



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 Gingerbread Learning Center, Inc.



Report 2014-S-79

October 2016

Executive Summary

Purpose

To determine whether the costs reported by the Gingerbread Learning Center, Inc. (Gingerbread) on its Consolidated Fiscal Reports (CFRs) were properly documented, program-related, and allowable pursuant to the State Education Department's (SED) Reimbursable Cost Manual (Manual). The audit focused primarily on expenses claimed on Gingerbread's CFR for fiscal year 2012-13 and certain expense categories on Gingerbread's CFRs for the two fiscal years ended June 30, 2012.

Background

Gingerbread is a not-for-profit organization that provides center-based (full-day, half-day, and integrated) preschool programs and a Special Education Itinerant Teacher (SEIT) program to children ages three through five years. During the 2012-13 school year, Gingerbread served about 145 students. The New York City Department of Education (DoE) refers students to Gingerbread based on clinical evaluations and pays for its services using rates established by SED. The rates are based on the financial information that Gingerbread reports to SED on its annual CFRs. Reimbursable costs must be reasonable, program-appropriate, and properly documented. SED reimburses DoE for a portion of its payments to Gingerbread based on statutory rates. For the three fiscal years ended June 30, 2013, Gingerbread reported approximately \$12.2 million in reimbursable costs for its SED programs.

Key Findings

For the three fiscal years ended June 30, 2013, we identified \$942,998 in reported costs that did not comply with Manual requirements and recommend such costs be disallowed. These ineligible costs included \$621,356 in personal service costs and \$321,642 in other than personal service (OTPS) costs. Among the disallowances we identified were:

- \$246,777 in fringe benefit expenses that were unsupported, ineligible, and did not comply with the Manual's guidelines;
- \$243,693 in inadequately documented and undocumented OTPS expenses;
- \$219,459 in over-allocated compensation costs associated with shared employees; and
- \$142,093 in employee bonuses that were not in compliance with the Manual's guidelines.

Key Recommendations

To SED:

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

To Gingerbread:

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

Agency Comments

SED officials agreed with our recommendations and indicated that they will take certain steps to address them. Gingerbread officials, however, disagreed with our findings and recommendations. Gingerbread's response is replete with incorrect and false assertions as well as misleading statements. The response also includes several baseless assertions intended to impugn the professional integrity of the auditors. Rather than making false accusations, we encourage Gingerbread officials to take the reasonable steps necessary to fully comply with the financial reporting and recordkeeping requirements of their publicly funded program.

Other Related Audits/Reports of Interest

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

[Institutes of Applied Human Dynamics: Compliance With the Reimbursable Cost Manual \(2014-S-39\)](#)

State of New York
Office of the State Comptroller

Division of State Government Accountability

October 26, 2016

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

Mr. Dennis Mosesman
Executive Director
Gingerbread Learning Center, Inc.
80 Woodrow Road
Staten Island, NY 10312

Dear Ms. Elia and Mr. Mosesman:

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, entitled *Compliance With the Reimbursable Cost Manual*, of our audit of the costs submitted by Gingerbread Learning Center to the State Education Department for the purposes of establishing preschool special education tuition reimbursement rates. This audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution; Article II, Section 8 of the State Finance Law; and Section 4410-c of the State Education Law.

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

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

Table of Contents

Background	5
Audit Findings and Recommendations	6
Personal Service Costs	6
Other Than Personal Service Costs	9
Recommendations	10
Audit Scope and Methodology	10
Authority	11
Reporting Requirements	11
Contributors to This Report	12
Exhibit	13
Notes to Exhibit	14
Agency Comments - State Education Department	15
Agency Comments - Gingerbread Learning Center, Inc.	16
State Comptroller's Comments	38

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

Background

The Gingerbread Learning Center, Inc. (Gingerbread) is a not-for-profit organization that provides center-based (full-day, half-day, and integrated) preschool programs and a Special Education Itinerant Teacher (SEIT) program to children ages three through five years. For the purposes of this report, these programs are collectively referred to as the State Education Department (SED) Programs. In addition to the SED Programs subject to our audit, Gingerbread also administered other programs including Evaluations, Related Services, and Early Intervention. Gingerbread also operated a private day care. Based in Staten Island, New York, Gingerbread provides these SED Programs to children throughout Staten Island and neighboring boroughs. During the 2012-13 school year, Gingerbread served about 145 students.

