

CATHOLIC FAMILY AND COMMUNITY :
SERVICES (FRIENDSHIP CORNER I AND :
FRIENDSHIP CORNER II), :
PETITIONER, : COMMISSIONER OF EDUCATION
V. :
STATE-OPERATED SCHOOL DISTRICT : DECISION
OF THE CITY OF PATERSON, PASSAIC :
COUNTY AND NEW JERSEY STATE :
DEPARTMENT OF EDUCATION, :
RESPONDENTS. :
_____ :

SYNOPSIS

Petitioning provider of Abbott preschool services appealed the Department’s recommendation that the respondent school district recover \$88,858 in tuition paid for the 2003-04 school year, based on an audit finding that – after deduction of disallowed expenditures – petitioner had underspent its approved budget by that amount. Petitioner contended that no repayment was warranted because the Department’s audit was based on standards not specified within the guidance document on which the budget was based, and because the district had not identified errors through review of quarterly reports. The Department contended, *inter alia*, that the appeal was untimely filed.

The ALJ found that the Department had raised the defense of untimeliness too late in proceedings and declined to consider dismissal of the appeal on that basis. The ALJ further found that – while the Department was entitled to place restrictions on provider expenditures and impose accountability requirements for such expenditures – it also had a duty to make providers aware of its expectations and could not, as here, make audit findings inconsistent with the guidance issued. The ALJ further found that – to any extent petitioner’s recordkeeping was not in accord with its contract with the district – petitioner cannot be penalized for this because the district did not fulfill its own obligation to provide monitoring and assistance.

The Commissioner adopted the ALJ’s recommendation as to untimeliness but rejected the substantive conclusions of the Initial Decision. The Commissioner found that the budget guidance document relied on by petitioner and the ALJ was not a comprehensive manual of fiscal and recordkeeping requirements, but a tool for budget construction purposes only, so that the ALJ erred in ignoring the clear provisions of the parties’ contract, regulation and Department policy as communicated to districts and providers at meetings and workshops. The Commissioner upheld the audit findings and dismissed the appeal, directing petitioner to repay \$88,858 to the district, but in installments during the 2009-10 school year so as to mitigate the impact on petitioner in recognition of the district’s failure to identify errors through the quarterly review process.

This synopsis is not part of the Commissioner’s decision. It has been prepared for the convenience of the reader. It has been neither reviewed nor approved by the Commissioner.

August 8, 2008

OAL DKT. NO. EDU 3681-06
AGENCY DKT. NO. 74-2/06

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The record of this matter and the Initial Decision of the Office of Administrative Law (OAL) have been reviewed, as have exceptions filed by the Department of Education (Department) pursuant to *N.J.A.C.* 1:1-18.4 and the reply filed by petitioner in accordance with *N.J.A.C.* 1:1-18.4 and *N.J.A.C.* 1:1-18.8. The Paterson School District (Paterson) filed neither exceptions nor replies.

On exception, the Department initially takes issue with the standard of review applied by the Administrative Law Judge (ALJ) in this matter, asserting that – as petitioner itself recognizes – the Department’s actions are entitled to deference and a presumption of correctness, and may not be disturbed unless a petitioner meets the burden of proving them patently arbitrary, capricious or unreasonable. (Department’s Exceptions at 2-3)

The Department next objects to the ALJ’s reliance on the 2003-04 Abbott Preschool Program Budget Instructions (“budget guidance”) (Exhibit P-1) to conclude

that – because the Department’s audit required accounting methods and applied standards not specifically set forth in this document – petitioner cannot be found to have underspent its approved 2003-04 budget and, thus, is not obligated to repay \$88,858 to the Paterson School District. The Department stresses that the document in question – distributed during the budget development process for a clearly specified purpose – controls budget preparation only and certainly does not govern a provider’s recordkeeping and accounting, nor audits thereof. (Department’s Exceptions at 3-4)

