UNITED STATES DEPARTMENT OF EDUCATION
WASHINGTON, D.C. 20202

Application of

**NEW YORK STATE**
**EDUCATION DEPARTMENT,**

Applicant.

Docket No. 91-81-R

ACN: 02-93225

Recovery of Funds
Proceeding

## DECISION

Appearances:
Michael Brustein, Esq., Kristin E. Hazlitt, Esq., of Brustein & Manasevit, Washington, D.C., for the Respondent.

Ronald B. Petracca, Esq., Office of the General Counsel, U.S. Department of Education, Washington, D.C., for the Assistant Secretary for Special Education and Rehabilitative Services.

Before:
Thomas W. Reilly, Administrative Law Judge.

## BACKGROUND

On September 30, 1991, the Assistant Secretary for Special Education and Rehabilitative Services (Assistant Secretary), U.S. Department of Education (ED or the Department), issued a Program Determination Letter (PDL) to the applicant based upon a state-wide audit of Federal programs for the period April 1, 1986, through March 31, 1987 ('86-'87). The Department sought a recovery of $1,743,851 of fiscal year '87 Education of the Handicapped Act (Part B) funds for disallowed grant expenditures. 20 U.S.C. § § 1401, 1411-1420. 1 The monetary determination in that PDL constituted a "Preliminary Departmental Decision" (PDD or Disallowance Decision) within the meaning of § 452 of the General Education Provisions Act (GEPA), 20 U.S.C. § 1234a. The Applicant timely appealed with its Application for Review dated October 31, 1991.

As indicated in the Application for Review filed by the New York State Education Department (New York or NYSED), the Assistant Secretary disallowed $1,743,851 in personal service costs (including related fringe benefits and indirect costs) for State employees whose salaries were charged against Part B of the Education of the Handicapped Act (EHA-B) on the grounds that those charges were not based upon time actually worked by those employees on the specific

grants being charged. This allegation was based on an analysis of New York's time-and-effort accounting system performed not by State auditors, but by ED's Office of Inspector General (OIG) after the audit had been completed. Wherever the Assistant Secretary determined that an employee's time had been assigned to a program code 2 that the Assistant Secretary suspected was unrelated to the grant, that employee's salary was disallowed.

New York's initial Application for Review argued that none of the $1,743,851 should be disallowed for three reasons: (1) the Assistant Secretary's analysis was erroneous because proper program codes were rejected, (2) the total effort properly allocable to the Federal grant exceeded the amount in dispute, and (3) a substantial amount of the funds in dispute are barred from recovery by the Statute of Limitations.

The parties filed a Stipulation on January 9, 1992, that reduced the amount in controversy from $1,743,851 to $602,172, based upon concessions as to the amount barred by operation of the Statute of Limitations, together with the amount of equitable offset that the State incurred during the period remaining after the Statute of Limitations had been taken into account. Another Stipulation (July 26, 1994) further reduced the amount in issue to $153,739 based on the impact of holdings in an earlier ED decision hereinafter referred to as "New York" 3 and which involved the same parties and a number of the same issues. In fact, the hearing in this proceeding was stayed in order to allow time for the final agency decision in New York I to be issued.

On June 14, 1995, an evidentiary hearing 4 was held in Albany, New York, on the limited issues of the propriety of ED disallowing the salaries of some 19 State employees who had full-time or part-time involvement in the EHA-B grant program, and the propriety of limiting NYSED to only a restricted indirect cost rate for administrative expenses related to the operation of that program. The crux of the matter is that if NYSED is credited with the disallowed salaries, this would offset the total amount demanded by the Assistant Secretary in this proceeding by application of the now-accepted doctrine of equitable offset. 5 The same is true if NYSED is allowed to claim its EHA-B administrative costs under an unrestricted indirect cost rate basis, since the relatively large amount of such further entitlement (the remaining net balance between the unclaimed unrestricted indirect costs and the restricted indirect costs actually claimed) would totally eliminate any further ED claim for refund of funds disallowed by the PDD for the period in question. Either alternative, or even a substantial part of either one (the inclusion of the disallowed salaries or eligibility for the higher unrestricted indirect cost rate) would more than offset the balance claimed to be due by the Assistant Secretary.