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

Chapter 545 of the Laws of 2013 mandates the State Comptroller to audit the expenses reported to SED by special education service providers for preschool children with disabilities. For the three fiscal years ended June 30, 2013, Gingerbread reported approximately \$12.2 million in reimbursable costs for its SED Programs. Our audit period focused on fiscal year 2012-13; however, we expanded our review to include certain items claimed on the CFRs for fiscal years 2010-11 and 2011-12.

Audit Findings and Recommendations

For the three fiscal years ended June 30, 2013, we identified \$942,998 in reported costs that did not comply with the Manual's requirements for reimbursement. The ineligible costs included \$621,356 in personal service costs and \$321,642 in other than personal service (OTPS) costs (see Exhibit on page 13 of the report).

Personal Service Costs

According to the Manual, personal service costs, which include all taxable and non-taxable salaries and fringe benefits paid or accrued to employees on the agency's payroll, must be reported on the provider's CFR as either direct care costs (e.g., teachers' salaries) or non-direct care costs (e.g., administrators' salaries). During the three fiscal years ended June 30, 2013, Gingerbread reported about \$10.5 million in reimbursable personal service costs. We identified \$621,356 in personal service costs that did not comply with the Manual's guidelines for reimbursement.

Non-Reimbursable Fringe Benefits Expenses

According to the Manual, fringe benefits (including pensions, life insurance, and tax-sheltered annuities) for individual employees or officers/directors should be proportionately similar to those received by other classes or groups of employees. According to guidance provided by SED to the State Comptroller's Office, fringe benefits are proportionately similar if the benefits-to-salaries ratio is the same/similar among all employees. The Manual also states that costs will be considered for reimbursement if they are reasonable, necessary, directly related to the education program, and sufficiently documented.

We recommend that SED disallow \$246,777 in fringe benefit expenses that did not comply with the Manual's guidelines, as detailed in the following narratives.

401(k) Retirement Plan Contributions

For the three fiscal years ended June 30, 2013, Gingerbread reported \$950,000 in contributions to a 401(k) profit-sharing retirement plan. We noted that two of the employees (Executive Director and Program Director) received contributions that ranged from approximately 24 percent to 33 percent of their gross salaries. The contributions for the remaining Gingerbread employees ranged from 5 percent (fiscal year 2012-13) to 8 percent (fiscal year 2011-12) of their gross salaries. We determined that the contributions of 24 percent to 33 percent of gross salaries for the two employees did not comply with the requirements in the Manual. For these two employees, we disallowed contributions that were in excess of contribution rates made to the other Gingerbread employees. Consequently, we recommend that SED disallow \$160,206 in payments that did not comply with the Manual's requirements.

Unsupported and Ineligible Expenses

We identified \$48,326 in unsupported or ineligible fringe benefit costs as follows:

- \$34,291 in unsupported pension accrual expenses in fiscal year 2012-13;
- \$11,258 in unsupported payroll taxes (e.g., FICA) and other miscellaneous mandated fringe benefits; and
- \$2,777 in insurance expenses related to the Executive Director's personal vehicle (which was incorrectly reported under the fringe benefits category).

We recommend that SED disallow the \$48,326 in payments that did not comply with the Manual's reimbursement requirements.

