New York State Office of the State Comptroller
Thomas P. DiNapoli
Division of State Government Accountability

Compliance With the Reimbursable Cost Manual

Kids Quality Care,Inc.
State Education Department

Report 2010-S-68 February 2013

Executive Summary

Purpose

To determine whether the costs reported by Kids Quality Care, Inc. (KQC) on the Consolidated Fiscal Report (CFR) were properly calculated, adequately documented, and allowable under the Reimbursable Cost Manual (Manual) issued by the State Education Department (SED). The audit covers the two fiscal years ended June 30, 2009.

Background

KQC, a privately-owned company located in New York City, provides special education itinerant teacher (SEIT) and related services to disabled preschool children. KQC leases office space in Manhattan for its business operations. In turn, KQC subleases to and shares office space with another privately-owned special education company, Kids & the Training Institute (KTI). The New York City Department of Education (DoE) pays tuition and fees to KQC using rates set by SED, which are based on financial information KQC presents in an annual CFR filed with SED. SED reimburses the DoE for a portion of its payments to KQC. For the two fiscal years ended June 30, 2009, KQC claimed and received $2.7 million in public support.

Key Findings

- KQC claimed $237,926 in costs that were not properly calculated, adequately documented, or allowable for the two years covered by our audit. The disallowances include $138,136 in personal services and $99,790 in other-than-personal services.
- The personal service disallowances consisted of $73,258 in excess salary costs for its Executive Director/Owner and $64,878 in unsupported bonus payments to employees.
- The other-than-personal service disallowances included $31,925 for unapproved facility lease and improvement costs and $32,120 for ineligible vehicle costs (among a range of ineligible expenses.)
- KQC did not comply with provisions of the Manual pertaining to a less-than-arms-length business relationship with KTI, time and attendance records, and the classification of expenses in its accounting records.

Key Recommendations

- SED should review disallowances resulting from our audit and make the appropriate adjustments to costs reported on the CFRs and the tuition reimbursement rates.
- SED should direct KQC officials to comply with provisions of the Manual pertaining to LTAL business relationships, time and attendance records and classification of expenses.
- KQC should comply with the procedural guidance provided by the Manual (e.g. LTAL business relationships, time and attendance records, classification of expenses). Also, ensure costs reported on CFR comply fully with the Manual requirements.

Other Related Audits/Reports of Interest

Bilingual SEIT & Preschool, Inc: Compliance with the Reimbursable Cost Manual (2011-S-13)
Special Education Associates: Compliance with the Reimbursable Cost Manual (2010-S-31)

State of New York
Office of the State Comptroller

Division of State Government Accountability

February 7, 2013

Dr. John B. King Jr.
Commissioner
State Education Department
State Education Building - Room 125
89 Washington Avenue
Albany, NY 12234

Ms. Orly Cohen
Executive Director
Kids Quality Care, Inc.
122 East 42nd Street
New York, NY 10168

Dear Dr. King and Ms. Cohen:

The Office of the State Comptroller is committed to helping State agencies, public authorities and local government agencies manage government resources efficiently and effectively and, by so doing, providing accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of State agencies, public authorities and local government agencies, as well as their compliance with relevant statutes and their observance of good business practices. The fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations. Audits can also identify strategies for reducing costs and strengthening controls that are intended to safeguard assets.

Following is a report of our audit of the State Education Department entitled *Kids Quality Care, Inc. - Compliance with the Reimbursable Cost Manual.* This audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

This audit's results and recommendations are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. If you have any questions about this report, please feel free to contact us.

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

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State Government Accountability Contact Information:
Audit Director: Brian Mason
Phone: (518) 474-3271
Email: StateGovernmentAccountability@osc.state.ny.us
Address:
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

This report is also available on our website at: www.osc.state.ny.us

Background

Kids Quality Care, Inc. (KQC), a Sub-Chapter S corporation located in New York City, is organized under the laws of the State of New York to provide special education itinerant teacher (SEIT) and related services, such as speech and occupational therapy, to disabled children between three and five years of age. The New York City Department of Education (DoE) pays tuition and fees to KQC using rates set by the New York State Education Department (SED). SED sets these rates using financial information that KQC presents in an annual Consolidated Fiscal Report (CFR) it has filed with SED. SED has issued a Reimbursable Cost Manual (Manual) to provide guidance on the eligibility of costs and documentation requirements that must be met for such rate-setting purposes. DoE uses the SED rates to pay for services and then is partially reimbursed by SED.

KQC is privately-owned and leases office space in Manhattan for its business operations. In turn, KQC subleases to and shares office space with another privately-owned special education company, Kids & the Training Institute (KTI). We audited KQC's and KTI's compliance with the Manual concurrently. The Executive Directors/Owners of KQC and KTI were previously married to one another and each provides services to the other's company.

SED requires an organization to disclose in its financial statements any less-than-arm's length relationships, including the identities of the related parties. This includes relationships where the principal owners of organizations or entities are related or have a relationship. SED also requires that payments made to related parties be reported on the CFR under the section Transactions with Related Organizations and Individuals.

During fiscal years ended June 30, 2008 and June 30, 2009, KQC claimed and received $2.7 million in public support.

