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
Hebrew Institute for the Deaf and Exceptional Children

Report 2015-S-67

November 2016

Executive Summary

Purpose

To determine whether the costs reported by the Hebrew Institute for the Deaf and Exceptional Children (Hebrew Institute) on its Consolidated Fiscal Reports (CFRs) were properly documented, program related, and allowable pursuant to the State Education Department's (SED) Reimbursable Cost Manual (Manual). The audit included expenses claimed on Hebrew Institute's CFRs for the three fiscal years ended June 30, 2014.

Background

Hebrew Institute is a Brooklyn, New York not-for-profit organization approved by SED to provide full-day and half-day Special Class (SC) and Special Class in an Integrated Setting (SCIS) preschool special education programs to disabled children who are between the ages of three and five years. During the 2013-14 school year, Hebrew Institute served about 171 students. The New York City Department of Education (DoE) refers students to Hebrew Institute based on clinical evaluations and pays for their services using rates established by SED. The rates are based on the financial information that Hebrew Institute reports to SED on its annual CFRs. SED reimburses DoE for a portion of its payments to Hebrew Institute based on statutory rates. For the three fiscal years ended June 30, 2014, Hebrew Institute reported approximately $11 million in reimbursable costs for the audited cost-based programs.

In addition to the SC and SCIS programs, Hebrew Institute operated two other SED programs: Evaluations and 1:1 Aides. However, payments for services under these other programs were based on fixed fees, as opposed to cost-based rates established through CFR-reported financial information. Hebrew Institute also operated a private day care program.

Key Findings

For the three fiscal years ended June 30, 2014, we identified $774,122 in reported costs that did not comply with the Manual's requirements and recommend such costs be disallowed. These ineligible costs included $624,868 in personal service costs and $149,254 in other than personal service costs, as follows:

- $194,438 in lump sum bonuses that did not comply with the Manual's requirements;
- $132,846 in over-allocated compensation costs for 24 shared employees;
- $132,377 in excessive executive compensation;
- $121,660 in undocumented and/or insufficiently documented expenses, including $56,568 in compensation paid to eight employees, $22,024 in checks written out to the Executive Director, $10,000 to a consultant, and $5,728 in petty cash disbursements;
- $108,639 in non-mandated fringe benefit contributions that did not comply with the Manual's requirements;
- $53,533 in ineligible expenses, including $13,641 for staff food, $8,617 in referral fees to employees, and $11,244 in legal fees not related to the SED cost-based programs; and
- $30,629 for vehicle expenses not supported by usage logs.

Key Recommendations

To SED:

- Review the recommended disallowances resulting from our audit and make the appropriate adjustments to Hebrew Institute's CFRs and reimbursement rates.
- Work with Hebrew Institute officials to help ensure their compliance with the provisions in the Manual.

To Hebrew Institute:

- Ensure that costs reported on future CFRs comply with all Manual requirements.

Other Related Audits/Reports of Interest

Milestone School for Child Development: Compliance With the Reimbursable Cost Manual (2014-S-37)
Institutes of Applied Human Dynamics: Compliance With the Reimbursable Cost Manual (2014-S-39)

State of New York
Office of the State Comptroller

Division of State Government Accountability

November 22, 2016

Ms. MaryEllen Elia
Commissioner
State Education Department
State Education Building - Room 125
89 Washington Avenue
Albany, NY 12234

Mr. Noah Brickman
Executive Director
Hebrew Institute for the Deaf
and Exceptional Children
1401 Avenue I
Brooklyn, NY 11230

Dear Ms. Elia and Mr. Brickman:

The Office of the State Comptroller is committed to helping State agencies, public authorities, and local government agencies manage their resources efficiently and effectively. By so doing, it provides accountability for the 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, entitled *Compliance With the Reimbursable Cost Manual*, of our audit of the costs submitted by Hebrew Institute for the Deaf and Exceptional Children, to the State Education Department for the purposes of establishing preschool special education tuition reimbursement rates. This audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution; Article II, Section 8 of the State Finance Law; and Section 4410-c of the State Education Law.

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

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

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

Background

The Hebrew Institute for the Deaf and Exceptional Children (Hebrew Institute) is a Brooklyn, New York-based not-for-profit organization authorized by the State Education Department (SED) to provide, among other programs, full-day and half-day Special Class (SC) and Special Class in an Integrated Setting (SCIS) preschool special education programs to disabled children ages three through five years. For the purposes of this report, these programs are collectively referred to as the SED cost-based Programs. During the 2013-14 school year, Hebrew Institute served about 171 students.

The New York City Department of Education (DoE) refers students to Hebrew Institute based on clinical evaluations and pays for Hebrew Institute's services using rates established by SED. These rates are based on the financial information that Hebrew Institute reports to SED on its annual Consolidated Fiscal Reports (CFRs). The State, in turn, reimburses the DoE 59.5 percent of the statutory rate paid to Hebrew Institute. To qualify for reimbursement, Hebrew Institute's expenses must comply with the criteria set forth in SED's Reimbursable Cost Manual (Manual), which provides guidance to special education providers on the eligibility of reimbursable costs, the documentation necessary to support these costs, and cost allocation requirements for expenses relating to multiple programs. Reimbursable costs must be reasonable, necessary, program-related, and properly documented.

Chapter 545 of the Laws of 2013 authorizes the State Comptroller to audit the expenses reported to SED by special education service providers for preschool children with disabilities. For the three fiscal years ended June 30, 2014, Hebrew Institute reported approximately $11 million in reimbursable costs for the aforementioned cost-based SED Programs. Our audit period included all claimed expenses for the three fiscal years ended June 30, 2014.

In addition to the cost-based SC and SCIS preschool special education programs, Hebrew Institute operated two other SED-approved programs: Evaluations and 1:1 Aides. However, payments for services under these other programs were based on fixed fees, as opposed to the cost-based rates established through CFR reported financial information. Hebrew Institute also operated a private day care program.

