New York State Office of the State Comptroller
Thomas P. DiNapoli

Division of State Government Accountability

Compliance With the Reimbursable Cost Manual

Kids & the Training Institute, Inc.
State Education Department

Report 2010-S-69

February 2013

Executive Summary

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

Background
KTI, a privately-owned company located in New York City, provides special education itinerant teacher (SEIT) and related services to disabled preschool children. KTI subleases from and shares office space with another privately-owned special education company, Kids Quality Care, Inc. (KQC). The New York City Department of Education (DoE) pays tuition and fees to KTI using rates set by SED, which are based on financial information KTI presents in an annual CFR filed with SED. The State reimburses the DoE for a portion of its payments to KTI. For the two fiscal years ended June 30, 2009, KTI claimed and received $3.3 million in public support.

Key Findings
- KTI claimed $287,952 in costs that were not properly calculated, adequately documented, or allowable for the two years covered by our audit. The disallowances include $215,592 in personal services, and $72,360 in other-than-personal services.
- The personal service disallowances consisted of $44,824 in excess salary costs for its Executive Director, $169,648 in unsupported bonus payments, and $1,120 in gift cards to employees.
- The other-than-personal-service disallowances we identified included (among a range of improper charges) $31,577 for ineligible vehicle costs, $16,389 for numerous personal expenses, and $3,753 in expenses claimed for the private residence of the Executive Director.
- KTI did not comply with provisions of the Manual pertaining to a less-than-arm's-length relationship with KQC, time and attendance records, and the classification of expenses.

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 KTI officials to comply with provisions of the Manual pertaining to less-than-arm's-length (LTAL) relationships, time and attendance records and classification of expenses.
- KTI should comply with the procedural guidance provided by the Manual (e.g. LTAL business relationships, program modifications for business location) and ensure that costs reported on the CFR comply fully with the requirements in the Manual.

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

Mr. Yair Cohen
Executive Director
Kids & the Training Institute, Inc.
380 Lexington Avenue
New York, NY 10168

Dear Dr. King and Mr. 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. This 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 & the Training Institute, 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 draft report, please feel free to contact us.

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

Table of Contents

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Background

Kids & the Training Institute, Inc. (KTI), 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 KTI using rates set by the New York State Education Department (SED). SED sets these rates using financial information that KTI 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 rate-setting purposes. DoE uses the SED rates to pay for services and then is partially reimbursed by SED.

KTI is privately-owned and subleases building space from (and shares office space in Manhattan with) another privately-owned special education company, Kids Quality Care (KQC). We audited KTI's and KQC's compliance with the Manual concurrently. The Executive Directors/Owners of KTI and KQC were married to one another, and each is employed by 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, KTI claimed and received $3.3 million in public support.

Audit Findings and Recommendations

KTI claimed ineligible costs totaling $287,952 during the audit period (see Exhibit). This included $215,592 in ineligible personal services costs and $72,360 in ineligible other-than-personal-service and contracted direct care costs. In addition, we identified non-compliance with certain procedural requirements prescribed by SED which must be addressed by KTI officials.

Personal Service Costs

Personal service costs include salaries, bonuses, and fringe benefits. We disallowed personal service costs totaling $215,592 for the two-year audit period. The disallowances included $169,648 in unsupported bonus payments, $44,824 in excessive salary costs for the Executive Director/Owner, and $1,120 in ineligible costs for gift cards given to employees.

Bonus Payments

The Manual states that bonuses may be reimbursed if they are based on merit, as measured and supported by employee performance evaluations. KTI's Executive Director claimed reimbursement for $30,000 in bonuses he awarded to himself during our audit period, and KTI claimed an additional $139,648 in bonuses for other employees. (29 employees received bonuses in 2007-08, and 29 employees received bonuses in 2008-09.) We concluded, however, that the bonuses were not based on merit.

During our audit, KTI 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 KTI officials that bonuses must be merit-based, they provided us with performance evaluations for 13 of the 29 employees who received bonuses in 2007-08 year. The evaluations were based on a scale of 1 to 5, with 5 being the highest level of performance.

However, we determined that the performance evaluations for the 13 employees were not consistent - as they did not correspond with the amounts of the bonuses paid. For example, an employee with a performance rating of 5 received a bonus of $1,150; whereas an employee with a rating of 3 received a bonus of $1,500. Further, KTI paid bonuses to two (of the 13 employees) before their evaluations were completed. Consequently, we questioned whether the bonuses, claimed for the 2007-08 year, were actually based on the evaluations. For the 2008-09 year, KTI officials provided no evaluations for the 29 employees who received bonuses.