Audit Findings and Recommendations

KQC claimed ineligible costs totaling $237,926 during the audit period (see Exhibit). This included $138,136 in ineligible personal services costs and $99,790 in ineligible other than personal service costs. In addition, we identified non-compliance with certain procedural requirements prescribed by SED which must be addressed by KQC officials.

Personal Service Costs

Personal service costs include salaries, bonuses, and fringe benefits. We disallowed personal service costs totaling $138,136 for the two-year audit period. The disallowances consisted of $73,258 in excess salary costs for its Executive Director/owner and $64,878 in unsupported bonus payments to several employees.

Compensation of Executive Director

According to the Manual, reimbursement for an individual employee should be limited to 1.0 Full-Time Equivalent (FTE) employee. The Manual also notes that when a person works more than 1.0 FTE position at multiple entities, his/her compensation must be allocated properly among those entities. In addition to her position at KQC, the Executive Director also worked as the Supervising Teacher for KTI, the company owned by her former husband. As such, KQC's Executive Director worked 1.5 FTE positions and received compensation totaling $282,290 ($213,342 at KQC and $68,948 at KTI) during the 2007-08 fiscal year. However, KQC did not prepare the required time and effort reports or equivalent documentation indicating how the Executive Director's time and compensation should be allocated. We reviewed this matter with SED officials and determined that KQC reported $73,258 more than it should have for the compensation of the Executive Director. (Note: At the time of our audit fieldwork, SED had reduced the amount of the owner's allowable compensation due to the concurrent positions she held at KQC and KTI).

Bonuses

The Manual states that bonuses may be reimbursed if they are based on merit, as measured and supported by employee performance evaluations. KQC's Executive Director claimed reimbursement for $15,000 in bonuses she awarded to herself during our audit period, and KQC claimed an additional $49,878 in bonuses for other employees. Nine employees received bonuses in 2007-08 (including $500 paid to the owner's daughter), and 18 received bonuses in 2008-09. We concluded, however, that the bonuses were not based on merit.

During our audit, KQC officials provided us with multiple explanations of how they determined and calculated bonuses. Initially, they told us that the bonuses were based solely on an employee's salary. For example, an employee who earned more than $50,000 received a certain bonus amount, and employees who earned less received a lower amount. When we advised KQC officials that bonuses must be merit-based, they provided us with performance evaluations for seven of the nine employees who received bonuses for the 2007-08 year. The evaluations were based on a scale of 1 - 5 (with 5 being the highest level of performance).

However, we determined that the performance evaluations for the seven employees were not consistent and did not correspond with the amounts of the bonuses they received. For example, an employee with a performance rating of 5 received a bonus of $1,000; whereas an employee with a rating of 3 received a bonus of $2,000. Consequently, we question whether the bonuses were actually based on the evaluations. Further, KQC officials provided no evaluations for the 18 employees who received bonuses in 2008-09.

Subsequently, KQC officials told us that the payments were not bonuses. Rather, they were lump sum payments for working hours in excess of employee's standard work schedules. However, the documentation KQC officials provided us did not support this claim. Moreover, we concluded that the payments in question were, in fact, bonuses that were not merit-based. Consequently, we disallowed the total amount ($64,878) of the bonus payments claimed by KQC.

Other Than Personal Service Costs

The Manual provides guidance on the eligibility of costs for reimbursement and the documentation that is required to properly support such costs when they are reported on the CFR. According to the Manual, costs should be reasonable, necessary, program-related, and properly documented. Further, all purchases must be supported with invoices that list the items purchased, the dates of the purchases and payments, and canceled checks. Certain costs, such as personal expenses and expenses not related to the educational program, are not reimbursable. KQC's Executive Director reported personal and other inappropriate costs for reimbursement. In total, we determined that KQC claimed $99,790 for ineligible other than personal service costs.

Leased Space and Related Costs

Written approval from the Commissioner of Education or his designee is required before instructional or non-instructional space can be leased and/or improved. However, KQC did not receive prior approval from SED for the following lease and building improvement costs totaling $31,925, as follows.

- KQC claimed $20,890 to rent office space within a private residence owned by the KQC's owner and her former spouse. This space was not approved by SED. We also disallowed an additional $3,660 in claimed expenses for facility improvements, utilities, and cable service related to this residential office property; and
- KQC claimed $7,375 for capital improvements at the Manhattan property it leases for business operations. KQC did not obtain approval from SED for these improvements.

Vehicle Expenses

Mileage for a privately-owned vehicle used for business purposes is eligible for reimbursement if such use is documented by a vehicle log that includes the date and time of the travel, the destination(s), the mileage to and from the points of travel, the purpose, and the name of the traveler. Further, certain expenses (i.e., lease, depreciation, insurance, gas, tolls, and parking) for a privately-owned vehicle are not eligible for reimbursement.

However, KQC claimed a total of $32,120 in expenses related to the owner's personal vehicle that were ineligible for reimbursement. These costs included $11,160 for a car lease (although there was no lease). KQC's owner purchased the vehicle with public funds, and the vehicle was registered, titled and insured under the owner's name. The disallowed costs also included $14,905 in depreciation and $5,450 for insurance. KQC's officials stated they inadvertently misclassified eligible mileage expenses under the improper categories. However, vehicle logs that officials provided did not include the required information - such as the date of the travel, the name of the individual who traveled, and the purpose of the trip. We also disallowed $605 for gas, tolls and parking costs that KQC's Executive Director claimed for the use of her personal vehicle.