Audit Findings and Recommendations

For the three fiscal years ended June 30, 2014, we identified $774,122 in reported costs that did not comply with the Manual's requirements for reimbursement. These ineligible costs included $624,868 in personal service costs and $149,254 in other than personal service (OTPS) costs (see Exhibit on page 14).

Personal Service Costs

According to the Manual, personal service costs, which include all taxable and non-taxable salaries and fringe benefits paid to or accrued to employees on an agency's payroll, must be reported on the provider's CFR as either direct care costs (e.g., teachers' salaries) or non-direct care costs (e.g., administrators' salaries). During the three fiscal years ended June 30, 2014, Hebrew Institute reported approximately $8.8 million in reimbursable personal service costs. We identified $624,868 in personal service costs that did not comply with the Manual's guidelines for reimbursement.

Employee Bonuses

The Manual states that a bonus is a non-recurring and non-accumulating (i.e., not included in base salary of subsequent years) lump sum payment in excess of regularly scheduled salary, which is not directly related to hours worked. A bonus may be reimbursed if it is based on merit, as measured and supported by employee performance evaluations. The Manual also states that entities operating approved programs shall develop employer-employee agreements with written salary scales and issue them to employees. For the three fiscal years ended June 30, 2014, we identified $194,438 ($150,984 in salaries and $43,454 in related fringe benefits) in bonus payments that did not comply with the Manual's requirements.

During the three fiscal years ended June 30, 2014, officials at Hebrew Institute issued lump sum payments, in the form of handwritten checks, to 50 employees in their SED cost-based Programs. Hebrew Institute officials claimed that these lump sum payments represented deferred salaries. We were able to determine that the lump sum payment represented a deferred salary for one of the 50 employees. However, we were unable to do so for the remaining 49 employees because Hebrew Institute did not provide documentation to show the employees' base salaries and did not maintain employee salary agreements, as otherwise required. Absent such documentation, we were unable to determine if the annual lump sum payments were indeed deferred salaries.

We then analyzed Hebrew Institute's payroll information and determined that the lump sum payments to the 49 employees, which totaled $150,984, were non-recurring and non-accumulating, and were not included in the employees' base salaries in subsequent years. Therefore, the lump sum payments to the 49 employees met the Manual's definition of a bonus. When we interviewed Hebrew Institute officials, they told us that, during each of the three years, employees had agreed to accept lower salaries if the institute experienced cash flow problems. These employees would then receive handwritten checks for the deferred salaries later in the fiscal year if cash flow improved. However, the Hebrew Institute would not accrue a liability for the deferred salaries if cash flow did not improve.

For two of the 49 employees, we allowed portions of the lump sum payments that were funded by teacher-turnover grants, which aim to keep teachers from leaving one provider for employment with another provider that pays a higher salary. For the same two employees, we allowed an additional 3.5 percent of the lump sum payment for fiscal year 2012-13 because Hebrew Institute provided evaluations for the two employees for that year. However, we disallowed amounts in excess of the teacher-turnover grants for fiscal years 2011-12 and 2013-14 because no evaluations were available for the two employees. We also disallowed the lump sum payments for the remaining 47 employees for the three-year period because Hebrew Institute could not provide evidence that the payments were either merit based (performance evaluations) or deferred compensation (base salaries and employee salary agreements). Hebrew Institute representatives did not dispute the disallowances pertaining to 47 of the 49 employees. As such, we recommend that SED disallow the $194,438 ($150,984 in salaries and $43,454 in related fringe benefits) paid to the 49 employees who worked for the SED cost-based Programs because these costs did not comply with the Manual's requirements.

Over-Allocation of Shared Employees Compensation

According to the Manual, actual hours of service are the preferred statistical basis upon which to allocate salaries and fringe benefits for shared staff who work on multiple programs. Entities must maintain appropriate documentation reflecting the hours used in this allocation. Acceptable documentation may include payroll records or time studies. If hours of service cannot be calculated or a time study cannot be completed, then alternative methods that are equitable and conform to generally accepted accounting principles may be utilized. This is especially important when a provider, such as Hebrew Institute, operates multiple programs. Further, the costs of employees who work as 1:1 aides are funded separately from the cost-based preschool special education programs. Therefore, charges associated with the time spent functioning as 1:1 aides are ineligible for reimbursement through the SED cost-based Programs.

However, Hebrew Institute officials did not maintain appropriate documentation to support the allocation of 24 shared employees' compensation between the cost-based and the 1:1 Aides Programs. Absent the required documentation, we used class rosters maintained by the school as an alternative method to determine what costs should have been allocated to the SED cost-based Programs. As a result, we identified $132,846 in salaries and related fringe benefit expenses that were over-allocated to the SED cost-based Programs. We recommend that SED disallow the $132,846.

Excessive Executive Compensation

According to the Manual, compensation (i.e., salaries plus fringe benefits) for an entity's staff whose function is that of Executive Director will be directly compared with the regional median compensation for comparable administration job titles of public school districts. Reimbursement of employee compensation for an Executive Director shall not exceed the median compensation paid to comparable personnel in public schools for similar work and hours of employment in the region in which the entity is located.

For the three fiscal years ended June 30, 2014, Hebrew Institute reported $356,558, $311,565, and $310,502, respectively, in compensation (salary and fringe benefits) for the Executive Director. The regional median compensation for an Executive Director during this three-year period was $267,596, $274,416, and $281,291, respectively - a difference of $155,322 over the three-year period. We recommend a disallowance of $132,377 - the amount over-allocated to the SED cost-based Programs. (Note: Pursuant to desk review, SED disallowed these costs prior to our audit.)

Non-Mandated Fringe Benefits

According to the Manual, fringe benefits (including pensions, life insurance, and tax-sheltered annuities) for individual employees or officers/directors should be proportionately similar to those received by other classes or groups of employees. According to guidance provided to us by SED, fringe benefits are proportionately similar if the benefits-to-salaries ratio is the same/similar among all employees. The Manual also states that costs will not be reimbursable on field audit without appropriate written documentation of such costs.

