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 Functional MDS

Report 2014-S-1

December 2014

Executive Summary

Purpose

To determine whether the costs reported by Functional MDS on its Consolidated Fiscal Reports (CFRs) were properly calculated, adequately documented, program-related, and allowable pursuant to the State Education Department's (SED) Reimbursable Cost Manual (Manual). Our audit included all expenses claimed for the fiscal year ended June 30, 2011.

Background

Functional MDS (MDS) provided special education itinerant teacher services and integrated therapeutic preschool special education programs (collectively referred to as Programs) for about 190 disabled children between the ages of three and five who live in Queens, Brooklyn, Manhattan, and the Bronx. MDS's Programs are funded by the New York City Department of Education (DoE), which refers students to MDS. The DoE reimburses MDS using rates established by SED that are based on the financial information reported on MDS's annual CFRs. To qualify for reimbursement, provider costs must comply with the Manual, which provides guidance to special education providers on cost eligibility and documentation requirements. For the fiscal year ended June 30, 2011, MDS claimed approximately $3.5 million in reimbursable costs. According to SED officials, MDS ceased providing SED-funded special education programs as of September 2014.

Key Findings

For the fiscal year ended June 30, 2011, we identified $794,219 in reported costs that do not comply with Manual requirements for reimbursement. These costs include $685,032 in personal service costs and $109,187 in other than personal service costs. The disallowances include:

- $198,888 in executive compensation and $62,866 in compensation to agency administrative support employees that were improperly allocated to the Programs;
- $373,200 in compensation to personnel who did not work for the Programs;
- $31,780 for an independent consultant who provided services to an affiliated entity and not the Programs; and
- $31,478 for contracted direct care purportedly provided by six independent contractors that was not supported by documentation.

Key Recommendations

To SED:

- Review the recommended disallowances resulting from this audit and make the appropriate adjustments to MDS's CFRs and reimbursement rates as appropriate.
- Recover the disallowances identified in this report, as appropriate.

To MDS:

- Ensure that costs reported on MDS's annual CFRs comply with Manual requirements.

Other Related Audits/Reports of Interest

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

State of New York
Office of the State Comptroller

Division of State Government Accountability

December 31, 2014

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Commissioner
State Education Department
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89 Washington Avenue
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Ms. Marian Sheng
Executive Director
Functional MDS, PLLC
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Dear Dr. King and Ms. Sheng:

The Office of the State Comptroller is committed to helping State agencies, public authorities, and local government agencies manage government resources efficiently and effectively. By so doing, it provides 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 expenses submitted by Functional MDS to the State Education Department for purposes of establishing the preschool special education tuition reimbursement rates used to bill public funding sources that are supported by State aid payments entitled *Compliance With the Reimbursable Cost Manual: Functional MDS*. 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.

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

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

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Background

Functional MDS (MDS) is a family-owned, for-profit organization that provided Special Education Itinerant Teacher (SEIT) services and integrated therapeutic preschool special education programs (collectively referred to as Programs) for about 190 disabled children between the ages of three and five who live in Queens, Brooklyn, Manhattan, and the Bronx. MDS shares services, building space, and teaching and administrative staff with a not-for-profit entity, Functional Life Achievement, owned by the same family that owns MDS. Functional Life Achievement provides Early Intervention services.

The New York City Department of Education (DoE) refers students to MDS and pays for these services using rates established by the New York State Education Department (SED). The rates are based on the financial information that MDS reports to SED on its annual Consolidated Fiscal Reports (CFRs). To qualify for reimbursement, provider costs must comply with SED's Reimbursable Cost Manual (Manual), which provides guidance to special education providers on the eligibility of reimbursable costs and the documentation necessary to support those costs. Reimbursable costs must be reasonable, program-appropriate, and properly documented.

The Manual also sets forth acceptable methodologies for providers to use when calculating and allocating indirect costs (e.g., utilities) and costs allocable to multiple programs. SED reimburses the DoE and other localities for a portion of their payments to MDS based on statutory rates.

