APPLICATION OF ARIZONA DEPARTMENT OF EDUCATION, Applicant.	Docket No. 06-07-R Recovery of Funds Proceeding ACN: 09-04-58090

Appearances: Chad B. Sampson, Esq., of the Office of the Attorney General, State of Arizona, for the Arizona Department of Education

Ronald B. Petracca, Esq., of the Office of the General Counsel, United States Department of Education, for the Office of Special Education and Rehabilitative Services

Before: Chief Judge Allan C. Lewis

INITIAL DECISION

This is an appeal initiated by the Arizona Department of Education (ADE) of a preliminary departmental decision issued on December 28, 2005, by the Assistant Secretary for Special Education and Rehabilitative Services of the United States Department of Education (ED) that demanded, in part, that ADE repay $212,436.03 of funds expended during the fiscal years 2001 through 2004 under Part B of the Individuals with Disabilities Education Act (IDEA-B). The Assistant Secretary for Special Education and Rehabilitative Services concluded that these funds were embezzled by an employee of ADE through payments to purported mediators for non-existent services and, therefore, were not spent on any activity that was reasonable and necessary to carry out the purpose of the grants under the IDEA-B programs. Pursuant to ED's demand, ADE reimbursed its Federal Funds account but now seeks to recover $181,605.87 of these funds under a theory of equitable offset. ADE argues that it expended $181,605.87 on qualified activities that it did not previously claim and that these expenditures may be used as a substitute for the improperly expended funds resulting in a refund of this amount from the deposited funds. Based upon the findings of fact and conclusions of law, infra, ADE may recover $165,243.04 of the $212,436.03 previously deposited in its Federal Fund account and, as to the remainder, the United States Department of Education may recover these funds.

OPINION

ADE participated in ED's grant program under IDEA-B in fiscal years 2001 through 2004. As part of that program, ADE was obligated to provide mediation services as a means to

resolve disputes concerning the individual education plans of students. Between April 5, 2001 and May 12, 2004, several employees of ADE in its Exceptional Student Services Dispute Resolution unit committed fraud by falsifying travel reimbursement claims and invoices to pay vendors who were not qualified as mediators and who did not perform any services. After the fraud was discovered, an audit ensued and a preliminary departmental decision was issued by ED on December 28, 2005. The preliminary departmental decision demanded a repayment of $212,436.03 in Federal funds which represented the total amount misappropriated by the fraud and was attributable to the four fiscal years as follows:

Fiscal Year	Amount
2001	$ 2,225.84
2002	$ 39,623.74
2003	$ 98,752.77
2004	$ 71,834.68
Total	$ 212,437.03

Thereafter, ADE deposited $212,436.03 in its Federal Fund account where it remains pending instructions from ED as to its final disposition.

On February 24, 2006, ADE filed an appeal of the preliminary departmental decision. In its appeal, ADE did not dispute that the funds were improperly expended and, therefore, were properly returnable to ED. Instead, ADE raised the doctrine of equitable offset. Under this doctrine, qualified expenditures made by ADE in furtherance of IDEA-B activities but which were not required under the grants, may be substituted for the expenditures disallowed by the audit. In this case, since ADE has already repaid the disallowed expenditures, the equitable offset, if successful, will result in a refund to ADE.

Initially, the parties agree that the doctrine of equitable offset may be applied in this case. The parties agree that the expenditures, identified by ADE, were incurred in furtherance of activities under IDEA-B and, therefore, are available to offset funds that were otherwise recoverable by ED as impermissible expenditures under the Federal grant program. Also, the parties recognize that, under 34 C.F.R. § 300.154(a) (2000), a state participant in the IDEA-B grant program, such as ADE, is required to maintain a minimum financial effort for special education and related services for a fiscal year that is, at least, equal to the amount of its financial effort in the preceding fiscal year. The parties recognize that any ADE's expenditures for special education used as an offset would effect a corresponding reduction in the amount of the State's maintenance of financial effort for that fiscal year. To the extent that any potential offset reduces the State's maintenance of financial effort below the maintenance of financial effort for the preceding fiscal year, then this amount of the potential offset would not qualify as an equitable offset.