For the three fiscal years ended June 30, 2014, the Hebrew Institute made contributions of between 16 percent and 52 percent of gross salaries to a 401(k) profit-sharing plan for two senior employees: the Executive Director and the Curriculum Coordinator. In comparison, contributions for the remaining Hebrew Institute employees ranged from 4 percent (for fiscal year 2013-14) to 9 percent (for fiscal year 2011-12) of their gross salaries. Consequently, the contributions of 16 percent to 52 percent of gross salaries for the two senior employees significantly exceeded (and were not proportional to) the benefits provided to other Hebrew Institute employees, as otherwise required by the Manual. For the two senior employees, we disallowed a total of $189,017 in contributions that were in excess of contribution rates made to the other employees. We recommend that SED disallow $107,025 in payments to the Curriculum Coordinator because these payments did not comply with the Manual's requirements. The remaining $81,992 ($189,017 - $107,025) was previously included in the disallowance recommended in the Excessive Executive Compensation section of this report.

Also, Hebrew Institute could not provide documentation to support an additional $1,614 in health insurance expenses. Therefore, we recommend that SED disallow a total of $108,639 ($107,025 + $1,614) in non-mandated fringe benefits charged to the SED cost-based Programs.

Unsupported Compensation

The Manual states that costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the education programs, and sufficiently documented. Costs will not be reimbursable on field audit without appropriate written documentation of such costs. Compensation costs must be based on approved and documented payrolls, which must be supported by employee time records prepared during, not after, the time period for which the employee was paid.

However, Hebrew Institute officials could not provide documentation, including evidence of work-product, to show that eight employees were assigned to or had provided services to the SED cost-based Programs. Therefore, we recommend that SED disallow the $56,568 in compensation that was claimed for the eight employees.

Other Than Personal Service Costs

For the three fiscal years ended June 30, 2013, Hebrew Institute reported $2.25 million in OTPS costs for the SED cost-based Programs. We identified $149,254 of these expenses that did not comply with the Manual's reimbursement requirements, as follows:

Undocumented and Insufficiently Documented Expenses

The Manual states that costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the education programs, and sufficiently documented. In addition, all purchases must be supported with invoices that list the items purchased, dates of purchase and payment, as well as with copies of canceled checks. However, for the three fiscal years ended June 30, 2014, we identified:

- $39,436 in undocumented expenses, including $22,024 in checks to the Executive Director, $6,742 for office supplies/postage, $5,728 in petty cash disbursements, $2,137 in staff development and travel costs, and $2,805 in other miscellaneous expenses. Hebrew Institute officials could not provide any documentation, such as invoices or receipts, to support these expenses; and
- $15,656 in insufficiently documented expenses, including $5,956 for office supplies; $5,349 in credit card payments - the transaction details supporting the expenses were obscured/not legible; and $4,351 in other miscellaneous expenses.

Consequently, we recommend that SED disallow the $55,092 ($39,436 + $15,656) because the expenses were not documented and/or were insufficiently documented.

Ineligible Expenses

The Manual states that costs must be program related. In addition, the Manual states that costs of food purchased for staff and the cost of clothing purchased for students or staff are not reimbursable. For the three fiscal years ended June 30, 2014, we identified $53,533 in expenses that were ineligible for reimbursement, as follows:

- $13,641 in food for staff members;
- $12,516 in t-shirts, jackets, and caps for adults and children;
- $11,244 in legal fees that were unrelated to the SED cost-based Programs;
- $8,617 in referral fees that were paid to employees for each child they referred to Hebrew Institute's SED Evaluation program;
- $3,897 in expenses not related to the SED cost-based Programs, including a private day

care; and
- $3,618 in other miscellaneous ineligible expenses.

Thus, we recommend that SED disallow the $53,533 in expenses because these expenses were ineligible for reimbursement.

Vehicle Expenses

According the Manual, vehicle use must be documented with individual vehicle logs that include at a minimum: the date and time of travel, to and from destinations, mileage between each destination, the purpose of travel, and the name of the traveler. The Manual also states that costs associated with the personal use of a program-owned or leased automobile are not reimbursable. In addition, the costs of vehicles used by program officials, employees, or Board members to commute to and from their homes are not reimbursable. For the three fiscal years ended June 30, 2013, Hebrew Institute charged $30,629 in lease payments and other related expenses for a 2010 Acura MDX and, later, a 2013 Acura MDX that were driven by the Executive Director.

We found, however, that Hebrew Institute officials did not maintain the required vehicle logs to support the use of the vehicle. Moreover, we determined that the Executive Director also used the vehicles for commuting to and from work. We recommend that SED disallow $30,629 in vehicle expenses because these expenses did not comply with the requirements in the Manual.

Consultant Expenses

The Manual requires consultant costs to be supported by a written contract that includes the nature of the services to be provided, the charge per day, and service dates. All payments must be supported by itemized invoices that indicate the specific services actually provided; and for each service, the date(s), number of hours provided, the fee per hour; and the total amount charged.

For the three fiscal years ended June 30, 2014, Hebrew Institute paid a consultant $138,292 to provide physical therapy services to students. During fiscal year 2013-14, Hebrew Institute paid the consultant an additional $1,000 per month, for 10 months, to provide support and training to school employees on the use of the EZ-Track online computer system for recording therapy sessions. We reviewed the documentation provided by Hebrew Institute in support of the $10,000 in payments and noted that the consultant's invoices did not indicate the specific services actually provided, the date of the services, and the number of hours provided, as required. Moreover, school officials did not maintain any evidence of the services rendered by the consultant. Therefore, we recommend that SED disallow the $10,000 in consultant expenses because these expenses did not comply with the Manual's requirements.