Organization Expenses

Organization expenses incurred to establish a school are eligible for reimbursement during the first five years of operation. However, KQC's educational program had existed since 2001, and therefore, organization costs (totaling $16,247) were not eligible during our audit period - which began in September 2007 (six years after KQC began operations). Furthermore, the organizational costs included ineligible items (such as food and groceries), and supporting documentation indicated that $11,032 in claimed costs were not incurred during our audit period.

Training, Education and Conferences

We disallowed expenses totaling $12,130 for training, education, conferences and their related travel costs that were incurred by KQC's Executive Director. Of this amount, $5,622 related to two training courses that the Executive Director purportedly attended in 2007-08 and 2008-09 in a foreign country. The Executive Director told us that the training she attended in 2007-08 was on a research-based teaching methodology that is not widely known or practiced in the United States. However, the support documentation provided did not demonstrate that the training related to (or benefited) KQC's education program, and it did not justify the costs for overseas travel. In addition, the documentation was not prepared contemporaneously with the costs in question. Instead, the Executive Director prepared the documentation pursuant to our audit inquiry.

We also disallowed $5,308 for conference expenses in excess of limits prescribed by SED. Each employee is limited to three off-site conferences within a 12-month period, and for conferences held out-of-state, the limit is three days per conference. However, the Executive Director claimed expenses for five conferences she attended during July 2008 through June 2009. Further, two of the conferences were held for 14 days each - in excess of the 3-day limit. The remaining $1,200 in disallowances pertained to coursework that was not related to KQC's education program and expenses which lacked adequate supporting documentation.

Other Ineligible Other Than Personal Service Costs

We disallowed $7,368 in various other ineligible costs. Specifically, we determined that KQC claimed:

- $4,826 for office supplies and materials, but the charges were actually for personal expenses - which are not reimbursable. Among the items claimed were Ticketmaster charges, fees for an online dating website, taxi cabs, cable service, books, foreign news magazines, food and meals;
- $1,445 for legal fees not related to KQC's educational program, overstated costs for property and casualty insurance, expenses attributable to another program, and other ineligible expenses; and
- $1,097 for two cell phone lines (registered under the owner's name) that were used by the owner's former husband and their daughter. KQC could not provide us with some of the bills for each line. Also, KQC did not allocate the expenses for the cell phone used by her former husband. Finally, the daughter was not entitled to a company provided cell phone.

Non-Compliance With Procedural Requirements

KQC did not comply with provisions of the Manual pertaining to a less-than-arms-length business relationship, time and attendance records, and the classification of expenses. The inability or unwillingness to comply with these requirements in the future could jeopardize the eligibility of costs reported on the CFR.

Undisclosed Less-Than-Arm's-Length Relationship

KQC also reported in the notes to its financial statements that it had leased office space in Queens under a month-to-month agreement. However, this note omits the fact that the space was located at the private residence owned by KQC's owner and her former husband. As noted previously, we disallowed $31,925 in costs pertaining to this space because it was not approved by SED.

Employee Time and Attendance Records

The Manual requires special education providers to prepare and maintain employee time and attendance records to support the personal service costs claimed on the CFR. The time and attendance records should indicate an employee's daily attendance and charges to leave accruals. They also should be prepared contemporaneously with the payroll period covered by the record.

KQC, however, did not require its administrative staff to prepare and maintain time and attendance records. KQC officials noted that, in April 2009, they began to maintain "time card reports" for administrative staff. However, the time card reports did not record an employee's daily attendance and leave use. Rather, they summarized (totaled) the time worked by an employee during a specific period. Further, these reports were not prepared by the employees in question; nor were they prepared contemporaneously with the payroll periods in question.

Without appropriate time and attendance records, there is limited assurance that the administrative employees worked the hours for which they were paid. Further, such records are essential because KQC's administrative staff also perform work for the related services program and for KTI, the organization that they share office space with. Thus, the time and attendance records are needed to properly allocate employees' time and work efforts to the various programs they work on.

Expense Classifications

SED's Consolidated Fiscal Reporting and Claiming Manual provides guidance on the proper classification of expenses on the CFR. The proper classification of expenses is important because it helps ensure that CFR readers obtain a clear understanding of the nature of a program revenues and expenditures, and it provides a consistent basis for comparisons from one time period to another.

However, we determined that several expenses were misclassified on the CFR. For example, we determined that certain: travel and food costs were reported as organizational expenses; payroll processing and computer services were reported as office supplies; and costs for conferences, college courses and taxi fares were reported as Supplies and Materials. Some of these expenses are among the disallowances we detailed previously in this report. Moreover, the misclassification of expenses could represent a conscious effort to conceal improper charges.

Recommendations

To SED:

1. Review the disallowances resulting from our audit and make the appropriate adjustments to the costs reported on the CFRs. Adjust KQC's reimbursement rates, as appropriate.

2. Direct KQC officials to comply with the provisions of the manual pertaining to LTAL business relationships, time and attendance records, and the classification of expenses.