For the fiscal year ended June 30, 2011, MDS claimed approximately $3.5 million in reimbursable costs. According to SED officials, MDS ceased providing SED-funded special education programs as of September 2014.

Audit Findings and Recommendations

For the fiscal year ended June 30, 2011, we identified a total of $794,219 in reported costs that did not comply with Manual requirements for reimbursement. These costs included $685,032 in personal service costs and $109,187 in other than personal service costs. (See Exhibit on page 11 of this report.)

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 the provider's CFR as either direct care costs (e.g., teachers' salaries) or non-direct care costs (e.g., administrators' salaries). The hours worked by individuals whose salaries are charged to the Programs must be supported by an official time and attendance record or similar documentation of the employees' work efforts. This is especially important when a provider operates multiple programs with different funding sources and staff may work on more than one program or with an affiliated entity.

The Manual further stipulates that the salaries of employees, including administrative or executive personnel, who perform tasks for more than one program or entity must be allocated across all programs and entities for which they work, based on a fair and reasonable allocation method. Such allocation method, as well as the statistical basis used to calculate allocation percentages, must be documented.

Excessive Allocations of Executive Salaries

We found that MDS's Chief Financial Officer (CFO) and Executive Director (ED), a husband-wife team, also served as CFO and ED for Functional Life Achievement. According to MDS's CFR, 68 percent of their executive compensation (totaling $329,901) was charged to the Programs. Since neither MDS nor Functional Life Achievement maintained time records to support the executives' work effort between the two entities, we recalculated the portion of their compensation that should have been charged to the Programs based on the ratio value method (i.e., the expenses of Functional MDS as a percentage of the total of the two schools' expenses). We determined that only $131,013 of the two executives' compensation should have been charged to the Programs. Therefore, we recommend SED disallow $198,888 in executive salaries and fringe benefits inappropriately charged to the Programs.

Questionable Employee/Consultant Expenses

MDS incorrectly reported $480,707 in compensation for some administrative employees and independent consultants on its CFR for fiscal 2010-11, as follows:

- MDS charged a total of $90,898 in compensation for some administrative (non-direct care) personnel (who worked in the main office shared by MDS and Functional Life

Achievement) as direct care costs rather than non-direct care expenses. In addition, MDS officials did not provide documentation showing how much time these employees spent on each program. Using the ratio value method, we determined that only $28,032 should have been charged to MDS's administrative costs and recommend that SED disallow the difference of $62,866 ($90,898 - $28,032).
- MDS charged the compensation of 11 employees, totaling $373,200, to the Programs; however, there was no evidence that they worked for the Programs.
- MDS charged payments of $31,780 to an independent consultant under personal services. Because the consultant was not an employee of MDS, there were no MDS payroll-related records for her. Instead, MDS officials provided us with an Internal Revenue Service Form 1099 (which reports non-employee compensation for income-tax purposes) issued to the consultant by an affiliated entity, Functional Life Achievement. MDS was not able to provide evidence that she provided any services to the Programs.
- A portion of the compensation paid to an MDS employee, who also worked as an independent consultant reportedly providing evaluation services to MDS clients, was inappropriately charged to the Programs. We recommend that SED disallow the $12,861 that was improperly charged to the Programs.

Person Not Employed by MDS

In addition, MDS charged the Programs $5,437 for someone who was not an employee of MDS. The supporting documentation provided by MDS indicated that this person worked 438.5 hours as a Supervisor and was charged as direct care to the title code for Special Education Teacher. However, there were no payroll records, W-2s, or personnel folder available for this person. Further, this person stated that he was never employed by MDS or its other entities, and he never supervised teachers. We recommend that SED disallow $5,437 ($4,714 salary plus $723 in fringe benefits) charged to personal services for this person.

Other Than Personal Service Costs

The Manual states that other than personal service (OTPS) costs must be reasonable, necessary, program-appropriate, and supported by documents, such as purchase orders, receiving reports, and invoices. We identified $109,187 of OTPS charges that did not meet the Manual's requirements.