Recommendations

To SED:

1. Review the recommended disallowances resulting from our audit and make the appropriate adjustments to Hebrew Institute's reimbursement rates.

2. Work with Hebrew Institute officials to help ensure their compliance with Manual provisions.

To Hebrew Institute:

3. Ensure that costs reported on future CFRs comply with all Manual requirements.

Audit Scope and Methodology

We audited the costs reported on Hebrew Institute's CFRs to determine whether they were properly documented, program related, and allowable pursuant to the Manual. The audit included all claimed expenses for the three fiscal years ended June 30, 2014.

To accomplish our objective, we reviewed the Manual, the Consolidated Fiscal Reporting and Claiming Manual, Hebrew Institute's CFRs, and relevant financial records for the audit period. We also interviewed Hebrew Institute's officials, staff, and independent auditors to obtain an understanding of Hebrew Institute's financial and business practices. To complete our audit work, we selected and reviewed a judgmental sample of costs reported by the Hebrew Institute. We included in our sample high-risk categories such as food, vehicle expenses, and checks written out to the Executive Director. We assessed the sample of reported costs to determine whether they were supported, program appropriate, and reimbursable. Our review of Hebrew Institute's internal controls focused on the controls over Hebrew Institute's CFR preparation process.

We conducted our performance 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 objective. We believe that the evidence obtained during our audit provides a reasonable basis for our findings and conclusions based on our audit objective.

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; Article II, Section 8 of the State Finance Law; and Section 4410-c of the State Education Law.

Reporting Requirements

We provided draft copies of this report to SED and Hebrew Institute officials for their review and formal comment. Their comments were considered in preparing this report and are attached to the end of it. In their response, SED officials agreed with our recommendations and indicated that they will take steps to address them. In their response, Hebrew Institute officials accepted some of our conclusions, but generally disagreed with other proposed disallowances. Also, our rejoinders to certain Hebrew Institute 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.

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

Hebrew Institute for the Deaf and Exceptional Children
Schedule of Submitted and Disallowed Program Costs
For the 2011-12, 2012-13, and 2013-14 Fiscal Years

Program Costs	Amount Per CFR	Amount Disallowed	Amount Remaining	Notes to Exhibit
Personal Services				
Direct Care	$7,492,240	$475,650	$7,016,590	A, B, D-G, K-M
Agency Administration	1,284,310	*149,218	1,135,092	
Total Personal Services	**$8,776,550**	***$624,868**	**$8,151,682**	
Other Than Personal Services				
Direct Care	$847,927	$49,472	$798,455	A, C, H-K, N-P
Agency Administration	1,406,217	99,782	1,306,435	
Total Other Than Personal Services	**$2,254,144**	**$149,254**	**$2,104,890**	
Total Program Costs	**$11,030,694**	***$774,122**	**$10,256,572**	

*Includes certain adjustments previously made by SED

Notes to Exhibit

The following Notes refer to specific sections of SED's Reimbursable Cost Manual used to develop our recommended disallowances. We summarized the applicable sections to explain the basis for each disallowance. We provided the details supporting our recommended disallowances to SED and Hebrew Institute officials during the course of our audit.

A. Section II - Generally, costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the special education program, and sufficiently documented.
B. Section II.13.B(2)(c) - Benefits, including pensions, life insurance and tax sheltered annuities, for individual employees or officers/directors are proportionately similar to those received by other classes or groups of employees.
C. Section II.11 - Cost of clothing and uniforms for children attending day care or public schools are assumed by children's parents or guardians and are not reimbursable. Clothing and uniforms purchased for staff, even when required by school, are not reimbursable.
D. Section II.13.A(1) - Entities operating approved programs shall develop employer-employee agreements with written salary scales and issue them to employees.
E. Section II.13.A(4a) - Compensation (i.e., salaries plus fringe benefits) for an entity's staff whose function is that of Executive Director will be directly compared with the regional median compensation for comparable administration job titles of public school districts. Reimbursement of employee compensation for Executive Director shall not exceed the median compensation paid to comparable personnel in public schools for similar work and hours of employment in the region in which the entity is located.
F. Section II.13.A(10) (July 2012 Edition) - 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 that is not directly related to hours worked. Bonus compensation is restricted to direct care titles/employees. Bonus compensation may be reimbursed if based on merit as measured and supported by employee performance evaluations and does not exceed 3.5 percent of salary for any direct care employee.
G. Section II.14.A(10) (July 2011 Edition) - 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 that is not directly related to hours worked. Bonus compensation is restricted to direct care titles/employees. Bonus compensation may be reimbursed if based on merit as measured and supported by employee performance evaluations and does not exceed 5 percent of salary for any direct care employee.
H. Section II.20.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.
I. Section II.30.C - Costs for food, beverages, entertainment, and other related costs for meetings, including Board meetings, are not reimbursable.

J. Section II.59.D(1) - The costs of vehicles used by program officials, employees, or Board members to commute to and from their homes are not reimbursable.
K. Section III.1 - Costs will not be reimbursable on field audit without appropriate written documentation of costs.
L. Section III.1.A (July 2011 Edition) - Compensation costs must be based on approved, documented payrolls. Payrolls must be supported by employee time records prepared during, not after, the time period for which the employee was paid. Employee time sheets must be signed by the employee and a supervisor, and must be completed at least monthly.
M. Section III.1.B - Actual hours of service are the preferred statistical basis upon which to allocate salaries and fringe benefits for shared staff who work on multiple programs. Entities must maintain appropriate documentation reflecting the hours used in this allocation for seven years.
N. Section III.1.C(2) - Adequate documentation includes, but is not limited to, the consultant's resume, a written contract which includes the nature of the services to be provided, charge per day, and service dates. All payments must be supported by itemized invoices which indicate the specific services actually provided; and for each service, the date(s), number of hours provided, the fee per hour; and the total amount charged. In addition, when direct care services are provided, the documentation must indicate the names of the students served, the actual dates of service, and the number of hours of service to each child on each date.
O. Section III.1.J(2) - 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.
P. Section III.D - 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.