There are a large number of briefs filed in this case which amply set forth the positions of the parties. 6 The parties filed a Joint Stipulation of Fact (November 30, 1994) which sets forth "the facts to which the parties agree and the facts which are in dispute." On the basis of that document, there appear to remain five contested issues to be resolved:

(1) whether New York is entitled to an equitable offset for State expenditures made at the State-operated schools in Rome and Batavia, New York,

(2) whether the Judge should consider the PAR Effort Report, along with other evidence, in determining the allowability of certain disputed employee salaries (and how much weight to be given the PAR codes) in light of contradictory testimony of State employees,

(3) whether part or all of the employee effort attributed by PAR Effort codes to the Chapter 1 Handicapped Program can be charged to the EHA-B program in view of other credible conflicting evidence,

(4) whether New York has met its burden of proving the allowability of the salaries of the 19 employees in dispute, and

(5) whether New York is entitled to credit for unclaimed indirect (administrative) costs under an unrestricted rate, i.e., whether the Regulations limit NYSED to claim its indirect costs only under a restricted rate reimbursement basis.

ED's position on several of the issues relies heavily on the New York decision. However, as persuasive and helpful as that decision is, many of its conclusions were based upon a lack of New York State evidence or insufficient evidence as the basis for finding against NYSED. I believe, and find, that the state of the record now is such that NYSED has established with a greater weight of credible and probative evidence some of the claims advanced in that case, and more particularly in this proceeding. Briefly stated, based upon the Applicant's documentary evidence, affidavits, and oral testimony at the Albany evidentiary hearing, I find for the Applicant on all of the above issues. In summary fashion, I will discuss my findings and conclusions as keyed to the disputed issues.

## DISCUSSION

NYSED presented witnesses at the evidentiary hearing to further support its claim that the amounts remaining in issue were properly allocable to the EHA-B grant program. Specifically, the Applicant presented reliable, probative, and credible evidence that an additional $192,284.07 (7) in salaries and related charges are appropriate claims against the EHA-B program for the period in dispute.

Witness testimony included that of George Plummer, the State's Coordinator of the Federal Aid Program within the Office of Education of Children with Handicapping Conditions (OECHC) during the period in question. He testified that the challenged employees in the Federal Aid Unit worked in one of two primary functions. Employees under Ron Ross performed child count functions, and employees under Maurice Olsen reviewed and processed applications. The child count functions all began with a determination of eligibility under EHA-B. (Tr. 143) "The overriding eligibility is that the children are served in accordance with the procedural rights and privileges and due process protections of EHA and then there are other qualifying eligibility rules for the two grant awards." (Tr. 144) Thus, although child counts were later divided between Chapter 1 Handicapped versus EHA-B participants, EHA-B served as the overriding guidance for the full child count. Accordingly, it would be inappropriate and unjustified for ED to disallow funds for the salaries of Diana Carter, Joseph Zabinski, and Sharon Williams just because their

PAR codes denoted both EHA-B and Chapter 1 handicapped activities, when, in fact, all of their responsibility pertained to the overriding umbrella of the EHA-B legislation.

Similarly, the employees who worked under Maurice Olsen on application processing ensured that the applications met all the requirements to serve handicapped children in compliance with EHA-B rules. (Tr. 149) Even in serving the Chapter 1 students, the applications were required to demonstrate compliance with the EHA-B program rules. (Tr. 149) Accordingly, it would be improper and unjustified for ED to disallow the salaries of Maurice Olsen, Inderjit Barone, and Theresa Smith, when all of their responsibilities were integrally related to the compliance goals set forth in the EHA-B grant program. This is further underscored by the fact that all Chapter 1 handicapped funds were distributed directly to eligible recipients. There were no separate funds available or allowed for administration. (Tr. 152-153) Thus, using the Assistant Secretary's argument, any use of PAR code "054" (denoting Chapt.1 handicapped activities) would result in total disallowance of that employee's salary, notwithstanding the preeminence of the EHA-B responsibilities in that employee's duties. This hardly seems equitable or fair. Since grant recipients were required to meet the standards set forth in EHA-B for the administration of funds under both EHA-B and Chapter 1 handicapped grants, it was reasonable to use EHA-B funds to compensate for those administrative work duties.