Unsupported and/or Inappropriate Expenses

We found the following expenses that were either unsupported by appropriate documentation or ineligible for reimbursement:

- $31,478 for contracted direct care by six independent contractors who purportedly provided speech, physical, and occupational therapy to students. The Manual requires that such costs be supported by itemized invoices showing the specific services provided, the hourly fee, and the total amount charged. MDS officials said that the session notes in the students' folders supported these charges, but we found that the documentation was insufficient and/or missing.

- $25,000 for workers' compensation insurance premiums for independent contractors. Workers compensation paid on behalf of independent contractors is not reimbursable. Moreover, there was no documentation to show that this amount, reported on the CFR, was paid during the fiscal year.
- $5,487 for food, $5,411 for travel, $300 for toner, and $105 for telephone expenses that lacked sufficient supporting documentation.
- $2,095 in tuition paid for a teacher who was taking graduate-level courses in pursuit of the certification that is the minimum qualification for the position she held.

We also found that MDS charged $26,000 in agency administrative costs for audit fees paid to two different CPA firms for the same services/same time period. We recommend disallowance of $13,414 for duplicated services.

In addition, on MDS's general ledger, we found payments totaling $4,660 to a vendor named "Job Fair." MDS was only able to provide invoices to support charges of $1,602 for this vendor. Therefore, we recommend disallowance of the remaining $3,058.

We also found that some equipment and network costs, totaling $17,817, were expensed during fiscal year 2011. This cost should have been capitalized and depreciated over the useful life of the equipment. Based on Internal Revenue Service guidelines, computer-related equipment is to be depreciated over a period of five years. As such, we recommend SED disallow $13,763, which represented the remaining four years of the equipment's useful life. In addition, we found that a charge of $1,900 for a water test at the administrative office was charged directly to the SED Programs. However, this cost should have been allocated among all the programs operated by the provider using the ratio value methodology. Of that amount, we recommend a disallowance of $1,539.

International Recruitment Costs

MDS charged the Programs $2,050 in recruiting costs, including H-1B visa fees, for an individual who did not work for the Programs but was eventually hired by its affiliate Functional Life Achievement. The H-1B visa allows foreign workers in specialty areas to work for sponsoring employers in the U.S. MDS officials explained that they had difficulties finding bilingual staff in New York and needed to recruit from abroad. Because the person in question did not provide services for the Programs, we recommend disallowance of the $2,050 in recruiting costs claimed by MDS.

Air Conditioners (Altered Invoice)

During the audit period, MDS purchased five air conditioners at a cost of $7,821. MDS's CFO provided us with a copy of a document which he claimed was the invoice for this purchase. The delivery address and other information on this invoice were deleted. We requested and received a copy of the original invoice from the vendor, which showed that the air conditioners were delivered to a Long Island address and were installed in the bedrooms of the home located at that address. We subsequently determined that this location was the personal address of MDS's ED and CFO. We recommend a disallowance of $5,487, the amount of this purchase that was charged to the Programs.

Recommendations

To SED:

1. Review the recommended disallowances resulting from this audit and make the adjustments to MDS's CFRs and reimbursement rates, as appropriate.

2. Recover the disallowances identified in this report, as appropriate.

To MDS:

3. Ensure that costs reported on its annual CFRs comply with Manual requirements.

Audit Scope and Methodology

We audited the eligibility of, and support for, the expenses reported by MDS on its CFRs for the fiscal year ending June 30, 2011. The objective of our audit was to determine whether the costs reported on MDS's CFRs were calculated properly, documented adequately, program-related, and reimbursable pursuant to SED's Manual.

To accomplish our objective, and assess the internal controls related to our objective, we reviewed the Manual, MDS's CFRs, and relevant financial records for the audit period. We compared the expenses reported on the CFRs with the Manual's requirements to assess compliance. We examined MDS's general ledger, bank accounts, and credit card charges, as well as personnel records, payroll registers, W-2 and 1099 forms, selected session notes, and students' folders. In addition, we interviewed SED and DoE officials, as well as Functional MDS officials, employees, independent CPAs, and selected vendors and contractors. We also site-visited MDS Programs locations and administrative offices.