Agency Comments - State Education Department

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

DEPUTY COMMISSIONER
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September 29, 2016

Mr. Kenrick Sifontes
Audit Director
Office of the State Comptroller
Division of State Government Accountability
59 Maiden Lane, 21st Floor
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Dear Mr. Sifontes:

The following is the New York State Education Department's (NYSED) response to the draft audit report, 2015-S-67, Compliance with the Reimbursable Cost Manual: Hebrew Institute for the Deaf and Exceptional Children.

In addition to the actions that will be taken in response to the specific recommendations described below, NYSED will closely examine the circumstances that led to the findings described in the audit report. This examination will include an assessment of the programmatic oversight and fiscal management employed at Hebrew Institute for the Deaf and Exceptional Children (Hebrew Institute), with particular attention given to the OSC findings related to undocumented and insufficiently documented personal services and OTPS expenses. NYSED's review of the audit findings and assessment of Hebrew Institute's oversight and management will be a factor in the consideration of the continued approval of this provider and the corrective action or enforcement actions that may be warranted.

Recommendation 1: Review the recommended disallowances resulting from our audit and make the appropriate adjustments to Hebrew Institute's reimbursement rates.

We agree with this recommendation. SED will review the recommended disallowances as noted in the report and make adjustments to the reported costs to recover any overpayments, as appropriate, by recalculating tuition rates.

Recommendation 2: Work with Hebrew Institute officials to help ensure their compliance with Manual provisions.

We agree with this recommendation. SED will continue to provide technical assistance whenever requested and will strongly recommend the Hebrew Institute 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).

Furthermore, Consolidated Fiscal Report (CFR) training is available both in person, at one of the six locations it is offered across the State, and online on SED's webpage. SED recommends that all individuals signing the CFR certification statements, namely Executive Directors and Certified Public Accountants, complete this training. At the direction of the Board of Regents, the Department intends to require that this training be mandatory and will require individuals to verify that they have completed the training.

If you have any questions regarding this response, please contact Suzanne Bolling, Director of Special Education Fiscal Services at (518) 474-3227.

Sincerely,

Sharon Cates-Williams

Sharon Cates-Williams

c: Christopher Suriano
Suzanne Bolling
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Monica Short

Agency Comments - Hebrew Institute

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††(ALSO ADMITTED IN NJ)

October 5, 2016

Mr. Kendrick Sifontes, Audit Director
Mr. Steven Lynch, Audit Director
Office of the State Comptroller
Division of State Government Accountability
59 Maiden Lane, 21st Floor
New York, NY 10038

Re: Hebrew Institute for the Deaf and Exceptional Children
Compliance With Reimbursable Cost Manual ("RCM")
Audit Report No. 2015-S-67

Dear Messrs. Sifontes and Lynch:

We have reviewed the proposed audit findings report for Hebrew Institute for the Deaf and Exceptional Children ("HIDEC") for audit years 2011-12, 2012-13, 2013-14 reflected in OSC's draft audit report. We acknowledge the revisions made to the preliminary report based upon further explanations and clarifications provided to the OSC auditors during the subsequent exit conference. While we appreciate OSC's openness to work towards proper resolution of issues, HIDEC continues to disagree in whole or in part with some of OSC's proposed findings and believes that clarification is required with respect to other proposed findings. We offer the following responses to the findings that still remain within the OSC's draft findings report, and we trust that you will take these responses into consideration before issuing OSC's final report.

At the outset, we note that HIDEC does not agree that OSC has or had authority to conduct the audit at issue under the New York State Constitution, as interpreted by the New York Court of Appeals in *Blue Cross & Blue Shield of Cent. N.Y. v McCall,* 89 N.Y.2d 160 (1996), *New York Charter Schools v. DiNapoli,* 13 N.Y.3d 120 (20019) and *Handler v. DiNapoli*, 23 N.Y.3d 239 (2014). HIDEC's cooperation with OSC's audit and this response to OSC's draft report do not waive any of its rights to challenge OSC's authority to conduct this audit or any decision to act upon it, and HIDEC expressly reserves all such rights. That said, we will now proceed to HIDEC's substantive responses to OSC's draft report.

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*See State Comptroller's Comments, page 27

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Personal Service Costs

Executive Director Compensation:

Within the draft report, OSC recommends disallowance of $132,846 attributable to amounts paid to HIDEC's Executive Director in excess of the allowable median salary. As we have discussed on numerous occasions, and as you acknowledge in the draft report, SED already eliminated the Executive Director's salary in excess of the allowable median salary on desk audit. To include this amount in OSC's findings and report is improper for two reasons.

First, it clearly overstates the disallowances presented, as HIDEC was never reimbursed for these costs as part of its reimbursement from the State. As a result, there is no reason to include this proposed "disallowance" in the report at all, and it should be removed from the report. With all due respect, it appears to us that OSC is including this item in its report for political purposes, because the only purpose it serves is to enable OSC to report an inflated amount of the disallowances that OSC purportedly "found" to the public and the legislature. The reality is that OSC did not find anything with respect to this item.

* Comment 2

Second, including this as a disallowance implies to the public that HIDEC did something wrong, when HIDEC in fact did nothing wrong. As OSC is well aware, there was nothing improper about HIDEC's paying the compensation or with the way HIDEC reported this compensation in its CFR. As OSC well knows, agencies are permitted to pay their Executive Directors more than the allowable median salary, and it is common for them to do so. The consequence of doing so is that the portion above the allowable median salary is not reimbursable and is excluded from costs used to determine the State-funded tuition rates. As OSC knows, if an agency chooses to pay its Executive Director more than the allowable median salary, it still is proper to report the entire salary on its CFR, and SED routinely makes the adjustment as part of its desk audit when it determines the tuition rate. SED does this for the many other agencies that pay executive compensation in excess of the allowable median salary, as it did in this case. While OSC's final report should not mention this proposed "disallowance" at all, because there is no *bona fide* reason to do so, if the final report does mention it, the report also should include the foregoing explanation to make clear to the public that what HIDEC did, and the way it reported this compensation, was permissible and proper, that the adjustment made by SED was a normal and routine part of SED's rate-setting process, and that the compensation above the allowable median was never reimbursed by public funding.