Specifically, the Department contends that: 1) In reversing the Department’s disallowance of the prorated salaries of administrative positions such as chief executive officer, comptroller and chief financial officer, the ALJ ignored testimony establishing that districts were notified of the limitation on approved administrative positions to a director, a clerical and a janitor, and did not place sufficient import on the Department’s express denial of the positions at issue in the prior budget year; 2) In rejecting the Department’s disallowance of purchases made on the last day of the contract period – clearly in an effort to use up excess funds – the ALJ ignored both contract provisions requiring that expenditures benefit the contract period and regulations requiring that Abbott district expenditures support the current school year; 3) In determining that petitioner was improperly penalized for lacking documentation in support of indirect and administrative expenditures, the ALJ ignored the fact that while costs of this type need not have been documented during the budget *construction* process – since a fixed amount would be provided for that purpose – they still needed to be documented and records still needed to be retained in order to comply with applicable contractual and regulatory provisions regarding propriety and review of expenditures; and

4) In concluding that petitioner's indirect and administrative expenditures should not have been prorated to adjust for non-Abbott program and classroom costs, the ALJ relied on nothing more than on petitioner's representation – based on quarterly expenditure reports not produced as evidence – that Abbott and non-Abbott monies were not commingled in fact, notwithstanding their commingling in the general ledger on which the Department's audit was based, and further ignored the clear requirement of both the Abbott contract and the budget guidance that Abbott and non-Abbott costs must be governed by separate agreement with Abbott costs budgeted on a prorated basis. (Department's Exceptions at 4-8)

In reply, petitioner counters that – while it does not object to the standard applied by the ALJ – if the Commissioner were to determine that the arbitrary and unreasonable standard should apply instead, either the ALJ's conclusion should nonetheless be adopted because the Department's actions were so unjust, or, alternatively, the matter should be remanded to the OAL for review under the correct standard. (Petitioner's Reply at 2-3)

Petitioner also objects to the Department's contention – raised, it claims, for the first time on exception – that the budget guidance was intended for budget preparation only. Petitioner asserts that testimony and argument in this matter have until now “conceded reliance” on the guidance document and focused instead on whether it was ambiguous and how it should be interpreted for purposes of the present litigation, with petitioner demonstrating that necessary expenditures were disallowed “based on an unwritten, unpublished, unverifiable, completely internal, and conspicuously convenient ‘policy’ ” that was not shared with petitioner until a year after the 2003-04 school year

had ended, and then only verbally. Thus, petitioner contends, the Department cannot now argue that petitioner unreasonably relied on the budget guidance's representation that a full 17.65 % of the overall budget would be received, without any need for special justification, to fund administrative costs. (Petitioner's Reply at 3-5, quotation at 4) Similarly, petitioner asserts that purchases made at the end of the contract period cannot be excluded solely on the basis of their timing – particularly where there is no challenge to their use for Abbott purposes – since neither the budget guidance nor the Abbott contract placed any restriction on the timing of purchases. (*Id.* at 5-6)

Finally, petitioner contends that to whatever extent the Abbott contract – as opposed to the budget guidance on which petitioner properly relied – required retention of expenditure records or development of a budget that segregated Abbott costs from non-Abbott, petitioner should not now be penalized for deficiencies in this regard when the Paterson School District – as found by the ALJ and, significantly, not challenged by the district on exception – failed to honor its own contractual obligation to provide financial management assistance and on-site monitoring. Had Paterson provided the requisite monitoring and assistance, according to petitioner, the alleged budgeting and recordkeeping errors underlying all of the exclusions at issue in this matter could have been timely corrected and petitioner would not have been faced with “crippling reclamations” years after the fact, when it was “too late to do anything about it.” (Petitioner's Reply at 7-9, quotations at 8 and 9)

Upon review, the Commissioner adopts in part and rejects in part the Initial Decision of the ALJ.

Preliminarily, the Commissioner concurs with the ALJ that dismissal of this matter on the basis of untimely filing would not be appropriate in view of the Department's having clearly asserted such defense so late in proceedings. (Initial Decision at 13) Additionally, the Commissioner finds that the ALJ's understanding (*Id.* at 14) of the standard of review to be applied in this matter – that findings of fact and conclusions of law must be made based upon the fullness of testimony and evidence presented at hearing so that the correctness of the Department's actions can be gauged – is not inconsistent with application of the arbitrary and capricious standard as (properly) invoked by the Department; indeed, the Initial Decision may fairly be characterized as a determination that petitioner met its burden of demonstrating that the Department's actions were unreasonable under the circumstances.

