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

Division of State Government Accountability

Compliance With the Reimbursable Cost Manual

John A. Coleman School
State Education Department

Report 2012-S-16 August 2013

Executive Summary

Purpose

To determine whether the costs reported by the John A. Coleman School (Coleman) on its Consolidated Fiscal Reports (CFRs) were properly calculated, adequately documented, and allowable pursuant to the State Education Department's Reimbursable Cost Manual (Manual). The audit covered the three fiscal years ended June 30, 2011.

Background

Coleman is located in White Plains and Yonkers, New York and provides special education itinerant teacher (SEIT), preschool, and school-aged special class services to disabled children. During the 2010-11 school year, Coleman had an enrollment of 491 students. The New York City Department of Education (DoE) and other school districts pay tuition and fees to Coleman using rates set by SED. These rates are based on financial information Coleman presents in an annual CFR filed with SED. SED reimburses DoE and the other school districts for a portion of their payments to Coleman. For the three years ended June 30, 2011, Coleman claimed about $27.3 million in public support.

Key Findings

- For the three years ended June 30, 2011, we disallowed $639,338 in costs that were not in compliance with the applicable provisions of the Manual. The disallowances included $512,783 in personal service costs and $126,555 in other-than-personal service (OTPS) costs.
- The personal service disallowances consisted of: $366,842 in bonus payments to employees and contracted personnel that were not supported by formal performance evaluations; $140,512 in bonuses that were claimed for the 2010-11 year, but were not paid in that year; and $5,429 in excessive charges for severance pay.
- The other-than-personal service disallowances included $126,555 in interest only loan payments. The Manual precludes interest only payments from reimbursement.

Key Recommendations

- SED should review the disallowances resulting from our audit and make the appropriate adjustments to costs reported on the CFRs and to Coleman's tuition reimbursement rates, as appropriate.
- SED should direct Coleman officials to fully comply with provisions of the Manual and to ensure that requests for reimbursement include only those expenses that are allowable.
- Coleman should ensure that requests for SED reimbursement include only those expenses that are allowed by the Manual.

Other Related Audits/Reports of Interest

Bilingual SEIT, Inc.: Compliance With the Reimbursable Cost Manual (2011-S-13)
IncludED Educational Services Inc.: Compliance With the Reimbursable Cost Manual(2010-S-59)

State of New York
Office of the State Comptroller

Division of State Government Accountability

August 5, 2013

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

Ms. Patricia A. Tursi
President and Chief Executive Officer
John A. Coleman School
317 North Street
White Plains, NY 10605

Dear Dr. King and Ms. Tursi:

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

Following is a report of our audit of the State Education Department and John A. Coleman School 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 and Article II, Section 8, of the State Finance Law.

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

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

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110 State Street, 11th Floor
Albany, NY 12236

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

Background

The John A. Coleman School (Coleman) operates facilities in White Plains and Yonkers, New York. Coleman is a private, not-for-profit educational corporation approved by the State Education Department (SED). SED approved Coleman to provide special education itinerant teacher (SEIT) services (program code 9135), preschool special education classes (program code 9100), and school age special education classes to disabled children between the ages of three and 21 years (program code 9000). During the 2010-11 school year, Coleman had an enrollment of 491 students. During our audit period (the three years ended June 30, 2011), Coleman operated classes at two sites – in New York City and White Plains. In 2012, the New York City campus relocated to the Elizabeth Seton Pediatric Center (Elizabeth Seton), a separate not-for-profit pediatric residential nursing facility in Yonkers. Students at Elizabeth Seton are not medically or physically able to attend school in the community.

The New York City Department of Education (DoE) and other school districts pay tuition and fees to Coleman using rates set by SED. SED sets these rates using financial information that Coleman reports in annual Consolidated Fiscal Reports (CFRs) it files with SED. SED issued a Reimbursable Cost Manual (Manual) to provide guidance to providers on the eligibility of costs, documentation, and allocation requirements that must be met for rate-setting purposes. The DoE and the other localities use the rates to pay for services and then are partially reimbursed by SED. To qualify for reimbursement, the costs reported on the CFR must fully comply with the Manual. For the three fiscal years ended June 30, 2011, Coleman claimed about $27.3 million in reimbursable costs.

Audit Findings and Recommendations

Personal Service Costs

According to the Manual, personal service costs, which include all taxable salaries and fringe benefits paid or accrued to employees on the agency's payroll, must be reported on its CFR as either direct care costs (e.g., teachers' salaries) or non-direct care costs (e.g., administrators' salaries). Non-direct care costs are to be allocated between all of Coleman's entities and school programs based on a fair and reasonable method. All claimed costs must comply with the applicable provisions of the Manual. We identified $512,783 in personal service costs that did not comply with the applicable provisions of the Manual. The disallowed personal service costs included non-compliant bonuses (totaling $507,354) and an excessive severance payment (totaling $5,429).

