



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

Division of State Government Accountability

Compliance With the Reimbursable Cost Manual

**State Education Department
TheraCare Preschool Services, Inc.**



Report 2012-S-21

April 2014

Executive Summary

Purpose

To determine whether the costs reported by TheraCare Preschool Services, Inc. (TheraCare), on its Consolidated Fiscal Reports (CFRs), were properly calculated and adequately documented pursuant to the State Education Department's Reimbursable Cost Manual (Manual). The audit covers the three fiscal years ended June 30, 2011.

Background

TheraCare provides special education services to children between the ages of three and five who live in New York City as well as Westchester, Nassau and Suffolk counties. Pursuant to New York State's Education Law, providers, such as TheraCare, are reimbursed by the State Education Department (SED) based on their annual CFRs which detail program-related expenses. To be eligible for reimbursement, the provider's reported expenses must comply with Manual guidelines. For the three fiscal years ended June 30, 2011, TheraCare claimed approximately \$50.1 million in reimbursable expenses for the programs we audited.

Key Findings

We disallowed \$876,898 in costs claimed by TheraCare because they did not comply with applicable provisions of the Manual. The disallowances include:

- \$316,539 in compensation paid to TheraCare's Executive Director, Chief Financial Officer and acting Assistant Executive Director in excess of SED's allowable compensation levels;
- \$474,080 in employee bonus payments that were not in compliance with Manual guidelines;
- \$76,766 in unnecessary and inappropriate South American recruitment-related costs;
- \$9,513 in other non-personal service expenses that were either unsupported or not program-appropriate.

Key Recommendations

- SED should review the disallowances resulting from our audit, make the appropriate adjustments to costs reported on the CFRs and to TheraCare's tuition reimbursement rates, and recover the overpayments as appropriate.
- SED should work with TheraCare officials to help ensure that only eligible costs are included on their CFRs.
- TheraCare should ensure that requests for SED reimbursement include only those expenses that are allowed by the Manual.

Other Related Audits/Reports of Interest

[Bilingual SEIT & Preschool, Inc.: Compliance With the Reimbursable Cost Manual \(2011-S-13\)](#)

[IncludED Educational Services, Inc.: Compliance With the Reimbursable Cost Manual \(2010-S-59\)](#)

State of New York
Office of the State Comptroller

Division of State Government Accountability

April 2, 2014

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

Mr. John Calderon
Executive Director
TheraCare Preschool Services, Inc.
116 West 32nd Street
New York, NY 10001

Dear Dr. King and Mr. Calderon:

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 *TheraCare Preschool Services, 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

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

Background

TheraCare Preschool Services, Inc. (TheraCare) is a for-profit organization that provides special education services to children between three and five years of age who reside in New York City as well as Westchester, Nassau and Suffolk counties. The special education programs it provides include preschool special education itinerant teacher services and preschool integrated special education. TheraCare's professional staff provides these services in-home, at schools, and in community centers. TheraCare is one of eight subsidiary companies of TheraCare of New York, Inc., which also operates in other states, including New Jersey and Connecticut.

The New York City Department of Education (DoE), other school districts, and counties whose children are served by TheraCare pay tuition and fees based on rates set by the State Education Department (SED). SED periodically develops these rates using the financial information that TheraCare reports on its annual Consolidated Fiscal Reports (CFRs).

SED officials issued a Reimbursable Cost Manual (Manual) to provide guidance to special education providers on the eligibility of reimbursable costs, the documentation necessary to support those costs, and allocation requirements for indirect expenses. SED reimburses the DoE and the other localities for a portion of their payments to TheraCare based on statutory rates.

TheraCare served 651 students during the 2010-11 school year and reported program-related costs of about \$50.1 million for the three fiscal years ended June 30, 2011 as shown in the Exhibit at the end of this report.

Audit Findings and Recommendations

We disallowed \$876,898 in costs claimed by TheraCare because they did not comply with applicable provisions of the Manual. These costs included excessive salaries paid to executive staff, bonuses that did not meet Manual criteria, and unjustified and inappropriate recruitment and other ineligible costs.

Executive Salaries

TheraCare's leadership team includes an Executive Director (ED); a Vice President for Operations, who for all intents and purposes functions as an Assistant Executive Director (AED); and a Chief Financial Officer (CFO). These individuals are responsible for running the day-to-day administrative and fiscal operations of TheraCare and its various educational programs. According to the Manual, if these management-level employees are responsible for more than one entity or multiple programs, their salaries should be charged to the various entities and programs based on a reasonable method. We found TheraCare was, in fact, doing so using the respective expenses of its various entities and programs as the basis for their salary allocations.

However, the Manual also states that the compensation paid to these specific leadership positions, and charged to a SED program, may not exceed certain guidelines which SED classifies as the "regional median compensation" for these positions. We disallowed \$316,539 of the compensation paid to these individuals based on these guidelines as follows:

- For the three-year period ended June 30, 2011, TheraCare reported \$81,147, \$84,851 and \$85,576, respectively, for the compensation paid to its ED. Yet the regional median compensation for an ED during these time periods was \$61,792, \$51,726 and \$64,236. As a result, we disallowed \$73,820 of these costs as ineligible.
- Similarly, the reported compensation paid to TheraCare's CFO for this three-year period was \$80,604, \$90,552 and \$90,278, while the related regional median income for a CFO was \$49,309, \$49,239 and \$51,089. As such, we disallowed \$111,796 for the excess compensation charged for this individual.
- As noted above, the Vice President for Operations of TheraCare's corporate parent functioned as TheraCare's AED. The compensation charged to SED-funded programs for this individual for our three-year audit scope was \$80,847, \$96,935 and \$102,779, while the regional median salary for an AED for this period was \$49,309, \$49,240 and \$51,089, respectively. We disallowed the \$130,923 in excess costs.