The parties disagree on two matters. One, they disagree whether, for each of the four fiscal years, ADE established that its current fiscal year's financial effort, as adjusted by the equitable offset, exceeded its preceding fiscal year's financial effort. In the event that ADE has met its burden of proof on the first matter, the second issue is determining the proper amount of the equitable offset in each of the four fiscal years.

ADE argues that it has established that the State's financial support for special education and related services in each of its fiscal years 2001 through 2004 is more than the State's financial support in the preceding year. It points to the affidavit of Ms. Chapman, the Director of Exceptional Student Services for ADE, to support its argument. Among her duties, Ms. Chapman oversees and is responsible for all matters regarding the State's compliance with the IDEA-B grant program. Ms. Chapman attests that ADE spent the following amounts on special education—

Fiscal Year	Amount
2001	$ 19,852,267.66
2002	24,985,302.50
2003	29,080,711.87
2004	29,247,603.32

She further states that "[t]he reduction in state expenditures [due to the substitution of qualifying expenditures to replace the impermissible expenditures in the amounts] of $3,424.00 in 2001, $39,623.74 in 2002, $63,986.02 in 2003, and $55,593.08 in 2004 for a total of $162,626.84 does not sufficiently reduce the level of state expenditures on special education [and] related services so that the state falls out of compliance with IDEA's maintenance of effort requirement." ADE Ex. R-5 at 2.

ED maintains that ADE has not established the amount of State financial support for the fiscal years in issue. ED argues, without citation of authority, that the affidavit of the ADE's Director of Exceptional Student Services that provides these figures is insufficient and "cannot be used as a substitute for the documentation needed to establish the level of State financial support for special education and related services." Since ADE has not provided "any financial or accounting records to substantiate the claims it makes on the question of the level of State financial support for special education and related figures," ED maintains that ADE has proffered no admissible evidence to prove its level of financial support for the fiscal years in issue. ED Br. at 10.

ED argument is, in effect, that the Director's statement regarding the levels of financial support in the fiscal years constitutes hearsay and, as such, is not admissible to prove the levels of financial support. Moreover, in ED's view, ADE must provide documentation that satisfies the business record exception to the hearsay rule in order to establish ADE's level of financial support in each of the four fiscal years. The foundation of ED's argument is that the Federal Rules of Evidence govern the admissibility of evidence in this action.

The Federal Rules of Evidence govern the admissibility of evidence in Federal judicial proceedings. This proceeding is not, however, a Federal judicial proceeding. Rather, it is a Federal administrative law proceeding under the General Education Provisions Act. 20 U.S.C. §§ 1234 and 1234a. The Department's regulation implementing the General Education

Provisions Act rejects the applicability of the Federal Rules of Evidence in these proceedings. Regulations Section 81.15 (34 C.F.R.) provides in pertinent part—

> (a) The Federal Rules of Evidence do not apply in proceedings under this part. However, the ALJ accepts only evidence that is—
> (1) Relevant;
> (2) Material;
> (3) Not unduly repetitious; . . .

Hence, hearsay evidence is admissible in this proceeding. Accordingly, the Director's affidavit is properly considered as evidence in this matter.

The question remains as to the effect of the Director's statements regarding the level of financial support in each of the four fiscal years. As the proponent of the equitable offset argument, ADE bears the burden of proof and must establish its case by the preponderance of the evidence. Under the preponderance standard, the question is whether it is more likely than not that ADE expended the financial support in the amounts indicated by its Director.

Initially, the State's level of financial support represents a figure that must be calculated each fiscal year for the State's financial records as well as for submission to the U.S. Department of Education. 34 C.F.R. § 300.154(a). The Director oversaw these computations and had access to this information in the ordinary course of her duties. The Director attests that the data provided is correct. This tribunal has no reason, nor has ED presented any, to doubt Ms. Chapman's credentials or her credibility on this matter. As a high level governmental official, she undoubtedly understands the significance of signing an affidavit for submission to a Federal official and that potential civil penalties may be imposed in the event that she has misrepresented the data therein. Accordingly, the tribunal is convinced by more than a preponderance that the figures regarding the levels of financial support in the affidavit are accurate.[1]