Subsequently, KTI 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, KTI officials could not provide documentation to 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 ($169,648) of the bonus payments claimed by KTI.

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 his position at KTI, the Executive Director also worked as the Assistant Executive Director for Kids Quality Care (KQC), the company owned by his former wife. As such, KTI's Executive Director worked 1.5 FTE positions and received compensation totaling $275,199 ($220,059 at KTI and $55,140 at KQC) during the 2007-08 fiscal year. However, KTI 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 KTI reported $44,824 more than it should have for the compensation of the Executive Director. (Note: At the time of our audit fieldwork, SED had already adjusted the amount of the owner's allowable compensation given the positions he held concurrently at his company and at KQC).

Gift Cards

The Manual also states that expenses for gifts given to employees are not reimbursable. Consequently, we also disallowed $1,120 for gift cards, distributed to KTI employees, which were charged as personal service costs to KTI's SEIT program.

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. KTI's Executive Director reported personal and other inappropriate costs for reimbursement. In total, we determined that KTI claimed $72,360 for ineligible other-than-personal-service and contracted direct care costs.

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 travel, destination(s), mileage to and from the points of travel, and the purpose and name of the traveler. Further, certain expenses (i.e., lease payments, depreciation, insurance, gas, and parking) for a privately-owned vehicle are not eligible for reimbursement.

However, KTI claimed $31,577 in lease payment, depreciation, insurance, fuel and parking costs for the owner's personal vehicle - all of which are ineligible. Although no car was leased, these claimed costs included $15,648 in car lease payments. KTI's owner purchased the vehicle with public funds, and the vehicle was registered, titled and insured under his name. The disallowed costs also included $11,824 in depreciation, $3,890 for insurance and $215 for gas and parking charges. KTI'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 travel and the name of the individual who traveled. The logs also showed that the traveler used the vehicle to commute to and from home.

Personal Expenses

We disallowed $20,142 for personal expenses which did not benefit the programs of KTI. This included $16,389 in payments for food and meals, prescription drugs and other pharmacy items, dental services, fees for an online dating website, spa and hair salon services, an iPhone, Broadway show tickets, flowers, candles and a foreign web TV subscription. In addition, KTI's Executive Director claimed expenses (totaling $3,753) for his private residence in Queens. Specifically, we disallowed charges of $2,288 for furniture and supplies; $1,265 for phone installation, cable TV and international calling services; and a $200 mortgage payment. All of these expenses were unrelated to KTI's programs, and were ineligible for reimbursement.

Leasehold Improvements

Written approval from the Commissioner of Education or his designee is required before improvements to instructional or non-instructional space can be made. We disallowed $7,875 KTI claimed for capital improvements made at the Manhattan property it subleases from KQC. Neither KTI nor KQC had obtained SED's approval for these capital improvements, as required.

Other Ineligible Other-Than-Personal-Service Costs

We disallowed $12,766 in various other ineligible costs. Specifically, the disallowances included:

- $4,770 for legal fees not related to its educational program. The disallowed costs include expenses paid to handle immigration matters, such as work visas and permits;
- $3,141 for training, education and related costs (including travel) incurred by KTI's Executive Director. This included $1,900 for the Executive Director's airfare overseas to purportedly attend a training course and $527 for telephone charges while overseas. We determined that the supporting documentation was not contemporaneous with the training. The Executive Director (not the course instructor) prepared the documentation to comply with our audit inquiry. Further, the documentation did not demonstrate that the training was related to KTI's education program. Moreover, the costs for overseas travel were not justified (as the course was for "document management"). The remaining $714 in disallowances pertained to another course the Executive Director took that was not related to KTI's programs and other miscellaneous costs related to training;
- $2,263 for telephone expenses, including $1,535 for two cell phones registered to the Executive Director. These cell phones were actually used by the Executive Director's former wife and their daughter. As previously noted, the former wife worked concurrently

for KTI and KQC. However, KTI did not allocate the cell phone expenses between KTI and KQC. Instead, all of the expenses were claimed on KTI's CFR. Moreover, the daughter was not an employee of KTI, and therefore, her cell phone expenses are personal and should not be claimed on the CFR. We also disallowed $728 claimed on the CFR for cable, TV and Internet charges, and prepaid calling cards. KTI did not provide documentation to support the business nature of these charges;

- $2,203 for equipment depreciation for KQC. KTI had purchased eight laptops; however, the laptops are used by both KTI and KQC employees. The disallowed amount is the depreciation expense applicable to KQC; and
- $389 for contracted direct care costs. KTI did not have documentation to support this expense.

