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
Mid Island Therapy Associates, LLC

Report 2014-S-40

December 2015

Executive Summary

Purpose
To determine whether the costs reported by Mid Island Therapy Associates LLC (Mid Island), aka All About Kids, 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 all expenses claimed on Mid Island's CFR for the fiscal year 2012-13, and certain expenses claimed on Mid Island's CFRs for the two fiscal years ended June 30, 2012.

Background
Mid Island is a for-profit organization authorized by SED to provide, among other programs, a preschool Special Education Itinerant Teacher (SEIT) program to disabled children between the ages of three and five years. During the 2012-13 school year, Mid Island served approximately 271 students. Local school districts refer preschool special education students to Mid Island's programs based on clinical evaluations. The counties pay for the preschool special education services Mid Island provides using rates established by SED. The rates are based on the financial information that Mid Island reports to SED on its annual CFRs. The State, in turn, reimburses the counties 59.5 percent of the tuition paid by the counties. Reimbursable costs must be reasonable, necessary, program-related, and properly documented. For the fiscal year ended June 30, 2013, Mid Island reported approximately $3 million in reimbursable costs to the SEIT program. Our audit scope period focused primarily on fiscal year 2012-13. However, we expanded our review to include certain items claimed on the CFRs for fiscal years 2010-11 and 2011-12.

Key Findings
For the three fiscal years ended June 30, 2013, we identified $655,055 in reported costs that did not comply with the Manual's requirements and recommend such costs be disallowed. These ineligible costs included $621,191 in personal service costs and $33,864 in other than personal service (OTPS) costs, as follows:

- $466,575 in over-allocated salaries and fringe benefits charged to the SEIT program;
- $147,121 in non-allowable 2012-13 retroactive salary increases that were paid in April and May 2014;
- $33,864 in non-reimbursable OTPS costs; and
- $7,495 in employee bonuses that were not in compliance with the Manual's guidelines.

Key Recommendations

To SED:
- Review the recommended disallowances resulting from our audit and make the appropriate adjustments to Mid Island's CFRs and reimbursement rates.
- Work with Mid Island officials to help ensure their compliance with Manual provisions.

To Mid Island:

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

Other Related Audits/Reports of Interest

Whitestone School for Child Development: Compliance With the Reimbursable Cost Manual (2014-S-38)
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

December 31,2015

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

Ms. Cathleen Grossfeld
Executive Director
Mid Island Therapy Associates LLC, aka All AboutKids
255 Executive Drive
Plainview, NY 11803

Dear Ms. Elia and Ms. Grossfeld:

The Office of the State Comptroller is committed to providing accountability for tax dollars spent to support government-funded services and 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 expenses submitted by Mid Island Therapy Associates, LLC to the State Education Department for the purposes of establishing the tuition reimbursement rates, entitled *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; 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 draft report, please feel free to contact us.

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

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Background

Mid Island Therapy Associates LLC (Mid Island), aka All About Kids, is a for-profit organization authorized by the State Education Department (SED) to provide a preschool Special Education Itinerant Teacher (SEIT) program, Preschool Evaluations, and Preschool Related Services. Mid Island also operates an Infant/Toddler program. Mid Island provides services to disabled children from birth through five years of age. Based in Plainview, New York, Mid Island provides its SEIT Program to children throughout New York City, and Nassau, Suffolk, and Westchester counties. During the 2012-13 school year, Mid Island provided SEIT services to about 271 students.

Local school districts refer preschool special education students to Mid Island's programs based on clinical evaluations. The New York City Department of Education (DoE) and counties pay for the preschool special education services Mid Island provides using rates established by SED. The rates are based on the financial information that Mid Island reports to SED on its annual Consolidated Fiscal Reports (CFRs). Costs reported on the CFRs must comply fully with the provisions in SED's Reimbursable Cost Manual (Manual) regarding the eligibility of costs and documentation requirements, and they must also meet the reporting requirements prescribed in the Consolidated Fiscal Reporting and Claiming Manual (CFR Manual). The State, in turn, reimburses the DoE and the counties 59.5 percent of the tuition they paid to Mid Island. Reimbursable costs must be reasonable, necessary, directly related to the special education program, and sufficiently documented.

Chapter 545 of the Laws of 2013 mandates the State Comptroller to audit the expenses reported to SED by special education service providers for preschool children with disabilities. For the fiscal year ended June 30, 2013, Mid Island reported approximately $3 million in reimbursable costs for its SEIT program. Our audit scope period focused on fiscal year 2012-13, however, we expanded our review to include certain items claimed on the CFRs for fiscal years 2010-11 and 2011-12.

Audit Findings and Recommendations

For the three fiscal years ended June 30, 2013, we identified $655,055 in reported costs that did not comply with the Manual's requirements for reimbursement. The ineligible costs included $621,191 in personal service costs and $33,864 in other than personal service (OTPS) costs (see Exhibit on page 15 of this report).

Personal Service Costs

According to the Manual, personal service costs, which include all taxable and non-taxable salaries and fringe benefits paid or accrued to employees on the 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). All claimed costs must comply with the applicable provisions of the Manual. For the three fiscal years ended June 30, 2013, Mid Island reported about $5.2 million in personal service costs for its SEIT program. We identified $621,191 in personal service costs that do not comply with the Manual's guidelines for reimbursement, as follows:

Compensation Allocation

According to the Manual, compensation charged to a program must be supported by employee time records prepared during, not after, the time period for which the employee was paid. Further, according to the Manual, compensation of individuals who work on multiple programs should be allocated based upon actual hours of service by program. 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 other fair and reasonable allocation methods, as determined by SED's fiscal representatives, may be used. The Manual requires the use of the ratio value method to allocate compensation of individuals who perform agency administrative duties. This method distributes shared costs as a percentage of an agency's total operating costs.

We determined that $466,575 in compensation was over allocated to the SEIT program because Mid Island officials used inappropriate allocation methodologies and misclassified certain individuals on its CFRs.

Executive Director

The Executive Director is one of Mid Island's owners. On the CFR for fiscal year 2012-13, the Executive Director was listed as an employee and her salary was split between two positions. Mid Island reported 55 percent ($102,461) of the Executive Director's salary under the Executive Director title - an agency administrative position. The remaining 45 percent ($83,832) was reported under a Program Director's title - a program administrative position. Although 100 percent of the cost for a program administrative position can be charged to a specific program, agency administrative costs must be allocated across all programs using the prescribed ratio value method. Mid Island allocated $96,402, ($12,570 from the Executive Director's title and the full $83,832 from the Program Director's title) to the SEIT program.

We requested supporting documentation for this allocation. However, the Executive Director did not maintain time records or time studies to support the distribution of her time, as required by the Manual. We then requested other reasonable support to justify the allocation and were provided with activity logs, calendar entries, email, and meeting references. We reviewed the email and activity logs and found they were incomplete and were not prepared contemporaneously with the time periods in question. We determined that the documentation provided by Mid Island to support the allocation of the Executive Director's compensation to the SEIT Program did not meet the requirements in the Manual as it was insufficient, was neither fair nor reasonable, and was based on estimates rather than contemporaneous time records and studies.

Mid Island officials advised that the Manual does not require an owner to maintain contemporaneous time records to reflect time spent working in more than one non-direct care (administrative) title within an agency. However, the Executive Director was not reported as an owner on the CFR. Instead, her compensation was reported as salary and fringe benefits, thus subjecting such costs to the Manual's time distribution (allocation) requirements. Since the Executive Director did not adequately substantiate the distribution of her time, we reallocated her 2012-13 salary using the recommended ratio value method and found that $22,854 (rather than $96,402) should have been allocated to the SEIT Program. Therefore, we recommend that SED disallow the difference of $73,548 ($96,402 - $22,854).

Mid Island officials indicated that one of the reasons for using this allocation was the limited SEIT Program supervision during fiscal year 2012-13. However, we noted that Mid Island used the same allocation percentage (45 percent) to allocate her time during the prior two fiscal years (2010-11 and 2011-12), when Mid Island had additional staff dedicated to the SEIT Program Director position. Further, these allocation percentages were based on estimates rather than on contemporaneous time records and studies. We recommend disallowance of $137,711 ($66,547 in 2010-11 and $71,164 in 2011-12) that was also improperly allocated for these fiscal years. In addition, we recommend a disallowance of $18,129 ($3,568 in 2010-11, $10,461 in 2011-12, and $4,100 in 2012-13) for fringe benefits associated with the over allocation of the Executive Director's salary to the SEIT Program.

Division Director

The Division Director is a co-owner of Mid Island. We determined that his salary was misallocated on Mid Island's 2012-13 CFR. Specifically, 75 percent ($139,720) of his compensation was reported as a Division Director on CFR-3, of which $17,141 was allocated to the SEIT program under the allocation methodology required for agency administrative costs. Mid Island reported the other 25 percent ($46,573) as SEIT Program Director, of which all $46,573 was allocated to the SEIT program. In total, $63,714 ($46,573 + $17,141) was allocated to the SEIT program. However, given his position and salary, as well as his level of influence, control, and interest in the organization, we determined that, at a minimum, he should have been classified as Assistant Executive Director on the CFR. In fact, SED reclassified his title from Division Director to Assistant Executive Director during its rate-setting process. Mid Island officials provided documentation showing that he was listed as Division Director as well as Executive Director. We note, however, that both positions entail performing agency administrative duties. Consequently, the Manual requires that his allowable compensation be allocated based on the ratio value method.

Further, the Division Director did not fill out contemporaneous time records reflecting his work hours, nor did he perform time studies supporting his time distribution. When asked to support his time, he provided a 2012-13 activity calendar based on his retroactive review of emails and electronic attachments and notes. However, the calendar accounted for less than half of his scheduled work hours. Further, he indicated that the dates and times were approximate. Based on this information, Mid Island officials determined that 23 percent of the Division Director's meetings were SEIT related and should therefore result in a .23 full-time equivalent (FTE) as SEIT Program Director for the entire year. They attributed another 2 percent of his time to other issues regarding SEIT and determined that the .25 FTE as SEIT Program Director was adequately supported. However, we determined that the documentation provided by Mid Island to support the allocation of the Division Director's compensation to the SEIT program did not meet the Manual's requirements because it was insufficient, neither fair nor reasonable, and based on estimates rather than contemporaneous time records and studies.

Mid Island officials stated that the Manual does not require an owner to maintain contemporaneous time records to reflect his or her time spent working in more than one non-direct care title within the agency. However, we note that the Division Director's compensation was claimed on the CFR as salary and fringe benefits and is therefore subject to the Manual's time distribution (allocation) requirements. As such, allocating compensation costs based on estimation rather than contemporaneous time records is not in accordance with the Manual's record-keeping requirements.

We also found that Mid Island directly charged 25 percent of his compensation to the SEIT program on its 2011-12 CFR as well. Given his position, agency administrative duties, and failure to keep adequate time records, we used the ratio value method to allocate his compensation among all of Mid Island's programs. We recommend disallowance of $88,485 ($45,348 for 2011-12 and $43,137 for 2012-13) in salary and fringe benefits that was improperly allocated to the Program.

Program Staff

We requested time studies for 50 employees whose salaries were allocated to SEIT and other Mid Island programs. Mid Island officials provided time studies for 43 of the 50 employees. We reviewed those time studies and found that only 22 of the 43 employees were properly allocated to the SEIT Program. We also found that, for the remaining 21 employees, Mid Island used a higher SEIT program allocation percentage than what was calculated from their own time studies. For example, $34,158 of salaries was allocated to the SEIT program for 9 employees whose time studies showed they did not perform any SEIT-related work; and $91,061 of salaries was over-allocated to the SEIT program for 12 employees whose time studies indicated a lower allocation.

Mid Island officials advised us that they used a revenue percentage method to allocate additional amounts to the SEIT program for 18 of these 21 employees. Mid Island officials stated that they used this alternative method to account for time spent by Early Intervention service coordinators on transition activities from Early Intervention to Preschool SEIT programs. However, the Manual allows the use of alternative allocation methods only if actual hours of service cannot be calculated or a time study cannot be completed. Since time studies were completed, we did not allow the alternative method and additional allocated amounts.

Mid Island officials stated they did not provide time studies for seven employees because they were not employed when the studies were conducted. Personnel records for these employees did not contain any SEIT-related material and/or showed that they worked for the Early Intervention program. To allocate their salaries in a fair and reasonable method, we referred to the time studies provided for other employees who held the same position. We calculated that 3.66 percent of these employees' time (in total) was dedicated to the SEIT program. Using this percentage, we determined that $4,579 was over-allocated.

In total, we recommend disallowance of $148,702 ($129,798 in salaries and $18,904 in associated fringe benefits) that was over-allocated to the SEIT program.

Retroactive Payments

The Manual requires that compensation costs be based on approved, documented payrolls. Providers must develop employer-employee agreements with written salary scales and issue them to employees. The Manual also states that costs must be reasonable, necessary, and sufficiently documented.

We identified a total of $133,342 in payments made to 144 SEIT teachers on April 30, 2014 and May 30, 2014 that were claimed for reimbursement on the 2012-13 CFR (the previous fiscal year). Mid Island officials stated that in (or around) January 2013, they increased the SEIT service providers' rates by $5 per unit retroactively to July 1, 2012 to remain competitive in the SEIT industry. According to officials, an accrual for retroactive raises was booked as a June 30, 2013 year-end adjustment; however, there was no documentation of the decision to grant retroactive raises (to support the accrual) prepared at the time of the entry. Further, Mid Island did not have written policies governing the terms of retroactive raises, including the circumstances under which they would be granted. As such, there was insufficient supporting documentation for this accrued expense.

In addition, the employer-employee agreements (in effect for the employees in question during the 2012-13 year) had no provisions for rate increases corresponding to the amounts of the retroactive costs Mid Island claimed. Further, pay rates documented on 2012-13 employee session notes did not reflect increased pay rates or retroactive raises. Consequently, the payments in question were not consistent with the Manual's requirement for formal employer-employee agreements with written salary scales.