* Comment 3

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Bonuses:

Within the draft report, OSC proposes to disallow $194,438 of salaries and related fringes associated with what you labelled "bonuses." These were not staff bonuses, but instead were checks paid to staff members for various reasons, including summer employment, deferred compensation, and the like. We understand that the RCM requires a certain level of documentation to support such expenditures, including salary agreements, detailed time records, etc., and that HIDEC unfortunately does not have the required level of documentation to support these expenditures. However, we stress that these disallowed salaries and fringes are valid expenses that were in fact paid to HIDEC's staff for services rendered for the betterment of the children served by HIDEC.

* Comment 4

Non-Mandated Fringe Benefits:

Within the draft report, OSC proposes to disallow $108,639 of non-mandated fringe benefits, principally associated with pension benefits paid to one employee. HIDEC continues to disagree with OSC's proposed disallowance for several reasons.

First, we believe that OSC is applying the wrong section of the RCM. The section OSC's draft report refers to, requiring the benefits to be "proportionately similar," is directed to fringe benefits generally. There is another section of the RCM, Section II.13.C directed specifically to pensions. It provides that: "Costs of employer funded pension plans which are approved by the Internal Revenue Service and accounted for under generally accepted accounting principles (GAAP) are reimbursable," subject to various listed specific exceptions and limitations that are not applicable to HIDEC's situation. HIDEC's plan indisputably was approved by the IRS and accounted for under GAAP. Therefore, contributions under the plan were reimbursable pursuant to Section II.13.C. The IRS does not require contributions to be "proportionately similar". It does have anti-discrimination provisions to assure that the plan does not discriminate in favor of certain classes or employees, and HIDEC's plan also indisputably met the IRS anti-discrimination test.

* Comment 5

Read in the context of RCM Section II.13.C, which defines the reimbursement rules for pension expenses, the language in RCM Section II.13.B.2 that OSC relies on appears to apply to all fringe benefits as a group, not to pension benefits alone. In other words, fringe benefits as a whole must be "proportionately similar," not each individual fringe benefits. Otherwise, the "proportionately similar" requirement would be included in the list of exceptions to the rule governing reimbursable pension expenses quoted above, contained in RCM Section II.13.C, because it would be an exception to the stated rule that costs of employer funded plans "approved by the Internal Revenue Service...are reimbursable," unless one of the stated exceptions applies. The reference in Section II.13.B to benefits "including pension, life insurance and Tax Sheltered Annuities" merely clarifies that those kinds of benefits are included in the classes of benefits that,

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as a total package of benefits, must be "proportionately similar". Again, if the "proportionately similar" language was intended to apply to pension contributions separate and apart from other benefits, it would and should have been included as an exception in RCM Section II.13.C.

Second, even if the "proportionately similar" language applied to pension contributions on a stand-alone basis, as opposed to fringe benefits as a group, we disagree with OSC's position that HIDEC's contributions were not "proportionately similar". By implication OSC is interpreting "proportionally similar" to mean "the same as," as the recommended disallowances assume that every employee must receive the same percentage contribution. However, nowhere does the RCM define "proportionately similar" to mean "the same as." Indeed, it does not define what "proportionately similar" means at all. Absent any specific definition of "proportionately similar" within the RCM, we are left to the anti-discrimination test under Internal Revenue Service rules, which serves the same purpose as the "proportionately similar" language of making sure that plans do not unfairly discriminate in favor of certain employees or classes of employees. The Internal Revenue Service rules are widely known and understood by employers, and absent any specific guidance in the RCM to the contrary, the most reasonable interpretation of what "proportionately similar" means, as applied to a pension plan, is that the plan contributions must meet the IRS discrimination test. Indeed, the language of RCM Section II.13.C expressly reinforces that conclusion. We have no doubt that most agencies do exactly what HIDEC did; that is, they rely on pension consultants to tell them what the appropriate contributions are under the applicable rules. The rules pension consultants look to for guidance are the well-defined and universally applied IRS rules. Thus, absent clearer regulatory guidance in the RCM, it was perfectly reasonable for HIDEC to believe, as many agencies do, that a contribution methodology that satisfies the IRS anti-discrimination requirements also satisfies the RCM's "proportionately similar" requirement.[1]

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We also note that in another audit, OSC auditors disallowed pension contributions similar to those in this case which provided higher percentage contributions to a small group of employees than to other employees, but OSC allowed pension contributions in subsequent years, made under a methodology based upon years of service and salary, even though such methodology produced similar contributions to those disallowed by OSC for the prior year and in this case. OSC's disparate treatment of substantially similar contributions underscores the ambiguity as to what "proportionately similar" means.

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Given that ambiguity, even if OSC believes that HIDEC's contributions were not "proportionately similar" within the meaning of the RCM, and even if SED were to agree with OSC's interpretation, it would not be appropriate for OSC to recommend retroactive disallowance of the contributions to the employee that OSC regards as not "proportionately similar". Rather, in

[1] We also question whether, under the supremacy clause of the United State Constitution, NYSED even legally can impose a non-discrimination standard in the RCM more stringent than the Federal standard.

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the face of an ambiguous RCM provision, the only appropriate recommendation would be a recommendation to SED to amend the RCM to clarify for all agencies what it means by "proportionately similar," just as the IRS has made clear for all organizations that have pension plans what it means by non-discrimination. That way, whatever SED intends 'proportionately similar" to mean could be clearly understood by all agencies and enforced prospectively.