To KQC:

3. Ensure that costs reported on the CFR comply fully with the requirements of the Reimbursable Cost Manual.

4. Comply with the procedural guidance provided by the Reimbursable Cost Manual - particularly as it pertains to LTAL business relationships, time and attendance records, and the classification of expenses.

Audit Scope and Methodology

We audited the expenses reported by KQC on its CFRs for the fiscal years ended June 30, 2008 and June 30, 2009. The objectives of our audit were to determine whether the costs reported were properly calculated, adequately documented, and allowable under SED's Manual.

To accomplish our objectives, we reviewed KQC's financial records, including audit documentation maintained by KQC's independent certified public accountants. We interviewed KQC officials to obtain an understanding of their financial and business practices as well as those of KQC's certified public accountants. In addition, we interviewed SED officials to obtain an understanding of both the CFR and the policies and procedures contained in the Manual. We also interviewed DoE officials to discuss their procedures and policies as outlined in their contract with KQC.

To complete our audit work, we reviewed supporting documentation for certain costs reported for the program during our audit period and determined whether those costs complied with, and were allowable by, the rules established in the Manual. We also selected for review a judgmental sample of costs reported by KQC. Our sample took into account the relative materiality and risk of the various costs reported by the school. The scope of our audit work on internal control focused on gaining an understanding of the procurement and disbursement procedures related to non-personal service expenditures and personal service expenditures. We identified certain significant control deficiencies that were significant to the audit's objectives, and discussed them in the appropriate sections of our report.

We conducted our performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members (some of whom have minority voting rights) to certain boards, commissions, and public authorities. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these management functions do not affect our ability to conduct independent audits of program performance.

Authority

The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

Reporting Requirements

We provided draft copies of this report to SED and KQC officials for their review and formal comment. We considered SED's and KQC's comments in preparing this report and have included them in their entirety at the end of it. SED officials agreed with our report's findings and recommendations. KQC officials disagreed with most of our report's findings. Our rejoinders to KQC's comments are included in the report's State Comptroller's Comments.

Within 90 days of the final release of this report, as required by Section 170 of the Executive Law, the Commissioner of Education shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and if the recommendations were not implemented, the reasons why. We also request that KQC officials advise the State Comptroller of actions taken to implement the recommendations addressed to them, and where such recommendations were not implemented, the reasons why.

Contributors to This Report

Brian Mason, Audit Director
Kenrick Sifontes, Audit Manager
Sheila Jones, Audit Supervisor
Rita Verma, Examiner-in-Charge
Trina Clarke, Staff Examiner
Julia Ibrahim, Staff Examiner
Margarita Ledezma, Staff Examiner
Teeranmattie Mahtoo-Dhanraj, Staff Examiner

Division of State Government Accountability

Andrew A. SanFilippo, Executive Deputy Comptroller
518-474-4593, asanfilippo@osc.state.ny.us

Elliot Pagliaccio, Deputy Comptroller
518-473-3596, epagliaccio@osc.state.ny.us

Jerry Barber, Assistant Comptroller
518-473-0334, jbarber@osc.state.ny.us

Vision

A team of accountability experts respected for providing information that decision makers value.

Mission

To improve government operations by conducting independent audits, reviews and evaluations of New York State and New York City taxpayer financed programs.

Exhibit

Kids Quality Care, Inc.
Schedule of Submitted, Disallowed, and Allowed Program Costs
For the Fiscal Years 2007-08 and 2008-09

Program Costs	Amount Per CFR	Amount Disallowed	Amount Allowed	Notes to Exhibit
Personal Services				
Direct Care	$2,013,849	$49,378	$1,964,471	
Agency Administration	$424,703	$88,758*	$335,945	
Total Personal Services	**$2,438,552**	**$138,136**	**$2,300,416**	A – C
Other Than Personal Services				
Direct Care	$29,930	$9,683	$20,247	
Agency Administration	$295,838	$90,107	$205,731	
Total Other Than Personal Services	**$325,768**	**$99,790**	**$225,978**	A, D - R
Contracted Direct Care	**$6,936**	**$0**	**$6,936**	
Total Program Costs	**$2,771,256**	**$237,926**	**$2,533,330**	

***** Includes $73,258 reduction made by SED to the compensation of the Executive Director.

Notes to Exhibit

The Notes shown below refer to specific sections of the Reimbursable Cost Manual on which we have based our adjustment. We have summarized the applicable section to explain the basis for the disallowance. Details of the transactions in question were provided to SED and KQC officials during the course of our audit.