We also determined that Mid Island officials did not announce the retroactive salary payments to staff at the time officials purportedly made the decision to grant them. Officials indicated that they did not want to announce the raises until Mid Island's cash flow had normalized, enabling them to pay retroactive and other pay increases as well. However, under such circumstances, officials established no formal obligation to pay the raises, and therefore, we question the basis for claiming them as an accrued liability for the 2012-13 school year. It is unclear that these accrued costs were reasonable and necessary, as otherwise required by the Manual.

Based on the aforementioned deficiencies, we recommend disallowance of $147,121 ($133,342 in salary payments and $13,779 in associated fringe benefits) that was charged to the SEIT program for the accrued costs in question.

Bonuses

The Manual defines bonuses as non-recurring and non-accumulating (i.e., not included in base salary of subsequent years) lump sum payments to employees that are in excess of regularly scheduled salary and not directly related to hours worked. Bonus compensation may be reimbursed if it is based on merit, as measured and supported by employee performance evaluations, for any direct care employee. During fiscal year 2012-13, the Manual specifically prohibits bonuses to non-direct care staff.

For the fiscal year ended June 30, 2013, Mid Island awarded $41,107 in bonuses to six non-direct care staff although the Manual specifically prohibits this. Of the $41,107, $6,793 was allocated to the SEIT program. In addition, Mid Island reported and paid $702 in payroll taxes (e.g., Social Security) associated with these bonuses. We recommend that $7,495 (representing $6,793 in ineligible bonuses and $702 in related fringe benefits) be disallowed.

Other Than Personal Service Costs

According to the Manual, OTPS costs must be reasonable, necessary, program-related, and supported by sufficient and appropriate documentation. For the three fiscal years ended June 30, 2013, Mid Island charged approximately $5.3 million in OTPS expenses to the SEIT program. We identified $33,864 of these expenses that did not comply with SED reimbursement requirements.

Real Property Rental Costs

Mid Island reported $879,700 in real property rental costs on its 2012-13 CFR. However, we found that $43,555 was not included in the terms of the building leases. Of this amount, $6,490 was allocated to the SEIT program. We also found that Mid Island incorporated a staff FTE methodology (in addition to square footage) to allocate these rental costs to the SEIT program. Officials indicated that they applied a staff FTE methodology because their special education programs used a significant amount of space, but not much space exclusively. Consequently, our findings regarding staff time distribution affect the rent allocation because the amount of SEIT FTE staff was overstated. As such, we determined that an additional $11,769 in rental costs were over-allocated to the SEIT program. In total, we recommend the disallowance of $18,259 ($11,769 + $6,490) in real property rental costs.

Vehicle Costs

The Manual states that vehicle usage must be documented with individual vehicle logs that include, at a minimum, the date and time of travel, places of departure and destination, mileage, purpose of travel, and the name of the traveler. During the audit period, Mid Island leased two vehicles – a 2011 Jaguar XF and 2011 Honda Odyssey – that were used by the Executive Director and the Division Director, and charged expenses, including lease payments, insurance, maintenance, parking, and gas, on its CFRs. Mid Island also paid automobile insurance on a 2008 Audi A6. However, Mid Island officials did not maintain logs for vehicle usage, as required by the Manual. In addition, we identified $96 in parking tickets and equipment for the Division Director's privately owned vehicle. In total, we recommend the disallowance of $7,006 in vehicle-related costs that were charged to the SEIT program.

Other Ineligible Expenses

We identified expenses totaling $8,599 that are specifically ineligible for reimbursement based on the Manual. The ineligible costs included:

- $2,854 for non-SEIT employees' travel costs over-allocated to the SEIT program;
- $1,560 for loan interest payments that were claimed twice on the CFR;
- $1,235 for expenses that were inadequately documented and/or not supported by invoices;
- $989 in certain costs not attributable to 2012-13;
- $793 for non-SEIT related costs, including computer equipment for non-SEIT employees and legal fees for the Early Intervention program;
- $415 for equipment reimbursed from IDEA 611 funds and were also charged to the SEIT program;
- $404 in credit card interest charges;
- $301 in various ineligible costs, including unnecessary hotel costs, private home telephone bills, and food; and
- $48 in parts for iPhones for the Executive Director and Division Director.

Recommendations

To SED:

1. Review the recommended disallowances resulting from our audit and make the appropriate adjustments to Mid Island's CFRs and reimbursement rates.

2. Work with Mid Island officials to help ensure their compliance with Manual provisions.

To Mid Island:

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

Audit Scope and Methodology

We audited the costs reported on Mid Island's CFRs to determine whether they were properly documented, program related, and allowable pursuant to SED's Manual. The audit included all claimed expenses for fiscal year 2012-13 and certain expenses claimed on Mid Island's CFRs for the two fiscal years ended June 30, 2012.

To accomplish our objective, we reviewed the Manual, the CFR Manual, Mid Island's CFRs, and relevant financial records for the audit period. We also interviewed Mid Island officials, staff, and independent auditors to obtain an understanding of their financial and business practices. In addition, we assessed a sample of reported costs to determine whether they were supported, program appropriate, and reimbursable. Our review of Mid Island's internal controls focused on the controls over Mid Island'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 objectives. We believe that the evidence obtained during our audit provides a reasonable basis for our findings and conclusions based on our audit objectives.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members 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 Mid Island officials for their review and formal comment. We considered SED's and Mid Island's comments in preparing this final report and attached those comments to it. In responding to the draft report, SED officials agreed with our recommendations and indicated that they will take steps to address them. In their response, however, Mid Island officials disagreed with our report's findings. Our rejoinders to many of Mid Island's comments are included in the report's State Comptroller's Comments.

Within 90 days of the final release of this report, as required by Section 170 of the Executive Law, the Commissioner of Education shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and if the recommendations were not implemented, the reasons why.

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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

Mid Island Therapy Associates LLC
Schedule of Submitted and Disallowed Program Costs
for Fiscal Years 2010-11, 2011-12, and 2012-13

Program Costs	Amount Per CFR	Amount Disallowed	Amount Remaining	Notes to Exhibit
Personal Services				
Direct	$5,046,983	$621,191	$4,425,792	A-C,G,H,K,L
Agency Administration	195,424	0	195,424	
Total Personal Services	**$5,242,407**	**$621,191**	**$4,621,216**	
Other Than Personal Services				
Direct	$5,019,511	$24,250	$4,995,261	A,E,I,J,L
Agency Administration	315,167	9,614	305,553	A,D,E,F,I,J,L
Total Other Than Personal Services	**$5,334,678**	**$33,864**	**$5,300,814**	
Total Program Costs	**$10,577,085**	**$655,055**	**$9,922,030**	

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 Mid Island 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.13.A.(1) - Entities operating approved programs shall develop employer-employee agreements with written salary scales and issue them to employees.
C. Section II.13.A.(10) - A merit award (or bonus compensation) shall mean 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 merit award may be reimbursed if it is based on merit, as measured and supported by employee performance evaluations, and does not exceed 3.5 percent of the base salary of the direct care employee who is receiving the merit award. In addition, merit awards are restricted to direct care titles/employees as defined by the Reimbursable Cost Manual's Appendix A-1 and those in the 100 job code series as defined by the Consolidated Fiscal Report's Appendix R.
D. 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.
E. Section II.22.C. - Costs of food provided to any staff including lunchroom monitors are not reimbursable.
F. Section II.59.B - Out-of-state travel should be severely restricted and should be on an exception basis only. Out-of-state travel costs are reimbursable to the extent they are critical to the success of the program and are for services or training that cannot be obtained in state. Out-of-country travel is not reimbursable.
G. Section III.1.A. - Compensation costs must be based on approved, documented payrolls. Payroll 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.
H. 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. 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. Documentation for all allocation methods (bases and percentages) must be retained for a minimum of seven years. Guidelines for acceptable time studies for CFR filers are provided in Appendix L - "Acceptable Time Studies" of the CFR Manual.
I. Section III.1.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. When applicable, competitive bidding practices should be used in conformance with the Purchasing Handbook.

J. 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. If the vehicle was assigned to an employee, also list the name of the employee to whom it was assigned. The annual mileage for program purposes and repairs and maintenance costs for each vehicle should be summarized and maintained.
K. Section III.1.M.(3) - For CFR filers (except Office of Children and Family Services Residential Facilities), agency administration costs shall be allocated to all programs operated by the entity based on the ratio value method of allocation.
L. Section III.2.B. - The accrual basis of accounting is required for all programs receiving Article 81 and/or Article 89 funds.

Agency Comments – State Education Department

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

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November 5, 2015

Mr. Frank Patone
Audit Director
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Albany, NY 12236

Dear Mr. Patone:

The following is the New York State Education Department's (Department) response to the draft audit report, 2014-S-40, Compliance with the Reimbursable Cost Manual: Mid Island Therapy Associates, LLC.

Recommendation 1: Review the recommended disallowances resulting from our audit and make the appropriate adjustments to Mid Island's CFRs and reimbursement rates as appropriate.

We agree with this recommendation. The Department 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 Mid Island officials to help ensure their compliance with Manual provisions.

We agree with this recommendation. The Department will continue to provide technical assistance whenever requested and will strongly recommend that Mid Island officials take advantage of our availability to help them better understand the standards for reimbursement as presented in Regulation and the Reimbursable Cost Manual. In addition, Consolidated Fiscal Report (CFR) training is available at six locations across the State and online on the Department's webpage. The training is recommended for all individuals signing CFR certification statements, namely Executive Directors and Certified Public Accountants, and is required for preschool special education providers upon approval and reapproval. Furthermore, the Department intends to require that the training be mandatory for all providers.

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: James P. DeLorenzo
Suzanne Bolling

Agency Comments – Mid Island Therapy Associates

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November 4, 2015

BY EMAIL (SLynch@osc.state.ny.us)
and FEDERAL EXPRESS

Steven Lynch
Audit Manager
New York State Office of the State Comptroller
59 Maiden Lane, 21st floor
New York, NY 10038

Re: Mid-Island Therapy Associates, LLC
Your Draft Audit Report #2015-S-44

Dear Mr. Lynch:

This letter is in response to your draft audit report, dated September 28, 2015, with respect to your audit of Mid-Island Therapy Associates, LLC, doing business as All About Kids ("All About Kids").

At the outset, we note that All About Kids does not agree that your office has 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 (2009) and *Handler v. DiNapoli*, 23 N.Y.3d 239 (2014). All About Kids' cooperation with your audit and this response to your draft report do not waive any of its rights to challenge your office's authority to conduct this audit or any decision to act upon it, and All About Kids expressly reserves all such rights. * Comment 1

I. Overview of Deficiencies in OSC's Report

All About Kids does not believe that OSC's draft audit report is a fair or balanced report. It is inaccurate factually and legally and is not a fair assessment of All About Kids' compliance with the governing reimbursement rules. Indeed, in our view the draft report does not even * Comment 2

*See State Comptroller's Comments, page 54.

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comply with Generally Accepted Government Auditing Standards ("GAGAS"), which require that specific reasons be provided for audit findings. OSC's draft report is devoid of reasons; it is a series of unsupported conclusions that give no reasons whatsoever as to why OSC has rejected the detailed arguments previously presented by All About Kids in response to OSC's previous preliminary reports.

At the outset, it is noteworthy that OSC found no evidence of financial wrongdoing during its audit of All About Kids after reviewing tens of thousands of documents and having a team of auditors in All About Kids' premises for more than six months. OSC's team examined tens of thousands of individual SEIT service items to verify that the services were properly provided, properly billed and properly documented, and the OSC audit team did not identify even a single item where any SEIT service was not properly provided or properly billed or properly documented. Similarly, the audit team did not find anything wrong with All About Kids' financial controls. At most what OSC "found" were areas where OSC disagrees with All About Kids in interpreting ambiguous provisions of the Reimbursable Cost Manual ("RCM"), promulgated each year by the New York State Education Department ("SED") to provide guidance to agencies providing state-funded special education services.

* Comment 3

Nevertheless, in the draft report, OSC makes misleading statements that it should know may be misinterpreted by a reader of the report or the press as evidence of wrongdoing, even though OSC is not saying that. For example, in the section on bonuses, OSC disallows certain bonuses that were paid to six lower level administrators in its Early Intervention Program ("EIP"), a small portion of which were allocated to the SEIT program because these employees' compensation was reported mistakenly as overall agency administration expenses. In its explanation, OSC says "the Manual specifically prohibits bonuses to non-direct care staff (e.g., the Executive Director)." The parenthetical is highly misleading because it falsely implies that the Executive Director was one of the six employees who received a bonus that OSC proposes to disallow. As OSC well knows, the Executive Director did not receive a bonus and was not one of these six employees. The disallowance had nothing to do with the Executive Director's compensation at all. There was no conceivable reason for OSC to include the parenthetical "(e.g. the Executive Director)" other than to mislead the public into believing that the Executive Director caused herself to receive a bonus, when OSC knows that she did not. In fact, OSC's report makes no comment at all on the amount of any compensation paid to the Executive Director. The parenthetical should be deleted from the final report. Indeed, it would be defamatory of the agency and the Executive Director not to do so.

* Comment 4

Similarly, the draft report describes a hotel expense incurred for attending an industry conference as "Miami Beach hotel," with no other explanation whatsoever of what the expense was or why OSC is proposing (incorrectly) to disallow it. This item should not be disallowed or mentioned in the report at all, but if OSC were to mention it, it should be called "Hotel expense

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for industry conference," not "Miami Beach hotel," and the text should explain that this was a hotel charge incurred attending a conference of the Education Industry Association, a highly respected industry trade group, since that is what it was. There is no conceivable reason to refer to it only as a "Miami Beach hotel," and not to include any explanation of why OSC believes it purportedly is not allowable (which All About Kids does not know why, since the draft report is the first and only time OSC has mentioned this expense). OSC should know that its description likely would mislead the public and press into believing this was a hotel charged to the State for a private vacation. Once again OSC risks impugning All About Kids' reputation through misleading language which does not accurately reflect the facts.