Employee Bonuses

The Manual defines bonuses as non-recurring and non-accumulating lump sum payments in excess of regularly scheduled salary which are not directly related to the number of hours worked. Bonus payments to employees are reimbursable by SED if they are based on merit as measured and supported by employee performance evaluations. Bonuses restricted to administrative (managerial) employees are not reimbursable.

During the three fiscal years ended June 30, 2011, TheraCare officials informed us that they had three bonus programs in place: one for administrative employees (variable compensation bonuses), and two for TheraCare instructors (performance bonuses and sign-on/retention bonuses). We found that instructor performance bonuses were in compliance with Manual guidelines. However, we recommend SED recover \$474,080 in other bonus payments to TheraCare employees that do not comply with Manual requirements.

Variable Compensation Bonuses

Under TheraCare's Variable Compensation Bonus Plan, administrative employees receive year-end bonuses if TheraCare New York Inc. and its subsidiary entities (e.g., TheraCare) achieve their respective budgets. Although TheraCare's written policy describing this bonus plan established a bonus range of zero to 10 percent of the employee's annual salary for certain administrative employee titles, it does not specify the specific percentages to be used for most. From our review of the bonus notices sent to these other employees, it appears that their bonuses are calculated as 5, 10, 15 or 30 percent of their annual salary. Since the payments made to employees under this plan are predicated on the organization achieving budget instead of employee performance, these bonuses do not meet the criteria required by the Manual. We recommend SED recover the \$253,205 in variable compensation bonuses that TheraCare charged to the audited programs during the three-year period ended June 30, 2011.

Sign-On/Retention Bonuses

Upon employment, TheraCare often awards its teaching staff a sign-on bonus with the proviso that they will remain in TheraCare's employ for at least one year. Similarly, each year thereafter, TheraCare often awards its teaching staff a retention bonus with a similar proviso. Here too no formal written guidelines explaining how the payments are made were provided to us. However, based on an e-mail from TheraCare and our own calculations, the amounts awarded to each recipient appear to be about 10 percent of their respective salaries.

As with the variable compensation bonuses, these payments are not performance based and do not meet the Manual's reimbursable eligibility requirements. TheraCare charged \$220,875 in these types of bonuses to the audited programs during the audit period.

TheraCare officials agreed that sign-on/retention bonuses are not actual bonuses, but a portion of each employee's base salary serving as an incentive for employees to accept employment or remain with TheraCare. However, we note that in the letters accompanying each of these awards, the employee's base salary and bonus amount are consistently described separately. These awards are also identified as bonuses on TheraCare's worksheets supporting compensation expenses.

Recruitment Costs

When reviewing TheraCare's CFR, we identified \$79,875 recorded as recruitment expenses.

When we inquired as to the support for, and propriety of, these expenses, we were told they were incurred to recruit bilingual (Spanish-English) education teachers in South America due to a shortage of New York State-based teachers with this specialty.

We confirmed the reported shortage of such teachers with documents maintained by SED and, since this issue is not addressed in its Manual, asked SED officials for their position on providers requesting reimbursement for these costs.

According to SED officials, they would expect that the providers charging them for such costs would be able to document their unsuccessful attempts to recruit qualified New York State-based teachers. They would also expect the teachers who were hired from different countries to be program-ready. SED's interpretation of program-ready is that the hired teachers would already possess the qualifications and skills necessary to assume their bilingual special education responsibilities and not need further training that would be paid for by the provider and charged to SED.

To document their unsuccessful attempts to hire New York State-based teachers, TheraCare officials provided us with a listing of recruitment events that their representatives reportedly attended. We have asked for details on the resumes received and the interviews performed, but have not received any such details as they pertain to the recruitment of special education instructors. Absent such documentation, it appears that earnest attempts to recruit qualified New York State-based teachers were not made, leaving us to question the actual need for out-of-country recruitment costs to be incurred.

We note that included in the above noted recruitment costs, TheraCare hired two South American-based recruiters on retainer to solicit and interview prospective teachers at a monthly cost of \$167 each, totaling \$4,019 for the audit period. We recommend SED recover these costs since TheraCare has not demonstrated its actual need to pursue teachers located in other countries.

The remaining \$75,856 in recruitment costs were for H-1B visa-related costs incurred to allow entry for 81 individuals reportedly recruited by TheraCare. However, only four of these individuals ever actually worked for the audited programs. Thus, we recommend SED recover the \$72,747 in visa-related costs relating to the 77 individuals who never worked on those programs.

SED officials informed us that they will be revising their Manual to address this issue.

Other Ineligible Costs

During the three fiscal years ended June 30, 2011, TheraCare reported \$4.1 million in non-personal service costs. We selected a judgment sample of 19 such costs, totaling \$24,480, to determine whether each was supported and program-appropriate. We identified \$9,513 worth of costs that were not eligible for reimbursement and should be recovered by SED. For example:

- We identified \$7,669 in non-program-related consultant and legal costs; and
- We also identified \$1,844 in expenses for tutoring classes and notary training for which no

supporting documentation was available tying them to the audited program.

Recommendations

To the State Education Department:

1. Review the disallowance resulting from our audit and make the appropriate adjustments to costs reported on the CFRs and to TheraCare's tuition reimbursement rates, and recover the overpayments as appropriate.
2. Work with TheraCare officials to help ensure that only eligible costs are included on their CFRs.

To TheraCare Preschool Services, Inc.:

3. Ensure that requests for SED reimbursement include only those expenses that are allowed by the Manual.

Audit Scope and Methodology

We audited the propriety of, and support for, the expenses reported by TheraCare on its CFRs for the three fiscal years ended June 30, 2011. The objectives of our audit were to determine whether the costs reported by TheraCare were program-appropriate, adequately documented and eligible for reimbursement pursuant to SED's Manual.