Witness Nancy Mackey Moore was an Education Program Assistant in the State's Office for Non-Public School Service during the period in issue. She regularly kept telephone logs allowing her to accurately calculate the percentage of time and effort expended on EHA-B activities. (Tr. 162-163.) This method of extrapolation permitted a credible and reasonably reliable record justifying a 25% charge of her salary to the EHA-B grant program administration expenses. 8 She also testified that she had no responsibilities for the Chapter 2 handicapped program, and said that any charges to that program would have been erroneous. (Tr. 163) Accordingly, the disallowance of $3,299.34 of her salary by the Assistant Secretary was not justified.

Witness Richard Connell was an Associate in the School Financial Aid Unit of the Bureau of Federally-Aided Programs, which processed thousands of federal grant documents annually. Because of this volume, it was impractical for the Bureau to use the PAR-code system of time-and-effort accounting. Instead, the Bureau used a cost-allocation plan 9 for the period in question. (Tr. 169) He testified that if, in fact, the Bureau had remained with the PAR system "it would have required almost as much time [to keep such individual time records under PAR] as [to do] the actual [grant] work." (Tr. 169) Since the cost allocation system had been in use for several years, he was able to apply the current method of allocation to the year in question. Thus, he was able to compare what was charged to the EHA-B grant using the PAR system and what would have been charged to the grant under the cost allocation method. The calculation disclosed that the Bureau of Federally-Aided Programs provided more EHA-B allocable work than the EHA-B grant provided in funding. (Tr. 175) He also testified that the cost allocation method was the more accurate method of allocating time and effort expended by the Bureau on the EHA-B program. (Tr. 170) He further testified as to the kind of work both Ms. Strait and Ms. Schwendinger performed and the estimated percentages that related directly to the EHA-B program. (Tr. 171-175, Appl. Ex.16). I conclude that ED's disallowances of the claimed portions of the salaries of Ruth Strait and Joan Schwendinger were inappropriate and unjustified, particularly where the Assistant Secretary offered no rebuttal evidence.

Witness Ed Sanders supported the billing of Christine Kuzmak's salary to the EHA-B program. Although she did not work 100% of her time on EHA-B allocable activities, the time and effort Mr. Sanders' staff expended on the development of Braille and large-type testing materials totalled at least one "full-time equivalent" position. (Tr. 185) Even though similar evidence was rejected in the prior PAR litigation (New York , Dkt.No.90-70-R, supra), witness Sanders, in this hearing, was able to present much more extensive and substantial evidence of the total amount of time the Braille and large-type testing preparation process takes. (Tr. 181-185) Again, this evidence saw no rebuttal by the Assistant Secretary. From the evidence, I conclude that Christine Kuzmak's salary (the only one from that staff office) was properly claimed by NYSED under the EHA-B grant, and should not have been disallowed by the Assistant Secretary.

Witness Michael Plotzker was the supervisor in the Office for Education of Children with Handicapping Conditions (OECHC), with responsibility for three different units in two different positions. Among his duties, he supervised Evelyn Vito during the period in question. She was an Education Program Assistant for the Program Development Section in OECHC. In that capacity, she was responsible for processing petitions to Family Court for pre-school education programs. Those petitions established county eligibility for State reimbursement for special education services to handicapped children, and she had to determine whether the services provided met the standards and requirements of EHA-B. Her responsibilities related 100% to the EHA-B program during the time in question, and in her case the PAR code used for the Chapter 1 Handicapped program was an error, probably precipitated by the fact that she started out in Mr. Plotzker's office as, technically, an "on-loan" employee and Mr. Plotzker did not know how long she would be working there. Accordingly, he was told (erroneously) that he should continue to use the old PAR code from her old office, when in fact she spent 100% of her time for the entire period in issue doing only EHA-B administrative work. (Tr. 189-196, Appl.Ex.17.) The evidence supports the legitimacy of NYSED's claim that Ms. Vito's salary should be applied against the EHA-B grant program. (There is no opposing evidence or testimony from ED.)