* Comment 5

OSC's use of such obviously misleading and inaccurate language is not what we would expect from a responsible public agency. OSC must be aware that its reports can do great reputational harm, whether or not it is intended, and whether or not OSC's statements are accurate. As Benjamin Franklin said more than 200 years ago, at a time when media dissemination did not remotely approach what we have today, "reputation is like fine china, easily broken and never well mended." We would expect OSC to be far more careful with its words than the draft report reflects.

While these two are the most egregious examples of inappropriate, indeed defamatory, wording by OSC in the draft report, there are many other examples of inappropriate, careless wording as well. These also must be corrected, in addition to the two examples just discussed. These additional examples include the following:

1. In the third last line of the "Background" section, it should be made clear that most of the costs are payroll and fringe benefits.

2. In the first bullet point of "Key Findings", "over-allocated" should be changed to "incorrectly allocated." While we disagree with these findings altogether, so that this entire bullet point should be deleted, "over-allocated" can be read to imply that the "over-allocation" was deliberate. We know OSC does not intend to imply that, but it could be read that way.

* Comment 6

3. In "Compensation Allocation" in the second paragraph on page 6, "over allocated" again should be changed to "incorrectly allocated" and "inappropriate" allocation methodologies should be changed to "incorrect" allocation methodologies. Again, we disagree with OSC's findings and believe that these statements should be deleted altogether, but if the incorrect findings remain in OSC's report, the wording should be changed to language that does not imply that All About Kids did something "inappropriate" or obviously or deliberately wrong.

* Comment 6

4. On page 8, in the last line of the 4th paragraph, the word "improperly" should be changed to "incorrectly." Again, we disagree with OSC's finding altogether, but in any event the

* Comment 7

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word "improperly" again implies something dishonest or immoral, as opposed to something just mistakenly incorrect. It is not appropriate or fair language.

5. On page 9, in the top line, the wording should be changed for clarity to "transition activities that were not billable to the Early Intervention Program and were not required of an Early Intervention Provider." This is the proper and accurate description provided to the auditors.

* Comment 8

6. In "Retroactive Payments" on page 9 in the first line of the second paragraph, "employees" should be changed to "SEIT teachers". That is who received these payments, and it should be clear that these were payments to teachers, not payments to administrators or executives.

* Comment 9

7. In the last bullet point on page 12, "food for employees" is incorrect. This was refreshments for persons attending on-site full day CPSE meetings (for example, parents and CPSE administrators), and it should say that. It was not food for employees.

* Comment 10

8. Similarly, in the last bullet point, a "private home telephone" is inaccurate. It was the charges for certain business calls made from a home telephone, not the cost of the phone, and it should say that.

* Comment 11

All of OSC's inaccurate language described above must be corrected, and All About Kids should have an opportunity to review and respond to the corrected language before a final report is issued.

Unfortunately, the specific language problems we have noted above are symptomatic of a broader problem. The more basic problem is that OSC's draft report states its proposed disallowances dogmatically in language that falsely suggests that every finding OSC made was based upon clear regulatory provisions that leave no doubt as to what a service provider is supposed to do. Language throughout the report stating that All About Kids' reporting "is not in accordance with the RCM" and other words to that effect falsely imply that any service provider should have understood that the RCM would be interpreted as OSC has done. However, as OSC well knows, exactly the opposite is true. The RCM often gives unclear guidance, or no guidance at all. General standards like "reasonable," "necessary" and "equitable" leave wide room for differences of opinion. Moreover, although OSC has suggested in meetings with special education providers that they should attend SED training on the RCM, as though such training sessions exist, in reality SED has not offered and does not offer any training on the RCM. Adding to the lack of clarity, SED sometimes does not issue the RCM until after the school year has started, so that provider agencies do not know what the governing rules will be, and cannot plan for them before the school year starts. For example, the 2013-14 RCM was not issued until January 2014, halfway through the school year, and the 2015-16 RCM has not yet been issued.

* Comment 12

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We know that OSC is very aware of this ambiguity in the RCM. As has happened in this audit, OSC in many audits has changed its positions during the course of the audit. If the RCM were so clear, that would not happen regularly, as it does. Moreover, OSC has changed its audit procedures because of the lack of clarity of the RCM, and OSC's own uncertainty around the meaning and intent of the RCM in many instances. OSC now includes SED in the final conference to help address matters of RCM interpretation. OSC also advised us during this audit, and also stated at a meeting of special education service providers, which we attended, that it consults with SED during the audit on matters of interpretation of the RCM. OSC did not do either of these things in earlier audits. In addition, a little over a year ago, OSC hired the former head of SED's rate setting unit as an OSC employee, again to guide OSC on what the RCM requires. None of these steps would have been necessary if the RCM were as clear as OSC's draft report misleadingly implies that it is.

* Comment 13

OSC should be aware that its interpretations of the RCM on which its disallowances are based are debatable at best, not settled issues. As a result, OSC should delete all of its language stating dogmatically that All About Kids' reporting was contrary to purported RCM "requirements" or was "inappropriate", or "improper" when All About Kids did nothing inappropriate or improper at all. OSC should make its report very clear that All About Kids did not ignore clear rules, but rather that the disallowances result from good faith differences of opinion between OSC and All About Kids as to what unclear provisions of the RCM require. Also, there should not be a press release accompanying the final report, as there is nothing newsworthy about this report. If OSC nevertheless issues a press release, which there is no good faith reason to do, the press release also should make clear that the major disallowances arise from good faith disagreements over what the RCM requires, not from "improper" or "inappropriate" agency interpretations. Absent this clarity, OSC's careless language can have a defamatory effect, no matter how incorrect OSC's findings may be and whether or not the recommendations made in the report ever are implemented.

* Comment 14

* Comment 15

Moreover, the problem goes beyond potential defamation; the reality is that OSC should not be recommending disallowances at all based on RCM provisions that do not give clear guidance to the SEIT service provider. All About Kids and other SEIT agencies necessarily rely on the written guidance SED provides in its manuals. They necessarily plan their staffing and expenses, and what they expect to be reimbursed for, based on what the manuals say. They also necessarily rely on guidance provided from SED's own annual reviews of their financial reports and the results of prior audits to guide their expectations as to what will be reimbursed and to continue implementing methodologies that have been reviewed and allowed by regulatory authorities.

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As OSC knows, SED's Rate Setting Unit conducts its own thorough examination of All About Kids' and all other SEIT service providers' financial reports each year as part of its rate-setting process. In its December 3, 2012 response to an OSC draft report of an audit of SED (2012-S-103), SED described its desk audits as follows: "[T]he rate setting unit performs a thorough review of the financial reports submitted by the providers in order to analyze the appropriateness of the expenses and ensure that reimbursement claims are allowable pursuant to program funding standards. The rate setting unit will undertake an even more extensive review of the financial reports submitted by the providers in order to analyze the appropriateness of the expenses and ensure that reimbursement claims are allowable pursuant to program funding standards. The rate setting unit will undertake an even more extensive review on a case by case basis (including obtaining source documentation for submitted claims) if their desk audit reveals problematic reporting. As noted in the draft audit [of SED], for the 2009-2010 reporting year, the rate setting unit review resulted in over 700 adjustments totaling nearly $4 million for claimed program costs and over 350 adjustments totaling nearly $14 million for agency administrative costs." Throughout the numerous thorough annual reviews of All About Kids' financial reports conducted by SED's Rate Setting Unit, SED did not make any of the adjustments OSC now recommends. All About Kids relied on that guidance as well in its financial planning, since SED, in so doing, by implication accepted All About Kids' methodologies.

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Comments
16 & 17

Moreover, All About Kids is unusual in that it is one of the few SEIT service providers in New York State (the only one that we know of) that already has had a full audit by OSC, so that the current audit was its second comprehensive tuition rate audit by OSC. OSC conducted a complete and comprehensive fiscal audit of All About Kids' 2007-08 school year during 2009 and 2010, four years before this audit was commenced, and found nothing wrong with All About Kids' allocation methodologies, reported expenses, policies, procedures, practices, fiscal controls, business practices, or anything else. In fact, OSC did not even issue a report of its findings. Instead, on February 1, 2011 it issued a letter stating that OSC would not issue a formal report because "our audit did not find any significant findings." A copy of that letter is provided as Attachment 1. The auditor in charge of that audit congratulated All About Kids for its strong internal controls.

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All About Kids' financial reporting practices have not changed greatly over the years. As will be explained below, some of the same practices that OSC now is disallowing in this audit are practices that existed in 2007-08. OSC found nothing wrong with them in its prior audit of All About Kids. Neither did SED in its annual reviews of All About Kids' CFR for over a decade. In addition, All About Kids has been subject to yet another third full audit, by the Nassau County Comptroller, of its 2010-11 year. While the Nassau County Comptroller did not complete its audit, it did complete its field work and issue preliminary findings, and it too did not find fault with any of the matters that OSC now proposes to disallow. Thus, OSC's draft report is inconsistent with all prior regulatory reviews and approvals by SED, the OSC itself and the

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Nassau County Comptroller, on which All About Kids justifiably relied in part in its financial planning and reporting.

The outstanding results attest to All About Kids' commitment to integrity and excellence, which it has maintained over the 27 years it has been in business. Another reason All About Kids has achieved these outstanding results is that All About Kids has hired expert CFR and RCM accounting consultants, going back many years, to help assure that All About Kids correctly interprets and follows the published regulatory guidance when filing its annual financial reports.

At the very least, the inconsistency between OSC's present conclusions in its draft reports and all prior regulatory reviews of All About Kids' financial reports should give OSC pause about the propriety of proposing disallowances that would retroactively reduce All About Kids' tuition rates. Doing that is patently unfair to All About Kids, because it results in tuition rate reductions on account of practices that All About Kids has been following for years, justifiably believing that they are correct based on the wording of the RCM, as well as all prior regulatory reviews by SED, OSC and the Nassau County Comptroller. Moreover, the financial effect of OSC's proposed disallowances would be greatly magnified, because the disallowances are applied retroactively to audited years long since passed, and under SED rate setting methodology the reduced tuition rate resulting from the disallowances becomes a ceiling for future years. Thus, the proposed disallowances would adversely affect All About Kids' tuition rates not only for the audited years, but also for every subsequent year. And once a provider has incurred costs, reasonably believing they are properly reimbursable, the money is spent; the provider cannot undo the expense if OSC disallows it years later because of a new and different interpretation of the RCM.

In light of this, rather than recommending retroactive disallowances that will reduce tuition rates for years long past, so that the provider cannot do anything to adjust its practices to avoid the disallowances, OSC should be recommending instead that SED amend the RCM to clarify it, so that service providers will know what standards they have to meet. In fairness, any such amended RCM provisions should be applied only prospectively, not retroactively. The fact that SED disagrees with the service provider's interpretation of unclear provisions does not mean that the service provider's interpretation was not reasonable. All About Kids and other responsible SEIT service providers take great pains to follow the rules, but to follow the rules, the rules need to be clear, so that SEIT service providers know what costs are and are not reimbursable. Unfortunately, the RCM does not come close to providing that kind of clarity and certainty for SEIT service providers. OSC also is wrong to rely on verbal advice from SED as to what the RCM intends to support recommended disallowances, as OSC claims that it does,

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because SEIT providers necessarily rely on what the published manuals say, not on unpublished statements that SED makes to OSC years after the expenses have been incurred and reported.[1]

Indeed, at least back in 2010-11, when OSC conducted its audit of All About Kids' 2007-08 year, OSC itself recognized as much. Several instances arose during that audit where OSC questioned All About Kids' interpretation of the RCM, but the auditors recognized that the RCM was not clear. OSC did not recommend any disallowance where the RCM was not clear as to what is required, but rather told All About Kids that it would recommend to SED that it provide clearer guidance to SEIT providers in the RCM on those matters. This is in sharp contrast to the current OSC team's actions. Frankly, we do not understand why the present OSC audit team does not do the same, as that plainly is what a proper and fair audit requires.

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Unfortunately, this leads to what in our view is the most disturbing part of OSC's audit process and of OSC's draft report – that OSC appears to have predetermined its positions, without any meaningful dialogue and without OSC's ever explaining its reasons for anything that it determined. In this regard, during field work, as OSC raised positions and All About Kids rebutted them, OSC's responses generally were to aggressively berate All About Kids for what it did rather than to listen to All About Kids' response and to discuss the substance. At the exit conference, OSC would not commit to a position on anything. The end result was that on virtually every issue, OSC merely said that it would "take it under advisement," without any meaningful discussion of what OSC's positions were after receiving All About Kids' detailed written responses to its preliminary reports, much less any discussion of why OSC believed All About Kids' positions were incorrect, if OSC believed that they were incorrect (which it did not say). Now in its draft report, OSC by implication has rejected many of All About Kids' positions, which were supported by RCM language, by prior reviews by SED and by prior audit results. Again OSC has stated no reasons for its determinations. It has merely repeated general conclusory statements about what the RCM purportedly "requires" without addressing what All About Kids said in its detailed responses to the preliminary reports and at the exit conference.

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As stated above, GAGAS requires OSC to state the specific reasons for its positions. With all due respect to the OSC, OSC's draft report, and the entire audit process, fall woefully short of that standard. OSC has stated only conclusions, not reasons, because it has no good reasons based on the language of the governing manuals for its positions. In this regard, we note that OSC's draft report also is flawed because it lists all RCM provisions upon which OSC relies at the end of the report, rather than citing them and quoting them in the context of its discussion

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[1] We also note that while SED now attends audit exit conferences, the OSC representatives did not express any opinion on the issues of interpretation of the RCM pertinent to this audit at the exit conference. Indeed, we have never heard the SED representatives express an opinion on any disputed issue of RCM interpretation at any exit conference. Whatever opinions it expresses are provided behind closed doors only to OSC.

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as they apply to each particular point. The obvious reason for this is not to allow the reader to make a side-by-side comparison between OSC's contentions and the actual language of the RCM. What the reader is provided instead is only OSC's inaccurate characterization of the RCM alongside their contention and disallowance. When one looks at what the RCM actually says, it does not support OSC's contentions at all.