To accomplish our objectives, we interviewed relevant SED and TheraCare officials to obtain an understanding of TheraCare's financial and business practices. In addition, we reviewed TheraCare's CFRs and available supporting books and records for the audit period. We also met with TheraCare's independent CPA firm to understand the scope of their audit work and to obtain audit-relevant information. To assess compliance with the Manual, we reviewed and assessed the propriety of both personal and non-personal service costs charged to the audited programs by selecting a judgment sample of expenses charged in both categories.

We conducted our compliance audit in accordance with generally accepted government auditing standards. These 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 did provide 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 to certain boards, commissions, and public authorities, some of whom have minority voting rights. 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 a draft copy of this report to SED and TheraCare officials for their review and comment. Their comments were considered in preparing this final report and are attached in their entirety at the end of this report.

SED officials agree with our recommendations and have asked for selected working papers supporting our recommended disallowances. We have provided them with the requested working papers. SED officials also note that they have already made certain adjustments to future period TheraCare reimbursement rates to recover some of the excess compensation we cite in our report and have also instituted a soon to be mandatory CFR-related training course for providers.

Conversely, via legal counsel, TheraCare officials take fundamental exception to our audit authority and specific exception to most of our findings. We address their exceptions in our Comptroller's Comments also attached at the end of this report.

Within 90 days after 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 where the recommendations were not implemented, the reasons why. We also request that TheraCare officials advise the State Comptroller of actions taken to implement the recommendation addressed to them, and if the recommendation is 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

TheraCare Preschool Services, Inc.
Schedule of Submitted, Disallowed and Allowed Program Costs
for the Three Fiscal Years Ended June 30, 2011

Program Costs	Amount Per CFR	Amount Disallowed	Amount Allowed	Notes to Exhibit
Personal Services				
Direct Care	\$ 43,163,945	\$ 404,127	\$ 42,759,818	A,C
Agency Administration	<u>2,765,769</u>	<u>386,492</u>	<u>2,379,277</u>	A,B,C
Total	\$ 45,929,714	\$ 790,619	\$ 45,139,095	
Non-Personal Services				
Direct Care	\$ 1,418,306	\$ 0	\$ 1,418,306	
Agency Administration	<u>2,727,044</u>	<u>86,279</u>	<u>2,640,765</u>	A
Total	\$ 4,145,350	\$ 86,279	\$ 4,059,071	
Total Program Costs	<u>\$ 50,075,064</u>	<u>\$ 876,898</u>	<u>\$ 49,198,166</u>	

Notes to Exhibit

The following Notes refer to specific sections of the Reimbursable Cost Manual upon which we have based our adjustments. We have summarized the applicable sections to explain the basis for the disallowances. Details of the transactions in question were provided to SED and TheraCare officials during the course of our audit.

- A. Section II. Cost Principles - Costs must be reasonable, necessary, program-related and sufficiently documented.
- B. Section II.14.A.(4)a - Compensation (i.e., salaries plus fringe benefits) for the entity's Executive Director, Assistant Executive Director, and Chief Financial Officer will be compared directly with the regional median compensation for comparable administration job titles of public school districts, as determined and published annually by SED's Basic Educational Data Systems (BEDS). Reimbursement of employee compensation for these job titles shall not exceed the median paid to comparable personnel in public schools for similar work and hours of employment in the region in which the entity is located.
- C. Section II.14.A.(10) - Bonus compensation shall mean a non-recurring and non-accumulating (i.e., not included in base salary of subsequent years) lump sum payment(s) in excess of regularly scheduled salary which is not directly related to hours worked. Bonus compensation may be reimbursed if based on merit as measured and supported by employee performance evaluations. Bonus compensation restricted to only administrative staff is not reimbursable.

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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December 12, 2013

Mr. Frank Patone
Audit Director
Office of the State Comptroller
Division of State Government Accountability
123 William Street – 21st Floor
New York, NY 10038

Dear Mr. Patone:

The following is the New York State Education Department's (SED) response to the draft audit report (2012-S-21) of the State Education Department TheraCare Preschool Services, Inc: Compliance with the Reimbursable Cost Manual.

Recommendation 1: Review the disallowances resulting from our audit and make the appropriate adjustments to the costs reported on the CFRs and to TheraCare's tuition reimbursement rates, and recover the overpayments as appropriate.

We agree with this recommendation. The Department will review and make adjustments to the CFRs as noted in the report and recover any overpayments as appropriate by recalculating tuition rates. We note that OSC's recommended disallowances relating to TheraCare executive staff compensation in excess of the median salaries was already adjusted by the Department. SED removed \$165,649 in executive compensation in the calculation of the tuition rates established for the three years ending June 30, 2011. OSC's recommended disallowance totaled \$316,539. SED has not received OSC's workpapers to verify that OSC's calculation included fringe benefit levels permitted under the methodology. If not, OSC's proposed disallowance may be overstated. We will also review and consider additional information TheraCare Preschool Services may submit in response to this report.

Recommendation 2: Work with TheraCare officials to help ensure that only eligible costs are included on their CFRs.

We agree with this recommendation. SED will continue to provide technical assistance whenever requested and will strongly recommend TheraCare officials take advantage of our availability to help them better understand the standards for reimbursement as presented in Regulation and the Reimbursable Cost Manual (RCM). In addition, beginning with the submission of CFR's for the 2012-13 school year, the Department is requiring that individuals signing the CFR certification statements, namely Executive Directors and Certified Public Accountants, either attend

a formalized Interagency CFR training at one of the six locations it is offered across the state or complete RSU's on-line CFR training course. This requirement will be mandatory for 2013-14 CFR submissions. The RSU will be tracking and verifying that individuals have completed the training.