Bonuses

The Manual defines bonus compensation as a non-recurring and non-accumulating (i.e., not included in a recipient's base salary in subsequent years) lump sum payment in excess of the regularly scheduled salary which is not directly related to hours worked. Bonus compensation may be reimbursed if based on merit as measured and supported by employee performance evaluations. During the audit period, Coleman awarded several types of bonuses (totaling $978,062) to employees and independent contractors. We disallowed a total of $507,354 in various bonus payments that did not comply with the provisions of the Manual. The disallowed bonus payments included $343,612 in differential bonuses, $140,512 in performance-based bonuses, and $23,230 in signing bonuses as detailed in the following narratives.

a. Differential Bonuses

Coleman awarded one-time "differential" bonuses to direct care employees who took on additional students - beyond their normal student workloads. Officials advised us that Coleman's enrollment increased significantly during the 2008-09 year, and consequently, many direct care employees provided services to new students (beyond the employees' normal workloads). For the 2008-09 year, Coleman claimed $432,104 in accrued differential bonuses, with some employees receiving as much as $13,250 in bonus awards. However, many of these differential bonuses were not supported by employee performance evaluations, and therefore, they did not comply with the Manual. Hence, we disallowed a total of $343,612 in differential bonus payments, as follows:

- $196,821 paid to 20 teachers;
- $73,833 paid to 31 teacher's aides/assistants; and
- $72,958 paid to 14 therapists who were contracted personnel (and not Coleman employees). The Manual does not provide for bonus awards to contractor staff.

Coleman officials stated that the students at the Yonkers campus have unique educational, medical, and rehabilitation needs. Therefore, officials awarded the differential bonuses as incentives to help recruit and retain staff for this location. Nevertheless, for financial reporting purposes, Coleman must comply with the pertinent provisions of the Manual.

b. Performance-Based Bonuses

In general, SED requires special education schools to submit their CFRs within four months after the end of the fiscal year. SED personnel use CFR data to set tuition rates and analyze the propriety of fees and contracts. Thus, CFR data must be complete and accurate. Coleman reported and claimed reimbursement for $477,957 in accrued performance bonuses on their 2010-11 CFR. However, we found that Coleman actually paid only $316,790 of this amount. Coleman officials advised us that the remaining $161,167 ($477,957 - $316,790) was not paid because the employees affected were terminated and/or they received unsatisfactory ratings on their performance evaluations.

Coleman submitted its CFR for the 2010-11 year to SED in December 2011, more than five months after the end of that fiscal year. At the time Coleman officials submitted the 2010-11 CFR to SED, they knew that Coleman had not paid the $161,167 in bonuses in question. Consequently, these bonuses should not have been included on the CFR. After we brought this matter to their attention, Coleman officials presented a journal entry to us indicating that the $161,167 would be reversed on the CFR for the 2011-12 year. Nevertheless, we maintain that Coleman officials should have reversed these costs on the CFR for the 2010-11 year (the year in which the bonuses were initially claimed). Therefore, we disallowed $140,512 (of the $161,167) in performance-based bonus expenses that were claimed improperly for the 2010-11 year and allocated to the programs we audited.

c. Signing Bonuses

During fiscal years 2009-10 and 2010-11, Coleman paid $68,001 in signing bonuses to newly hired therapists. About one-third of the bonuses were paid to employees when they accepted their positions. The remaining amounts were paid at the end of employees' six-month probationary periods. We disallowed $23,230 in signing bonuses (including $15,588 for the 2009-10 year and $7,642 for the 2010-11 year) that were paid at the outset of employment. Contrary to the Manual's requirements, these bonuses were not based on merit as evidenced by formal performance evaluations. We question how Coleman officials could assess the job performance of employees prior to the periods of their employment.

Coleman officials advised us that it was difficult to find certified therapists; and therefore, they paid signing bonuses to these employees. However, the Manual requires that bonuses be merit-based and supported by performance evaluations. Further, the payment of signing bonuses could provide supervisors with a need to give employees high performance ratings to justify the bonuses (that were awarded prior to employment and the employee's actual performance of their job duties).

Severance Pay

According to the Manual, severance pay expenses are reimbursable provided that the cost does not exceed two weeks' pay for a full time employee. We reviewed the personnel file for an employee who received a $7,500 severance payment upon termination during the 2009-10 year. We calculated the two-week salary for this employee to be $1,889. Therefore, we disallowed the $5,429 in expenses that were allocated to the programs we audited.

Other-Than-Personal-Service Costs

The Manual states that interest expense is reimbursable only when there is a corresponding amortization of principal on the capital indebtedness. Payments, which represent interest only, are not reimbursable.

In fiscal year 2005-06, Coleman received a $1.5 million loan from the New York Foundling Charitable Corporation, an entity related to Coleman. For fiscal years 2008-09 through 2010-11, Coleman made no payments to reduce the $1.5 million principal on the loan. Instead, $166,588 in interest expense was reported. We disallowed $126,555 in interest expenses that were allocated to the programs we audited because interest only payments are not reimbursable.

Coleman officials told us that they did not pay down the principal loan balance because they were experiencing financial difficulties. According to officials, fundraising activities did not raise as much money as they had anticipated. Further, Coleman officials advised us that they began to pay down the principal on the loan during the 2011-12 fiscal year (or subsequent to the period of our audit).

Recommendations

To SED:

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

2. Direct Coleman officials to fully comply with the provisions in the Manual and to ensure that only eligible costs are included on the CFR.

To Coleman:

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

4. Ensure that costs reported on the CFRs are accurate and complete.

Audit Scope and Methodology

We audited the expenses reported by Coleman on its CFR for the three fiscal years ended June 30, 2011. The objective of our audit was to determine whether the costs reported by Coleman were properly calculated, adequately documented and allowable under SED's Manual.