Witness Larry Gloeckler was the Assistant Commissioner for the Office for Education of Children with Handicapping Conditions (OECHC) during 1986-87. His testimony established that many employees in several different divisions under OECHC did not use proper EHA-B PAR codes, even though, in fact, their job responsibilities were directly related to and benefitted the EHA-B State plan. As specific examples, he described the EHA-B work done by Michael Radlick and his staff in the Division of Planning and Support Services, including Michelle Green, Jim Harrison, Campion Leczinsky, and Janice Pecora, as well as David Irvine in the Gifted Education program (ensuring that handicapped students were included in gifted education initiatives), and Marlene Shorts in the Transportation Unit (transportation requirements for students with handicaps under EHA-B). Mr. Gloeckler also testified to the responsibilities of George Plummer, Ron Ross, Maurice Olsen, Robert Seebolt (Superintendent of the State School for the Blind at Batavia, N.Y.), Phil Cronlund (Superintendent of the State School for the Deaf at Rome, N.Y.), and Tom Sawran (Budget & Personnel for both the Batavia and the Rome schools), and how their duties were related to the administration of the EHA-B program. Due to the long gap in time between the period in issue and the evidentiary hearing, NYSED was unable to call every single employee whose salary was in issue. However, there is extensive and specific documentation relating to the originally-named employees in the record (affidavits and attachments stating their jobs, duties, and salaries), and the testimony of Mr. Gloeckler, Mr.

Connell, Mr. Sawran, and other witnesses adequately support other evidence relating to the legitimate allocability of the time and effort of those employees to the EHA-B grant (in some cases only a portion of their time, in others 100% of their time). (Gloeckler, Tr. 68-84.) The only opposing evidence on this is the total reliance of the OIG's auditors on the PAR codes found during the audit. The evidence clearly indicates that during the period in question the PAR codes were not being used by all NYSED offices, were not being consistently applied even in offices supposedly using it, and were being misapplied in many individual cases for one reason or another, and eventually the PAR system was discarded altogether. Obviously, the PAR code system was no longer a reliable accounting of what employees were actually doing and what aspects of what programs they were working on. OIG auditors had no way of knowing this when they performed their audit, so their after-the-fact conclusions based solely on PAR codes is in fact unreliable and non-conclusive. New York has since moved to a cost allocation system that has been approved by ED. (DiVirgilio, Tr. 57.)

For the period in question we must look to other evidence, other documentation and testimony to ascertain the actual programs worked on by the various employees in issue. The record and hearing testimony establish the relationship to EHA-B for the duties of the various employees in dispute.

Witness Thomas Sawran was and is the Assistant Superintendent for the State School for the Deaf in Rome, N.Y., and for the State School for the Blind in Batavia, N.Y. Both schools serve multiply-handicapped children from early childhood to age 21. Both schools supply a myriad of administrative services coming well within the purview of EHA-B, as well as other programs. He pointed out that the staff he supervises does not supply direct services to children, rather it supplies the administrative services needed by State employees who do supply such direct services. (Tr. 132.) In his testimony and in his affidavit, he provided a breakdown of the pro rata costs that could have, and should have, been charged as costs to EHA-B, but which were not. (Tr. 118-136, Appl. Ex. 37.) Mr. Sawran's testimony, together with the other evidence of record, leads to the conclusion that ED's adamant rejection of any credit for the administrative expenses incurred by NYSED at the Rome and Batavia schools was without justification.

In sum, I believe that New York has met its burden of proving the allowability of the salaries of the 19 employees in dispute, that salaries for employee effort in areas where the evidence clearly shows that their administrative services were directly related to the EHA-B program should be allowed notwithstanding the initial contrary impression given by conflicting PAR codes, and that there should be an equitable offset permitted for State administrative services rendered at the State-operated schools in Rome and Batavia, New York, which were directly connected to the EHA-B program, and yet did not constitute direct services to the program's handicapped beneficiaries. In sum, NYSED has documented in the record an additional $192,284.07 in salaries and related charges that could have and should have been properly charged to the EHA-B grant program. That amount is available as an equitable offset against any net disallowances found by OIG's auditors.

## INDIRECT COSTS RATE QUESTION

The remaining question is whether New York is entitled to credit for the unclaimed administrative costs (indirect costs) under an unrestricted rate, i.e., whether law or regulations limited NYSED to only a restricted rate for reimbursement of indirect costs.

