for debt service, and transfers to the capital fund for construction purposes.

Erie 2 BOCES reported \$2,012,645 in administration costs for the 1995-96 school year, not including capital expenditures. This represents about six percent of the total of administrative and program general fund expenditures. Statewide, BOCES administrative expenditures ranged from about three to 11 percent with an overall average of 6.6 percent.

The audit found that Erie 2 BOCES has paid for personal expenditures of a Board member, and provided meals at a business officials' meeting without documentation to support its appropriateness.

Unnecessary Expenses

Board Member Travel

General Municipal Law, Section 77b, only authorizes the payment of travel expenses that are actual and necessary. Such payments shall be for travel expenses incurred for the purpose and benefit of the BOCES. Article 8, Section 1, of the New York State Constitution states that no county, city, town, village or school district shall give or loan any money or property to or in aid of any individual, private corporation or association, or private undertaking.

The audit determined that Erie 2 BOCES paid for the personal travel expenses for a board member. Audit testing revealed that Erie 2 BOCES paid \$448 in personal travel expenses incurred by a board member to stay an additional three days in San Diego, California. The travel expenses were incurred following the conclusion of a conference. Following the completion of audit site

work, Erie 2 BOCES was reimbursed for the personal expenses incurred by the board member.

Erie 2 BOCES officials indicated that they have adopted a new policy and implemented new procedures which will ensure that only actual and necessary travel expenses are reimbursed in the future.

Business Meeting

The Guide, Volume 1, Subsection 8.1025, states that as a general rule a particular expense may be considered actual and necessary if: (1) an expenditure was actually made; (2) the item was necessarily incurred for an authorized purpose; and (3) the expense was in an amount no greater than necessary.

The audit determined that Erie 2 BOCES held a business officials' meeting on December 21, 1995. In addition to the business officials from the 27 component school districts, Erie 2 BOCES staff were also invited. The accounting records indicated that refreshments costing \$849 were served. The refreshments were prepared by the Food Occupations CO-SER and the expense was charged to the Administration CO-SER. The audit believes that the amount was greater than necessary.

Erie 2 BOCES officials indicated that the business officials' meeting was an opportunity for the food service programs to prepare and serve real food for real customers. They further state that the actual cost of the event was approximately \$300. They state that the remaining \$549 was inappropriately coded and was actually used for other food service class activities and not related to the business managers' luncheon. The officials also state that the Erie 2 BOCES employees attending the luncheon should have paid for their meals. In the future, Erie 2 BOCES will monitor meeting costs to ensure that costs associated with class activities are consistent with the performance needs of the food service program.

Recommendations

9. Establish a policy to prohibit personal expenses being charged to Erie 2 BOCES.
10. Improve the accounting for food purchases related to training students.

11. Establish a policy requiring staff payment for meals provided and outlining the appropriate use of Erie 2 BOCES prepared food at official meetings.

Comments of Erie 2 BOCES Officials

Erie 2 BOCES officials agreed with these recommendations.

Employment Preparation Education

Employment Preparation Education (EPE) programs serve students 21 years of age or older who have not received a high school or equivalency diploma. School districts and BOCES generate EPE aid by reporting contact hours on Form SA-160.1, EPE State Aid Claim Form. Part 168.2 of the Regulations of the Commissioner of Education defines a contact hour as 60 minutes of instruction given by a teacher in an approved program. To ensure that EPE aid paid is appropriate, the number of reported contact hours must be clearly documented. Any undocumented or overstated contact hours will be questioned upon audit and revenues will be reduced accordingly.

Erie 2 BOCES reported a total of 82,968 contact hours on form SA-160.1. The documentation to identify and support the reported contact hours was not readily available. Erie 2 BOCES could not immediately identify the students served or the contact hours reported for each student. However, Erie 2 BOCES was able to provide two summaries, one by class code and one by district, of the total contact hours served. The summaries reported a total of 88,641 contact hours, 5,673 contact hours greater than reported on form SA-160.1.

Erie 2 BOCES was requested to provide monthly summaries from the current final database for the 1995-96 school year. The monthly summaries reported a total of 89,216 contact hours, 7.03 percent greater than the total contact hours reported on form SA-160.1. Erie 2 BOCES officials believed that this was the correct total of EPE eligible contact hours served and that the other summaries and the SA-160.1 forms were prepared prior to receiving all attendance records.

In order to test the validity of the EPE claims a test sample of 18,418 contact hours was chosen, which represented 20.64 percent of the 89,216 contact hours. Audit testing determined that attendance records supported these contact hours. However, 6.98 percent of the tested contact hours did not meet the age criterion for eligibility. The audit test disclosed that Erie 2 BOCES understated the contact hours reported; however it also showed that ineligible students were included in the total. The errors identified were offsetting and had no material effect on the EPE funding received by Erie 2 BOCES.

Erie 2 BOCES officials indicated that the Adult and Continuing Education division has implemented a new computer software program which enables it to accurately track and report EPE hours.

Recommendations

12. Improve procedures to ensure that attendance documentation is retained to support all reported contact hours.
13. Improve procedures to ensure that only the contact hours of eligible students are claimed for EPE aid.

Comments of Erie 2 BOCES Officials

Erie 2 BOCES officials agreed with these recommendations.

Erie 2 BOCES
Contributors to the Report

- James Conway, Audit Manager
 - Brian Jackson, Auditor-in-Charge
 - Charles Archibald, Senior Auditor
 - Ronald Talarico, Senior Auditor
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**NEW YORK STATE EDUCATION DEPARTMENT
OFFICE OF AUDIT SERVICES
AUDIT REVIEW PROCEEDINGS**

Requests for Audit Review

It is the policy of the State Education Department to consider for review matters of significant disagreement which result from a final audit report issued by the Office of Audit Services.

An organization requesting an audit review must make a written application to the Associate Commissioner for Planning and Policy Development within 30 days of receiving the final audit report. An organization may request a review of an audit whenever the final audit report directs the recovery of funds from the organization and one or more of the following conditions is met:

- Recovery of funds would cause immediate and severe financial hardship to the organization, thereby affecting the well-being of program participants;
- The organization's violation was caused by erroneous written guidance from the State Education Department;
- The State Education Department failed to provide timely guidance on the matter or condition when the organization had previously requested such guidance in writing; and/or
- The report contains errors of fact or misinterpretation of laws, statutes, policies or guidelines.

Organizations requesting an audit review must submit a written application describing how one or more of the above conditions have been met. This application must include all evidence and information the organization believes are pertinent to support its position.

An audit report which recommends improvements in internal controls of administrative or financial systems, but has no material financial impact on the organization, will not be considered for an audit review proceeding.