To accomplish our objectives, we reviewed Coleman's financial records, including audit documentation maintained by Coleman's independent certified public accountants. We interviewed Coleman officials and staff to obtain an understanding of their financial and business practices as well as those of Coleman's certified public accountants. In addition, we interviewed SED officials to obtain an understanding of both the CFR and the policies and procedures contained in the Manual. To complete our audit work, we reviewed supporting documentation for costs submitted for the three programs in our audit scope and determined whether the costs complied with the provisions of the Manual. To complete our audit work, we selected a judgmental sample of costs reported by Coleman for review. Our sample took into account the relative materiality and risk of the various costs reported by Coleman. The scope of audit work on internal control focused on gaining an understanding of the procurement and disbursement procedures related to other-than-personal-service and personal service expenditures. We identified certain significant control deficiencies that were significant to the audit's objectives. These are discussed in the appropriate sections of our audit report.

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

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

Authority

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

Reporting Requirements

We provided draft copies of this report to Coleman and SED officials for their review and formal comment. We considered the comments of Coleman and SED in preparing this report and have included them at the end of it. Our rejoinders to Coleman's comments are included in the State Comptroller's Comments at the end of this report. Also, in its response to our draft report, Coleman submitted multiple attachments which we have not appended to the final report. We will, however, retain those attachments on file at the Office of the State Comptroller.

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

Contributors to This Report

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Vision

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

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

Exhibit

John A. Coleman School
Schedule of Submitted, Disallowed, and Allowed Program Costs
Fiscal Years 2008-09, 2009-10 and 2010-11

Program Costs	Amount Per CFR	Amount Disallowed	Amount Allowed	Notes to Exhibit
Personal Services				
Direct Care	$21,436,622	$506,524	$20,930,098	
Administrative	$2,183,642	$6,259	$2,177,383	
Total Personal Services	$23,620,264	$512,783	$23,107,481	A,B,C,D
Other-Than-Personal-Services				
Direct Care	$2,872,674	$0	$2,872,674	
Administrative	$837,689	$126,555	$711,134	
Total Other-Than-Personal Services	$3,710,363	$126,555	$3,583,808	E
Total Program Costs	**$27,330,627**	**$639,338**	**$26,691,289**	

Notes to Exhibit

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

A. Section II. Cost Principles - Costs must be reasonable, necessary, program-related and sufficiently documented.
B. Section I.10 - A cost is reasonable if, in nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost.
C. Section II.14.A10 - Bonus compensation shall mean a non-recurring and non-accumulating (i.e., not included in base salary of subsequent years) lump sum payment(s) in excess of regularly scheduled salary which is not directly related to hours worked. Bonus compensation may be reimbursed if based on merit as measured and supported by employee performance evaluations.
D. Section II.46.B - The cost of severance pay is reimbursable provided that the cost does not exceed two weeks' pay for a full-time employee.
E. Section II.28.B, C4 - Interest expense on capital indebtedness is reimbursable only when there is a corresponding amortization of principal on the capital indebtedness. Payments, which represent "interest only," are not reimbursable.

Agency Comments - State Education Department

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

DEPUTY COMMISSIONER
Office of Performance Improvement and Management Services
O: 518.473-4706
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March 20, 2013

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

Dear Mr. Mason:

The following is the New York State Education Department's (Department) response to the draft audit report (2012-S-16) of the State Education Department John A. Coleman (Coleman) School: Compliance with the Reimbursable Cost Manual.

Recommendation 1:

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

We agree with this recommendation. The Department will review and make adjustments to the CFRs as noted in the report and recover any overpayments as appropriate by recalculating tuition rates. To do this, the Department will require additional documentation from Office of the State Comptroller (OSC) that provides a detail breakout of the disallowances by year and program. We will also review and consider additional information Coleman may submit in response to this report.

Recommendation 2:

Direct Coleman officials to fully comply with the provisions in the Manual and ensure that only eligible costs are included on the CFR.

We agree with this recommendation. The Department will continue to provide technical assistance whenever requested and will strongly recommend Coleman officials take advantage of our availability to help them better understand the standards for reimbursement as presented in the Regulation and the Reimbursable Cost Manual (RCM).

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

Sincerely,

Sharon Cates-Williams

Sharon Cates-Williams

c: Commissioner King
Beth Berlin
James Delorenzo
Suzanne Bolling
Joseph Conroy
James Conway
Mary Kogelman
Ann Marsh

Agency Comments - John A. Coleman School

John A. Coleman School

March 25, 2013

VIA E-MAIL

Brian Mason
Audit Director
Office of the State Comptroller
State of New York
123 William Street – 21st Floor
New York, New York 10038-3804

Re: John A. Coleman School
OSC Audit Report #2012-S-16

Dear Mr. Mason:

I am writing on behalf of the John A. Coleman School (the "Coleman School" or the "School") in response to the Draft Report (the "Report") received on February 15, 2013, issued by the Office of the State Comptroller ("OSC"), containing its proposed audit findings of the Coleman School's reported Personal Service Costs ("PSC") and Other Than Personal Service Costs ("OTPS Costs"). We acknowledge and thank you for granting us additional time to respond to the Report until Monday, March 25, 2013.

I. Overview of the School's Response

As discussed more fully below, the School agrees with some of the audit findings in the Report, but maintains that several of the proposed disallowances should be eliminated. With the additional time given to respond to the Report, the Coleman School has been able to locate additional documentation showing that certain costs proposed for disallowance were properly documented and are allowable.[1] First, the School's personnel records show that the "differential" bonuses being disallowed for lack of documented performance evaluation were in fact paid to Coleman School employees on the basis of their successful performance during the School's over-enrollment, and bonuses were denied to employees who were disciplined for unsatisfactory performance.