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

c: Ann Marsh
Maria Guzman

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GEORGE SHEBITZ (1947-2006)

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† (ALSO ADMITTED IN DC)

December 12, 2013

BY EMAIL (FPatone@osc.state.ny.us)
AND FEDERAL EXPRESS

Mr. Frank Patone
Audit Director
State of New York Office of the State Comptroller
123 William Street, 21st Floor
New York, NY 10038

Re: TheraCare Preschool Services, Inc.
Your Draft Audit Report # 2012-S-21

Dear Mr. Patone:

Enclosed is a response to your office's above-referenced draft audit report. We sent this identical response letter (except it was dated yesterday). addressed to Steven Lynch of your office, yesterday. Mr. Lynch asked us to re-address it to you.

Very truly yours,



Frederick J. Berman

FJB:jp
Enclosures

SHEBITZ BERMAN COHEN & DELFORTE, P.C.

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December 12, 2013

BY EMAIL (FPatone@osc.state.ny.us)
AND FEDERAL EXPRESSState of New York Office of the State Comptroller
123 William Street, 21st Floor
New York, NY 10038
Attn: Mr. Frank Patone, Audit DirectorRe: TheraCare Preschool Services, Inc.
Your Draft Audit Report # 2012-S-21

Dear Mr. Patone:

We are counsel for TheraCare Preschool Services, Inc. ("TheraCare"). This letter is submitted on behalf of TheraCare as its response to the above-referenced draft report entitled "TheraCare Preschool Services, Inc.: Compliance With the Reimbursable Cost Manual". Your draft report was transmitted to TheraCare on November 12, 2013.

At the outset, we first wish to raise three preliminary objections to your draft report. First, as we have advised you previously, TheraCare does not agree with your assertion that Article V, Section I of the New York State Constitution and Article II, Section 8 of the State Finance Law confer authority on the Office of the State Comptroller ("OSC") to conduct this audit. *See, e.g., New York Charter Schools Ass'n v. DiNapoli*, 13 N.Y.3d 120 (2009); *Blue Cross and Blue Shield of Central New York, Inc. v. McCall*, 89 N.Y.2d 160 (1996). Accordingly, TheraCare continues to object to this audit on jurisdictional grounds and continues to reserve its right to challenge OSC's publication of any final audit report or any decision to act on any final report, on the grounds that the OSC did not have legal authority to conduct the audit in the first place.

Second, TheraCare objects to your listing of Reports 2011-S-13 and 2010-S-59 as "Other Related Audits/Report of Interest" in the Executive Summary of your report. Those two reports involved highly publicized findings of fraud by the OSC. The OSC has not made any findings of

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Comment

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* See State Comptroller's Comments, page 29.

SHEBITZ BERMAN COHEN & DELFORTE, P.C.
ATTORNEYS-AT-LAW

Frank Patone
December 12, 2013
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fraud or other wrongdoing on TheraCare's part. Your claimed disallowances all result from differences in interpretation as to what the Reimbursable Cost Manual ("RCM") promulgated by the New York State Education Department ("SED") requires. There is nothing "related" or similar between your draft findings with respect to TheraCare and your findings in those two reports. Your references to those two other reports as "Other Related Audits/Reports of Interest" should be deleted from your report, as they create a false and prejudicial impression that similar findings have been made with respect to TheraCare for a reader who reads only the Executive Summary, but not the full report.

*
Comment
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Third, we object to your description of the audit in the first sentence of the second paragraph of your draft letter transmitting the report to Dr. King and Mr. Calderon as "our audit of the State Education Department." The audit was not an audit of the State Education Department; it was an audit of TheraCare. That is clear from the title of the report: "TheraCare Preschool Services, Inc.: Compliance With the Reimbursable Cost Manual." It also is clear from the stated objectives of the audit "to determine whether the costs reported by TheraCare were program-appropriate, adequately documented and eligible for reimbursement pursuant to SED's Manual." It also is clear from the substance of the draft report itself, which makes clear in the "Audit Scope and Methodology" that "TheraCare's financial and business practices", not SED's, were examined and which throughout the draft report evaluates only TheraCare's practices, not SED's. Accordingly, the description in the letter should be changed to: our audit of TheraCare Preschool Services, Inc."¹

*
Comment
3

We now will address the specific cost disallowances proposed in the OSC's draft report.

Executive Salaries – Executive Director
and Chief Financial Officer

TheraCare disagrees with your "disallowances" of a portion of the salaries of its Executive Director ("ED") and Chief Financial Officer ("CFO"), and requests that they be removed from your report. Your comments reflect a misunderstanding of the process used by SED in reviewing these salaries in connection with its rate-setting process.

¹ Your email transmitting the draft report to TheraCare included a second attachment labeled "2012-S-Draft-SED" which the password provided to TheraCare by the OSC did not open. TheraCare asked the OSC for the password that would open "2012-S-Draft-SED" in writing two times, but such password never was provided to TheraCare, so that TheraCare has had no opportunity to review or comment on whatever is in the file labeled "2012-S-Draft-SED". If that second file contains a report pertaining to TheraCare that differs in any way from the draft report labeled "2012-S-Draft-TheraCare", it should not be published before TheraCare has an opportunity to review and comment on it. If that second file contains some separate report commenting on an audit of SED's practices, that would not change our objection to the transmittal letter language discussed above, since the language we are objecting to is contained in a transmittal letter pertaining to the report on OSC's audit of TheraCare, not a report on an audit of OSC's practices.