In the discussion that follows, we lay out in detail once again, as we did in our responses to the prior preliminary reports, why the RCM simply does not support OSC's contentions on any of the major issues. OSC is making arbitrary determinations, not supported by the language of the RCM, and stating them as "fact". In so doing, OSC incorrectly is auditing All About Kids against what OSC (or SED if OSC truly is consulting SED as it says), believes the RCM should require, not against what the RCM actually says. What the RCM actually says is what SEIT providers necessarily rely on in their financial planning and reporting, and the RCM, as written, fully supports All About Kids' positions, not OSC's positions. No service provider, however responsible and diligent it is, can follow rules that are made up after the fact, as OSC has done in its draft report. An audit of compliance with the RCM, as OSC's audit purports to be, must measure compliance only with what the RCM actually says.

* Comment 24

We will now proceed to discuss OSC's specific proposed disallowances.

II. Personal Services Costs

1. Executive Director's Compensation

All About Kids disagrees completely with OSC's proposed disallowance of the 45% portion of the compensation of one of the owners of All About Kids that was reported under the Program Director job title. OSC contends incorrectly that All About Kids' support for this allocation of the compensation purportedly "did not meet the requirements of the Manual." All About Kids' documentation did meet all requirements of the RCM. In making this point, we note that OSC does not question at all the propriety of the amount of compensation paid to the Executive Director; it questions only the documentation supporting the allocation of 45 percent of that compensation to the SEIT program, rather than reporting it all as an agency administration expense across all of the programs operated by All About Kids.

First, tellingly, OSC has changed completely its reasons for this disallowance from what OSC contended in its prior preliminary report on this issue. In that preliminary report, OSC contended only that the RCM purportedly did not allow All About Kids to allocate salary and fringe benefits across the Executive Director title and a program administrative job title, in this case Program Director. In All About Kids' response, dated October 22, 2014, we explained in detail why OSC's auditors were misinterpreting the RCM and the RCM in fact did allow

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compensation to be allocated between the Executive Director and Program Director job titles. We also pointed out that OSC's interpretation of the RCM was contrary to SED's, as SED had seen this allocation of the owner's time during its annual desk audits and never had questioned it or made any adjustment relating to it. OSC's draft audit report now abandons the contention made in the prior preliminary audit report. OSC now claims instead that All About Kids' documentary support for this allocation purportedly is insufficient. OSC did not make this contention in any preliminary report.

OSC had asked for the documentary support for this allocation at the very beginning of its field work, and All About Kids gave it to OSC. OSC never questioned All About Kids about the allocation after that documentation was provided to OSC and did not comment on the documentation at all in its preliminary reports. OSC first questioned All About Kids about this allocation at the exit conference. At that time we pointed out that it was inappropriate for OSC to be raising new issues for the first time after the close of field work at the exit conference. OSC agreed and assured us that only issues presented in the preliminary reports would be considered in the draft report. Nevertheless, the draft report improperly, and contrary to those assurances, proposes a disallowance based entirely on this issue, which was not presented in the preliminary reports. This is inappropriate audit procedure, and it improperly deprives All About Kids of an opportunity to address OSC's contentions before the draft report was issued.

* Comment 26

In any event, OSC's new and belated contention that the support for All About Kids' allocation of compensation between the two positions "did not meet the requirements of the Manual" is flat-out wrong, just as its prior contention was wrong. All About Kids' allocations were not based on estimates picked out of the air. They were based on this owner's calendar and emails and other documentation reflecting the work that she did, all of which was provided to OSC. Those entries fully supported that 45% of her time was spent on SEIT Program Director work, and OSC does not dispute that she in fact did that work. Rather, OSC wrongly and belatedly contends that the documentation of the work did not meet what the RCM requires.

* Comment 27

OSC's contention appears to be based on the mistaken belief that All About Kids was required by the RCM to maintain contemporaneous time sheets or time studies to support this allocation. For example, the draft report states that "the Executive Director did not maintain time records or time studies, as required by the Manual." OSC's contention is wrong. Time records or time studies are not required by the RCM. The draft report does not cite any RCM provision that requires an agency owner who works for the agency in more than one job title to maintain time records or time studies to support the allocation of compensation across different job titles, and there is no such provision.

* Comment 28

RCM Section II.13.A(4)(d)(2012-13 edition), which OSC cited in connection with the Division Director in its preliminary report relating to his salary, does not require time records or

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time studies to support such an allocation. That Section, by its express terms, applies only to the allocation of compensation across entities for an owner who "work[s] in more than one entity (including organizations that have a less-than-arms-length relationship with the approved program)...." This owner did not work in any other entity; she worked only in All About Kids. Neither of the RCM Sections that addresses an owner's compensation, Section II.13.A.(b) and Section II.13.A(5), imposes any requirement for time sheets or time studies, even though Section II.13.4(b) expressly contemplates that the owner might be employed in a "combination of job titles by the entity operating the approved programs." Section III.I.B, relating to "Time Distribution", also does not apply to an owner's compensation; it applies to "shared staff". An owner is not "staff". Even if that Section did apply, which it does not, it does not require time sheets or time studies as an absolute requirement. Rather, it expressly recognizes that "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." The allocation made by All About Kids, based on this owner's records reflecting the work that she did, provided an accurate allocation and is equitable and conforms to GAAP.

* Comment 29

As to its being equitable, All About Kids has shown that her calendar entries, emails and other documents fully support that 45% of her time was spent on SEIT Program Director work. Moreover, All About Kids also provided OSC's auditors information reflecting that All About Kids has a large SEIT program averaging over 60,000 units per year. Its SEIT programs extend across multiple geographic regions and municipalities from eastern Long Island to northern Westchester County. A program of that size and scope requires a full-time SEIT Program Director; indeed, 1.0 FTE is very modest for a program of All About Kids' size and scope. All About Kids also provided information showing that the total FTE of administrators, including this owner, allocated to the SEIT Program Director position was .976 FTE and that the .976 FTE represents approximately 4% of total FTEs reported for SEIT. These all are reasonable, indeed extremely modest, amounts and percentages for a SEIT program of that size and scope. OSC has not presented any facts disputing the accuracy of this allocation, because there are none. All About Kids' allocation also fully complies with all requirements of GAAP; if OSC believes otherwise, OSC has not said that, much less provided any support for such a contention, because there is none.

* Comment 30

OSC further states in its draft report that All About Kids "indicated that one of the reasons for using this allocation was the limited SEIT program supervision during fiscal year 2012-13," but that All About Kids used this same allocation percentage for the two prior years. That is inaccurate. All About Kids offered the fact that its SEIT Program Director left during the 2012-13 year as one of the reasons why the Executive Director and Division Director both allocated time to SEIT Program Director work in 2012-13 (see Section 2 below on this). It was the primary reason why the Division Director did so. He did not allocate any time to SEIT

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program direction prior to 2012-13. It was not the only or primary reason why the Executive Director spent time on SEIT program direction in 2012-13.

The reasons why the Executive Director had spent much of her time on SEIT Program Director work were explained to the auditors and were different. Commencing in 2012, one of All About Kids' Early Intervention Program ("EIP") directors had a serious illness. To accommodate her needs, All About Kids gave her a diminished workload and had one of its newly hired SEIT directors spend approximately half of her time on EIP work. The Executive Director picked up the slack. That situation, combined with the need for more SEIT program supervision as a result of the conversion of SEITs from independent contractors to employees mandated by SED, were the primary reasons why the Executive Director spent large portions of her time on SEIT program direction both in 2011-12 and 2012-13. In 2010-11, and in years before that as well, she spent the same portion of her time on SEIT program direction because All About Kids' SEIT program was larger (40% more units of service in 2010-11 than in 2012-13) and required more supervision. (It was still large and geographically spread out in 2012-13 but not as large as in earlier years) All About Kids found that it was more cost-efficient and cost-effective for her to spend part of her time doing this than to hire another SEIT director. Thus, there were good reasons why the Executive Director spent 45 percent of her time on SEIT program direction in every year from 2010-11 through 2012-13. Her time allocation to SEIT in 2011-12 and 2012-13 would have dropped as the program reduced in size, but for the factors just described. The employee health situation described above alleviated in 2013-14, and as a result the Executive Director's allocation of time to SEIT program direction dropped significantly (to 15%) in that year.

OSC's draft report by implication admits that there is no provision in the RCM that requires an owner to maintain contemporaneous time records, as OSC must admit because there is no such provision. The draft report then states that "the Executive Director was not reported as an owner on the CFR. Instead her compensation was reported as salary and fringe benefits, subjecting such cost to the Manual's time distribution (allocation) requirements." (OSC presumably means RCM Section III.1.B discussed above.) That statement in OSC's draft report is incorrect. There is nothing in CFR reporting rules that allows an agency to designate the compensation of any owner who works for the agency as an "owner". The only reporting classifications are CFR 4 (salaries) and CFR 4A (contractor). Thus, it is unclear, to say the least, how OSC believes All About Kids could have "reported [her compensation] as an owner on the CFR." Moreover, her compensation and the compensation of her co-owner, the Division Director (discussed below), both were clearly indicated on the CPA auditor's reconciliation, which both the OSC auditors and SED as part of its desk audit reviewed, as Partner/Salary Draw with related taxes. Thus, her salary clearly was reported as owner compensation.

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Comment
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OSC's contention that this allocation was "unfair" and "unreasonable" also is inconsistent with SED's annual desk audits. SED clearly was aware of this allocation, which was 45% of her salary in each of the 2010-11, 2011-12 and 2012-13 years and in every year before that commencing in 2006-07, and was aware of this owner's role in the organization. SED never questioned the allocation to Program Director for 2012-13 or any other year. If SED thought that anything about the allocation appeared questionable, it could and undoubtedly would have asked for an explanation and/or documentation supporting it. OSC's positions that this allocation was "unfair" and "unreasonable" and that time sheets or time studies were required also is inconsistent with OSC's own prior audit of All About Kids' 2007-08 year. All About Kids allocated the same 45% of her time to the program director job title in 2007-08 and she did not prepare contemporaneous time sheets or time studies in 2007-08, and OSC found nothing wrong with that. OSC's positions in the draft report also are inconsistent with the Nassau County Comptroller's audit, as the Nassau County Comptroller also did not make any preliminary finding regarding this allocation in its audit of All About Kids' 2010-11 year. * Comment 33

This is a good example of exactly what we spoke of in our preliminary statement. All About Kids' CFR consultant, and the independent CPA performing its annual audits and SED had reviewed its financial reports, which reflected this allocation, for every year. OSC had reviewed them for the 2007-08 year and the Nassau County Comptroller for the 2011-12 year. Everybody reviewing it found All About Kids' allocation and documentation supporting it acceptable. Given this, All About Kids had no reason to believe that something different was required in 2012-13. Yet, OSC now would disallow large amounts of her salary allocated to SEIT based on its own new after-the-fact interpretation of the RCM, contradicting every prior regulatory interpretation of the RCM, including OSC's own interpretation when it audited the 2007-08 year. No SEIT agency can plan its business if the tuition rates on which its very survival depends are subject to these kind of arbitrary, after-the-fact determinations. * Comment 33

For all of these reasons, OSC's disallowance of the allocation of 45% of her salary to the Program Director job title is patently incorrect and should not be included in OSC's final report.

2. <u>Division Director</u>

All About Kids disagrees with OSC's contention that the Division Director should be re-classified as an Assistant Executive Director, although it makes no difference to the end result. All About Kids also disagrees completely with OSC's disallowance of the 25% of his compensation reported under the SEIT Program Director job title and its re-allocating that compensation to all programs using the ratio value method. * Comment 34

The proposed re-classification of the Division Director's position as an Assistant Executive Director in the draft report is both incorrect and irrelevant. It is incorrect because his

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responsibilities were consistent with what the Consolidated Fiscal Reporting and Claiming Manual ("CFR Manual") describes as the duties of a Division Director, not those of an Assistant Executive Director. An Assistant Executive Director is described in the CFR Manual as a person who assists the Executive Director and acts on the Executive Director's behalf when necessary. That is not what the Division Director did. He did not report to or "assist" the Executive Director or stand in for her when necessary. What he did was to oversee independently a major segment of functions for the agency, its fiscal functions. The CFR Manual describes that as the function of a Division Director (PTC 604). His job description, which was given to the audit team, confirms this. This also would have been easily verifiable, as both the Executive Director and Division Director were available to the audit team for months, but not a single question was asked of either of them about their respective functions in the company. Nor did OSC listen to anything they said when All About Kids objected to OSC's proposed re-classification of the Division Director's job title in its preliminary report.

OSC's draft report misleadingly states that All About Kids "provided documentation showing that he was listed as Division Director as well as Executive Director," as though both titles were used interchangeably. As OSC knows, what happened was that in response to its pointing out a handful of documents and an incorrect website description that erroneously described the Division Director as Executive Director, All About Kids made available a large number of documents describing him as Division Director and could have provided hundreds more. We also explained that All About Kids' website was not updated regularly to correct erroneous content. That is not unusual; we could point out numerous inaccurate job title descriptions on SED's own website. The draft report neglects to mention that. In any event, his proper position code is determined by what he in fact did, not how a few documents incorrectly described him, and what he did was the work of a Division Director.

* Comment 34

OSC's statement that SED re-classified him as an Assistant Executive Director during the rate-setting process also is highly misleading. As OSC knows, SED's rate-setting sheets did not reflect that re-classification, and SED has acknowledged in writing by email that it did not advise All About Kids in any way that it had done so. Accordingly, All About Kids did not know that the re-classification has been made and had no opportunity to dispute or otherwise address SED's re-classification with SED. As a result, that re-classification cannot be viewed as a final or proper determination by SED, as the regulations require that agencies be provided an opportunity to respond to SED adjustments impacting on rate-setting before the adjustments are implemented.

* Comment 35

OSC's statement is misleading for a second reason as well; SED re-classified only the 75% of the Division Director's compensation reported under the Division Director job title. It did not re-classify the 25% of the Division Director's compensation reported under the SEIT Program Director job title.