* Comment 1

[1] The School submitted much of this documentation to OSC earlier this month, under cover letters dated March 15, 2013 and March 20, 2013 respectively. Because many of the documents are personnel records with personal identifying information, we have not attached all of the documentation to this submission and instead have attached selected documents, for ease of reference.

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* See State Comptroller's Comments, Page 26.

Brian Mason
March 25, 2013

Second, the 17 therapists misclassified as "contract employees" on the School's 2008-09 Consolidated Fiscal Report ("CFR") were employed jointly by the Coleman School pursuant to a shared service agreement with the School's related entity, the Elizabeth Seton Pediatric Center. Although nominally employed by the Pediatric Center, the therapists worked at the Coleman School; were at all times under the immediate supervision and direction of the Coleman School principal and other managerial staff; and depended solely upon the School for continued employment. For these reasons, the bonuses paid to the therapists should be recognized no differently than those paid to other Coleman School employees.

* Comment 2

Third, the School followed Generally Accepted Accounting Principles ("GAAP") in reversing on its 2011-12 CFR, the bonuses that had been accrued in the prior 2010-11 School Year but were not paid to employees who left the School's employ or who performed unsatisfactorily. GAAP applies as well to the reporting of costs on the CFR in this instance.

* Comment 3

Fourth, with respect to the interest expense on the School's working capital loan, we have supplied the loan documentation along with other School financial records demonstrating that the working capital loan was not an "interest only" loan but was subject to repayment of both principal and interest, on demand, and in fact has been partially repaid and continues to be repaid by the School going forward. Moreover, we have furnished copies of correspondence and emails exchanged with the State Education Department ("SED") evidencing that the SED was fully aware of the working capital loan from the New York Foundling Charitable Corporation in all of the audited years.

* Comment 4

Simply put, without the Charitable Corporation working capital loan, along with the intervention and support of the State Education Department ("SED") (detailed later), the Coleman School would not have survived beyond its fourth year of operation, in 2008. Instead, the School would have suffered the fate of the prior three not-for-profit operators of the school and shuttered operation. The casualties of closing the School, averted by the working capital loan and SED aid, would have been the hundreds of profoundly disabled and needy children that the School has taught and served since.

II. John A. Coleman School

The Coleman School is a non-public, not-for-profit education corporation approved by SED to provide special educational services to children. The Coleman School's sponsor is the Sisters of Charity of St. Vincent de Paul of New York, certain of whose members are the sole governing members of the School. The School operated at two sites: one in New York City and the other in White Plains. The School's New York City campus provides services to approximately 135 children age birth to 21 in their early intervention, preschool and school age classrooms. The School's White Plains campus provides a continuum of services to children with disabilities from birth to 21 years of age. This center-based program offers early intervention, preschool, preschool integrated and school age classes to approximately 130 children and provides facility and home / community-based services, including Early

* See State Comptroller's Comments, Page 26.

Brian Mason
March 25, 2013

Intervention, Special Education Itinerant Teacher (SEIT), Related Services Only (RSO) and multidisciplinary evaluations.

During the years under review by the Office of the State Comptroller, the Coleman School served 1,617 children in SY 2009; 1,390 in SY 2010; and 1,561 in SY 2011 through its various educational models.

The School's mission is to ensure that "... all children participate in exceptional educational programs that engage their unique abilities by adapting the learning environment and providing opportunities for creative expression and spiritual growth."

The Coleman School is Not Comparable to Other Freestanding Schools. What makes the Coleman School unique among special education schools is the fact that the majority of its students, in addition to having orthopedic, cognitive and language impairments have complex medical needs that require daily medical attention and nursing care. Our student profile represents approximately 3% of special education students nationwide. As a result of the greater challenges to serving exceptionally medically compromised students, the School's operations and associated costs cannot be fairly compared with "free standing" schools.

New York City Program: All of the students receiving educational services in the New York City program reside at the Elizabeth Seton Pediatric Center, a separately incorporated not-for-profit pediatric skilled nursing facility.[2] The children are not medically or physically able to attend school in the community and must receive educational services in the residential health care facility, where the School is located.

The children in the New York City program have complex medical diagnoses, including metabolic and respiratory disorders, genetic syndromes, neurological diseases, traumatic brain injuries, cerebral palsy, congenital heart disease, spina bifida, paraplegia, spinal muscular atrophy, failure to thrive, and diverse complications due to prematurity. More than 45% of the children have tracheostomies that require constant monitoring and suctioning, and approximately 25% require continuous oxygen while 8 children are ventilator-dependent. All classrooms are equipped with oxygen, suction machines and supplies that are used by our registered nurses to provide respiratory care, tracheal suctioning, oxygen administration and other procedures. Many of the children are also diagnosed with and medicated for seizure disorders; the school nurses monitor these children for the seizures and provide necessary intervention and treatment. Furthermore, many children are unable to eat food by mouth and receive enteral feedings to provide daily nutrition and hydration.

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[2] Members of the Sisters of Charity are also members of the Elizabeth Seton Pediatric Center. The Coleman School and the Pediatric Center each have a separate board of trustees and are not a parent or subsidiary of each other. The School's New York City Campus, along with the Pediatric Center, relocated to a new facility in Yonkers last year.