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 objective. We believe that the evidence obtained did provide a reasonable basis for our findings and conclusions based on our audit objective.

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

Authority

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

Reporting Requirements

We provided a draft copy of our report to SED and MDS officials for their review and comment. Their comments were considered in preparing this final report and are attached in their entirety at the end of the report. In their response to our draft report, SED officials agreed with our recommendations. In their response, MDS officials disagreed with most of our proposed disallowances. Our rejoinders to certain MDS 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 the State Education Department shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and if the recommendations were not implemented, the reasons why.

Contributors to This Report

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Vision

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

Mission

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

Exhibit

Functional MDS
Summary of Recommended Audit Disallowances
for the Fiscal Year Ended June 30, 2011

Expense Category	Charged to Programs	Disallowed	Allowed	Notes to Exhibit
Personal Services				
Program Cost	$892,981	$468,594	$424,387	A, B, C, D, E, G, H, I, L, M
Agency Administration	$349,957	$216,438	$133,519	
Total Personal Services	**$1,242,938**	**$685,032**	**$557,906**	
Other Than Personal Services				
Program Cost	$2,191,112	$ 89,396	$2,101,716	A, F, G, J, K, L, M
Agency Administration	$91,541	$19,791	$71,750	
Total Other Than Personal Services	**$2,282,653**	**$109,187**	**$2,173,466**	
Total Expenses	**$3,525,591**	**$794,219**	**$2,731,372**	

Notes to Exhibit

The following Notes refer to specific sections of SED's 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 Functional MDS officials during the course of our audit.

A. Section II. Cost Principles - Costs must be reasonable, necessary, program-related, and sufficiently documented.
B. Section II.14 A (4a) - For any individual who is employed in any job title or combination of job titles by the entity operating the approved programs, compensation up to 1.0 FTE for that individual in total will be considered in the calculation of the portion of 1.0 FTE reimbursable in the tuition rates. Allocation of non-direct care compensation among various direct care job titles is not allowable.
C. Section II.14 A (4b) - An entity that employs co-Executive Directors shall have total reimbursement for all co-Executive Directors combined limited to a level commensurate with a 1.0 FTE position. This level will be the maximum compensation level for the entire entity operating the approved programs.
D. Section II.14 A (4c) - For any individual who works in more than one entity (including organizations that have a less-than-arm's-length relationship with the approved program), the FTE in total across entities cannot exceed 1.0, and the allocation of compensation must be supported by time and effort reports or equivalent documentation. Compensation beyond 1.0 FTE for any individual in total will not be considered reimbursable in the calculation of tuition rates.
E. Section II.15.E - Fringe benefit costs for independent contractors or consultants are not reimbursable.
F. Section II.18 A (1) - Items having a unit cost of $1,000 or more and an estimated useful life of two years or more must be capitalized. Group purchases of similar items (e.g., furniture, small tools) or separate purchases of similar items in the same fiscal year totaling $1,000 or more should be treated as a single unit purchase.
G. Section III.1 - Costs will not be reimbursable on field audit without appropriate written documentation of costs.
H. 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.
I. Section III.1 B - Actual hours of service is 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.

J. Section III.1 C (2) - All payments must be supported by itemized invoices that indicate the specific services provided and, for each service, the date(s), number of hours provided, the fee per hour, and the total amount charged. In addition, when direct care services are provided, the documentation must indicate the names of students served, the dates of service, and the number of hours of service to each child on each date.
K. Section III.1.D - All purchases must be supported with invoices listing the items bought, 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.
L. Section III.1 M (1) - Any expenditures that cannot be charged directly to a specific program must be allocated across all programs and/or entities benefited by the expenditure.
M. Section III.1 N - Entities operating programs may be required upon audit to support the classification of costs as direct care.