* Comment 36

The proposed re-classification ultimately is irrelevant. OSC's draft report states that because he was performing agency administration duties, "the Manual requires that his allowable compensation be allocated based on the ratio value method." All About Kids did that. The 75% of his salary that was allocated to the Division Director job title was reported as agency administration and allocated based on the ratio value method. OSC omits to mention this in its draft report. Thus, in the final analysis, whether his agency administration work is classified as Assistant Executive Director or Division Director makes no difference to All About Kids' tuition rate; either way it is reported as agency administration. We assume that this is why SED did not even bother to tell All About Kids about its re-classification of the Division Director to an Assistant Executive Director job title.

* Comment 37

OSC's disallowance of compensation of the Division Director proposed in the draft report arises solely from OSC's contention that the allocation of 25% of his compensation to the Program Director job title purportedly is not adequately supported. The draft report takes this position for the same reasons as for the Executive Director discussed above. Once again, OSC claims that he "did not fill out contemporaneous time records" and "did not meet the Manual requirements because it was insufficient, neither fair nor reasonable, and based on estimates rather than contemporaneous time records and studies."

OSC's position is incorrect for the same reasons that it was wrong for the Executive Director as explained above. Simply stated, OSC does not cite any RCM provision that required an owner to keep contemporaneous time records or time studies, because there isn't any such provision. OSC does not cite any provision that makes "contemporaneous time records and studies" the standard of "fairness" or "reasonableness" because there is no such provision. Again, neither OSC in its prior audit of All About Kids' 2007-08 year nor the Nassau County Comptroller in its audit of the 2011-12 year contended that the RCM imposed any requirement that an owner prepare contemporaneous time records and studies or commented on allocations of the Executive Director's salary that were not supported by contemporaneous time sheets or time studies. Nor does OSC explain why the allocation made by All About Kids was not fair and reasonable. As with the Executive Director, the allocation was based on analysis of calendars, emails and other documentation reflecting the Program Director work he performed; it was not an "estimate" based on no documentation or other support. Again, OSC does not cite any provision in the RCM that requires anything more, because once again there is no such provision. Moreover, as stated above, the Division Director picked up Program Director work in 2012-13 only after the full-time SEIT Program Director left, and even with 25% of his time being spent on Program Director work, the total FTE for SEIT Program Director still was very low for a program of this size and scope, less than 1.0 FTE. The draft report does not, and cannot, dispute any of these facts. Nor does it or can it cite any facts demonstrating that this allocation was inaccurate or unreasonable, because there are no such facts.

* Comment 38

As with the Executive Director, the assertion in the draft report that the Division Director's compensation "was claimed on the CFR as salary and fringe benefits" is irrelevant, because that is the only way that owner compensation can be reported on the CFR. That does not change the fact that it is owner compensation. Again, the CPA auditor's reconciliation, reviewed by SED and OSC, clearly showed that his compensation was an owner's draw.

Finally, as with the Executive Director's compensation, SED clearly was aware of the reporting of part of the Division Director's compensation under the Program Director job title and did not object to it. Indeed, when SED re-classified him as an Assistant Executive Director, it did not change the classification of the portion of his salary reported as Program Director, so clearly SED specifically focused on the fact that his compensation was allocated between the two titles. SED interfaced with the Program Director a great deal and was well aware of what he did for All About Kids. If SED thought anything was questionable about the allocation of 25% of his salary to the Program Director job title, undoubtedly SED would have asked for additional information and/or documentation of the allocation as part of its annual desk audit. The fact that SED did not do that reflected that SED was satisfied with the allocation and further contradicts OSC's contention in the draft report that the allocation was unreasonable.

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Comment
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For all of these reasons, OSC's re-classification of the Division Director's job title is both incorrect and irrelevant to reported costs. OSC's proposed disallowance of the portion of his salary allocated to the Program Director job title is totally baseless, as it is predicated entirely on purported RCM "requirements" that do not exist. Accordingly, this entire section of the draft report should not be included in the final report.

3. Program Staff

All About Kids disagrees completely with OSC's proposed disallowances of a portion of the compensation of certain staff on the basis that All About Kids' allocations of their salaries to SEIT program were higher than what was calculated from their time studies. As was explained to OSC previously, All About Kids supplemented the time studies with other equitable methodologies because the time studies manifestly did not include certain SEIT work, and, therefore, manifestly were not entirely accurate.

The summary description in OSC's draft report does not fully explain All About Kids' allocation methodology for these staff members. All About Kids furnished the auditors with an allocation methodology memo at the start of fieldwork. That memo stated:

> "Actual hours of service is the preferred statistical basis upon which to allocate salaries and fringe benefits for staff which are jointly shared

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> between State agencies, or work at multiple programs. Current requirements as outlined in the RCM Manual in terms of staff reporting are followed. Other methods, if actual hours are not utilized, may be time studies per the CFR manual or other equitable methods under GAAP as per the RCM. Time studies are currently being done where applicable. See Payroll Schedule for Allocations.
>
> Methods Utilized:
>
> Direct: Based On Actual Billing
> Time Studies
> Job Description/Duties
>
> All staff are also reviewed against Appendix R for education and license requirements."

This methodology follows the guidance of RCM Section III.1.B. All About Kids allocated staff salaries and fringe benefits in its CFR in accordance with the methodology quoted above.

All About Kids made allocations based upon time studies for its staff who had completed time studies with one modification. For Early Intervention Program ("EIP") service coordinators (PTC 516), All About Kids added an additional increment to account for time they spent on work relating to transition activities from early intervention to pre-school SEIT programs. As part of their work, these employees reviewed CPSE evaluations to determine if a child was eligible to receive CPSE services and, if the child was eligible, worked with the parents to find an appropriate placement, including a SEIT provider or center-based program. This included visiting possible placements with the parents.

The transition activities described above are SEIT transition services. In discussions with three of All About Kids' supervisors of its EIP service coordinators, the Finance Director was told by all the supervisors that these transition activities took from 10% to 20% of the service coordinators' total time. (Two said 15-20% and one said 10-20%.) The average case load of an EIP service coordinator at any time is 40 to 50 children, but they are responsible for far more than 50 children overall during the year because new children enter the EIP and children leave the program as they turn three years old. These services are not billable as EIP services under EIP contracts. Accordingly, in time studies the time spent on this work should have been recorded as SEIT time.

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When All About Kids reviewed the EIP service coordinators' time studies, it was obvious that they had treated these transition activities as Early Intervention time in their time studies, as all of them allocated little or no time to SEIT, despite the fact that all of them spent a significant portion of their time (10-20% of their total time) on this transition work.[2] Therefore, All About Kids made an additional allocation to SEIT for these employees to account for these SEIT transition activities. OSC's draft report does not and cannot dispute any of these facts.

This dual allocation was calculated by revenue allocation, based on the proportion of the agency's SEIT revenue to its EIP revenue, which was 15%. The 15% allocation was based on the portion of the employee's time spent on EIP activities. For example, for a full-time EIP service coordinator, 15% was allocated to SEIT. If the employee spent 80% of his or her time on EIP service coordination, 12% (15% of 80%), was allocated to SEIT. The 15% allocation also was consistent with the estimates of the time EIP service coordinators spent on SEIT transition activities provided to the Finance Director by the supervisors of those service coordinators.

This additional allocation is why for the PTC 516 employees OSC selected for analysis, the SEIT percentages reported by All About Kids did not match the time studies. It also is why the full-time EIP service coordinators who reported no SEIT time at all on their time studies were allocated 15% to SEIT. It also is why the EIP service coordinators who did not submit time studies also were allocated 15% to SEIT. There is nothing "fair" or "reasonable" about OSC's using the demonstrably inaccurate time studies of EIP coordinators, which incorrectly reported SEIT transition activities as EIP time, to determine allocations for the employees who had left All About kids before the time studies were done, as OSC contends. To the contrary, it is unfair and unreasonable for OSC to do so, because it projects the same inaccuracy into the allocations for the employees who did not prepare time studies as well.

* Comment 39

OSC's contention that the RCM does not allow use of other methodologies as well if time studies were performed is incorrect. All About Kids' methodology is allowed by Section III.1.B of the RCM. Nothing in the RCM states or suggests that time studies must be used as an exclusive methodology. To the contrary, that section of the RCM provides that: "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." In this case, hours of service cannot be calculated and time studies cannot be completed with respect to the time spent on SEIT transition activities, because no records of that time or time studies that reported that transition time were completed contemporaneously. Nevertheless, it is indisputable that every EIP coordinator in fact performed a substantial amount of SEIT transition activities.

* Comment 39

[2] We believe that the EIP service coordinators, who are not involved in billing, did not understand that this transition work is considered SEIT program work which cannot be billed as EIP work.

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The objective of the RCM is to obtain accurate allocations, and where, as in this case, the time studies demonstrably would produce an inaccurate allocation, because they incorrectly recorded SEIT transition activities as EIP work, an alternative methodology that is equitable and that conforms to GAAP is appropriate and allowed. All About Kids' methodology is equitable and conforms to GAAP. Indeed, it would defy common sense and the overriding objective of the RCM to arrive at accurate expense allocations not to make such an adjustment to the time studies. There is no rational way to interpret the RCM to require time studies to be used exclusively when, as in this case, doing so would produce a demonstrably inaccurate allocation.

* Comment 39

There are other errors in OSC's position on this issue as well. In addition to the adjustment for all EIP service coordinators described above, one employee required a reconstruction of her time studies. As was explained to the auditors, her time studies (which were shown to the auditors) could not be used as written because she had invalidated them by marking them up in a way that re-defined the categories and added responsibilities that resulted in improperly defined categories. Her allocations were determined after a teleconference with All About Kids' Finance Director, witnessed by this employee's supervisor, to discuss what she did, so that her time could be assigned accurately to the defined categories based on her explanations. She did not work exclusively as an EIP coordinator, and a large portion of her time was spent on SEIT activities. This was explained to the auditors in writing. Again, there would be no rational reason to compel All About Kids to use her time studies as written.

* Comment 40

Finally, we note that OSC's calculation of some of the percentage allocations from the times studies also is flawed. OSC calculates a separate percentage for each quarter and applies those percentages to the quarterly compensation. Many small variances are due to rounding in OSC's calculation. In addition, in reviewing OSC's data against the actual hours on the time study, All About Kids found that OSC used incorrect hours for several employees, and the incorrect salary amount for two employees. A correct calculation of the allocations was provided to OSC in response to its earlier preliminary report on this issue. This schedule confirmed that All About Kids' methodology produced the same amounts reported in the CFR, with a few immaterial variations.

* Comment 41

For all of these reasons, OSC's proposed disallowances are patently incorrect and should not be included in OSC's final report.

4. <u>Retroactive Payments</u>

All About Kids disagrees completely with OSC's proposed disallowances of payments of retroactive pay raises. In this case, OSC's proposed disallowance ignores a fundamental concept of tuition rate financial reporting. The regulations clearly require the financial statements and CFR to be prepared based on accrual accounting in accordance with GAAP. *See*, 8 N.Y.C.R.R.

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§§ 200.9(d)(2) and 200.9(e)(1)(i)(b). Section III.2.B of the RCM also clearly states that "[t]he accrual basis of accounting is required," and Section III.2.A states that programs "must maintain accounts in accordance with generally accepted accounting principles." OSC's proposed disallowances in essence are based on cash basis accounting and would require All About Kids to report the compensation in a manner that is inconsistent with GAAP requirements for accrual reporting.

* Comment 42

Again, OSC's draft report omits the relevant factual context. As was explained to the auditors in detail, All About Kids began to consider raising its payment rates to SEIT service providers in June 2012 to address concerns about teacher retention, after learning that teachers were considering leaving All About Kids for higher paying SEIT jobs at competitor agencies. All About Kids provided the auditors with documentation reflecting this concern. In or about January 2013, All About Kids decided to increase the SEIT's hourly rates by $5 per unit, retroactive to July 1, 2012, the beginning of the 2012-13 school year. No documentation of this decision was generated at the time it was made, and none is required by the RCM, the CFR Manual or GAAP. All About Kids is a small company with a small, centralized management, and it generally makes business decisions verbally, not by written memo or Board resolution. There is nothing unusual or improper about that. All proper and required payroll and program protocols were followed. An accrual for the raises, reflecting management's commitment to pay the raises retroactively to July 1, 2012, was booked as a June 30, 2013 year-end adjustment.

* Comment 43

All About Kids did not publicly announce its decision when it was made or make the payments at that time because it anticipated, unfortunately correctly, that there would be a significant cash flow disruption within the company caused by the then-upcoming transition to a new state EIP payer system, which would delay EIP payments. All About Kids' management did not want to announce the retroactive raises until its cash flow had normalized, enabling it to pay retroactive and prospective pay increases while maintaining overall company fiscal prudence. Otherwise, employees could become alarmed by the delay in making the payments, thereby defeating the purposes of the raise of improving teacher morale and teacher retention.

* Comment 43

However, the principal reason for the delay in paying the raises so long beyond the June 30, 2013 end of the fiscal year was that beginning in the summer of 2013 and continuing until May 2014, a second additional and unexpected cash flow disruption that was entirely SED's fault occurred. This second cash flow disruption occurred when three counties stopped SEIT payments to All About Kids for the duration of 10 months because SED did not input All About Kids' prospective tuition rate into its system, and without a rate in the system, they would not make any payments for SEIT services to All About Kids. While the failure to input a prospective rate into the system was SED's failure, not All About Kids' failure, All About Kids bore the consequences. If this cash flow disruption caused by SED's error had not occurred, All About Kids would have paid the retroactive raises by or very soon after June 30, 2013.

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All About Kids made retroactive payments of the raises to SEIT providers in May 2014, after SED corrected its error and posted prospective rates and ten months of back SEIT payments were made by the three counties. All About Kids provided the OSC auditors documentation of how the raises were calculated and of their payment.