A. Section I - Costs must be reasonable, necessary, program-related and sufficiently documented.
B. Section 1.14 A (4)(d) - For any individual who works in more than one entity and whose FTE in total across entities exceeds 1.0, the allocation of compensation must be supported by time and effort reports or equivalent documentation. Compensation beyond 1.0 FTE for any individual in total will not be considered reimbursable in the calculation of tuition rates.
C. Section 1.14 A (10) - Bonus compensation may be reimbursed if based on merit as measured and supported by employee performance evaluations.
D. Section 1.15 B - Costs of legal, accounting or consulting services, and related costs incurred in connection with reorganization of the agency, including mergers and acquisitions, unless mandated by the State Education Department, are not reimbursable.
E. Section I.21.A - Costs incurred for entertainment of officers or employees, or for activities not related to the program, or any related items such as meals, lodging, rentals, transportation, and gratuities, are not reimbursable.
F. Section I.21.B - All personal expenses, such as personal travel expenses, laundry charges, beverage charges, gift certificates to staff and vendors, flowers or parties for staff, holiday parties, repairs on a personal vehicle, rental expenses for personal apartments, etc., are not reimbursable unless specified otherwise in this Manual.
G. Section I.23.C - Costs of food provided to any staff including lunchroom monitors are not reimbursable.
H. Section I.30 - Conferences and meetings must be directly related to the education program or to the administration of the program. Reimbursement for offsite conferences costs are limited to no more than three conferences within a 12-month period per individual. Reimbursements for costs of conferences held out of state are allowed up to three days per conference for each person. Costs for food, beverages and other related costs are not reimbursable.
I. Section I.55.A - Costs incurred for telephone service, local and long distance telephone calls, electronic facsimiles (FAX) and charges for cellular telephones, etc., are reimbursable provided that: 1) They pertain to the special education program; and 2) Long distant telephone or message charges are documented by monthly bills, and proof of payment is directly attributable to the programs funded under Articles 81 and 89.
J. Section I.55.B - Long distance telephone charges and all cell phone charges that are not properly documented will not be reimbursed.
K. Section I.57.D - Costs of personal use of a program-owned or leased automobile are not reimbursable. The costs of vehicles used by program officials, employees, or Board members for commuting to and from their homes are not reimbursable.

L. Section II A.1 - Compensation costs must be based on approved and documented payrolls. Payrolls must be supported by employee time records prepared during, not after, the time period for which the employee was paid. Employee time sheets must be signed by the employee and a supervisor, and must be completed at least monthly.

M. Section II A (4) - All purchases must be supported with invoices listing items purchased and indicating date of purchase and date of payment, as well as canceled checks. Costs must be charged directly to specific programs whenever possible. The particular program(s) must be identified on invoices or associated documents.

N. Section II A (5) - Logs must be kept by each employee indicating dates of travel, destination, purpose, mileage, and related costs such as tolls, parking, and gasoline; and must be approved by supervisor as reimbursable.

O. Section II.A (10) - Vehicle use must be documented with individual vehicle logs that include, at a minimum: the date, time of travel, to and from destinations, mileage between each, purpose of travel and name of traveler. If the vehicle was assigned to an employee, the name of the employee to whom it was assigned must also be listed.

P. Section II.C (1b) - Program and fiscal issues that require prior written approval of the Commissioner’s designees include, but are not limited to: 1) Education program expansion requiring additional staff, property-related costs, and classroom equipment, etc., when the cost is expected to be reimbursed fully or partially through the tuition rate. Written approval is required for both program and fiscal designee. 2) New or renovated facility space, both instructional and non-instructional, to be occupied by approved programs, including costs associated with such space. Written approval is required for both program and fiscal designee.

Q. Section II.C (10) - A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost.

R. Section II.C(4) - Less-Than-Arm's-Length (LTAL) Relationships must be disclosed in the notes to the audited financial statements.

Agency Comments - State Education Department

THE STATE EDUCATION DEPARTMENT / THE UNIVERSITY OF THE STATE OF NEW YORK / ALBANY, NY 12234

DEPUTY COMMISSIONER
Office of Performance Improvement and Management Services
O: 518.473-4706
F: 518.474-5392

November 30, 2012

Mr. Brian Mason
Audit Director
Office of the State Comptroller
Division of State Government Accountability
110 State Street – 11th Floor
Albany, NY 12236

Dear Mr. Mason:

The following is the New York State Education Department's (Department) response to the draft audit report (2011-S-68) of the Kids Quality Care, Inc. (KQC): Compliance with the Reimbursable Cost Manual.

In addition to the actions that will be taken in response to specific recommendations described below, the Department will closely examine the circumstances that led to the findings described in the audit report. The examination will include an assessment of the programmatic oversight and fiscal management employed by KQC's ownership and management staff and will be a factor in the consideration of the continued approval of this provider, corrective action measures that may be required, and if applicable, any subsequent renewal requests.

Recommendation 1:

Review the disallowances resulting from our audit and make the appropriate adjustments to the costs reported on the CFRs. Adjust KQC's reimbursement rates, as appropriate.

We agree with this recommendation. The Department will review and make adjustments to the CFR as noted in the report and recover any overpayments as appropriate by recalculating tuition rates.

Recommendation 2:

Direct KQC officials to comply with the provisions of the manual pertaining to LTAL business relationships, time and attendance records, and the classification of expenses.

We agree with this recommendation. The Department will provide technical assistance to KQC and recommend that officials attend CFR training. It should be noted, however, that the Department may be undertaking other actions relative to KQC based upon the nature of the findings contained within the audit report.

If you have any questions regarding this response, please contact Ann Marsh, Director of the Rate Setting Unit at (518) 473-2020.

Sincerely,

Sharon Cates-Williams

Sharon Cates-Williams

c: Commissioner King
Valerie Grey
James Delorenzo
Mary Kogelmann
Ann Marsh
James Conway

Agency Comments - Kids Quality Care, Inc.