Brian Mason
March 25, 2013

White Plains Program: The School's program in White Plains offers special education programs to children who reside in the surrounding communities of Westchester, Putnam and the Bronx. They are referred to Coleman School from over 25 school districts because of the expertise and reputation of the School in providing services to children with orthopedic and complex medical needs. Over one-third of the students are also outpatients of another affiliated entity, the Children's Rehabilitation Center ("CRC"), a separately incorporated licensed diagnostic and treatment center located on the same site. CRC is also sponsored by the Sisters of Charity and has a separate board of trustees from the School and the Pediatric Center.

Coleman School students at both campuses receive a high frequency of related services, including occupational, physical and speech therapies, vision services, psychological counseling, family support and skilled nursing services in accordance with their Individualized Educational Program (IEP). Due to the compromised medical conditions and severe cognitive and motor delays of the children, most utilize adapted strollers or wheelchairs as their primary means of mobility and specialized adapted equipment to allow them to fully participate in educational activities. Approximately 20% of the students receive psychological counseling services from the school psychologists to address the social-emotional and behavioral issues they experience due to their multiple disabilities.

Equally vital to the School's success, especially in New York City, is its ability to recruit and retain qualified staff able to thrive professionally in a challenging work environment and ensure compliance in meeting the special educational needs of students with profound medical impairments and disabilities. Special education teachers, teacher assistants and aides, physical therapists, occupational therapists, and speech/language pathologists are especially difficult to recruit and retain. The School must successfully compete with, not only public and private educational providers, but also health care providers, to attract and retain the most highly trained professionals with specialized pediatric experience.

Compensation Policy: Our compensation policy plays a vital role in the recruitment, retention and motivation of the School's employees. To that end, in addition to offering competitive salaries, the School has paid bonuses to deserving employees at the end of the School Year. One form of bonus is denominated as "performance-based", which is based on aspects of an employee's performance specific to that individual. Another form of bonus has been described as a "differential" bonus. The differential bonus, however, is also merit-based in that it is designed to reward deserving employees for extraordinary performance during periods of the School's growth and over-enrollment, when the demands made of our staff are much greater.

Regardless of how a bonus is labeled, bonuses are not paid to employees who have either left the School's employ at the time the bonus is paid or were subject to disciplinary action for unsatisfactory performance.

Brian Mason
March 25, 2013

Disciplinary Policy: Indeed, the School's bonus compensation – whether "performance-based" or a "differential" – is inextricably linked with its standards of employee performance and disciplinary policy. The School maintains a Code of Conduct to which School employees are required to adhere. Any infraction committed by an employee in performing his/her job responsibilities is subject to disciplinary action, up to and including termination, pursuant to the School's Policy and Procedure ("Employee Discipline"). (Copies attached.) If during the School Year, an employee's performance does not meet standards, such as quality of care, the School will initiate progressive discipline, which can include counseling the employee on goals and objectives for remediating the unsatisfactory performance. Any employee placed on performance goals and objectives or other disciplinary action is ineligible for a bonus.

Effective Policies and Practices: The School's investment in its staff, including its compensation practices, has benefitted the children it serves, as recognized by the National Association of Special Education Teachers ("NASET"). In each of the school years under audit, the School was recognized by NASET as a School of Excellence. To my knowledge, we are one of only 11 other special education programs in New York State that have been awarded this distinction.

The following is the Coleman School's specific responses along with supplemental documentation and information supporting the allowability of the costs cited in the Report. The discussion below corresponds with the sections of the Report:

III. PSC—Bonuses "Differentials" $384,500 (School Years 2008-09 and 2009-10)

A. Additional Performance Reviews for 13 Teachers and 4 Therapists: $91,210 in SY 2008-09

The Coleman School was able to locate and furnished OSC earlier this month the formal performance evaluations for 13 teachers and 4 therapists who received differential bonuses in School Year 2008-09. To the extent that the disallowance was based on a lack of a performance evaluation in the personnel file, this documentation effectively moots the proposed disallowance.

* Comment 5

B. 27 Teachers: $232,140; 31 Teacher Aides: $73,833; and 17 Therapists: $78,549 in School Year ("SY") 2008-09

The Coleman School determined to pay a differential bonus to its teachers, teacher aides and therapists in the 2008-09 School Year in light of increased responsibility borne by the staff due to student over-enrollment in the School that year and in order to retain these important professionals. The differential bonus was specifically designed to reward deserving employees for assuming the additional responsibilities and for successfully performing by meeting the

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* See State Comptroller's Comments, Page 26.

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increased demands and pressures of a larger class size.[3] At the same time, the School determined that including the amount of the differential bonus in the base salary was inappropriate and imprudent because it was uncertain whether the high levels of enrollment experienced during the 2008-09 School Year would be sustained in subsequent years.

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Comments
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The differential-bonus compensation proved highly effective: the retention rate for the teachers receiving the additional pay in SY 2008-09 was 81.5% as of June 30, 2011, a vast improvement and a significant savings to the School's ongoing recruitment expenses otherwise reimbursed by the State. The differential bonus payments likewise contributed to improved retention of teacher aides: 93.5% of the 31 teacher aides and assistants remained employed through the end of the audit period.

On the other hand, consistent with the School's Code of Conduct and disciplinary policies, 4 teachers and therapists did not receive either a differential bonus or an individual performance-based bonus due to unresolved disciplinary action in School Year 2008-09. Critically, only employees whose performance merited a differential bonus (or for that matter a performance-based bonus) actually received a bonus.