In making this point, we also note that OSC stated in correspondence after the exit conference that its position was based on guidance from SED. HIDEC was not a party to OSC's discussions with SED, and OSC refused to disclose exactly what it asked SED and what SED said, even when HIDEC requested the same. We submit that this lack of transparency is not proper audit procedure, and we reiterate our request that OSC disclose to HIDEC exactly what OSC asked SED and what SED said and provide HIDEC a copy of written guidance, if any, that OSC received from SED.

* Comment 10

For all of these reasons, HIDEC contends that the proposed disallowance is incorrect. In addition, as we have pointed out to OSC previously, if OSC nevertheless keeps this recommended disallowance in its final report, the disallowance of these fringe benefits reduces the overall fringe benefits of HIDEC (as HIDEC utilizes a global fringe benefit percentage). In making their disallowances, the OSC auditors utilized the fringe benefit percentage reflected on the originally filed CFR, as opposed to revised fringe benefit factor that eliminates the pension disallowance. As a result, all disallowances of fringes associated with disallowed personnel costs would be overstated. If OSC includes this disallowance in its report, we reiterate once again that OSC should modify its fringe benefit percentage in calculating disallowed costs. OSC's only prior response to this point has been to state that "it is our office policy" not to make such an adjustment. We submit that if that is OSC's office policy, OSC's office policy reflects incorrect accounting and should be changed. Moreover, any "policy" of the State's fiscal officer, especially a policy pertaining to audits, should be published.

* Comment 11

Other Employee Expenses:

Within the draft report, OSC also recommends disallowance of "overallocated" employee salaries and related fringes and insufficiently supported compensation totaling $189,414. Once again, we stress that although HIDEC does not have the level of documentation required by the RCM to substantiate the allowance of these costs, these all were real and necessary and appropriate payments actually made to staff members for services provided which benefitted children receiving mandated services from HIDEC.

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Other than Personal Services Costs

Undocumented or Insufficiently Documented Expenses:

OSC's draft report recommends the disallowance of $59,526 of costs attributable to undocumented or insufficiently documented expenses. HIDEC disagrees with two of the proposed disallowances: $22,024 of checks reimbursing HIDEC's Executive Director for expenditures incurred on behalf of the School and $4,434 in audit and legal expenses, As was explained during the audit, HIDEC had appropriate support for the Executive Director expenditures; however, that documentation was destroyed in a flood within the building attributable to a defective air conditioning unit. Support for the flood loss was provided to the auditors. Accordingly, HIDEC believes that under these circumstances, the expenses should be accepted as reimbursable. In addition, HIDEC also disagrees with the disallowances of legal fees. The legal fees disallowed represent valid legal expenses for which HIDEC provided the OSC auditors support. OSC disallowed these costs because they were attributable to non-SED funded programs. HIDEC charged all legal fees to administrative costs (which were allocated to all programs including tuition based programs utilizing the ratio value method as proscribed by the RCM), which is a common and proper way to allocate legal expenses. It is not necessary to parse through legal bills to try to determine which activities related to which programs.

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"Ineligible" Expenses:

OSC's draft report recommends the disallowance of $53,533 of costs attributable to ineligible expenses. These costs included $13,641 of staff food, $12,516 of clothing provided to the students and staff at a carnival intended to assist in student socialization, $12,514 in referral fees, $11,244 in legal fees, and $3,618 in other miscellaneous ineligible expenses. HIDEC again disagrees with two of OSC's proposed disallowances.

The $12,516 of clothing recommended for disallowance consisted of t-shirts, jackets, and caps purchased for HIDEC's children for the carnival that HIDEC operates each year. The purpose of the clothing was to be able to readily discern HIDEC's children and staff the day of the carnival from the other attendees at the event. In total between 200 and 300 children, parents and families attend the carnival to interact and partake in the games and events that have been partially developed and created by the children served by HIDEC. The purpose of the carnival is to help provide socialization skills and create an immersive integrated environment. Unfortunately, in such an environment it is often quite difficult to keep track of the special needs children. The purpose of the clothing was to help identify the special needs children, so that other participants can assist in the integration, and to help participants identify HIDEC staff. We understand that the RCM does not cover uniforms, but these are not uniforms. They were reasonable and necessary

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expenses incurred in connection with activities designed to assist in the development and integration of special needs children, and we once again submit that these costs should be allowed. OSC has not articulated any reason why these costs should be disallowed in the face of these facts, and there is no valid reason to disallow them.

The disallowed legal fees represent legal fees provided to HIDEC fully supported by legal bills. As stated above, HIDEC charged all legal fees to administration, which is a common and appropriate practice, and the legal fees were allocated to all programs utilizing the ratio value method. OSC identified specific legal fees that were not attributable to the tuition based programs and disallowed them under the premise that they should be charged directly to the non-SED programs, leaving all of the rest of the legal fees in administration costs. OSC's contention is incorrect, as OSC has stated no reason why legal expenses should not be considered agency administration, and there is no reason not to do so.

* Comment 13

Moreover, OSC's position is inconsistent. OSC carved out all the non-SED legal costs and disallowed them, stating that they should be directly charged to the impacted programs; however, OSC did not directly charge the legal fees that related exclusively to SED programs to only the SED programs. By leaving those expenditures in administration, they are partially being allocated to non-SED programs. HIDEC provided OSC auditors with an analysis of all legal fees, so that costs could be properly charged, if OSC required them to be charged to specific programs. While we continue to believe that allocating all legal expenses to agency administration is proper, and no adjustment should be made, if OSC were to determine otherwise, OSC must either allocate all such fees to specific programs where applicable or none; it cannot allocate only the non-SED program related legal expenses to specific programs.

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Additionally some of the legal expenses OSC characterized as not related to SED programs in fact did relate to SED programs. For example, included in the disallowed legal fees were $1,517 of fees paid to HIDEC's attorney for consultation regarding a DUI charge against one of HIDEC's custodial staff. The attorney was involved in advising the School about its reporting requirements with respect to SED regulations surrounding reporting staff criminal activities. This cost is definitely related to the tuition based programs and should be allowed under any circumstances.