The Assistant Secretary argues 10 that the entire EHA-B program is subject to a restricted indirect cost rate by 34 C.F.R. § 76.563 and further stresses that Judges are not free to "waive" regulations (34 C.F.R. § 76.900). But this is not a "waiver" situation, rather it is a question of a fair and reasonable interpretation of a regulation. It is true that § 76.563 lists the EHA-B ("Part B of the Education of the Handicapped Act") as one of several examples of programs falling within the purview of programs requiring a restricted cost rate; however, the introductory language of the section clearly says :". . for each program that has a statutory requirement not to use Federal funds to supplant non-Federal funds." The problem is that EHA-B is comprised of three distinct programs, only one of which is subject to a "supplement-not-supplant" prohibition: (1) "Flow-through funds" to local education agencies are subject to the "supplement-not-supplant" restriction, 20 U.S.C. § 1411(d), but (2) State discretionary funds are not subject to non-supplanting restrictions, and (3) State administrative funds are not subject to non-supplanting provisions. Accordingly, the restricted rate applies only to the program with the non-supplant provision, i.e., flow-through funds to local recipients.

Counsel for the Assistant Secretary conceded that the administrative funds at issue here were not subject to a non-supplanting requirement. 11 (See also the Assistant Secretary's Initial Brief, at 61, note 21.) 12 Moreover, the regulations regarding state-level non-supplanting requirements under EHA-B contained a note specifically stating that "the portions of Part B funds that are not distributed to local education agencies or intermediate education units under the statutory formula - are not subject to this non-supplanting provision." Note to 34 C.F.R. § 300.150 (1989), citing H.R. Rep. No.860, 99th Cong. 21-22 (1986) (emphasis added). 13 So there is no real dispute that administrative funds under EHA-B are not subject to a "supplement-notsupplant" restriction.

But the Assistant Secretary contests NYSED's right to apply the unrestricted indirect cost rate in this particular case on the theory that the EHA-B program is indivisible and inseparable, and argues that the mere inclusion of that program in the "examples" chart 14 at the end of § 76.563 compels the conclusion that the entire EHA-B program (and its grant funds) must fall under the umbrella requirement for a restricted indirect cost rate. I disagree. That conclusion is clearly belied by the introductory language of § 76.563: "for each program listed in § 76.1 that has a statutory requirement not to use Federal funds to supplant non-Federal funds." (See testimony of CPA witness Frank McKune, 15 Tr. 93-112; see also DiVirgilio testimony, Tr. 31-45.) In the words of witness Frank McKune, what "separates a state using a restricted versus an unrestricted rate, is the presence or absence of a supplement non-supplant provision." (Tr. 110-111.) If there is no non-supplanting provision, there simply is no basis for using a restricted indirect cost rate. The relevant statute specifies that "the provisions of section 1413(a)(9) of this Title shall not apply with respect to amounts available for use by any State under paragraph (2)." 20 U.S.C. § §1411(c)(3). Section 1413(a)(9) contains the non-supplanting provision which applies to flow-through funds to local recipients. The paragraph 2 to which the provision refers is the relevant set-aside for administrative funds. 20 U.S.C. § 1411(c)(2)(A). 16

Accordingly, based upon a review of the evidence and the relevant statute and regulations, I see no valid basis for limiting the Applicant to a restricted indirect cost rate for its administrative expenses related to EHA-B grant activities. The Applicant has carried its burden of proving that NYSED is now entitled to be credited with the difference between the restricted indirect cost rate received and the unrestricted indirect cost rate to which it was entitled. 17 The Assistant Secretary never disputed the calculations submitted on this point of by NYSED (DiVirgilio affidavit, Appl. Ex. 36; & NYSED Post Hearing Brief, at 10-11.) This calculated amount ($696,339.14) is available as an equitable offset to the Applicant. 18

## CONCLUSIONS OF LAW

I find from the evidence of record that the disputed salaries were improperly disallowed, and that the Applicant was improperly precluded from claiming an unrestricted indirect cost rate for the administrative expenses incurred for the operation of the EHA-B program by NYSED during the audit period in issue. Whether the equitable offset for the improperly disallowed salaries and related charges ($192,284.07) is used, or the equitable offset for the new balance due by application of the unrestricted indirect cost rate ($696,339.14) is used, either way each figure far exceeds the total disallowances in issue ($153,739). (The disallowances themselves were disputed and were found to be unjustified.) Accordingly, there is no balance of liability remaining against the Applicant, NYSED, for the period in question.