The relevant criterion is stated in the 2012-13 RCM Section II. 13.A as follows: "Salaries include all taxable and non-taxable salaries and wages paid *or accrued* to employees on the agency payroll, including severance pay for regular employees." (Emphasis added.) This provision could hardly be clearer that it is *not* necessary that the salary actually be paid during the school year; all that is necessary is that it be properly accrued according to GAAP. That is exactly what All About Kids did. It accrued the extra salary, because it had made a management decision to pay the retroactive raises as soon as its temporary cash flow disruptions, all caused by governmental inefficiency, abated, and which it in fact paid as soon as the temporary cash flow perturbations ended. Proper accrual accounting required All About Kids to report the expected cost of the raises as a 2012-13 accrual to match the expense with the time period when the work to which it related was performed and the revenues that work generated were booked. Under GAAP an accrual must be made if the expense is "probable"; these retroactive raises were more than probable as of June 30, 2013; they were certain. All About Kids' management had committed to pay them; the only question was when, not if. The only thing holding them up was SED's posting of All About Kids' prospective tuition rate on its website and the counties then paying amounts owed to All About Kids, all of which All About Kids had been told would happen imminently. Accordingly, the accrual not only was proper, it was required by GAAP. The independent CPA auditing All About Kids' financial statements took no issue with this accrual.

* Comment 43

OSC's contentions that the accrual purportedly was not justified are incorrect. They are a series of completely unsupported statements that would impose requirements that simply do not exist. Tellingly, OSC does not cite any regulation, RCM provision or GAAP requirement that supports any of its purported requirements, because there aren't any. With all due respect, OSC is making up its own requirements, which are not RCM or GAAP requirements. For example, the draft report states that "there was no documentation of the decision to grant retroactive raises...prepared at the time of the entry." GAAP does not require any such documentation to support the entry. All that was required was management's making the decision, so that payment of the retroactive raises was probable. That decision was made and was documented by the accrual entry itself, which was based on management's communicating the decision to All About Kids' financial personnel. No further documentation was required by GAAP or by the RCM.

* Comment 44

Similarly, the draft report states that All About Kids' "established no formal obligation to pay the raises, and therefore, we question the basis for claiming them as an accrued liability for

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the 2012-13 school year." GAAP does not require a "formal obligation" to pay an accrued liability; the requirement is that if payment of the accrued liability is probable (whether or not it is a formal legal obligation), an accrual must be made. In this case, All About Kids' management's decision to pay the raises retroactively as soon as SED corrected its error and SEIT payments resumed, which All About Kids had every reason to believe that this would occur shortly as it had been told, made the payments more than probable; it made them certain., Therefore, under GAAP an accrual not only was proper, it was necessary.

Similarly, OSC's statement in the draft report that All About Kids had no written policy regarding retroactive raises is both irrelevant and untrue. Again, GAAP and the RCM do not require any written policy expressly authorizing retroactive raises in order to make them. Moreover, All About Kids did have a written policy regarding raises, and nothing in that policy precluded retroactive raises; the policy was silent on the issue. Therefore, by implication, it allowed retroactive raises.

* Comment 44

The fact that All About Kids "did not announce the retroactive salary payments to staff at the time officials purportedly made the decision to grant them" similarly is irrelevant. Again, neither GAAP nor the RCM requires such an announcement. OSC's requirement of an announcement apparently stems from its purported requirement that there be a "formal obligation" to make the payments. As stated above, under GAAP, an accrual must be made if payment of the obligation is probable, whether or not there is a "formal obligation". Again, as explained above All About Kids had sound business reasons not to make an announcement.

* Comment 44

OSC's statement that the employer-employee agreements in effect during the 2012-13 year and session notes did not reflect the raises is irrelevant. All About Kids' employer-employee agreements with its service providers do not state a rate. The rate is stated in the therapist's engagement agreement for each case. By definition, those documents would memorialize what is communicated to the therapist at the time of the case engagement and what in fact is paid at the time of the services. It would not reflect a retroactive change on account of All About Kids' decision to implement a retroactive raise. Again, doing so would communicate the raise to the therapists, which for all the reasons discussed above All About Kids could not prudently do until May 2014. The retroactive pay raise was not documented by changing the agreements for already completed services; it was implemented by notification to providers and payment of the retroactive raises in May 2014. Copies of the notification of the raises given to providers in May 2014 and spreadsheets showing the revised salary amounts and retroactive payment amounts were provided to the auditors. All About Kids did not go back and alter the prior year teacher rate forms after the raises were paid retroactively in 2014, because it would serve no functional purpose to do so. GAAP and RCM did not require All About Kids to do so. As a matter of fact, it would be inappropriate to alter documents that were the basis for the contemporaneous payroll payments. All of rate forms going forward are updated, and the raises

* Comment 45

* Comment 46

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are in the base salary, and this was documented to the auditors as well. At the auditors' request, after the final conference All About Kids also provided documentation demonstrating that the raises were carried over into subsequent school years, that is, that the raises were not a non-recurring bonus, which appeared at the time of the request to be the auditors' only remaining concern. The carryover of the raises to subsequent years was fully documented in All About Kids' financial reports, audited by an independent public accountant and approved by SED in setting All About Kids' rates for subsequent years.

Nothing about this was "not consistent with the Manual's requirement for formal employer-employee agreements with written salary scales," as OSC claims. All About Kids fully met the requirements of RCM Section II.13.A.1. The initial engagement agreements stated the SEITs' pay scale supporting payroll when All About Kids paid its SEITs for those services. The written notification of the raises in May 2014 amended that pay scale and was issued to each employee receiving the raises supporting the retroactive payroll payments. Nothing in the RCM provision required All About Kids to go back and retroactively amend the engagement agreements for each case to reflect the raises as well.

* Comment 46

In sum, the proposed disallowance would violate the bedrock principle of SEIT tuition rate accounting that accrual accounting consistent with GAAP must be used. What OSC would require in practice is cash basis accounting, not accrual basis accounting as required by the regulations, as it would not match the expense with the revenue it produced. Accordingly, the proposed disallowances are incorrect and should not be included in OSC's final report.

OSC's final and belated contention that "it is unclear that these accrued costs were unreasonable and necessary, as otherwise required by the Manual" both is procedurally improper and lacks any factual foundation. It is procedurally improper because this contention was not made in the preliminary reports or in any discussions of OSC's proposed disallowances. It is made for the first time in OSC's draft report without any prior notice or opportunity to address it. This is improper audit procedure, and again, also is contrary to OSC's assurances at the exit conference that no OSC positions not included in the preliminary reports would be considered for the draft and final reports. In any event, there is no factual basis for it. All About Kids has shown that its pay rates were below what competitors were paying, and that it was hearing complaints and reports that teachers might leave for higher paying jobs. It was reasonable and prudent to redress that situation as expeditiously as practicable and to make the raises retroactive to the beginning of the school year to improve teacher morale, close the pay gap, and show its teachers that All About Kids appreciated their value. This is important to All About Kids to enable it to attract and keep the highest quality teachers. OSC does not and cannot identify any facts to the contrary. This is yet another example of OSC's changing its position at the last minute in a desperate attempt to find some purported basis for a disallowance it wants to make, when there simply is no basis for the disallowance. Moreover, we are very surprised to learn that

* Comment 47

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OSC apparently does not believe that special education teachers should be paid fairly, at rates commensurate with the market, for their very difficult and important work.

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Comment
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5. Bonuses

All About Kids does not dispute OSC's proposed disallowance of bonuses paid to six non-direct care employees for the 2012-13 year. All About Kids recognizes that bonus compensation is allowable only to direct care employees, and agrees with OSC's disallowance of bonus compensation to the six non-direct care employees, which was a mistake. Specifically, the six employees identified worked in All About Kids' EIP. These EIP employees earned bonuses for their work in the EIP, but All About Kids mistakenly charged the bonus pay to Agency Administration on CFR-3, pursuant to the ratio value allocation methodology, thereby allocating incorrectly a portion of the bonus compensation to the SEIT program.

However, as stated above, All About Kids does object to OSC's wording that "the Manual specifically prohibits bonuses to non-direct care staff (e.g., the Executive Director)." That wording falsely and misleadingly implies that All About Kids paid a bonus to its Executive Director and that she is one of the six non-direct employees referred to in the discussion. As OSC knows, she was not paid a bonus and was not one of the six non-direct employees to whom the draft report refers.

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Comment
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III. Other Than Personal Services

1. Real Property Costs

All About Kids disagrees with OSC's proposed disallowances of real property costs. This proposed disallowance is procedurally inappropriate for two reasons.

First, at the exit conference, OSC advised us that the problem was that it needed copies of wire transfers evidencing these payments, and the disallowances would be removed once that was provided. All About Kids provided OSC that evidence by email on June 24, 2015. Nevertheless, without any explanation OSC continues to include the disallowances (and indeed appears to have increased the amount). OSC's doing so is completely arbitrary, and it renders the exit conference process useless. At this point, All About Kids has no idea why OSC thinks these costs should be disallowed, because All About Kids provided the information that OSC said at the exit conference was the only issue.

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Comment
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Second, the amount of such costs that OSC now proposes to disallow has changed from $27,359 in its preliminary report on this subject to $43,555 in the draft report. All About Kids cannot identify what is causing this difference. Also, while the amount of real estate expenses

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Comment
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proposed for disallowance has grown, the amount of such expenses allocated to SEIT now is less in the draft report ($6,490) than it was in the prior preliminary report ($10,784). All About Kids does not understand how OSC determined that either, since it was not discussed at the final conference and OSC has not provided detail concerning those changes. Please explain in detail exactly what costs OSC now is proposing to disallow in a way that shows which costs were not included in OSC's prior preliminary report, so that All About Kids can understand what the additional costs OSC now proposes to disallow are. If there are new costs disallowed that were not identified in OSC's prior draft reports, it is inappropriate for OSC essentially to continue field work after the final conference and now raise new disallowances for the first time, when All About Kids has had no opportunity to address them verbally or in writing. This kind of re-opening of field work is exactly what OSC stated at the exit conference OSC would not do. No such new disallowances should be included in OSC's report for this reason alone. If, contrary to OSC's assurances and proper audit procedure, they are to be included, they must be fully explained to All About Kids, with an opportunity for All About Kids to address them in writing and to discuss them at a further conference before any final report is issued.

* Comment 51

Substantively, as we explained to OSC previously in response to the preliminary report on this issue, all of the expenses OSC proposes to disallow were real estate taxes, parking costs and repairs, which are allowable expenses that All About Kids, as tenant, was required to pay under its leases. While it is difficult to understand from OSC's spreadsheets exactly what costs OSC proposes to disallow, to the extent OSC now proposes to disallow utility costs in leased premises as well, these also are allowable expenses that All About Kids, as tenant, was required to pay under its leases. If OSC believes otherwise, the draft report offers no explanation as to why real estate taxes, parking costs, repair costs or utility costs are not allowable expenses, and there is no reason. OSC also has not pointed out any lease provisions that purportedly made the landlord responsible of any of these things, and there are no such lease provisions.

* Comment 52

Moreover, while OSC accepts All About Kids' allocation methodologies (staff FTE and square footage), it concludes that All About Kids over-allocated rent to SEIT because it purportedly over-allocated staff FTE to SEIT. However, that is incorrect. For the reasons stated above in section 3 of the Personal Service Section relating to Program Staff, all of All About Kids' staff allocations were correct. Therefore, no disallowance is warranted.

* Comment 53

For all these procedural and substantive reasons, OSC's proposed disallowances relating to rent are incorrect and should not be included in the final report.

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2. Consulting Services

All About Kids disagrees completely with OSC's proposed disallowance of consulting services expenses. Once again, OSC is making up requirements that simply do not exist. The support for this consultant's services more than met the requirements of the RCM.

OSC's draft report once again omits relevant context. All About Kids provided OSC with the consultant's monthly invoices and all of the back-up documentation that supports, and by implication is incorporated into and made part of, the monthly invoices. The back-up documentation that comprises the details of the invoices was not provided to the auditors during the field work stage because the auditors never questioned this consultant's standalone invoices and never asked for any of the detailed back-up that comprises the entirety of the invoices. The first time OSC questioned this consultant's invoices was in its prior preliminary report. The OSC's primary objection to these expenses was that the services purportedly were not necessary, a position OSC now has dropped. OSC's objection to the detail contained in the invoices was a secondary point. All About Kids offered in its response to the preliminary report to provide back-up detail if OSC desired. OSC did not ask for that detail, but All About Kids provided it anyway.

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Comment
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The invoices and back-up documentation more than meet the requirements of Section III.1.C(2) of the RCM. They indicate the specific services provided, the dates, the number of hours, the fee per hour and the total amount charged. That is all that the RCM requires. OSC's contention that this information still is inadequate because the back-up "described the nature of the services provided rather than the specific services provided" is ludicrous. OSC is parsing words about the level of detail required in the descriptions. The draft report does not explain what is the difference between a description of the "nature of the services" and a description of "the specific services actually provided". The RCM provides no guidance on the fine-tooth distinction that OSC makes; nor is the difference between a description of "the nature of the services" and of "the specific services actually provided" self-evident. Here once again, OSC is imposing an amorphous, undefined requirement – in this case the level of detail of the description of the services – that simply does not exist.

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Comment
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We also note there is no dispute as to the *bona fides* of this expense. OSC no longer is contending that it was not necessary; OSC is not contending that the billing rates were above market rates; OSC is not contending that the fees were not reasonable or that the work was not done; and notwithstanding its quibbling over the degree of detail in the service descriptions, OSC is not contending that it did not understand what the consultant did. Moreover, if OSC had questions about what the consultant did, this consultant and All About Kids' management, who knew what she had done, were available to the auditors for months. The auditors never asked for further information about what she had done. Nor did they ask for more detail after reviewing the back-up descriptions of the services provided by All About Kids after the final conference.