Non-Compliance With Procedural Requirements

KTI did not comply with provisions of the Manual and other SED requirements pertaining to the disclosure of less-than-arm's-length (LTAL) business relationships, time and attendance records, the classification of expenses, and approvals of program (site) modifications. 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

SED requires special education providers to disclose LTAL relationships in the notes of their financial statements. The disclosure of LTAL relationships and transactions is necessary to help ensure the propriety of costs claimed for reimbursement. However, KTI's owner failed to disclose in the financial statements, his business relationship with his former spouse and her company (KQC). KTI's owner and his former wife worked for each other's business, shared common office space, and KTI also received interest free loans from KQC. These circumstances should have been disclosed in the financial statements.

For example, in addition to being the Executive Director of her own company, the former wife of KTI's owner was employed as the Supervising Teacher at KTI. In this role, she made important programmatic decisions and received compensation of $68,948 for 2007-08 year. However, KTI did not disclose this relationship in its financial statements. Similarly, KTI's owner worked as an Assistant Executive Director at KQC and was paid $55,140 in 2007-08. This LTAL relationship was also not disclosed in the financial statements. (As noted previously, we disallowed $44,824 in KTI's personal service costs because the owner also worked for and was compensated by KQC.) In addition, although KTI's financial statements note that it subleased office space from KQC, the statements do not disclose the LTAL relationship between the two owners and their respective companies.

Employee Time 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.

However, KTI did not require its administrative staff to prepare and maintain time and attendance records. 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 KTI's administrative staff also perform work for the related services program and for KQC, the organization with which they share office space. 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's revenues and expenditures. Proper classification also provides a consistent basis for comparing the financial activity of one program year to other program years. Moreover, the misclassification of expenses could represent a conscious effort to conceal improper charges.

However, we determined that several expenses were misclassified on the CFR. For example, costs for food, payroll processing and computer consulting services were reported as office supplies and/or organizational expenses, and some legal fees were reported as office supplies. Some of these expenses are among the disallowances we detailed previously in this report.

Unapproved Program Site

SED requires special education providers to request and obtain a "program modification" approval to change a program location or to add a new site. KTI has operated from the SED-approved Manhattan facility it subleases since starting its program in 2005. In addition, KTI listed another location (in Queens) on forms filed with SED. At the time of our audit, however, KTI officials had neither requested nor obtained formal SED approval for the Queens location.

Recommendations

To SED:

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

2. Direct KTI officials to comply with the provisions of the Manual and other Department requirements pertaining to LTAL business relationships, time and attendance records, the classification of expenses, and SED program site approval.

To KTI:

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

4. Comply with the procedural guidance provided by the Manual and other Department requirements - particularly as it pertains to LTAL business relationships, time and attendance records, the classification of expenses, and SED program site approval.

Audit Scope and Methodology

We audited the expenses reported by KTI 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 KTI's financial records, including audit documentation maintained by KTI's independent certified public accountants. We interviewed KTI officials to obtain an understanding of their financial and business practices as well as those of KTI'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 KTI.

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 KTI. 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 KTI officials for their review and formal comment. We considered SED's and KTI'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. KTI officials disagreed with most of our report's findings. Our rejoinders to KTI'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 KTI 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

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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 & the Training Institute, 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		$140,768	$2,225,913	
Direct Care	$2,366,681			
Agency Administration	$545,193	* $74,824	$470,369	
Total Personal Services	**$2,911,874**	**$215,592**	**$2,696,282**	A - C
Other-Than-Personal-Services				
Direct Care	$28,741	$1,114	$27,627	
Agency Administration	$369,211	$70,857	$298,354	
Total Other-Than-Personal-Services	**$397,952**	**$71,971**	**$325,981**	A, D - R
Contracted Direct Care	**$819**	**$389**	**$430**	A
Total Program Costs	**$3,310,645**	**$287,952**	**$3,022,693**	

*Includes $44,824 adjustment 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 KTI 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 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.
E. 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.
F. Section I.23.C - Costs of food provided to any staff including lunchroom monitors are not reimbursable.
G. Section I.30. - Conferences and meetings must be directly related to the education program or to the administration of the program. Costs for food, beverages and other related costs are not reimbursable.
H. 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.
I. Section I.55.B - Long distance telephone charges and all cell phone charges that are not properly documented will not be reimbursed.
J. 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.
K. 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.
L. 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.