I find and conclude that the New York State Education Department has carried its burden of proving by substantial probative evidence that it should not be assessed any further liability by virtue of the disputed Program Determination Letter (Preliminary Departmental Decision), and should not be required to return the amount of funds for which recovery was sought. 20 U.S.C. §1234a(b)(3); 34 C.F.R. § §81.30, 81.31.

IT IS SO ORDERED.

Thomas W. Reilly
Administrative Law Judge

Issued:November 3,1995
Washington, D.C.

## SERVICE LIST

A copy of the attached DECISION was mailed by CERTIFIED MAIL on this 3rd day of November, 1995, to the following parties:

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1 Now referred to as the "Individuals With Disabilities Education Act", § 901 (a)(1) of P.L.101-476 (1990), 20 U.S.C. § 1400 (a) (1994).

2 New York State used a "Performance Accountability Reporting" (PAR) system as a method of accounting for employees' time and effort expended in various programs, both State and Federal. The PAR system utilized a listed series of three-digit code numbers to assign personnel effort to various programs and administrative duties. There are both general program codes and specific program codes. This enabled both cost allocation and time distribution analysis. (See Appl. Ex.3, at 4; Appl. Ex.5.) However, testimony and affidavits placed in doubt absolute blind reliability of the particular codes used at any given time. The PAR system, although initially commended by ED, was not uniformly followed by all employees or supervisors and apparently created confusion and more audit problems than it was worth, so after an internal State audit, the PAR system was discontinued July 1, 1993 (witnesses DiVirgillo, Tr. 12; Plummer, Tr. 153; Connell, Tr. 168-170), although some witnesses failed to recall the exact date.

3 Application of the New York State Education Department, Docket No. 90-70-R, U.S. Dept. Of Education (Final Agency Decision, July 5,1994).

4 NYSED produced nine witnesses at the hearing; ED produced none and chose to rely on the documentary record and the briefs. NYSED offered 35 exhibits in this proceeding, 37 filed prior to the hearing (see NYSED Amended Exhibit List, Nov.30, 1994), and one (Appl. Ex. 38)offered and received at the hearing. ED filed three exhibits prior to the hearing (ED Exs.1 , 2, & 3; Prehearing Memorandum, 11129/94). All exhibits for both sides, regardless of when filed, were formally received in evidence at the hearing. (Tr. 5, 181.)

5 Under the doctrine of equitable offset, New York's liability for otherwise unallowable EHA-B administrative expenditures can be offset by expenditures that could have been charged for that same purpose, but which were paid with State funds instead. ED Post-Hearing Brief, at 3; Joint Stipulation of Fact, at 33, § IV(A)(1). Accord, New York 1, at 120-122, and Supplemental Decision After Remand in Appeal of the State of New York, EAB Docket No.26(226)86, U.S. Dept. Of Education (Education Appeal Board, June 27,1989) (Final Agency Decision, Aug.29, 1989), at 4-7.

6 NYSED's Application for Review, Oct. 4, 1991; Applicant's Brief in the Appeal of NYSED, Feb.10, 1992; Reply Brief of NYSED, Mar. 20, 1992; Prehearing Memorandum of NYSED, Nov. 30, 1994; and Post-Hearing Brief of NYSED, Sept. 25, 1995. ED's briefs consist of Brief of the Assistant Secretary in the Appeal of NYSED, Mar.11, 1992; Prehearing Memorandum,

November 29,1994; Brief of the Assistant Secretary on the Indirect Cost Issue, Feb. 24, 1995; and Post-Hearing Brief of the Assistant Secretary, Sept. 25, 1995.

7 This figure includes $131,873.04 in salaries, plus indirect costs at a stipulated rate of 16.3% and fringe benefits at a stipulated rate of 29.51%. (Joint Stipulation of Fact, Nov.30, 1994.)

8 See Principle for Determining Costs Applicable to Grants and Contracts with State and Local Governments, OMB Circular A-87, Part II, 8.10.