As noted above, 34 C.F.R. § 300.154(a) requires a state to maintain a minimum financial effort for special education and related services for a fiscal year that is at least equal to the amount of its financial effort in the preceding fiscal year. In this case, the original figures for the level of financial effort in each fiscal year must be adjusted downward to reflect the expenditures that will be used as the equitable offset. For the fiscal years 2003 and 2004, the adjustment will be the amount of the misappropriated funds because the offset expenditures are at least equal to the amount of the misappropriated funds. For the fiscal year 2002, the adjustment will be limited to the amount of the offset expenditures because it is less than the amount of misappropriated funds. As shown by the following table, the effect of a reduction in ADE's maintenance of effort

[1] The tribunal does not accept, however, her statement that the reduction in state expenditures caused by the equitable offset does not reduce the level of State support to the extent that the State falls out of compliance with IDEA's maintenance of effort requirement for the four fiscal years. This statement represents a conclusion of law and, as such, is a matter within the providence of the tribunal.

by virtue of ADE's proposed equitable offset in fiscal years 2002, 2003, and 2004 does not result in a violation of this regulation.

Fiscal Year	Maint. of Effort	Adj. Amount[2]	Adj. Maint. of Effort
2001	$ 19,852,267.66	$ 2,225.84	$ 19,850,041.82
2002	24,985,302.50	39,623.74	24,945,678.76
2003	29,080,711.87	64,093.82	29,016,618.05
2004	29,247,603.32	61,525.48	29,186,077.84

Inasmuch as there is no admissible evidence in the record regarding the level of maintenance of effort for fiscal year 2000, it is not possible to ascertain whether ADE's adjusted maintenance of effort for 2001 is at least equal to its maintenance of effort for fiscal year 2000. Hence, it cannot be determined whether ADE has satisfied 34 C.F.R. § 300.154(a) for fiscal year 2001. Accordingly, ADE's equitable offset claim for this fiscal year is rejected. As a result, ADE is liable for $2,225.84, the amount of Federal funds misappropriated in this fiscal year and may not recover this amount from the funds previously deposited in its Federal Funds account.

For the fiscal years 2002 and 2003, the parties agree that the amounts of the equitable offset are $55,986.54 and $64,093.82, respectively. The effect of the equitable offset for fiscal year 2002 reduces ADE's liability from $39,623.74 to zero.[3] As such, it may recover $39,623.74 from the funds deposited in its Federal Fund account. The effect of the equitable offset for fiscal year 2003 reduces ADE's liability from $98,752.77 to $34,658.95. Accordingly, ADE may recover $64,093.82 from the funds deposited in its Federal Fund account.

For fiscal year 2004, the amount of the misappropriated funds is $71,834.68 and the amount of the equitable offset is $61,525.48. Hence, ADE may recover $61,525.448 and the amount of ADE's remaining liability for fiscal year 2004 is $10,309.20.

In summary, of the $212,436.03 deposited by ADE in its Federal Funds account, ADE may recover a total of $165,243.04 and ED is entitled to retain the remainder of the funds.

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[2] As discussed above, the adjusted amount reflects the lesser of either the misappropriated funds for the year or the amount of the expenditures under the equitable offset.

[3] ADE argues that it may carryover any unused equitable offset in a fiscal year 2002 to its succeeding fiscal year. This position has no merit. The fiscal years of grants as well the fiscal years within a grant are treated separately for accounting and reporting purposes.

ORDER

In view of the foregoing, it is HEREBY ORDERED that the Arizona Department of Education may remove or otherwise use for its benefit the sum of $165,243.04 of the $212,436.03 previously deposited in its Federal Fund account. As to the remainder of this amount, the United States Department of Education may recover these funds in the manner as prescribed by law.

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Allan C. Lewis
Chief Administrative Law Judge

Issued: August 12, 2010
Washington, D.C.

SERVICE

On July 28, 2010, a copy of the attached Initial Decision was sent by hand-delivery or Departmental mail to--

The Honorable Arne Duncan
Secretary of Education
United States Department of Education
400 Maryland Avenue, S.W., Room 7 W 311
Washington, D.C. 20202

On July 28, 2010, a copy of the attached Initial Decision was sent by certified mail, return receipt requested, by the Office of Administrative Law Judges to—

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A courtesy copy was also sent by Departmental mail to--

Nancy I. Hoglund, Supervisor
Accounts Receivable Group
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