SHEBITZ BERMAN COHEN & DELFORTE, P.C.
ATTORNEYS-AT-LAW

Frank Patone
December 12, 2013
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TheraCare properly reported on its Consolidated Fiscal Report ("CFR") the entire salaries for these executives, irrespective of the limitations provided for in the RCM, because that is what CFR reporting instructions require. When the RCM states that salaries for these executives "will be directly compared" to certain median public school official salaries, it is SED, not the provider in its CFR, that makes this comparison. If you are suggesting that TheraCare should have reported these salaries differently on its CFR, your belief is incorrect.

*
Comment
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As we have advised you previously, as part of SED's review process in setting TheraCare's rates for the years at issue, SED reviewed these salaries and adjusted the allowable compensation for these two employees, based on comparison to median salaries of Superintendents and Assistant Superintendents, respectively, in establishing TheraCare's tuition rates for these years. Thus, your "disallowances" for these employees should be removed from your report, because SED already has made the disallowances. If you do mention them at all, your report should expressly state that the salaries were reported properly on TheraCare's CFR and that these adjustments already were made by SED in setting TheraCare's tuition rates in accordance with SED's normal practices. We assume that you do not intend to suggest that an additional \$73,830 of the ED's salary should be disallowed, or that an additional \$111,796 of the CFO's salary should be disallowed, on top of the adjustments already made by SED, as there is no conceivable basis to do so.

We also note that there are slight differences between your calculation and SED's. In your preliminary report, your total "disallowance" was \$24,438 less than SED's; now it is \$1,140 more than SED's disallowance. You have offered no explanation of your calculation or why it changed. The difference between your numbers and SED's are caused by your using different fringe benefit rates. You have not explained your fringe benefit rates, and TheraCare does not know how you derived them. In any event, with all due respect to your office, SED is best suited to interpret and apply the limitations set forth in its RCM, and its calculation should not be adjusted other than for a mathematical computation error, which this is not. In fact, if SED were to use your numbers for TheraCare, SED would have to recalculate its executive compensation disallowances for every provider in New York State, as it cannot use a different calculation methodology for TheraCare from what it used for everybody else.²

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² As stated in TheraCare's August 21, 2012 response to your preliminary reports, TheraCare reserves the right to challenge the propriety of the limitations on these salaries imposed by the RCM, although in responding to your draft report we are addressing only your application of the limitations set forth in the RCM, not the propriety of those limitations.

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Executive Salaries – Vice-President For Operations

TheraCare also disagrees with your disallowance of a portion of the salary and fringe benefits of its Vice-President for Operations (“VPO”) and requests that you remove such disallowances from your final report. Your disallowance is based entirely on your reclassification of TheraCare’s VPO as an Assistant Executive Director (“AED”), based on your arbitrary and incorrect assertion that he “for all intents and purposes functions as an Assistant Executive Director.” You have offered no factual support for that assertion, and there is none.

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The description of an AED in the CFR Reporting and Claiming Manual is a person who “assists the Executive Director in the overall administration of the agency and acts on their behalf when necessary.” The VPO did neither of these things; he neither assisted the ED in the overall administration of the agency nor acted on behalf of the ED. TheraCare’s VPO was responsible for direct administration of day to day operations of TheraCare’s various programs. He had no responsibility for overall agency administration.

This can readily be seen by reviewing the ED’s job description, a copy of which is submitted herewith as Attachment 1. This job description lists broad responsibilities relating to overall administration of the agency, including conducting official business of the organization, performing fiscal functions, representing and interfacing with the Board and negotiating and executing contracts and grants. The VPO did not assist with any of the administrative items listed in this job description. He was not an officer or director of the company. He had no authority to sign checks or loans or execute contracts or grants or otherwise conduct official business of the company, and he did not participate in decisions regarding these things. His job was at the time and is currently limited to managing the operational aspects of TheraCare’s programs, not overall agency administration. Moreover, as we advised you previously, he never “acted on behalf” of the ED, and in fact, TheraCare’s parent company’s bylaws expressly preclude him from doing so, as the bylaws require that the Vice-President authorized to act on behalf of the ED in the ED’s absence must be both a shareholder and a director. The VPO was neither. The only person employed by the Company who meets this criteria is N.C., who is the Vice President and Secretary of TheraCare’s parent company and a member of the Board of Directors. TheraCare will classify her as an AED for CFR purposes going forward.

As we advised you previously, the VPO’s responsibilities do not neatly fit any of the CFR Reporting and Claiming Manual categories. His responsibilities most closely match those of a Program Director (510), because he directly administers specific programs, although he does not literally fit that category because he is responsible for direct administration of multiple programs at multiple sites. That is why TheraCare classified him as an Office Worker. While TheraCare believes that Program Director probably would be a more accurate classification for this employee, and it will be using that classification for him for future years, that would make

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no difference in determining how much of his salary is allowable, as neither a Program Director nor an Office Worker is subject to compensation limitations under the RCM.

You appear to be assuming, incorrectly and without evidence, that because the VPO was highly compensated, he must be performing the function of an AED. That simply is not the case. He was highly compensated because TheraCare's parent company, by which he is directly employed, is a large company which, through its subsidiaries, operates multiple programs in multiple states. The VPO's job, managing the operational aspects of those programs, is a very important one. That is why he was highly compensated, even though his work did not involve assisting the ED with overall agency administration or acting on behalf of the ED at any time.

While the foregoing demonstrates that there is no factual basis for your re-classification of the VPO as an AED, we also note that the VPO's compensation was listed first on TheraCare's CFR 6 in 2010-11 and second in the other two years and clearly was seen by SED as part of its review. SED never has taken issue with the VPO's job classification or made any adjustment to the reimbursable compensation claimed for him in its review as part of the rate-setting process.

Variable Compensation "Bonuses"

TheraCare disagrees with your disallowance of the variable compensation "bonus" compensation and requests that you remove such disallowance from your report.