December 4, 2012

Brian Mason, Audit Director
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, New York 12236

Dear Mr. Mason:

We have reviewed the NYS Office of State Comptroller's (OSC) draft audit report 2010-S-68 dated October 2012 of Kids Quality Care (KQC) and have identified certain factual inaccuracies in the report as well as certain instances where we believe that principles contained in the governing Reimbursable Cost Manual (RCM) have been misapplied or misinterpreted. Although the audit staff had generally conducted themselves in a professional and helpful basis, there are circumstances where we have provided explanations to the auditors and or provided them with supporting documentation which seems to be misunderstood or simply ignored. Based on these inaccuracies we challenge the report findings and their validity.

* Comment 1

The following is our item by item response to the audit findings which will explain the basis of our contentions.

Audit Findings and Recommendations

Personal Service Costs - *Compensation of Executive Director*

This comment is moot given the fact that it had been addressed administratively with SED's Rate Setting Unit (RSU) more than a year before OSC's audit had started. The RCM actually does allow staff to be greater than a 1.0 FTE between organizations, including related organizations, but we agreed to limit our reimbursable compensation to a 1.0 FTE based on our discussions with RSU. Therefore, the inclusion of this comment in this report is not appropriate as this is not a reimbursed cost to the organization.

* Comment 2

Personal Service Costs – *Bonuses*

The assertion that KQC's Executive Director received a bonus is factually incorrect. The payment that is cited in the report is in fact a late payment of the Executive Directors annual compensation. Private agencies need to navigate their cash flow and the Executive Director is always the last to be paid. While it is true that it was paid at the same time as the staff bonuses that does not however define the payment as a bonus. In fact, by definition an owner/CEO cannot give themselves a merit based bonus. It is always compensation which is then subjected to SED's own Median Salary Screen designed to impose limits on CEO compensation. Even including this compensation, the CEO's compensation was less than

* Comment 3

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* See State Comptroller's Comments, Page 23.

the Median Salary level. In addition in 2007/08 and 2008/09 the NYSED RSU disallowed portions of the Executive Director compensation in excess of the stated bonuses. Therefore, this amount had already been excluded from reimbursable costs. Therefore, this adjustment is factually incorrect and should be removed from the report.

The statement that the bonuses paid to staff were not based on merit is completely wrong. It appears that OSC is misunderstanding which periods the bonuses paid relate to. The bonuses for the year ended June 30, 2007 were accrued as of June 30, 2007 but were paid in December 2007. These bonuses relate to the work performed in 2006/07 and the evaluations that they received in 2006/07. OSC has been matching the bonuses paid in December 2007 (for 2006/07 services) to the evaluations done for the 07/08 year. Therefore, since they are trying to correlate evaluations and bonuses from different fiscal years, it is not surprising that there are some inconsistencies between the two. If they had matched the bonuses paid for 2007/08 to the performance evaluations for 2007/08 for the individuals they cited, they would have seen that the evaluation scores do correlate with the bonuses paid. Similarly the auditors are miss-matching the 2008/09 evaluations with the 2007/08 bonuses that were accrued as of June 30, 2008, but were paid during the 2008/09 school year. The statement that we did not provide evaluations for employees receiving bonuses in 2008/09 is also incorrect, evaluations were provided for all staff receiving bonuses.

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Comment
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We were unaware of the auditors' miss-matching bonuses and the years they relate to since the auditors had not discussed this issue with us until after the "closing conference" in February 2012. At that time we showed the audit team the way we calculated the bonuses and there did not seem to be any questions that we had not answered to their satisfaction. Bonuses were clearly based on merit as documented in the employee evaluations provided to the auditors. We tried on numerous occasions to explain this to the auditors to no avail. Therefore, this adjustment is factually incorrect and should be removed from the report.

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Comments
4 and 5

Other Than Personal Service Costs – Leased Space and Related Costs

We take exception to the disallowance of the expenses for the storage/office space in Queens based on it not having prior approval from SED. The Queens space charged to the program is used exclusively for storing children's records for KQC and as an off hour office space. The expenses incurred were for shelving used for storage of files and costs associated with operating the office. These costs were charged to KQC at cost in accordance with the Reimbursable Cost Manual guidelines. The auditors never visited this location to see how it was used by KQC and therefore has no basis to disallow the cost. In addition, as this site was not used by teachers or children, we contest the assertion that it required formal approval from SED. We do not believe that the requirement to obtain a "program modification" approval from SED relates to record storage space. We know of no school that has sought or received approval of space for storing records. And the disallowances for the off hour office space does not recognize the practicalities of today's business world where work is often done at nights and on weekends. Therefore, we request that this finding be removed from this report.

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Comment
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* See State Comptroller's Comments, Page 23.

We take exception to the disallowance of the leasehold improvements made to the Manhattan office location. Kids Quality Care did get approval for the space from the Commissioner of Education's designee. The cost of incurring depreciation on leasehold improvements was directly related to that lease. When we negotiated the lease, we could have paid a higher rent ($4 a square foot more) to have the renovations built into the lease. Instead, as a cost savings measure, we decided to elect a lower lease payment and incur the renovation costs ourselves. Therefore, these costs are not separate leasehold improvements unrelated to the approved lease of the facility. Instead they merely represent a more cost effective method of paying for necessary space which had been approved by SED. Not including the renovations in the lease will result in even more savings when the space is up for renewal as any increase in rent will be starting from a lower base than if the renovations had been built into the rent. In fact that was the case when the lease expired in October 2010 and since the space was well maintained, there was no additional renovations necessary we could negotiate a much lower rate resulting in significant costs savings to KQC and the State. The basis for this disallowance is incorrect and therefore it should be removed from this report.