Agency Comments - State Education Department

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

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December 31, 2014

Mr. Frank Patone
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Dear Mr. Patone:

The following is the New York State Education Department's (SED) response to the draft audit report, (2014-S-1), Compliance with the Reimbursable Cost Manual: Functional MDS.

Recommendation 1: Review the recommended disallowances resulted from this audit and make the adjustments to MDS's CFRs and reimbursement rates, as appropriate.

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

Recommendation 2: Recover the disallowances identified in this report, as appropriate.

A rate based on audit will be calculated to reflect tuition rate adjustments, as appropriate.

Please let me know if you have any questions regarding this response.

Sincerely,

Maria C. Guzman

c: Sharon Cates-Williams
James P. DeLorenzo
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Agency Comments - Functional MDS

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December 17, 2014

VIA HAND DELIVERY
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Re: Functional MDS // Report 2014-S-1
Compliance with the Reimbursable Cost Manual

Dear Mr. Patone:

We have reviewed the "Draft Report" dated November, 2014 and appreciate the opportunity to provide clarification and comment. We maintain that in certain limited instances, select principles set out in the New York State Education Department Reimbursable Cost Manual against which Functional MDS (the "School") has been audited for the fiscal year ending June 30, 2011, have been misapplied.

Key Findings

While challenges to specific findings are set out in greater detail below, the School requests consideration of the following points of reference which, we believe, warrant rephrasing of certain Report statements.

1
- Since the purpose of the audit is narrowly defined "to determine whether the costs reported…on (the School's) CFRs were properly calculated…pursuant to the…(Manual)", we request that specific identification of related companies by name be struck from the Report as unwarranted and unnecessary. There is precedent for OSC use of generic descriptions in its references. *Comment 1

2
- It is important to note that the CFR has been designed to consolidate the reporting of costs of multiple cost centers and programs. Accordingly, where certain costs may have been misclassified as relating to a specific cost center (such as SCIS) due to an error in cost allocation rather than to a complementary cost center (such as evaluations), it is misleading to suggest that the costs were not education related, as the Report intimates. Such costs may well be appropriate evaluation costs - - a complementary 4410 program component - - but misclassified as SCIS costs. *Comment 2

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*See State Comptroller's Comments, page 20

Mr. Frank Patone
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While we concede weaknesses in cost allocations allowed the misreporting of select costs to the appropriate cost center, a significant portion of such costs were, in fact, 4410 evaluation costs, and not, as the Report suggests totally unrelated to the 4410 operations. We suggest clarifying language such as "the costs were not related to the audited SC/SCIS/SEIT programs" to distinguish from education costs (including evaluations) from non-education costs.

Personal Service Costs

3
- *Allocation of Executive Salaries*

We challenge the auditors' proposed disallowance of $198,888 in executive salaries and fringe benefits resulting from the auditors' recalculation of compensation based on the ratio value allocation method (i.e. the expenses of the School as a percentage of the total of all related operations' expenses). While we concede that time records to support the executive's work effort between related entities were incomplete, the auditors may well have interviewed office personnel to confirm the executive (ED) and CFO's assertion of work effort.

* Comment 3

In addition, the ED and CFO had provided the auditors multiple examples of work product, including a notebook of daily activities which reflect and support the significant work effort expended by both individuals on behalf of the audited educational program. We believe documentation such as such activity notebooks/calendars are greater testament to work effort - - provide greater detail - - than the requested time records and should be considered more favorable than apparently did the auditors.