You appear to be considering this program as "bonus" compensation and disallowing it because it does not meet the RCM criteria for bonus compensation to be reimbursable. As we explained to you in our prior response to your draft report, this program is not a bonus program at all within the meaning to the RCM. Since the variable compensation is not a bonus at all, the criteria for reimbursement of bonus compensation do not apply to the variable compensation.

Rather, what the variable compensation program does is to make a portion of each manager-employee's salary contingent on TheraCare's meeting its budgeted performance. This is necessary for TheraCare's financial viability, since TheraCare, unlike a school district, does not have a guaranteed revenue stream and needs to match its spending to what its revenues in fact turn out to be. Therefore, it splits the budgeted compensation for each staff member who is a manager into a fixed guaranteed component and a variable component which will be paid 100% only if TheraCare achieves its budget. As was explained to you previously, the reasons that the program is restricted to managers, and that higher paid managers have a higher percentage of variable compensation than lower paid managers do, is that higher salaries have a greater impact on the budget, and there would be a greater adverse impact on the company if those larger salaries had to be fully paid even if the budget projections were not met. Variable compensation is not a benefit for these managerial employees; it is a disadvantage because, unlike other

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employees, it makes a portion of their budgeted salary contingent on the parent company and subsidiaries' collectively meeting their budgeted results.

This is not bonus compensation as defined in RCM Section 14(A)(10). That section defines a bonus as "a non-recurring and non-accumulating part of compensation (i.e., not included in the base salary of subsequent years)... in excess of regularly scheduled salary..." The variable compensation is regularly scheduled salary, not compensation "in excess of regularly scheduled salary." Variable compensation is recurring, as it is paid monthly or quarterly so long as the company is on budget, and it is scheduled for payment at the same percentage of the employee's overall salary in each succeeding year. It also is accumulating, as the amount of variable compensation is increased each year by the same percentage as the employee's non-variable guaranteed salary is increased. In other words, if an employee's salary is budgeted for \$100,000, 90% guaranteed and 10% variable in one year and in the next year the budget includes a 5% salary increase for such employee, both the guaranteed component and the variable component of his or her salary increases by 5%.

You appear to recognize that variable compensation is not really a bonus when you say that the variable compensation plan "appears to be a 'profit-sharing' plan as opposed to a bonus plan." While we don't agree with your characterization of the plan as a "profit-sharing plan" (as it is a plan that makes a portion of regular budgeted salary contingent), if it is a "profit-sharing" plan, you should not be applying the criteria applicable to bonus compensation under the RCM to determine whether such compensation is reimbursable. Compensation paid under a "profit sharing plan" is reimbursable under the RCM. In this regard, the Internal Revenue Service describes a profit sharing plan as an employee benefit plan. *See, www.irs.gov/Retirement-Plans/Plan-Participant-Employee/Definitions*. The RCM in turn expressly provides that "specific employee benefit packages" are reimbursable. Thus, your own characterization of the plan is inconsistent with your disallowance. You appear to assume that if the program is not a bonus program, it is not reimbursable. That assumption is mistaken. If it were a bonus program, which it is not, you would apply the RCM criteria regarding whether the bonus is tied to employee performance to determine whether it is reimbursable bonus compensation. Here, those criteria do not apply because it is not a bonus plan at all. Whether you view the variable compensation as a part of regularly scheduled salary, as TheraCare does, or as a profit-sharing plan, as you do, it is reimbursable under the RCM.

We also note that you mischaracterize the plan when you say that this compensation is paid if TheraCare's parent company and its subsidiaries had a profitable year. That is not true; as explained above, the variable component of their compensation is paid if TheraCare's parent company and its subsidiaries' net operating income meets budget. The variable component is part of the employees' budgeted salary, but this plan has the effect of reducing salaries if

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budgeted results are not achieved as a way of keeping TheraCare's costs in line with its revenues.

Finally, your statements that the plan does not specify the specific percentages of their compensation that is variable for most employees and that the payments are calculated as 5, 10, 15 or 30 percent of their annual salary are both irrelevant to whether the payments are reimbursable and inaccurate. The written plan stated that variable compensation could be set in the range of 0 – 10 percent for branch staff. It in fact was set at 10 percent. The plan stated that the range of 0 – 2.5 percent of compensation could be made variable for clinical supervisors and service coordinators; the variable compensation for all such employees was set at 2.5 percent. We are advised that your office was given precise percentages for each staff member who was part of the plan. If you need additional copies of these calculations or need explanation of the information previously submitted, it can be provided again. The only employees whose variable compensation was greater than 10 percent were the CFO (20 percent) and VPO (30 percent). Again, the reason for this is that their compensation was higher and, therefore, needed to be reduced more if financial results fell short of expectation, because their larger salaries would have a greater adverse impact on the company's finances.

We also reiterate our prior point that TheraCare paid variable compensation during the years covered by a prior audit by the New York City Department of Education, pursuant to a methodology approved by SED, of the 2002-03, 2003-04 and 2004-05 years, and the auditors did not adversely comment on it or recommend any disallowance of variable compensation paid during those years.

Sign On/Retainer "Bonuses"

TheraCare disagrees with your disallowance of the sign on/retainer "bonuses" and requests that such disallowance be removed from your report.

Again, as you acknowledge, these payments were not true bonuses. As was explained to you in TheraCare's response to your preliminary reports, TheraCare instituted this program to try to provide a disincentive to SCIS classroom teachers' leaving before the end of a year. Thus, TheraCare split the SCIS classroom teachers' pay into two components, base pay and a forfeitable "sign on bonus," which was roughly equal to one month's salary. The "sign on bonus" was not a pay increase; rather, a portion of the same annual salary (including the year-to-year increase from the prior year) was made contingent on the teacher's remaining for the entire year. No employee's salary was increased as a result of this program. When the program was instituted, each participant's total compensation ("base" pay plus "sign on bonus") was the same as his or her previous pay with no "sign on bonus", plus a normal annual increase. Similarly, when the program was discontinued for the 2011-12 year, all participants' total compensation

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("base" salary plus "sign on bonus"), with a normal annual increase for 2011-12, became their fixed salary going forward. The two employees you tested, V.T. and N.V., fully confirm this.