9 Under the cost allocation plan, NYSED requires that respective Federal and State grant programs bear their fair share of the administrative costs of the operation of the office, based upon a pro rata share of the total individual grants administered by that office. (Connell, Tr. 168-169.)

10 See Brief of the Assistant Secretary on the Indirect Cost Issue, Feb.24, 1995, and Post-Hearing Brief of the Assistant Secretary, Sept.25, 1995, at 14-18.

11 Mr. Petracca: "In fact, I think we are all in agreement on this point that the administration funds at issue in this case were not subject to a non-supplanting requirement." (Tr. 115.) See also Assistant Secretary's Post-Hearing Brief: "(T)he substance of the note following 34 C.F.R.§300.150, that the Part B 'supplement-not-supplant' requirement does not apply to administrative funds, is accurate - both now and during the period at issue in this case." (ED Brief, at 17, note 7, emphasis added.)

12 "Unlike the VEA and Perkins Act programs, the use of EHA-B administrative funds is not governed by a non-supplanting requirement. 34 C.F.R. §300.372." (Initial Brief of the Assistant Secretary, at 61, note 21.)

13 From the transcript of the evidentiary hearing, an erroneous first impression might be gained (if not read carefully) that there was some question as to the applicability of the non-supplanting distinctions to the year in issue (FY '86-87). (Tr. 114-116.) Although a cite was read from a 1990 C.F.R. volume, the note, first included in the C.F.R. in 1989, references a House Report for 1986. (H.R.Rep.No.860, 99th Congr. 21-22 [1986].) There is no question that the interpretation applies to the year in issue.

14 I interpret the examples table or chart at the end of the section as being merely illustrative or explanatory, and not as a separate mandatory or ordering clause. It was apparently intended to help "clarify", but instead it had the opposite effect, in that not all portions of EHA-B grants had "supplement-not-supplant"" requirements. It was no mere coincidence that this misleading and confusing "examples" chart has since been dropped from the end of 34 C.F.R. § 76.563. (Tr. 61, 65; NYSED Post-Hearing Brief, at 8-9; see 1990 C.F.R. and later volumes.)

15 Frank Mckune, was a Senior Cost Policy Specialist at HHS who became the Director of the Division of Cost Allocation for HHS in Washington, D.C., until his retirement and return to the CPA/Management firm of KPMG Peat Marwick, where he is a Senior Manager, responsible for developing indirect cost rates and cost allocations for clients. He has devoted his entire

professional career as a CPA (26 years) to issues relating to the calculation of indirect cost rates. (Tr. 93-101)

16 See also admission of ED counsel in prior proceeding, New York 1, counsel for Assistant Secretary for Vocational and Adult Education:

"For a program with the supplanting prohibition in it like the Vocational Education Act and Chapter 1 and other programs, those programs use what is called 'restricted indirect cost rate.' They cannot claim the full indirect cost the full overhead, because that would be supplanting costs of the state with federal funds that would have been incurred anyway. So, these restricted rates are used. You get different rates then. The EHA uses an unrestricted indirect cost rate. The VEA uses a restricted cost rate because of the supplanting prohibition in VEA." (Tr. 115-116, August 18, 1993; NYSED Prehearing Memorandum, at 11, emphasis added.)

17 The affidavit of Michael DiVirgilio, submitted with NYSED's Prehearing Memorandum (Nov. 30, 1994), calculates and documents the credit involved. (Appl. Ex. 36.) For FY "86-"87, the final ED-negotiated restricted indirect cost rate was 8.9%. The unrestricted indirect cost rate would have been 27.9%. Application of the unrestricted rate now results in an additional allowable charge of $696,339.14. (See also summary calculations in NYSED Post-Hearing Brief, at 10-11.)

18 See also Appeal of Michigan, Dkt. No. 11-(143)-84, ACN: 05-30021, U.S. Dept. Of Education (EAB, Feb. 6, 1986), (Final Decision of the Secretary, May 13,1986), wherein the State had been using an interim indirect cost rate pending approval of a final rate by ED. Under the higher final rate, Michigan was allowed to offset the additional $111,376 in indirect costs to reduce its audit disallowances