M. 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.

N. 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.

O. 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.

P. 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.

Q. Section II.C(4) - Less-than-arm's-length (LTAL) Relationships must be disclosed in the notes to the audited financial statements.

R. Appendix D - II.A - All applications for capital projects for preschool only programs must be submitted via the "Approved Preschool Special Education Program Modification Requests" process. Preschool programs considering a capital project, a change in program location or adding a new site or deleting an existing site should contact their Regional Associate for further guidance on the required procedures.

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
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November 30, 2012

Mr. Brian Mason
Audit Director
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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-69) of the Kids & the Training Institute, Inc. (KTI): 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 KTI'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 KTI'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. This will entail additional discussion with the Office the State Comptroller's auditors and review of auditor's worksheets showing how disallowances are to be applied by expense category and year since this was not specifically identified in the report.

Recommendation 2:

Direct KTI officials to comply with the provisions of the Manual and other Department requirements pertaining to LTAL business relationships, time and attendance records, the classification of expenses, and Department program site approval.

We agree with this recommendation. The Department will provide technical assistance to KTI and recommend that officials attend CFR training. It should be noted, however, that the Department may be undertaking other actions relative to KTI 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 & the Training Institute, Inc.

December 5, 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-69 dated October 2012 of Kids & the Training Institute, Inc. (KTI) 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 – *Bonuses*

The assertion that KTI'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 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.

* Comment 2

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

1

* See State Comptroller's Comments, Page 23.

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 from the example given 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.

* Comment 3

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. The first time the bonuses were discuses was at the "closing conference" were it was agreed that there will be another field day ay our office to see the actual figures. The meeting was set to February 2012 were 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.

* Comments 3 and 4

In addition, the auditors incorrectly included $7,890 of regular salary for services provided during the 2007/08 school year in the amount of bonuses to be disallowed. These payments relate to a late payment to four teachers who had submitted their timesheet for June 2008 after the June payroll had already been run. We paid this to them in 2008/09 at the same time as the bonuses were paid. However, these payments were for actual hours of service worked and are not related to the bonuses. Therefore, these payments should not be included in this finding.

* Comment 5

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 6

Personal Service Costs – Gift Cards

We are not formally contesting the disallowance of gift cards of $1,120 that were given out to our direct care staff. However, we feel that the amounts were de minimis and that providing small gifts to employees for their important events, such as having babies, is a reasonable business policy followed by most companies in both the public and private sectors.

* 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

* See State Comptroller's Comments, Page 23.

reimbursement based on either a lease payment or the depreciation of the car. However, in accordance with the Reimbursable Cost Manual KTI 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 – Personal Expenses

We take exception to the disallowance of the expenses for the storage/office space in Queens. This space was used exclusively for storing children's records for KTI 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 KTI at cost in accordance with the Reimbursable Cost Manual guidelines. The auditors never visited this location to see how it was used by KTI and therefore has no basis to say that it was unrelated to KTI's program. 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.

* Comment 9

Other Than Personal Service Costs – Leasehold improvements

We take exception to the disallowance of the leasehold improvements made to the Manhattan office location. This space is sublet from Kids Quality Care, another SEIT provider. Kids Quality Care did get approval for the space from the Commissioner of Education's designee which should then apply to KTI as well. In fact SED was provided with the sublease when KTI filed its first CFR back in 2005/06. Therefore, SED did request, review and thereby approve the lease as part of its CFR desk audit process. In addition, 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 resulted in even more savings when the space is up for renewal since the increase in rent started 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 KTI and the State. The basis for this disallowance is incorrect and therefore it should be removed from this report.

* Comment 10

* See State Comptroller's Comments, Page 23.

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 Quality Care and KTI 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 KTI. In addition, this cost needs to be added back to KTI's expense in the next year since they were not charged for any phones in that year.

* Comment 11

Additionally, the equipment depreciation relating to Kids Quality Care's (KQC) laptop, inadvertently reported on KTI's CFR should be added to KQC's reimbursable costs as part of the rate setting process.

* Comment 12

We could not find the documentation for the $389 of contracted direct care costs. However, these were necessary expenses which we incurred.

* Comment 13

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 Quality Care. 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 14

Employee Time Records

We take exception with the findings that we did not maintain time and attendance records for its administrative staff since it fails to mention that KTI had already implemented a time-clock system in the office in April 2009 long before the initiation of the audit. Failure to mention this fact is misleading.

* Comment 15

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 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

* Comment 16

* See State Comptroller's Comments, Page 23.

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.