The Commissioner cannot, however, agree with that determination.

The ALJ's decision in this matter is premised in its entirety on acceptance of the contention that the Department could not, through audit, hold petitioner to recordkeeping and expenditure limitation standards not expressly set forth in the Department's budget guidance document for the year in question – particularly where Paterson did not honor its own monitoring and assistance responsibilities under the effectuating contract. As correctly noted by the Department, however, this contention is rooted in a fundamental misconception of the nature and purpose of the budget guidance document (Exhibit P-1);¹ moreover, it ignores the Department's independent obligation

¹ The Commissioner categorically rejects petitioner's assertion that the Department is foreclosed from arguing on exception – since it did not do so previously – that the guidance document was for budget preparation only. In point of fact, the purpose of the guidance document was repeatedly raised at hearing (see, for example, T2:31-33, 57, 60, and 117, T3:210-11, and T4:88), and the Department consistently argued that other documents and communications controlled in this matter. (These and all subsequent similar references refer to the transcripts of hearings conducted on March 22, 2007 (T1), May 9, 2007 (T2), May 16, 2007 (T3) and November 27, 2007 (T4).)

to ensure that Abbott district funds have been expended – whether directly by the district or indirectly through contracted service providers – in a manner that is effective, efficient and consistent with law.

Petitioner’s central assertion in this matter is that the budget guidance document entitled it to incur administrative and indirect costs in the amount of a flat 17.65 % of its total approved budget – without documentation or limitation except as specifically stated in the guidance – so that the Department could not later seek to apply standards and limitations not embodied in the guidance document to disallow individual expenditures within the allowable percentage. In effect, what petitioner is contending is that – because providers were instructed to develop budgets allocating a fixed percentage to administrative and indirect costs without providing specific line-item documentation for each component thereof – their actual expenditure of budgeted funds is insulated from scrutiny in accordance with otherwise applicable contractual and regulatory provisions.

However, both on its face and as utilized by the Department,² the budget guidance document on which petitioner relies is nothing more than a tool developed to assist districts and their providers, in conjunction with related informational and interactive meetings, in constructing approvable budgets for the upcoming school year; it is not – nor was it at any time purported to be – the definitive statement of all fiscal requirements for Abbott preschool providers.³ Thus, petitioner and the ALJ cannot employ the document as they have done herein, citing it as the standard against which petitioner’s audit should have been conducted and relying on its silence or ambiguity

² See Exhibit P-1 at 2, 4 and 9, and testimony of Karin Garver at T2:31-34.

³ Indeed, separate workshops and informational sessions were held by the Department to address the requirements of the contract. (Testimony of Karin Garver at T2:44-45)

with respect to a particular point to hold petitioner harmless from any finding of error, or any consequence therefor, notwithstanding that the point at issue is addressed by contract or regulation, or duly communicated Department policy.

In this latter regard, the ALJ fully accepted petitioner's contention that it had no notice of the standards to which it was eventually held, asserting that – while the Department was entitled to place restrictions on provider expenditures and impose accountability requirements for such expenditures – it also had a duty to make providers aware of its expectations. (Initial Decision at 16) However, the record in this matter is clear that districts and providers were, in fact, notified – through informational meetings and workshops – of the nature and purpose of the new “flat rate” method of budgeting administrative costs for 2003-04, which did not include permission to budget for previously unapprovable costs – such as staffing over and above a director, clerical and janitor (Testimony of Corradina Fronte at T3:206-07, 210-213 and testimony of Steven Hoffmann at T2:132-33); that the information provided at these sessions was somehow missed or misunderstood by petitioner or “lost in translation” in its communications with Paterson – whose representative (Fronte) clearly heard the pertinent instruction – does not alter the correctness of the disallowance. Similarly, the contract underlying this matter (Exhibit IAU-4) pertains on its face to provision of services between July 1, 2003 through June 30, 2004, so that expenditures for postage and computers made on the last day of the contract period cannot possibly have been for the purpose of fulfilling the 2003-04 contract; that petitioner continued to provide services during 2004-05 under a new contract effective July 1, 2004, and that the disallowed expenditures would have been permissible if budgeted for that year, does not alter the fact that funds budgeted for the 2003-04 school year were not expended on services rendered during that year. Finally,