C. 17 Therapists: $78,549 in SY 2008-09

At the outset, we wish to clarify an issue concerning the School's personnel policy discussed in the Report. The Report correctly notes that the Coleman School's therapists work with students with severe disabilities. Contrary to the Report, however, the School does not believe that our therapists should be exempt from performance reviews. As noted above, the School does not exempt any of its staff from the requirement that they perform satisfactorily in order to receive a bonus and that they be denied a bonus for unsatisfactory performance evidenced by any unresolved disciplinary action in the School Year. We also concur with the statement in the Report that management should actively monitor and evaluate the performance of all personnel, including, and especially, those who work closely with special needs children.

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Comment
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The Report also proposes to disallow the School's cost for 17 therapists who were misclassified on the School's CFR as "contract personnel".[4] As a technical matter, we note that the provision in the SED Reimbursable Cost Manual relied on in the Report did not impose the bar on bonuses to contracted personnel until the 2010-11 School Year and should not be retroactively applied to the 2008-09 period. In any event, although nominally employed by the Pediatric Center, the therapists in fact provided services almost exclusively at the

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[3] The School paid a higher differential bonus to the teachers in the New York City school because the school age students enrolled in the New York City program have more unique educational and rehabilitation needs and the School had experienced greater difficulties in recruiting and retaining qualified staff at this site.

[4] The School is prepared to correct the CFR if necessary.

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Coleman School pursuant to a shared service agreement with the Pediatric Center. The Pediatric Center operated the nursing home in New York City where the School provided educational and related services in the same building that served as the home of the Pediatric Center's residents. The therapists were given the opportunity to transfer from the Pediatric Center to the School because of the challenges faced by the School in recruiting qualified professionals with the requisite prior experience working with disabled children. Upon transfer, however, the therapists were required to, and did, devote all of their working hours to the School, and were under the direct supervision and control of the School's principal and other management staff.[5]

Disallowing the cost for the 17 therapists as "contract personnel" is inconsistent with federal labor laws which recognize those therapists to be jointly employed by the Coleman School employees and, thus, are afforded all of the same rights and protections as all other School employees. The disallowance also is inconsistent with the reality as documented in the attached personnel files. Practically speaking, the therapists are employed only by the School, provide services almost exclusively to the School, and have no duties or responsibilities to the Pediatric Center. Indeed, their continued employment depends upon their continued satisfactory service to the School.

* Comments 2,9

IV. <u>PSC—Performance-Based Compensation $140,512 (School Year 2010-11)</u>

The Report proposes to disallow $140,512 in School Year 2010-11 for performance-based bonuses that were accrued as of June 30, 2011, but were ultimately not paid because the employees had left the employ of the School before the date the bonuses were paid. The Report asserts that the Coleman School should have reversed these accruals on the 2010-11 CFR (the year in which the bonuses were initially accrued and claimed), instead of reversing them in the subsequent year when it was determined that the employees were no longer employed. The reversals, however, were consistent with sound accounting practices as well as the cost reporting principles in the CFR and the Reimbursable Cost Manual ("RCM") promulgated by SED.

First, the CFR is supposed to be prepared based on the revenue and expenses that are reported on the audited financial statements in accordance with the Generally Accepted Accounting Principles ("GAAP"). The only exception to this requirement would be when there is a specific cost reporting rule in the CFR or RCM to the contrary. Since there is no requirement in either the CFR or RCM Manuals warranting an exception to GAAP in this instance, the CFR should mirror the recording of the bonuses on the School's financial statements.

* Comment 3

5 Among the transferred employees were the four therapists who transferred in the 2008-09 School Year. Prior to their change in employment status, these four therapists were formally reviewed and determined to be qualified for transfer, with a satisfactory work record and no unresolved disciplinary action, in accordance with School policy. (See attached transfer policy.) Those four therapists are also referenced in Section IIIA earlier.

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At the time of the audit of the School's financial statements, most of the staff for whom the bonuses had been accrued were still in the employ of the Coleman School. Therefore, those financial statements and the CFR which was based on it appropriately included these amounts. We note also that at the time of the preparation of the CFR two months later, almost half of the individuals who were to receive the bonuses were still in the employ of the School. At that juncture, the School had no ability to re-audit all of the figures on the financial statements when preparing the CFR.

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Comments
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More fundamentally, the correct accounting and reporting for this transaction under GAAP is to reverse the accrued unpaid compensation in the subsequent fiscal year (2011-12), not to revise and reissue the financial statements for the prior year (2010-11). Financial Accounting Standards Board ("FASB") Codification Standards Section 250-10-45-17 clearly states that a change in an accounting estimate shall be accounted for in the period of change. It further states that a change in an accounting estimate shall not be accounted for by restating or retrospectively adjusting the amounts reported in the financial statements of prior periods. A change in accounting estimate is defined by FASB's Master Glossary in the Codification Standards as a change that affects the carrying amount of an existing liability based on ***new information*** that comes to light. The fact that employees resigned after the year-end financial statements were issued would clearly qualify as ***new information***. Therefore, the audit finding, which would require the restatement and re-issuance of the 2010-11 CFR, would be inconsistent with GAAP and contrary to CFR reporting requirements. For these reasons, this finding should be removed from the Report.

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Comments
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V. <u>PSC—Sign-On Bonuses to Therapists: $23,230 (School Years 2009-10 and 2010-11)</u>

The Report states that a portion of the sign-on bonuses paid to 21 therapists in School Years 2009-10 and 2010-11 are not allowable because they are not based on merit. We acknowledge that the RCM does not expressly recognize sign-on bonuses unrelated to merit or performance. Nevertheless, the School submits that the bonuses were reasonable and appropriate in all respects.