In any event, the consultant has prepared an even more detailed chart, which is not required, amplifying the description of the services provided earlier by describing in even more detail day by day exactly what was done. We will provide this chart to the OSC under separate cover. While the RCM cannot reasonably be read to require anything close to this level of detail, this is being provided to satisfy OSC's purported stated concern, however baseless it may be under the RCM. This summary also includes a breakdown of how much of the services actually related solely to SEIT if they were allocated to the specific program to which specific services related, rather than reported under CFR-3 overall agency administration. As this breakdown shows, 62% of the services, or $28,080, actually related directly to SEIT, so the $5,255 allocated to SEIT by CFR-3 was a large understatement of the true costs directly attributable to SEIT services. * Comment 54

OSC's comment that All About Kids' contract with its consultant for the 2012-13 CFR was executed on August 15, 2013, after the fiscal year ended, is both inaccurate and irrelevant. It is inaccurate because the engagement letter was signed on August 2, 2013, not August 15, 2013. The fact that it was signed after the fiscal year was irrelevant. There is nothing surprising about that, as work to prepare the CFR is not done until after the end of the fiscal year, and that is when the contract to do that work is signed. OSC should know that. If OSC was interested in the contract covering work performed during the course of the 2012-13 fiscal year, OSC should have reviewed the contract executed in August 2012 that covered those services. The auditors never asked for a copy of that contract either before or after receiving the August 2, 2013 contract. Each engagement letter remains in effect until superceded by the next one. * Comment 55

OSC's statement that All About Kids reported $52,870 in consulting fees for the 2012-13 year also is inaccurate. The amount indicated by OSC includes $7,530 which were expenses paid during the 2012-13 year that related to the 2011-12 year. These expenses were correctly reversed in 2012-13 from a prior year accrual. * Comment 56 All About Kids also disagrees with OSC's contention that $743 of the costs claimed on the CFR pertained to services performed during a previous fiscal year. All About Kids is not aware of any such services and has no idea what OSC is talking about. Please identify the specific cost entry OSC claims pertains to a prior year. * Comment 57

For all these reasons, OSC's proposed disallowance is patently incorrect and should not be included in the final report.

3. Vehicle Expense

All About Kids does not dispute OSC's recommended disallowance of the vehicle lease expenses allocated to SEIT program for the 2012-13, 2011-12, and 2010-11 fiscal years. While the owners' vehicles at issue were, in fact, used in connection with their respective SEIT job

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functions, which is why the expenses, in applicable part, were reported, and while the expenses were otherwise appropriately charged pursuant to the approved ratio value methodology, the owners did not maintain complete logs to confirm the usage during the years at issue, as required by the RCM. However, OSC overstated the 2011-12 disallowance by $407, because it disallowed the gross cost of the lease rather than 80% of the lease, which it should have done since All About Kids self-reported a 20% disallowance (the amount attributed to personal use) on its CFR. $407 represents the 20% disallowance already taken by All About Kids.

* Comment 58

All About Kids also disputes a vehicle expense disallowance of $357 for parking lot fees that appears to be included within OSC's proposed disallowances. These parking lot fees were for SEIT employees assigned to All About Kids' Westchester office. As part of its lease, All About Kids is assigned and pays for two parking spots on-sight for use by staff and/or guests (*e.g.,* CPSE Chairpersons or other CPSE members, parents having their children evaluated at the site, etc.). The landlord bills All About Kids the spots as a separate charge outside the lease. There is no prohibition against charging as an agency expense on-site parking spaces for which a cost is incurred by an agency. Therefore, such an expense could only be disallowed to the extent that it was deemed unreasonable and unnecessary by SED. The use of these parking spots by Westchester staff and visitors is both reasonable and necessary, as there is no street or other convenient public parking available to staff and visitors at or near the office. Therefore, this expense is allowable. This was explained to OSC previously, but OSC does not appear to have removed this item from its report and has offered no explanation as to why not.

* Comment 59

4. Other "Ineligible" Items

OSC's proposed disallowances for other "ineligible" items are set forth below. We have not devoted a lot of time to these matters given the rather small amounts involved. Frankly, we view a lot of these proposed disallowances as petty, to say the least, and a waste of government resources to have spent the substantial time OSC spent on them. Undoubtedly the costs of "discovering" these matters was much greater than the proposed disallowances, even if the proposed disallowances were correct, which most of them are not.

(i) $3,291 for non-SEIT employees' travel reimbursement

All About Kids disagrees with this proposed disallowance. As OSC knows, All About Kids' travel allocation was based on staff FTE; All About Kids provided OSC with a memorandum indicating same. Specifically, All About Kids determined the total SEIT FTE as 18% of the agency's total FTE and multiplied the total agency travel expense by that percentage, which is an appropriate methodology consistent with the allocation principles established by the RCM. OSC substituted its own methodology (*i.e.,* OSC allocated to the SEIT program 18% of the total travel expenses only of the employees who spent at least some of their time working in

* Comment 60

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the SEIT program), without any legal or factual basis to do so. All About Kids' methodology already accounted for the fact that some employees did not work in the SEIT program by its 18% allocation based on FTE. Accordingly, these travel expenses should not have been disallowed.

(ii) $2,612 for promotional items

All About Kids disagrees with these proposed disallowances. The draft report states no reason for this proposed disallowance. In its prior preliminary report, OSC claimed, without explanation, that these items were "not necessary for the operation of the program" and also that certain of the items were purchased in February 2012. First, GAGAS requires the OSC to state the specific basis upon which it decided to disallow the items at issue, and stating only that they were "unnecessary" falls short of OSC's burden. OSC has provided no further reasons for its unsupported conclusion. On that basis alone, these disallowances are inappropriate. Regardless, the items purchased were reasonable, necessary and directly related to the SEIT program, which is the standard established by the RCM. Furthermore, these items were purchased during the 2011-12 year in February 2012, when such promotional items were allowed by the RCM, and were charged in that year by an accrual entry. The accrual was reversed in 2013 when the items were paid for, in accordance with GAAP. Thus, there was no 2012-13 charge for those items. OSC has stated no reason for its disallowance after receiving this explanation. There is no reason, and OSC has not met its burden under GAGAS to provide reasons for its proposed disallowance.

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Comment
61

(iii) $2,654 in certain costs not attributable to 2012-13

All About Kids disagrees with this proposed disallowance. These costs are allowable. As All About Kids previously explained, a prior year accrual was made for these items and subsequently reversed. OSC has stated no reason for its continuing to assert that these items should be disallowed after receiving this explanation. There is no reason, and OSC has not met its burden under GAGAS to provide reasons for its proposed disallowance. Furthermore, OSC has provided absolutely no explanation as to why it increased this disallowance from $2,353 in its preliminary report of findings to $2,654 in its draft audit report, again ignoring its responsibilities under GAGAS.

*
Comment
62

(iv) $1,560 for loan interest claimed twice on the CFR

All About Kids mistakenly and inadvertently claimed the $1,560 twice on the CFR. As a result, it agrees with the disallowance.

(v) $1,235 for "inadequately documented" expenses

All About Kids disagrees with this proposed disallowance. We previously advised OSC in response to the preliminary report on this subject that All About Kids provided OSC with documentation of all expenses requested, and absent explanation from OSC, All About Kids does not understand why OSC considers any of that documentation "inadequate". OSC still has not provided any explanation of its reasons. Without such an explanation, All About Kids cannot meaningfully respond, and OSC has not met its burden under GAGAS to provide reasons for its proposed disallowance.

* Comment 63

(vi) $906 for non-SEIT related costs

All About Kids disputes a portion of this proposed disallowance. The disallowances totaling $123 of American Express charges for various advertising should not be disallowed. Those charges were properly allocated across the SEIT and EIP programs by revenue. OSC has offered no explanation for continuing to propose this disallowance after receiving this explanation. Again, OSC has not met its burden under GAGAS to provide reasons for its proposed disallowance. An additional $301 of these expenses were prior year accruals reversed when paid in 2012-13. Accordingly, there was no 2012-13 expense, and nothing should be disallowed.

* Comment 64

All About Kids agrees with the remaining disallowances under this category, which were EIP expenses mistakenly and unintentionally charged to the SEIT program.

(vii) $518 for cell phone related charges

While the Executive Director's and Division Director's iPhones are used primarily for business, All About Kids will not dispute the $48 expense for iPhone parts. However, All About Kids disagrees with the $470 remainder, as it was reasonable, necessary, and entirely related to the SEIT program, and therefore allowable. These charges are comprised of modems which were used by the Division Director and three Program Directors for the sole purpose of accessing the internet during meetings and at offices where internet access was needed but unavailable. There is no such prohibition against these items in the RCM, and internet access is vital to these individuals while carrying out their various duties. Therefore, these were reasonable and necessary expenses that should not have been disallowed. OSC has not articulated any reason for its contention that these expenses purported were "unnecessary" and there is no reason. Again, OSC has not met its burden under GAGAS to provide reasons for its proposed disallowance.

* Comment 65

(viii) $415 for IDEA grant purchases

All About Kids agrees that this item was paid for by the IDEA grant. It was mistakenly reported, and we agree with the proposed disallowance.

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(ix) $509 in credit card interest charges.

All About Kids disagrees with $201 of this disallowance. All About Kids agreed with the disallowance of credit card charges in the amount of $308 claimed in the preliminary report. All About Kids does not understand what the additional $201 is, as OSC has not identified it with sufficient specificity. Accordingly, All About Kids cannot meaningfully respond. In any event, it is inappropriate for OSC now to be adding new proposed disallowances after the final conference, as to which All About Kids had no prior opportunity to review and respond. This is both contrary to what OSC said it would do and deprives All About Kids of any meaningful right to respond to OSC's contentions.

* Comment 66

(x) $182 for employee food items

All About Kids does not dispute the food items charges totaling $182; however, we note that these purchases were made when All About Kids hosted school district CPSE annual review meetings at its site. These meeting typically lasted a half to a full day, and All About Kids believed providing refreshments to parents and district staff was the right thing to do. All About Kids was not buying food items as a benefit to its employees as OSC implies, which is misleading.

(xi) $97 for private home telephone bills

While the telephone bills all were calls made for business, because All About Kids has not in the past sought reimbursement of home telephone charges incurred due to business, All About Kids will not dispute this disallowance and instead will reevaluate its policy in connection with the same for going forward purposes.

(xii) $134 for hotel charges for industry conference

All About Kids disagrees with this proposed disallowance. All About Kids does not understand with certainty what the proposed hotel disallowance is. There was no such proposed disallowance in the preliminary report, and this was not discussed thereafter. The expenses are not identified with specificity. It is inappropriate for OSC to be adding new proposed disallowances after the final conference, as to which there has been no prior disclosure and as to which All About Kids has been given no opportunity to respond or discuss at the final conference. The proposed disallowance should be removed for this reason alone. In any event, the only trip to Miami Beach was to attend a conference sponsored by the Education Industry Association ("EIA"). This was an essential and reasonable expense. OSC has recognized that All About Kids' participation in EIA serves a valid business purpose, as OSC reviewed, questioned

* Comment 67

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and now has allowed All About Kids' membership due for EIA. All About Kids attends the conference to exchange ideas for best practices, to further education and learning opportunities in its programs, and to develop All About Kids' practices geared towards providing the best education services at the lowest possible cost. The information available at EIA conferences is valuable to All About Kids and is not available elsewhere at any in-state conferences or professional education programs.

IV. Conclusion

OSC's report is misleading, legally incorrect and factually inaccurate and falls woefully short of a proper and fair audit report. We trust that your final report will modify the draft report appropriately in light of this response. We also trust that OSC will delete the proposed disallowances which are based on contentions not previously made and numbers which have changed in the draft report, as All About Kids had no opportunity to discuss or respond to those matters before the draft report was issued. If OSC does not do so, which by OSC's own admission at the exit conference would be a violation of proper audit procedure, we trust that OSC will provide All About Kids full factual details and will provide All About Kids an opportunity to respond to the changed contentions and changed numbers before a final report is issued.

* Comment 68

Sincerely,

Frederick J. Berman

Frederick J. Berman

FJB:jp
Enclosure

Attachment 1

THOMAS P. DINAPOLI
STATE COMPTROLLER

110 STATE STREET
ALBANY, NEW YORK 12236

STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

February 1, 2011

David M. Steiner
Commissioner of Education and President of the University of the State of New York
NYS Education Department
89 Washington Avenue
Albany, NY 12234

Dear Commissioner Steiner:

In October 2009, our office initiated an audit (2009-S-61) titled *State Education Department: Payments to Mid Island Therapy Associates, LLC.* Mid Island, a private institution based in New York City and Long Island, is reimbursed millions of dollars in SED funding annually for providing special education programming for speech-impaired, preschool-aged children. Our audit objective was to assess the propriety, justification and support for Mid- Island's reimbursed claims.

* Comment 19

Our audit did not find any significant findings in this regard, and any improvement opportunities identified during our field work were shared with SED staff. As such, we will not be issuing a formal public report for this audit.

We appreciate the cooperation afforded our examiners during the audit.