Again, as you acknowledge, the "sign on bonus" payments do not meet the RCM definition of a "bonus". They were regularly scheduled salary, not payments "in excess of regularly scheduled salary." They were recurring, because they were made as part of each salary payment and because they were made every year as a part of the teacher's compensation. They also were cumulative, because the percentage annual raise the teacher received each year was based on the total salary, including the "sign on bonus".

Again, your error is that you appear to assume that if these payments do not meet the RCM definition of a "bonus", they therefore are not reimbursable. That is not the case. If they were a bonus, then the RCM criteria for determining whether they are a reimbursable bonus would apply. Those criteria do not apply here, because these payments, like the variable compensation, are a part of those employees' regularly scheduled salaries, not true "bonuses". They are reimbursable because they are a part of salary, not because they are a reimbursable "bonus".

The fact that the letters employees signed and some workpapers relating to these payments labeled them as "bonus" does not make them a bonus. As you are well aware, substance, not the labels parties use, govern, and the substance, as you acknowledge, is that these are not true bonuses. We know that you are aware that the labels parties use do not govern, as some of your proposed disallowances in this audit (for example, the VPO's compensation) and in other OSC audits we have seen are based on your disregarding the labels the audited company used and applying what you perceive the substance to be instead.

Finally, we note that there certainly is no policy, in the RCM or elsewhere, against using state funds for incentive payments to encourage employee retention. In fact, SED itself has a grant program to provide funds, which payments are built into tuition rates of grant recipients, to support incentive payments to retain teacher employees. See, www.oms.nysed.gov/rsu/Grants/TeacherTurnover/GrantOverview.html.

Recruitment Costs

TheraCare disagrees with your disallowances for recruitment costs and requests that they also be removed from your report.

You expressly acknowledge that there was a documented shortage of bi-lingual teachers, as reflected by SED documentation we provided to you. As we pointed out to you previously, in a July 18, 2011 letter, SED stated that "[g]iven the difficulty in hiring bilingual special education personnel," schools must include "the steps they are going to take or have taken to hire

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appropriately certified staff or to enroll a current staff member in a program leading to a bilingual extension.”

You also expressly acknowledge that there were no standards regarding this issue in the RCM during the years in question. Your application of what SED officials purportedly told you they “would expect” is inappropriate. SED did not incorporate the requirements you say were communicated to you in 2013 as to what they “would expect” into the RCM, or any other guidance to providers, until the 2013-14 year. It is highly inappropriate to apply them retroactively to prior years, as you are doing. Particularly given the well-publicized shortage of New York State-based bi-lingual teachers during the years in question, in the absence of an RCM provision or other regulatory guidance to the contrary, there is no reason why TheraCare should have expected, or could have known, at the time that it would need to document its efforts to recruit “qualified New York State-based teachers” before out-of-state recruitment efforts would be reimbursable. Neither you nor SED properly can apply these kinds of requirements retroactively, when they did not exist at the time.

With respect to the H-1B visa costs, there also was no published standard in the RCM or elsewhere that allowed only for such expenses which resulted directly in the employee’s being hired. It should be obvious that such expenses sometimes will be incurred for prospective employees who do not ultimately come to the program, but the efforts that cause those expenses are a necessary part of the overall recruitment efforts. The provider has to incur them before it knows whether the employee ultimately will join its program. Moreover, in many cases, there were lengthy delays by SED in approving applications by TheraCare to hire these employees for its program, which caused or contributed to the employee’s ultimately not coming to the program. TheraCare acknowledges that the expenses relating to the few employees working in Connecticut and New Jersey should be disallowed. Other than those, there is no basis to disallow these expenses.

Other Ineligible Costs

TheraCare disagrees with your disallowances of consultant and legal costs as non-program related and requests that they be removed from your report. While you say these were “non-program related,” all of them were overall agency administration costs properly allocated 31 percent to the SEIT program. Therefore, whether or not all of these expenses were directly related to the SEIT program is irrelevant. In this regard, more specifically, you disallowed expenses related to the ESOP benefit plan, which expenses are allowable under the RCM and related in part to employees in the SEIT program. You also disallowed expenses related to the company’s annual meeting and Board meetings, which again are allowable under the RCM and related in part to the SEIT program. You also disallowed Medicaid related expenses, and classified them as relating only to the Early Intervention program. That is not true, as Medicaid is

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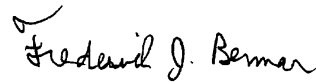
a factor in CPSE documentation and billing, so that these expenses should have been classified as corporate administration allocable in part to the SEIT program.

Moreover, if you were going to disregard the 31 percent allocation properly made by TheraCare, and instead determine how much of each bill was SEIT program related (which you should not do), your analysis was distorted by two factors. First, you disallowed costs which were bills tested that related entirely to CPSE and therefore should be charged 100 percent to the SEIT program in such an analysis. If you were going to quantify how much of the bills relate to each program, you would need to credit TheraCare for the other 69 percent of such bills, as those costs were charged only 31 percent to the SEIT program in the CFR, due to the allocation. You did not do so. Second, you left legal bills which related mostly to SEIT, but which TheraCare charged only 31 percent to the SEIT program because they were overall administration costs, out of your analysis altogether. If you are trying to determine how much legal expense was expended on SEIT related matters, rather than relying on the 31 percent overall allocation properly made by TheraCare, you must consider all the bills, not just selectively choose those where more of the expense did not directly relate to the SEIT program.