The sign-on bonuses were offered as part of the School's efforts to recruit highly qualified pediatric clinicians with the requisite skill set to work with multiply disabled children with complex medical needs. To reiterate, the School faces stiff competition for clinicians throughout New York City and surrounding counties, not only from schools within the New York City Department of Education but also with private special education schools as well as specialty hospitals and rehabilitation centers. To our knowledge, these other prospective employers utilize sign-on bonuses as a recruitment tool, necessitating the School's use of sign-on bonuses to remain competitive.

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VI. PSC—Severance Pay: $5,611 for Employee Severance Pay in School Year 2009-2010

The Report has proposed to disallow the amount of the $7,500 severance pay that exceeds two weeks' pay for a full-time employee in accordance with the Manual. The School does not contest this proposed disallowance.

VII. OTPS Costs—Loan Interest: $126,555 in School Years 2008-2009, 2009-2010, and 2010-2011

The Report proposes to disallow, in full, all of the interest paid by the School pursuant to the terms of the $1.5 million loan with the New York Foundling Charitable Corporation, a related entity, on the grounds that (i) the interest expense is "less than arm's length" ("LTAL") and had not been approved by SED in advance and (ii) the loan is an "interest-only" loan.

We take exception to the Report's findings that the interest expense from the School's working capital line of credit should be disallowed on those bases.

Ground One: LTAL Loan. By way of background, in April 2005, the School's Chief Financial Officer prepared an analysis of the options for obtaining a working capital line of credit needed for the startup of the operation of the Coleman School. Three banks provided proposals: JP Morgan Chase, Atlantic Bank and the Allied Irish Bank. The JP Morgan Chase and the Atlantic Bank required collateral requirements that the Coleman School could not meet. The Allied Irish Bank did not impose the same requirements, but did require the New York Foundling Charitable Corporation to guarantee the loan. Accordingly, the Charitable Corporation allocated $1.5 million of its existing line of credit, and the Allied Irish Bank was directed to transfer that amount to the Coleman School. (See attached.)

As the Coleman School had no history or assets to secure credit, Allied Irish still required the Charitable Corporation to directly draw on the line itself instead of the bank loaning Coleman the money directly. As a result, a revolving loan agreement had to be entered into between the Coleman School and the Charitable Corporation. Under the terms of the revolving loan note between the Charitable Corporation and Coleman School, the School was charged interest at the same rate as Charitable Corporation's rate with the bank: 1% above prime. Significantly, there was no markup in the interest paid by the School to the Charitable Corporation. Thus, the School paid directly to the party lender, Allied Irish, the interest due on the School's share of the loan, and at the same rate, and no more. (See attached copies of loan documentation.)

* Comment 13

Subsequent to this initial transaction, in February 2009, the Charitable Corporation had to retire the Allied Irish line of credit as part of obtaining a mortgage from the New York City Construction Authority associated with the sale of its building in New York City. However, this refinancing did not change the nature of the transaction: the Coleman School continued to be responsible to pay the interest on its share of the mortgage at the mortgage's stated interest rate of 3.5%. That is, the working capital loan of $1.5 million to the Coleman School was now

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payable directly to the Charitable Corporation, but again, at the same interest rate that the Charitable Corporation pays its third party lender: 3.5%.

Even if the loan could be fairly characterized as an "LTAL" transaction (as noted above, that view is inaccurate), a disallowance for lack of SED advance approval would be improper. The School has located and has produced a series of emails and correspondence exchanged with SED (copies attached) evidencing that subsequent to the issuance of the working capital loan, and as early as January 2008 (prior to the audited years) if not earlier, SED was made aware of the School's relationship to the Charitable Corporation and of the loan issued by the Charitable Corporation to the School. That information was especially critical to share with SED in 2008 because at the time, the School was asking SED to expedite reimbursement relief for the School's start-up costs. The School specifically referenced the working capital loan as a significant cost that the School had to incur due to delays in obtaining final reconciliation rates during the start-up period. Despite such knowledge, the SED did not act to disapprove the loan or associated interest.

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Comments
4, 14

What is more, the School reported the $1.5 million loan on its financial reports accompanying the CFR that was submitted to SED each year through the audited period. (Example copy attached.)

As such, it appears that SED was made aware of the School's borrowing from the Charitable Corporation at least during all of the audited school years.

Ground Two: Interest-Only Loan. The loan documentation together with the School's financial records establishes that the revolving loan note is not an "interest only" loan. This loan is a demand note – typical for working capital loans – with the principal due and payable upon demand by the bank or lender; payments to reduce the outstanding line are made when there is sufficient cash flow to enable the organization to do so. In other words, working capital loan, by its very nature, is typically not subject to repayment of principal on a fixed amortization schedule, and borrowers will often pay interest only for periods of time, while remaining fully liable for principal. The fact that only interest may be paid in a given year does not convert the loan into an "interest only" loan so long as the lender expects, and the borrower remains liable, for repayment in full of both principal and interest. Although the RCM refers to "corresponding" payments of principal in connection with working capital loans, it does not mandate simultaneous or fixed principal payments. Indeed, the latter interpretation could not be reconciled with the fact that the RCM expressly recognizes the allowability of working capital loans, which as noted above, by their nature, do not call for simultaneous or fixed repayment of principal amounts.