* Comment 7

Other Than Personal Service Costs – Vehicle Expenses

We acknowledge that the vehicle costs were inadvertently categorized on the CFR as a lease instead of charges for a car owned by the Executive Director. And based on that, we are not entitled to reimbursement based on either a lease payment or the depreciation of the car. However, in accordance with the Reimbursable Cost Manual KQC should still be entitled to reimbursement for its business related travel expenses based on the mileage rate allowed by the Internal Revenue Service for automobile travel. Therefore, we request that the disallowance be adjusted to reflect the inclusion of documented business use of the car.

* Comment 8

Other Than Personal Service Costs – Organization Expenses

We take exception to the disallowance of the expenses under this category. These expenses were not organization expenses, but were other allowable expenses inadvertently reported on that line on the CFR. In February 2012 in a follow-up site visit, we provided the auditors with the list of items that were in these expenses, but they continue to disallow them on the basis that organization costs should have been fully amortized in the first five years of KQC's operations. Since these were not organization expenses, the basis for this disallowance is incorrect and therefore it should be removed from this report.

* Comment 9

Other Than Personal Service Costs – Training Education and Conferences

We take exception to the disallowance of the training course that the Executive Director attended in 2007-08. The conference was about a research-based teaching methodology used widely outside of the United States that is applicable to preschool children with disabilities. It was therefore directly related to KQC's SEIT program. We did show the audit team the agenda and three books about the methodology presented at the conference. At no time during the field audit did OSC indicate that the supporting information was insufficient or unsatisfactory, and the field auditors did not request additional supporting documentation despite being on KQC's premises for six months. There is no

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* See State Comptroller's Comments, Page 23.

prohibition in the Reimbursable Cost Manual against traveling abroad to learn about developments in the field, especially when those developments are not widely known or practiced in the United States and may produce a benefit to the SEIT program and the children who attend it. Thus the conference costs and associated travel should not be disallowed.

* Comment 10

Other Than Personal Service Costs – *Other Ineligible Other-Than-Personal-Service Costs*

We take exception to the complete disallowance of the cell phone expense. In another cost savings measure, instead of having two separate cell phone plans, one for each company, we obtained the cell phones for Kids & the Training Institute (KTI) and KQC under one plan. By doing this, the second phone line was only $10 a month instead of significantly more for a separate plan. Due to the relatively small amounts of these transactions, we had accounted for these by charging both phones to one company in one year and then charging both phones to the other company in the next year. Therefore, for the purpose of this audit, the phone should not be entirely disallowed since one of the phones was clearly related to the executive director's work at KQC. In addition, this cost needs to be added back to KQC's expense in the next year since they were not charged for any phones in that year.

* Comment 11

Non-Compliance with Procedural Requirements

Undisclosed Less-Than-Arms-Length relationship

We take exception with the findings that we did not disclose the less-than-arms-length relationship with Kids & the Training Institute. All transactions between the companies were fully disclosed on CFR-5 "Transactions with related organizations" in accordance with the Consolidated Fiscal Reporting Manual requirements. In addition, under Generally Accepted Accounting Principles (GAAP), KTI and KQC are not related entities, and disclose in the notes to the financial statement is not necessary. Therefore, the statement that the notes to the financial statements did not disclose the relationship is misleading as it implies that the financial statements were inaccurate and that the intercompany transactions were not appropriately disclosed to SED on the CFR. Therefore, we request that this finding be removed from this report.

* Comment 12

Employee Time Records

Although we acknowledge that KQC had not maintained time and attendance records for its administrative staff for a portion of the audit period (July 2008 through March 2009) it is important to note that we had already implemented a time-clock system in the office in April 2009 prior to the initiation of the audit. Therefore, we had already implemented procedures in order to be compliant.

* Comment 13

Expense classification

We agree with the auditor's statement about the importance of reporting costs in their appropriate category, and we always strive to attain this. However, we disagree with the unilateral statement that "many" expenses were misclassified on the CFR. We are a very small agency and do not have the accounting staff of some larger schools. Therefore, miss-postings sometimes do occur and are

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* See State Comptroller's Comments, Page 23.

then not picked up. However, these are the exception and are not the "many" as implied by the audit. In addition, these miss-postings identified during the audit were for minor expenses of the company and because of their small size were difficult to detect. Therefore, we request that this finding be adjusted to reflect the de minimis nature of these findings.

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Comment
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Items Not Discussed in this Report

We understand that the auditors function is to find and report on areas of non-compliance with the Reimbursable Cost Manual (RCM). However, we feel that this is a misleading presentation since it does not site any positive findings which occurred most of the time. By presenting their findings in this one sided basis, it paints a picture of disregard for rules and regulations as opposed to simply a case of record keeping mistakes or differing interpretation of the requirements of the Reimbursable Cost Manual. The audit field work went on for well over six months and almost all of the items requested and reviewed by the auditors were fully in compliance with the RCM requirements. We feel that those findings should be disclosed in the report in order to present a true picture.