* Comment 16

Vehicle Costs:

OSC's draft report recommends that $30,629 of costs associated with the executive director's vehicle be disallowed as HIDEC did not maintain the vehicle use logs as required pursuant to the RCM. We are not challenging this disallowance, although we again stress that the vehicle was used for valid business purposes.

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Payments to a Consultant:

OSC's draft report recommends disallowance of $10,000 of costs attributable to "unsupported" charges paid to a therapist. HIDEC entered into a contract with a therapist familiar with the EZ-Trac system (a software allocation that is required to be utilized by New York State to track the provision of services to special education students) to provide on-going support and training to the therapists utilized by HIDEC on the proper use of the EZ-Trac system. While he indisputably provided such services, he did not provide definitive documentation detailing the actual hours spent performing these services and the dates of specific services. His contract was for $1,000 per month. We submit that the requirement in the RCM that a consultant's services should be documented by a description of hours worked and dates of service makes no sense, and does not apply, to a consultant who does not work on an hourly fee basis. There is no logical reason for a consultant who is working for a set fee, not based on hours worked, to provide such records. In that context, only the more general requirements set forth in RCM section II.14 make sense and should apply. In any event, HIDEC's therapeutic staff explained to the auditors what the consultant did, which explanations verified that the services were truly provided on a regular basis and were commensurate with the fees charged. In addition, the auditors could speak to the consultant to obtain any further details the auditors desire, as HIDEC suggested during the audit that the auditors do.

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Conclusion

HIDEC appreciates OSC's consideration of our prior responses to OSC's contentions, and we hope and trust that OSC will carefully consider the points above before issuing its final audit report.

Very truly yours,

Frederick J. Berman

Frederick J. Berman

FJB:ea

State Comptroller's Comments

1. The State Comptroller's legal authority to audit the costs submitted by Hebrew Institute on the CFRs submitted to the State Education Department (SED) is expressly cited on pages 3 and 12 of the report.
2. The assertion is inaccurate. In our report, we acknowledged SED's review of executive salary compensation as part of its annual desk review of providers' CFRs. As part of SED's routine follow-up on our audit recommendations, SED officials reconcile our recommended disallowances to their previously identified disallowances, if any, and adjust the amount to be disallowed, as may be appropriate. Also, in our report, we note when SED has disallowed a cost prior to our audit to help ensure that amounts of disallowances are not double counted.
3. It is appropriate for us to report on the excessive compensation the Hebrew Institute claimed for the executive director. Our audit is independent of SED's desk review, and consequently, there could be differences in the amounts allowed/disallowed in question. Also, see Comment No. 2.
4. As detailed on page 6 of the report, the lump sum payments made by Hebrew Institute met the Manual's definition of a bonus.
5. We disagree. Section II.13.B(2) of the Manual clearly states that benefits, including pensions for individual employees or officers/directors, must be proportionately similar to those received by other classes or groups of employees. Further, SED officials concur with our interpretation of this provision of the Manual. Also, nothing in the Manual obviates the Hebrew Institute from following the requirements of Section II.13.B(2).
6. Contrary to Hebrew Institute's contention, Section II.13.B(2) does not refer to fringe benefits "generally" or "as a group."
7. As detailed in the report, the pension contributions of all but the two employees in question were between 4 percent and 9 percent of their respective gross salaries, while the two employees received contributions of 16 percent to 52 percent of their gross salaries. Given the magnitude of the differences in the contribution rate ranges, we maintain that the contributions were not proportionately similar.
8. Hebrew Institute officials could have sought guidance and/or clarification from SED officials. Also, in response to the draft report, SED officials stated that they will continue to provide technical assistance whenever requested and strongly recommend that providers take advantage of SED's availability to help them better understand the standards for reimbursement as presented in Regulation and the Manual. Further, although certain costs might be compliant with IRS anti-discriminatory requirements, that does not obviate a provider (including Hebrew Institute) from compliance with the Manual.
9. The assertion is inaccurate. Our approach to determining "proportionately similar" is consistent throughout our audits.
10. Hebrew Institute officials can seek guidance and/or clarification from SED officials regarding their position on this issue.
11. Our report recommends disallowances to both fringe benefits and other personal service (non-fringe benefit) costs, which could both impact the overall fringe benefit rate. Consequently, we provide SED with detailed line item information on both cost

components so that it can make the appropriate adjustments for CFR reporting and rate-setting purposes.

12. The Manual states that costs will not be reimbursed upon field audit without appropriate written documentation. The Manual does not make exceptions for claims of lost or destroyed supporting documentation.
13. We disagree. The Manual states that any expenditures that cannot be charged directly to a specific program must be allocated. However, in this case, the legal expenses can be attributed to a specific program; therefore, they should not be allocated.
14. Contrary to Hebrew Institute's contention, the cost of clothing and uniforms that are normally assumed by parents or legal guardians of students attending day care centers or public day schools are not reimbursable. Further, clothing expenses for staff, such as uniforms for custodians or bus drivers, even if required by school policy, are not reimbursable. Such costs are considered to be personal expenses.
15. Our position is not inconsistent. Our recommended disallowances to SED consisted of legal expenses that were not directly related to the SED cost-based Programs. Further, our recommended disallowances were based on the respective ratio-values of the SED cost-based Programs and the non-SED programs.
16. We revised our report to delete the disallowances related to the custodial staff legal fees.
17. We disagree. The section of the Manual cited by Hebrew Institute (Section II.14) describes what type of consultant costs are reimbursable. Section III.1.C of the Manual details the recordkeeping requirements for consultants. In fact, Section II.14 clearly refers the reader to Section III.1.C of the Manual for direction pertaining to recordkeeping requirements.