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Comments
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In fact, the School did remain liable under the terms of the loan agreement for repayment of the entire principal as the School's certified financial statements reflect the full $1.5 million as a liability. However, because of the cash flow needs during the School's startup period and the inadequate initial tuition rates promulgated by SED, along with the subsequent takeover of the

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struggling diagnostic and treatment center in White Plains in 2006, the School's cash flow had been insufficient to pay down the loan balance until recently. Beginning in July 2011 – before this audit commenced – the School did start making monthly principal payments of $15,000 on the line of credit and continues to make payments.

* Comment 15

In other words, the School's working capital loan operated precisely as expected, meeting the School's needs for cash during its start-up phase and deferring repayment of principal until it achieved financial stability.

Finally, even assuming the School were required to repay some principal each and every year regardless of financial circumstances (we strongly disagree with that position), the disallowance of <u>all</u> interest expense would be improper. Rather, any disallowance would have to be limited to that portion of the interest payment that should have been allocated to principal.

* Comment 14

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After three prior failed attempts to operate the school by well-intentioned, nonprofit health care providers, the Coleman School was able to make a success of it – in no small measure due to SED's collaboration with us in establishing and finalizing reconciliation rates sufficient to hire and retain the professional and paraprofessional staff required to address the educational needs of the medically compromised children. Part and parcel to this success story as well is the School's compensation incentives, including bonuses, along with the working capital loan issued by the Charitable Corporation at the very moment when the Coleman School's future hung in the balance. We believe that this historical context is important to bear in mind as you consider whether to recommend taking back dollars that have been applied to the School's operation.

Of course, if you have any questions or request further information, please do not hesitate to contact me.

Very truly yours,

Patricia A. Tursi

Patricia A. Tursi
President and Chief Executive Officer

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1. In fact, several recipients of differential bonuses were not Coleman employees. They were employees of Elizabeth Seton Pediatric Center (Pediatric Center). Further, as detailed in our report, Coleman officials had not prepared formal performance evaluations for certain bonus recipients. The Manual requires providers to justify bonuses with formal performance evaluations.
2. We concluded that Coleman had not "misclassified" the therapists in question as contract employees. Pertinent records, including IRS W-2 forms, clearly indicated that the therapists were employed by the Pediatric Center. As Coleman officials note in their response, Coleman and the Pediatric Center have separate boards of trustees and are not a parent or subsidiary of each other. Bonus payments to non-employees are not reimbursable.
3. Providers must comply with the Manual as well as Generally Accepted Accounting Procedures (GAAP). As detailed in our report, Coleman had not incurred the costs in question by the time officials submitted the school's CFR for the 2010-11 year. Only actual costs, supported by adequate documentation, are eligible for reimbursement.
4. Our report does not state that the loan was an "interest only loan." Rather, it states that Coleman's payments were for "interest only." The Manual requires debt service payments to include loan principal to be eligible for reimbursement. Further, the correspondence with SED occurred after the loan was initiated, and SED officials advised us that they did not pre-approve the loan or any provision for "interest only" loan payments.
5. In light of Coleman's response, we visited the school and reviewed the additional performance evaluations made available by Coleman officials. For certain employees, we accepted the evaluations and reduced the amounts of the proposed disallowances accordingly. For certain other employees, the evaluations were not prepared contemporaneously with the time periods in question, and consequently, we maintained the disallowances of the differential bonuses paid to those employees.
6. For the differential bonuses in question, Coleman was unable to provide formal performance evaluations, as otherwise required by the Manual and detailed in our report.
7. We deleted from our report comments regarding the exemption of therapists from performance reviews.
8. The changes SED made to the Manual for the 2010-11 fiscal year simply clarified existing policy. The Manual has never provided for bonus compensation of contract personnel.
9. Coleman officials did not identify the specific federal labor laws (or their applicable provisions) that would apply in this circumstance.
10. Coleman submitted its CFR for the 2010-11 fiscal year to SED in December 2011 (more than five months after the end of the fiscal year.) In their response, Coleman officials state that bonuses are not paid to employees who have left the school. Moreover, Coleman officials acknowledge that less than half of the employee's in question were still employed by the school at the time the CFR was prepared. Consequently, Coleman officials were aware that large portions of accrued bonus costs (particularly those attributable to former employees) had not been and would not be paid. Also, with regard to accrued bonus costs, officials would not have had to re-audit all financial statement figures. A review limited to accrued bonus costs would have sufficed.

11. There should not have been a need to restate or re-issue the CFR for the 2010-11 year. As noted previously, Coleman officials knew that less than half of the employees in question were still employed by the school at the time the CFR was prepared. Consequently, officials were aware that many accrued bonuses had not been and would not be paid, and therefore, Coleman should not have claimed costs for those bonuses on the CFR.
12. The Manual neither expressly nor implicitly recognizes sign-on bonuses. As detailed in our report, the Manual requires all bonuses to be merit-based and supported by employee performance evaluations. Because sign-on bonuses are not merit-based or supported by performance evaluations, they are ineligible for reimbursement.
13. With regard to the loan in question, we deleted references to a less-than-arms-length (LTAL) relationship from our report.
14. The Manual's provisions apply to working capital loans as well as other forms of loans. As noted previously, the Manual does not allow "interest only" payments. Coleman did not pay any principal on the loan in question before or during the period of our audit.
15. This payment was subsequent to the period of our audit.