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Comment
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In addition, the findings fail to discuss Kids Quality Care's long track record of providing quality services to preschool children with disabilities in attaining and exceeding their educational goals. This is the purpose and goal of our company and we are proud of our successes in attaining those goals.

The report also fails to mention that Kids Quality Care's reimbursement rate was one of the lowest SEIT rates in New York City. For the two years that were audited (June 30, 2008 & 2009), KQC's SEIT rate was below the Regional Weighted Average by $12 and $13 per service. This is 25% below the "average" rate paid to other SEIT providers in NYC. Based on this, KQC was paid over $850,000 less than a provider with an "average" rate would have been paid for providing the same services during those two years. Therefore, KQC has provided quality SEIT services at a significant savings to New York State compared to other SEIT providers. These savings should be taken into consideration when reviewing the impact of these findings.

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Comment
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In order to not be misleading, we respectfully request that you revised your report to make the aforementioned adjustments to your findings. We would be happy to discuss these issues with you in more length if you desire.

Sincerely,

Cohen

Orly Cohen,
Executive Director

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* See State Comptroller's Comments, Page 23.

State Comptroller's Comments

1. We did not ignore any explanations or documentation provided by KQC. In fact, we carefully assessed and considered any explanation and documentation provided by KQC in conducting our audit and preparing our report. Also, where appropriate, we modified our report to reflect comments or information provided by KQC. Further, as noted in their response, SED officials concurred with our findings and recommendations.
2. For the 2007-08 year, the costs in question were included on the CFR subject to our audit. Consequently, it was appropriate for us to review and comment on this matter, irrespective of the actions taken by SED (which we acknowledge in the report). Further, the Reimbursable Cost Manual (Manual) limits reimbursement for an employee who works for more than one entity, including organizations with a less-than-arm's-length relationship, to 1.0 FTE.
3. KQC's general ledgers and payroll journals classified the payment in question to the Executive Director as a bonus. Moreover, in their response, KQC officials note that: "NYSED RSU disallowed portions of the Executive Director compensation in excess of the stated bonuses."
4. We did not mismatch bonus payments and the corresponding performance evaluations. KQC reported its December 2007 bonus payments on the CFR for the 2007-08 year. Similarly, bonuses paid during in the 2008-09 year were reported on the CFR for the 2008-09 year. KQC officials provided us with evaluations and other documentation for some of the bonuses paid during those years. However, we disallowed those bonuses that did not comply with the Manual.
5. We discussed issues related to bonuses with KQC officials on several occasions during and subsequent to the audit's fieldwork. During such discussions, we advised KQC officials of bonuses which did not comply with the Manual.
6. As noted in our report, the space in question is located at the personal residence (in Queens) of KQC's Executive Director. Further, we maintain that KQC should have received SED's prior approval to use this space for KQC operations and to claim the related "rental" costs. Moreover, we advised SED of this matter, and SED officials concurred that KQC should not have claimed reimbursement for space in the Executive Director's personal residence in Queens.
7. The fact remains that KQC did not request or obtain the prior SED approval (required by the Manual) to make the leasehold improvements in question. KQC officials should have advised SED of its plans (including the estimated costs) to renovate the space when it requested SED's approval to rent it.
8. KQC claimed lease payments and depreciation expense on a personal vehicle purchased with public funds, and as such, these expenses are not allowable. The Manual allows reimbursement for the business use of a personal vehicle if such use is supported by a log that distinguishes personal mileage from business mileage. However, the mileage logs provided by KQC did not comply with the Manual.
9. The costs in question would remain ineligible even if they were transferred to another CFR line item. As noted in the report, these costs included ineligible items such as food and groceries. Also as noted in the report, supporting documentation indicated that most of

the costs were not incurred during our audit period.

10. We acknowledge that the Manual does not prohibit foreign travel for training. However, out-of-state training is limited to three days - and the foreign travel in question was for nine days. Moreover, the documentation provided by KQC did not demonstrate that the training was necessary, directly related to KQC's education program, and reasonable. Also, we discussed this issue with KQC officials during the course of the audit.
11. We amended our report to allow the cell phone charges (totaling $548) of KQC's Executive Director.
12. As detailed in the report, the Less-Than-Arms-Length relationship in question pertained to KQC's lease of space in the Executive Director's personal residence in Queens (and not to the relationship between KQC and KTI).
13. We acknowledge the time-clock system KQC implemented in April 2009. However, as detailed in the report, KQC did not require administrative staff to prepare and maintain time and attendance records as prescribed by the Manual.
14. We amended our report to note that "several" expenses were misclassified.
15. The Exhibit to our report summarizes both the allowed and disallowed costs resulting from our audit. Thus, we used a comprehensive and balanced approach to conduct our audit work and present our findings. By design, our report details non-compliance with the Manual so that focus can be placed on those matters requiring corrective actions.
16. Our audit scope was limited to the CFRs submitted by KQC and their compliance with the Manual. Thus, we did not compare KQC with any other special education provider. Moreover, we have no basis to comment on the quality of services provided by KQC.