Employee/Consultant Expenses

4
- Again, we challenge the auditors' application of the ratio value method of cost allocation where, as here, specific administrative employees were stationed at specific program sites and therefore more appropriately assigned to the cost center associated with that exclusive 4410 program site. We do not challenge the auditors' clarification that some of these costs were more appropriately reported as "non-direct", but vigorously challenge the allocation of costs associated with these individuals to general "agency administration" through ratio value allocation (billing clerks, cleaning services). Review of the square footage of the School's sites support our reporting such costs by site, as classroom cleaning services is clearly a significant portion of the service costs, and therefore more appropriately related to the classroom operation costs and not across all program components, including administration office space. Similarly, each billing clerk is assigned to a specific classroom site with responsibilities limited to the operations of that location, and not the more school-wide administration. Accordingly, we request these costs be reallocated to the cost center which enjoyed the benefit of the service costs, as directed by the RCM and that the $62,866 disallowance be restored.

* Comment 4

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Mr. Frank Patone
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In addition, we challenge the auditors' categorization of certain supervisor's salaries as non-direct costs where, as here, these direct care supervisors were properly coded (501), reflective of their job responsibilities and activities.

5
- We also vigorously challenge the auditors' assertion that there was no evidence that 11 employees worked for the audited education program where, as here, the School provided substantial documentation in support of the reported costs, including time records, child records reflecting clinical session notes and daily schedules reflecting activities. These individuals' salaries were properly allocated to the appropriate cost center on the CFR proportionate to the work effort.

* Comment 5

6
- *Persons Employed by MDS*

* Comment 6

The School challenges the proposed disallowance of $5,437 relating to costs associated with the services of an individual who, the School concedes, was not an employee of the School, but who had provided services on behalf of the School. As shared with the auditors, the individual had provided the School certain "recruitment services" through his "Job Fair" corporation. The expense should have been reported as "recruitment fee", but was erroneously reported as salary because the reimbursement check for the provided services had been made payable to the owner of the recruitment company rather than to the company itself. The School bookkeeping personnel then combined the check with other checks made payable to other individuals as "salary" or "compensation". Clearly, the error lies in the mis-categorization of the expense as salary. The amount should, however, be reclassified as "recruitment fees" which are fully reimbursable under the RCM where, as here, the School shared detailed documents of its engagement of Job Fair services.

* Comment 7

Other than Personal Services

7
- We challenge the auditors' conclusion that the documentation provided to the auditor was insufficient to support $31,478 in claimed clinical expenses. While lacking the specificity of an invoice, the documents provided did, when taken together, provide the essential information regarding specific services provided, the hourly fee and the total amount charged. The students' session notes attest to the specific services provided and number of sessions, while the clinicians' engagement letters reflect hourly rates of compensation. Payment to the provider clinician was conditioned upon verification of services provided and calculation of rates of reimbursement X verified hours. The elements of an invoice having been provided, the disallowance should be restored.

* Comment 8

8
- The School recognizes that select food expenses lacked documentation to support a finding of "program related" (approximately $6,000). However, the balance of the proposed disallowance was demonstrated to have been mis-categorized as "food expenses" rather than materials/supplies and household supplies. Accordingly, we

request that approximately $10,000 be restored as reasonable and allowable supply and material expenses.

9 • The School has provided the auditors the requisite documentation in support of our claimed expense of $2,095 in tuition payments made on behalf of a teacher who required and obtained a specialization credential. Additional copies are attached herein (See: Attachment 1).

10 • We vehemently challenge the auditors' finding that CPA expenses were duplicative. As shared with the auditors, and easily verifiable through interviews with the subject CPA firms, the initial accountant services proved substandard and inadequate. As auditors are aware, accountant work product is difficult to evaluate, especially without the benefit of a "second opinion". The second accountant firm was engaged for the very purpose of correcting the errors made by the initial accountant. As comparison of the engagement letters reveal, the second accountant was tasked with "amending" the requisite cost reports - - clearly a "follow-up", remedial task and hence not at all "duplicative" as the auditors suggest. Accordingly, we request full restoration of the second accountant fees which were properly supported by an engagement letter and work-product.

International Recruitment Costs

11 • The School has attempted to clarify that the persons identified on whose behalf the School incurred recruitment and visa fee costs, <u>did</u> in fact provide services for the School, but in the succeeding school year (and not therefore, reflected on audit year staff rosters). This delay in hiring was a necessary result of the recruitment and visa process and not related to the School. Accordingly, we request restoration of the $5,295 disallowance (See: Attachment 2).