Very truly yours,

Frank P. Patone, CPA
Audit Director

cc: Jim Conway (SED Audit)
Michael Grossfeld (Mid Island)

State Comptroller's Comments

1. The State Comptroller's legal authority to audit the costs submitted by Mid Island on the CFRs to the State Education Department is expressly cited on pages 3 and 12 of the report.
2. We maintain that our report is both factually and legally correct. As prescribed by the Reimbursable Cost Manual, the regulatory references for our findings are detailed in the report's Notes to Exhibit. Further, we reviewed and considered all evidence or information provided by Mid Island. As such, we maintain that the evidence obtained during the audit provides a reasonable basis for our findings and conclusions. We also maintain that our report fully complies with Generally Accepted Government Auditing Standards (GAGAS).
3. As the report states, we conducted an audit of the expenses reported by Mid Island on its CFRs to determine compliance with SED's Reimbursable Cost Manual (Manual). We did not audit SEIT service items to verify that services were properly provided and properly billed. Our testing was generally limited to the verification of CFR-reported costs. As such, Mid Island's assertion that we verified the proper delivery of services and billing is incorrect.
4. We have revised our report to delete the reference to the Executive Director.
5. We have revised our report to delete the reference regarding the Miami Beach hotel.
6. We use the term "over-allocation" to mean more than the proper amount. It does not indicate explicitly or implicitly whether or not any discrepancy was deliberate.
7. We use the term "improperly" to mean more than the proper amount. It does not indicate explicitly or implicitly whether or not any discrepancy was dishonest.
8. No additional clarification is warranted. The services and related costs in question were allocable to the Early Intervention program and should not have been charged to the preschool special education program we audited.
9. We have revised our report to indicate that the 144 employees were SEIT teachers.
10. We revised the report to delete the reference that food was for employees.
11. We have revised our report to make it clear that the ineligible costs were private home telephone bills.
12. The changes in this language are negligible and do not impact the facts presented or the spirit of our report.
13. It is our understanding that SED officials have provided training on the Manual. In addition, in their response, SED officials stated that they will continue to provide technical assistance whenever requested and strongly recommend officials take advantage of their availability to help them better understand the standards for reimbursement as presented in Regulation and the Manual. The Manual is the standard upon which our findings are based and are derived from SED's statutory authority. In addition, the Manual's basic provisions do not change dramatically from year to year, and revisions go into effect when the Manual is issued.
14. The audit process entails the development of facts, and as new facts are developed, audit approaches and techniques can change. Further, in certain instances, we contacted SED to obtain technical assistance to ensure our application of the Manual was correct. We urge Mid Island officials to seek similar guidance when questions about the Manual's provisions arise.

15. The language in our report is not careless. Our findings are presented using language consistent with the applicable GAGAS provisions for audit reporting.
16. SED's desk reviews do not include the level of detail of OSC's on-site audits of the provider's source and supporting records for the costs reported on the CFRs. Consequently, the fact that a particular cost was allowed pursuant to SED's desk review does not mean that the same such cost will not be disallowed upon on-site audit of the required supporting documentation.
17. We acknowledge the amounts of adjustments that SED makes to CFR reported data based on its reviews. However, our findings are often based on our examination of records and information that SED staff generally does not have in the course of their reviews.
18. The Comptroller has the legal authority to audit the costs submitted by SEIT providers on CFRs to the State Education Department. The frequency of such audits is at the discretion of the Office of the State Comptroller.
19. Each audit performed by the Comptroller is a separate and distinct undertaking. As commonly occurs, audit fieldwork involves the selection of samples of records to review. In addition, there have been changes to the Manual in the years since our last audit (which was not completed, and as such, did not result in a report), and Mid Island's financial policies and practices might have changed over time. These factors likely account for the differences between this audit and prior engagements.
20. The Manual provisions concerning the recommended disallowances for Mid Island are clear. Overpayments are recovered when determined through an audit or SED reconciliation process. In fact, Mid Island (like many providers) has been issued reconciliation rates by SED over the years. Also, the recovery of ineligible reimbursements helps to ensure that limited public funding is used for its intended purpose.
21. Refer to Comment no. 19.
22. As noted in our draft report, preliminary copies of our audit observations were provided to SED and Mid Island officials for their review and comment. We considered these comments in preparing the draft report. Also, the audit's exit conference provided opportunity for discussion of our audit findings. We use information derived from the exit conference and written responses to our preliminary findings to help prepare the draft report. We did not ignore any evidence or information provided by Mid Island. Further, the regulatory references (per the Manual) for our findings are detailed in the report's Notes to Exhibit. As such, we maintain that the evidence obtained during the audit provides a reasonable basis for our findings and conclusions.
23. We maintain that our report fully complies with GAGAS.
24. We maintain that the evidence obtained during the audit provides a reasonable basis for our findings and conclusions.
25. By definition, preliminary findings are non-final audit observations. Further, we informed Mid Island officials that the preliminary findings offered both SED and Mid Island with an opportunity to formally respond to audit issues prior to the conclusion of audit fieldwork. Any responses from SED and the school provides OSC with the opportunity to consider and make audit adjustments, as warranted. Based on the responses, we made appropriate adjustments to the audit criteria and findings, consistent with GAGAS.
26. Mid Island's comment is misleading. At the closing conference, we did not assure Mid Island that the draft report would include only issues previously addressed in preliminary

findings. Based on our analysis of the matter, including consultation with SED, we advised Mid Island officials of our concerns and provided them with the pertinent details, consistent with what is normally included in a preliminary finding. As such, the audit procedures employed were not inappropriate. Furthermore, Mid Island officials were not deprived of opportunities to address this issue. In fact, Mid Island had ample opportunity to address the issue both prior and subsequent to issuance of the draft audit report. Also see Comment no. 25.

27. As stated on page 7 of the report, the documentation provided by Mid Island did not adequately support the allocation to the SEIT program.
28. The Manual requires that compensation costs be based on approved, documented payrolls. Payroll must be supported by employee time records prepared during, not after, the time period for which the employee was paid. As stated on page 7 of the report, the Executive Director was not reported as an owner on the CFR. Instead, her compensation was reported as salary and fringe benefits, thus subjecting such costs to the Manual's time distribution (allocation) requirements.
29. Section II.13 of the Manual states the basis for reimbursement of compensation for personal services including all salaries and wages. Within that provision, a specific reference is made to Section III.1.A Recordkeeping – Payroll, which states that compensation costs must be based on approved, documented payrolls, and Section III.1.B applies to the owners of an entity who would be deemed staff as they were paid a salary. That provision states that 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. Section II.13.A (4) d further enforces the need for such documentation when allocating time of non-direct care staff, owners or related parties. Mid Island's Executive Director and Division Director met all three of these classifications, and the documentation presented to support an allocation of their time to titles other than Executive Director and Division Director was insufficient.
30. As stated on page 7 of the report, we determined that the documentation provided by Mid Island to support the allocation of the Executive Director's compensation did not meet the requirements in the Manual as it was insufficient, was neither fair nor reasonable, and was based on estimates rather than contemporaneous time records and studies. We also noted that Mid Island used the same allocation percentage (45 percent) to allocate her time during the prior two fiscal years (2010-11 and 2011-12), when Mid Island had additional staff dedicated to the SEIT Program Director position.
31. We disagree. Mid Island indicated that limited SEIT supervision was one of the reasons for allocating the Executive Director's compensation to the SEIT program during fiscal year 2012-13. Further, Mid Island did use the same allocation percentage to allocate the Executive Director's compensation for the two prior fiscal years. We also disagree that the Division Director did not allocate any time to the SEIT Program Director position prior to fiscal year 2012-13. We note that the Division Director used the same allocation percentage in fiscal year 2011-12, when Mid Island allocated additional staff to the SEIT Program Director position.
32. Refer to Comment no. 28.
33. SED generally does not require providers to submit documentation of their allocation

methodologies or their actual allocation calculations when they submit their CFRs. Thus, SED fiscal representatives do not routinely assess in detail providers' allocation methodologies and calculations. Nonetheless, the Manual requires providers to maintain such documentation to support amounts claimed on the CFRs.

34. As stated on page 7 and 8 of the report, Mid Island officials provided documentation indicating that the Division Director was listed as both Division Director and Assistant Executive Director. As noted in our report, the Division Director's compensation was claimed on the CFR as salary and fringe benefits, and therefore was subject to the Manual's time distribution (allocation) requirements.
35. SED reclassified the Division Director to Assistant Executive Director based upon its assessment of his responsibilities. We concur with SED's assessment based upon our review of the Division Director's responsibilities, which aligned with those of an Assistant Executive Director.
36. Refer to Comment no. 35.
37. At the closing conference, we were advised that the allocation was based, in part, on an estimate. Also see Comment no. 32.
38. Refer to Comment No. 33.
39. The additional allocated time for PTC 516 employees was listed as non SEIT-related time on the employees' time studies. The Manual allows alternative allocation methods, only if actual hours of service cannot be calculated or a time study cannot be completed. Since time studies were completed, an alternative method was unnecessary, and therefore we did not allow the additional allocated amounts. Further, records for the seven employees (for which time studies were not provided) did not have any SEIT-related material and/or indicated that the employees worked for the Early Intervention program. To allocate their compensation in a fair and reasonable manner, we used the time studies provided for other employees who held the same position.
40. We used the contemporaneous time studies that were provided to us during the audit.
41. We have revised our report by adjusting certain hours and salaries used in our calculations, as warranted.
42. We concur that the Manual requires providers to report costs on their CFRs using Generally Accepted Accounting Principles (GAAP), including the accrual basis of accounting, in the absence of other Manual direction. Mid Island, however, did not comply with GAAP requirements for recognition of an expense when they recorded retroactive payments. Under GAAP the principle for recognition of accrued expenses "represent estimates of expenses incurred on or before the date of the statement of financial position that have not yet been paid and that are not payable until a succeeding period within the next year. Examples of accrued expenses include salaries, vacation pay, interest, and retirement plan contributions." Mid Island had not incurred the retroactive raise as staff performed services at the existing pay rate and without notification of an increase to their pay rate in the year the expense was claimed. In fact, employees were not paid the higher rate and retroactive raise for another 10 months after the expense was recorded.
43. We determined that Mid Island officials did not announce the retroactive salary payments to staff at the time officials purportedly made the decision to grant them. Further, officials indicated that they did not want to announce the raises until Mid Island's cash flow had normalized, enabling them to pay retroactive and other pay increases as well. In other

words, the retroactive salary payments were contingent upon Mid Island's cash position. Under such circumstances, however, officials established no formal obligation to pay the raises, and therefore, we questioned the basis for claiming them as an accrued liability for the 2012-13 school year.

44. Because Mid Island did not update employer-employee agreements, incorporate written policies, or announce the retroactive salary payments to staff during the 2012-13 year, Mid Island had not established a formal obligation to pay the retroactive raises in the future. Therefore, it did not constitute an accrued liability for the 2012-13 year.
45. During our fieldwork, we found employer-employee agreements [Notice and Acknowledgement of Pay and Payday for hourly rate employees] in which employees acknowledged that they received notice of their pay rates from Mid Island. However, the rates stated in these agreements (in effect for these employees during fiscal year 2012-13) did not include rate increases corresponding with amounts of the raises in question claimed by Mid Island. Similarly, pay rates documented on 2012-13 employee session notes did not reflect increased pay rates.
46. The Manual requires providers to develop employment agreements with written salary scales and issue them to employees. In addition, we found that the employer-employee salary agreements, in effect for these employees during 2012-13, did not include rate increases that corresponded with amounts of the raise claimed by Mid Island. Similarly, pay rates documented on 2012-13 employee session notes did not reflect increased pay rates. As such, we disallowed these expenses.
47. Mid Island's statement "it is unclear that these accrued costs were unreasonable and necessary, as otherwise required by the Manual" is misquoted from the draft report.
48. The assertion that OSC does not believe special education teachers should be paid fairly is baseless.
49. Refer to Comment No. 4.
50. We did not state that the disallowances would be rescinded if wire transfer documentation was provided. Further, we did not increase the amount of the disallowance; instead, it was reduced. Also see Comment no. 52.
51. Mid Island is incorrect in stating that we "propose to disallow" $43,555. After considering additional documentation provided by Mid Island, we reduced the applicable disallowance from $10,784 (in the preliminary report) to $6,490 (in the draft report). Further, we provided Mid Island officials with a spreadsheet showing the expense descriptions and amounts not included in the building leases prior to the issuance of the draft report.
52. As stated on page 10 of the draft report, the applicable real property rental costs were disallowed because the amounts were not included in the terms of the building leases.
53. We concluded that Mid Island over-allocated costs to SEIT. However, we revised our report to reduce the disallowance by $191.
54. During the audit field work, we advised Mid Island that the consultant's invoices did not meet the Manual's requirements. However, based on additional documentation provided by Mid Island, we rescinded the disallowances (totaling $5,255) associated with the consultant and revised our report as appropriate.
55. Mid Island's comment is incorrect. Our report does not state that the contract was executed on August 15, 2013. Instead, the report states that the contract was executed in August 2013.

56. The reversal in Mid Island's General Ledger did not indicate that it was applicable to this consultant's costs. Further, Mid Island officials had not advised us of the reversal prior to its response to the draft report. Given this new information, we revised the report, and reduced the disallowance to reflect the reversal.
57. The $743 was excluded from the report.
58. Mid Island's comment is incorrect. We did not overstate the disallowance by $407. We disallowed $1,628 in 2011-12 vehicle related costs, which represents $2,035 less the $407 that was ultimately not claimed for reimbursement.
59. Mid Island's comment is incorrect. We did not disallow the $357 for parking lot fees.
60. After reviewing additional information, we revised our report and reduced the disallowance by $437.
61. We revised our report to allow $2,612 in promotional expenses that were previously disallowed.
62. After reviewing additional information, we revised our report and reduced the disallowance by $1,665.
63. We provided Mid Island with a detailed listing of all claimed costs that were not adequately documented. In some instances, invoices were missing, and in other instances, we could not determine what was purchased. Without adequate supporting documentation, the costs in question did not meet the Manual's eligibility requirements.
64. We revised our report to allow $113 in costs that were previously disallowed and note that Mid Island's total of $123 is incorrect. Also, Mid Island did not provide sufficient supporting detail regarding the $301 in prior year accruals that were purportedly reversed when paid in 2012-13.
65. We revised our report to allow the $470 in modem charges and reduced the disallowance accordingly.
66. The $201 expense in question was disallowed in the preliminary report as an inadequately documented cost. However, after further review of Mid Island's General Ledger, we determined that this expense was for credit card interest charges and was identified as such in disallowance spreadsheets provided to Mid Island prior to issuance of the draft report. After further review of credit card statement descriptions, we determined that only $96 of this expense was a credit card interest charge. We revised our report to exclude $105 in credit card interest disallowances.
67. Mid Island's comment is incorrect. This disallowance is not a new finding. In fact, it was noted in the preliminary findings provided to Mid Island on January 12, 2015.
68. Mid Island's comment is incorrect. All conclusions drawn in this report were previously discussed with Mid Island. Further, we reviewed and assessed all evidence and information provided by Mid Island. As such, we maintain that the evidence obtained during the audit provided a reasonable basis for our findings and conclusions.