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TheraCare thanks you for your consideration of its prior comments on your preliminary report and thanks you in advance for your anticipated careful consideration of this response. We are confident that you will modify your draft report to take account of this response.

Very truly yours,



Frederick J. Berman

FJB:jp
Enclosure

Attachment 1

Agency Comments - TheraCare Preschool Services, Inc.



JOB DESCRIPTION

Job Title: CEO

Job Class: Exempt

Date: 11/07/2013

Reports To: Board of Directors and all governing regulatory parties

ESSENTIAL JOB FUNCTIONS/ DUTIES

The essential functions/duties include, but are not limited to the following:

- Oversee for the organization, supervises the activity of all staff, and is the senior representative for conducting the official business of the organization.
- Oversee the selection, employment, supervision and disciplinary action of employees to include the determination of whether applicants meet required personnel standards as set forth in the Company's policies and directives.
- Assess the need, planning, coordination and implementation of behavioral health services as approved by the Board.
- Advises and participates with the Board to establish priorities for the corporation.
- Represents the Board in dealing with the public, other agencies, funding entities, governmental officials and regulatory organizations.
- Negotiate contracts, terms of agreements, grants, funding requirements and execute such as determined by official policy or Board directive.
- Serve as an ex-officio member of the Board of Directors and to all committees.
- Work with staff, Board of Directors and community agencies to plan, to develop and implement programs to meet both short range and long term goals of the corporation.
- Responsible for administering and maintaining the internal structure of the corporation in an effective, efficient and professional manner.
- Insures coordination and referral among and between service programs operated by the corporation.
- Reports activities of the corporation to the Board in an accurate, concise, clear and timely manner.
- Coordinates with staff in the preparation of grant proposals, management reports

and internal administrative structure to assure accountability and appropriate oversight of fiscal and clinical functions.

- Such other duties and responsibilities as delegated or directed by the Board.

KNOWLEDGE, SKILLS AND ABILITIES

The items listed below are representative of the knowledge, skill, and/or ability required:

- Demonstrated progressive advancement in managerial/administrative positions
- Evidence of mature judgment and leadership skills
- Evidence of accomplishments in promoting program development, advancement of organizational goals and/or leadership achievements.

REQUIREMENTS

- Advanced degree in behavioral health or public administration, business or finance with five years experience in the behavioral health field, three of which were in a senior administrative or supervisory capacity.
- Licensure is required if clinically trained.

PHYSICAL REQUIREMENTS

- Hand dexterity ability (ability to operate mobile device, telephone, computer) Ability to sit for extended periods of time
- Ability to travel to various locations on a near daily basis
- Ability to stand for extended periods of time

NOTE: The statements herein are intended to describe the general nature and level of work being performed by employees assigned to this classification. They are not intended to be constructed as an exhaustive list of all responsibilities, duties, and skills required of personnel so classified. This job description may be changed or updated at any time without notice.

State Comptroller's Comments

1. The Comptroller's broad authority to audit the State Education Department and its associated entities (e.g., contracted special education providers) is expressly cited on page 9 of our report.
2. Our Executive Summary cites selected related reports that might be of interest to readers of this report. It is our standard practice to make such reference.
3. The scope of our audits, and the related addressees, are the prerogative of the State Comptroller's Office. Our reports of special education providers fall under the umbrella of either the State Education Department or the (NYC) Department of Education. These oversight agencies have the express authority to implement our recommendations relating to their respective providers.
4. Our report addresses the salary reimbursement requests made by TheraCare, which are those reported on its CFRs. We have revised page 9 of our report to acknowledge the previous adjustments made by SED officials.
5. Our calculations include the actual fringe benefits applied by TheraCare versus the percentages included in SED's regional median compensation. Our detailed calculations have been shared with both SED and TheraCare.
6. TheraCare's VPO reported directly to TheraCare's Executive Director and performed duties similar to an Assistant Executive Director as outlined in the Consolidated Budget and Claiming Manual (CBC Manual). The CBC Manual defines the AED as one who "assists the Executive Director in the overall administration of the agency and acts on their behalf when necessary." To support our assertion, TheraCare's own position description for its VPO includes tasks and responsibilities that range from supervising services, overseeing recruitment, monitoring statistics for trends on productivity, anticipating personnel needs, initiating corrective action and termination, and attending high-level meetings related to operations. These tasks and responsibilities far exceed those defined in the CBC Manual for a Program Director whose responsibilities are limited to program supervision.
7. TheraCare officials apparently agree that what they classify and report as "variable compensation bonuses" are not really bonuses and do not meet the criteria for bonuses as outlined in the Manual. They have also not offered any documentation to support their assertion that such payments are actually part of regularly scheduled salaries. If they were, conditions, such as TheraCare's achieving budgeted performance, would not be a prerequisite for payment. We have revised our report wording to note that these bonuses are predicated on TheraCare meeting budgeted results and deleted references to the bonuses being predicated on profit.
8. Here too, TheraCare officials acknowledge that "Sign On/Retainer Bonuses," although categorized as such, are not really bonuses and do not meet the Manual's criteria for such. Once again we are asked to consider these payments to be reimbursable as part of regularly scheduled employee salaries. Yet we have not been given any documentation to support this assertion.
9. The overwhelming majority of expenses in this disallowance category pertain to individuals who were never employed by the audited program – a fact which is not debatable. TheraCare officials must realize their fiduciary responsibility to spend taxpayer monies

effectively and efficiently using sound business judgment. This responsibility would extend to their recruitment program where only ordinary and necessary expenses are to be made.

10. We have revised our report Exhibit illustrating disallowed program costs, as well as the report body, for certain expenses disallowed in our draft report for which additional supporting documentation has been provided. These revisions result in our total recommended disallowance being reduced by \$3,928.