12 • *Air Conditioners*

We take exception to the auditor's presentation of the purchase of five (5) air conditioners. The Executive Director had explained at the very outset of the field work discussions that the five (5) air conditioners had been initially purchased for personal use, and had, in fact, been originally installed for use at the residence of the Director's mother. Upon the mother's passing, the Director sought to apply personal resources for the benefit of the School, and promptly orchestrated the installation of the equipment into School space. These units were clearly visible to the auditors.

As best as can be surmised, it appears that the school accountants included the full value of the units as program expensed equipment, as confirmed by their own visual verification of installation, unaware of the previous personal use. We challenge disallowance of the entirety of the cost of such units, and argue that the proportionate value of the units upon installation in the School should be allowed, in recognition of the obvious fact that the School did, in fact, benefit from the installation of the units.

* Comment 9

* Comment 10

* Comment 11

* Comment 12

* Comment 13

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Again, the full narrative of the air conditioner units had been shared with the auditors during the auditors' field work. At no time did MDS misrepresent the facts of the narrative to the auditors.

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We appreciate the opportunity to provide additional comment and context to the auditors' findings and observations and trust due consideration will be accorded these comments in the finalization of the Report.

Very truly yours,

GREENBERG TRAURIG, LLP

Pamela A. Madeiros

PAM/kac
Enclosures

cc: Kenrick Sifontes

ALB 1828259v2

State Comptroller's Comments

1. We included the identities of MDS's affiliates in the report to provide sufficient clarity and demonstrate the relationships among these entities.
2. We acknowledge that certain costs may be "education-related." However, the costs reported on the CFR must be related to and necessary for the specific Programs audited (and not only be education-related). As our report details, there were significant costs that were non-Programs-related and/or were otherwise ineligible pursuant to the Reimbursable Cost Manual (Manual).
3. The Manual requires adequate documentation of costs reported on the CFR. Interviews with staff do not constitute sufficient evidence of employees' work assignments (by program) and the amounts of time actually worked on those programs. Further, the items referenced by MDS do not document the actual amounts of time that employees worked among the affiliates. Under such circumstances, the Manual prescribes the use of the ratio value method for cost allocations.
4. There was no tangible evidence to support MDS's assertion. Absent formal time records or studies, the ratio value method was appropriate for cost allocation purposes.
5. MDS did not provide any documentation to demonstrate that the individual in question provided direct care services to the Programs audited.
6. MDS did not provide any documentation to support that the 11 employees provided direct care services to the Programs audited.
7. The $5,437 remains disallowed because MDS charged the cost twice (as both compensation and recruitment).
8. The noted disallowance related to charges for which there were no session notes or invoices (as otherwise required by the Manual). Where such records were available, we allowed the charges.
9. Based on information provided by MDS, we reduced the amount of the disallowance (by $11,094) for materials and supplies that were misclassified as food, as detailed on page 7 of the report.
10. Based on the information provided by MDS, we determined that the teacher in question was taking courses toward a certificate that was the minimum qualification for the position she held. Nonetheless, the associated costs were ineligible for reimbursement, and we revised the report to clarify the basis for this disallowance.
11. The Manual requires claimed costs to be reasonable and necessary. Thus, providers should ensure that consultants are qualified and capable to perform the services for which they are hired and paid. In this instance, the initial accountant was not capable of providing the required services, and therefore, MDS should not have selected the firm to perform those services. We maintain the proposed disallowance because the costs in question were not reasonable and/or necessary.
12. Based on the information provided by MDS, we reduced the amount of the disallowance (by $3,875) for international recruitment costs, as detailed on page 7 of the report.
13. The fact remains that the air conditioning equipment was installed at the personal residence of senior MDS officials in 2011 and remained there during the audit period. Although that equipment was moved to MDS premises in 2014 (after our audit fieldwork began), the amounts in question remain disallowed.