Unapproved Program Site

As previously discussed, KTI subleases its space from Kids Quality Care (KQC). When KQC moved to the Manhattan office, they had notified SED and had received approval of the space. KTI recently sent to SED RSU a change of address request so reflect the actual current address. However, since the site on the initial SEIT application that was approved by SED, and the current sublease location is approved as well, we fail to see how this location was unapproved.

* Comment 17

Items Not Discussed in this Report

As mentioned we are a very small agency and do not have the accounting staff of some larger schools, therefore we are able to provide low cost services to NYC DOE. In our opinion the State should encourage more small agencies to provide services by reducing the complexity of the system. We also strongly feel that the State should make the SEIT program a fee base service (similar to related services). This would eliminate administrative burden to both the agencies and the State, and result in a more savings to the State, in addition to efficient and effective program.

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 almost 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.

* Comment 18

In addition, the findings fail to discuss Kids & the Training Institute'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.

* Comment 19

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,

Yair Cohen,
Executive Director

5

* See State Comptroller's Comments, Page 23.

State Comptroller's Comments

1. We did not ignore any explanations or documentation provided by KTI. In fact, we carefully assessed and considered any explanation and documentation provided by KTI in conducting our audit and preparing our report. Further, as noted in their response, SED officials concurred with our recommendations. Also, where appropriate, we modified our report to reflect comments or information provided by KTI.
2. KTI's general ledgers and payroll journals classified the payments in question to the Executive Director as bonuses. Further, in their response, KTI officials note that: "NYSED RSU disallowed portions of the Executive Director compensation in excess of the stated bonuses." Also, the bonus in question was not included in the reduction made by SED's rate-setting unit.
3. We did not mismatch bonus payments and the corresponding performance evaluations. KTI reported its December 2007 bonus payments on the CFR for the 2007-08 year. Similarly, bonuses paid during the 2008-09 year were reported on the CFR for 2008-09 year. KTI 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 provisions of the Reimbursement Cost Manual (Manual).
4. We discussed issues related to bonuses with KTI officials on several occasions during and subsequent to the audit's fieldwork. During such discussions, we advised KTI officials of the bonuses which did not comply with the Manual.
5. Throughout the audit, KTI's Executive Director indicated that these payments were bonuses. Further, KTI provided us with no documentation indicating that the payments were other than bonuses.
6. 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 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.
7. Pursuant to the Manual, gifts are not reimbursable - regardless of their amounts or to whom they are given.
8. KTI claimed lease payments and depreciation expense on a personal vehicle purchased with public funds, and these expenses are not allowable. The Manual allows reimbursement for the business use of personal vehicle if such use is supported by a log that distinguishes personal mileage from business mileage. However, the mileage logs provided by KTI did not comply with the Manual.
9. As noted in our report, KTI claimed expenses for the office space it subleased in Manhattan. We disallowed ineligible expenses claimed on the CFR, such as phone installation, cable TV, international calling services, a mortgage payment and furniture and supplies pertaining to space located in Queens (the Executive Director's personal residence) that KTI claimed on its CFR. Moreover, we advised SED of this matter, and SED officials concurred that these costs were not reimbursable.
10. The fact remains that neither KTI nor KQC (the related organization that KTI subleased office from and shares such space with) requested or obtained the required SED approval

prior to making the leasehold improvements in question. KTI officials should have advised SED of its plan (including the estimated costs) to renovate this space.

11. As noted in our report, we disallowed expenses claimed for phones used by KQC's Executive Director and the daughter of KTI's and KQC's Executive Directors.
12. Costs must be directly related to the educational program being offered. We disallowed expenses KTI claimed for equipment depreciation that should have been charged to KQC.
13. The Manual requires adequate supporting documentation for all costs claimed on the CFR.
14. As detailed in the report, the Less-Than-Arms-Length relationship between KTI and KQC was not disclosed in the KTI's general purposes financial statements, as otherwise required by SED. We did not state or imply that intercompany transactions were not reported properly on KTI's CFRs.
15. We acknowledge the time-clock system KTI implemented in April 2009. However, as detailed in the report, KTI did not require administrative staff to prepare and maintain time and attendance records as prescribed by the Manual.
16. We amended our report to note that "several" expenses were misclassified.
17. Our report clearly acknowledges that SED had approved KTI's Manhattan location. However, as noted in our report, KTI's Queens location (the Executive Director's residence) was not approved by SED.
18. 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.
19. Our audit scope was limited to the CFRs submitted by KTI and their compliance with the Manual. Thus, we did not compare KTI with any other special education provider. Moreover, we have no basis to comment on the quality of services provided by KTI.