the same contract – like the budget guidance document itself (at 2-3, 4 and 7-8) – expressly requires documentation and recordkeeping consistent with the requirements of *N.J.A.C. 6A:10A-2.2(b)* and (d) and clearly provides for segregation of Abbott and non-Abbott monies, with shared costs to be prorated according to an established formula; that petitioner misunderstood the budget construction process to mean that the fundamental accountability provisions and generally accepted accounting practices required by the parties’ signed contract would not apply to administrative costs – and that Paterson did not correct this misunderstanding during the course of the contract year – cannot serve to shield petitioner from all consequences of noncompliance.

The Commissioner, then, finds that the Department’s review on audit was not – indeed, could not be – limited to the language of the budget guidance document alone, but was properly based on all standards of applicable law and policy. Consequently, the Department’s cost disallowances and determination of under-expenditure of budgeted funds must be upheld as reasonable and proper in all respects, and the funds identified must be refunded to the district.

There can be no question of the Department’s overarching obligation to ensure the proper and prudent use of Abbott monies, nor of its ability – indeed, duty, if State oversight of Abbott expenditures is to be at all meaningful – to seek their recoupment by a contracting district when, as here, the contracted provider has been found through a duly conducted State audit⁴ to have underspent the approved budget by making unallowable or insufficiently documented expenditures.⁵ This remains so

⁴ Petitioner was audited at random as part of a continuing cycle of audits of contracted preschool providers in State-operated school districts. (Testimony of Steven Hoffmann at T2:70-74)

⁵ The Commissioner rejects petitioner’s suggestion that recoupment is not warranted because its errors were not the result of malfeasance or flagrant impropriety. (Statement of counsel at T1:33-34)

notwithstanding that the contract between provider and district – which provides for a quarterly reporting-and-recoupment process that is separate and apart from the after-the-fact audits conducted by the Department⁶ – makes no express provision for recovery by the district once the contract year has ended, and notwithstanding that the district itself may bear a degree of responsibility for the provider’s misunderstandings and failure to make corrections during the course of the contract year.

On this latter point – while in no way minimizing petitioner’s own responsibility to know and comply with the provisions of its contract and applicable law – the Commissioner does agree with the ALJ that Paterson cannot be found on the present record to have provided the monitoring and assistance required of it during the 2003-04 school year, and that such monitoring and assistance might well have prevented in significant part the disallowances subsequently found by the Department on audit. Consequently, although petitioner cannot be permitted to retain Abbott preschool monies which have not expended or documented strictly pursuant to law, the Commissioner does deem it appropriate to afford petitioner an opportunity to budget for the required refund and effectuate it over a reasonable period of time; for that reason, the Commissioner directs that petitioner’s payment to Paterson is to be made in equal monthly installments during the 2009-2010 school year, as either a credit toward the tuition charged pursuant to the contract in effect for that year or as a direct remittance to the district in the event the parties’ relationship has ceased prior to or during the 2009-2010 school year.

Accordingly, for the reasons set forth above, the Commissioner adopts in part and rejects in part the Initial Decision of the OAL. The appeal is dismissed and

⁶ Testimony of Steven Hoffmann at T2:89.

petitioner is directed to repay the Paterson School District – in accordance with the schedule established herein – \$88,858 attributable to underspending of its Abbott preschool budget for the 2003-04 fiscal year.

IT IS SO ORDERED.⁷

COMMISSIONER OF EDUCATION

Date of Decision: August 8, 2008

Date of Mailing: August 11, 2008

⁷ This decision may be appealed to the Appellate Division of the Superior Court pursuant to *P.L. 2008, c. 36*.