Life Insurance Premiums

For the three fiscal years ended June 30, 2013, we found that Gingerbread reported a total of \$61,871 in premiums for two life insurance policies for the Executive Director. The Executive Director is the owner of both policies, and his wife is the beneficiary. We determined that Gingerbread did not offer life insurance to other employees; therefore, this benefit is not "proportionately similar" for other employees. Consequently, we determined that Gingerbread overstated life insurance expenses applicable to the SED Programs by a total of \$38,245 and recommend that SED disallow \$38,245 in payments that did not comply with the Manual's requirements.

Excessive Allocation of Shared Employees' Compensation

The Manual requires that compensation paid to employees who work for multiple programs be allocated among these programs based on the employees' actual work effort or other allocation methods that are fair and reasonable. This is especially important when a provider, such as Gingerbread, operates multiple programs. Further, the costs of special education teacher assistants who work as 1:1 aides are funded separately from the preschool special education tuition reimbursement rate. As such, charges associated with the time spent functioning as 1:1 aides are ineligible for reimbursement through the SED Programs, and the costs for 1:1 aides should be charged to a distinct Program code (9230).

We identified 24 Gingerbread employees whose compensation was over-allocated to the SED Programs for fiscal year 2012-13. In total, \$341,587 was reported to the SED Programs on Gingerbread's CFR for these employees. However, Gingerbread failed to maintain the appropriate documentation to support its allocation of shared staff. According to the class rosters and other documentation (e.g., personnel records), these employees worked at least partially for the Early Intervention program (as 1:1 aides) or the Evaluations program. Significant portions of these employees' compensation costs for the Early Intervention and Evaluations programs were charged incorrectly to the SED Programs we audited.

Our review of the class rosters and other documentation identified the actual work assignments of the shared employees. We determined that Gingerbread officials over-allocated the shared

employees' compensation to the SED Programs. As a result, we determined that only \$122,128 of the \$341,587 in compensation for the 24 employees should have been allocated to the SED Programs. Consequently, we recommend that SED disallow the \$219,459 (\$341,587 - \$122,128) in over-allocated compensation costs charged to the SED Programs.

Unsupported and Ineligible Bonuses

According to the Manual, bonus compensation may be reimbursed if based on merit, as measured and supported by employee performance evaluations. Also, bonus payments are restricted to direct care titles/employees. Indirect care (administrative) staff are not eligible for bonuses.

We identified \$142,093 in ineligible bonus payments, accruals, and related fringe benefits reported on Gingerbread's CFRs for fiscal years 2010-11 and 2011-12 as follows:

- \$75,000 in bonuses (accrued in fiscal year 2010-11) that were never paid to employees; and
- \$67,093 in bonuses and related fringe benefits that were not supported by employee performance evaluations or were paid to ineligible administrative staff members.

Gingerbread officials partially disagreed with our disallowances, claiming that all employee performance evaluations were included in the personnel files. We maintain, however, that Gingerbread officials did not provide us with the required performance evaluations. Therefore, we recommend that SED disallow \$142,093 in ineligible bonus costs reported to the SED Programs for the three fiscal years ended June 30, 2013.

Unsupported Compensation

The Manual requires that reimbursable compensation costs be based on approved and documented payrolls. Payrolls must be supported by employee time and attendance records, which must be signed by both the employee and his/her supervisor and completed at least monthly. We identified \$13,027 in compensation costs that were not in compliance with the requirements in the Manual.

During fiscal year 2011-12, Gingerbread reported \$13,027 in salary and fringe benefit expenses related to a maintenance supervisor who had no time records. We reviewed the employee's personnel file and found that it did not contain an employment contract, job description, or work schedule. Further, we could not find any evidence of his work product.

According to Gingerbread officials, the employee did not have a fixed work schedule, nor was he required to submit timesheets. Although Gingerbread officials stated that this individual supervised the cleaning staff, there was no evidence of any supervisory actions, such as approving leave requests for cleaning staff. Moreover, timesheets were required, per the Manual.

Thus, we recommend that SED disallow \$13,027 in unsupported compensation expense charged to the SED Programs.

Other Than Personal Service Costs

According to the Manual, OTPS costs must be reasonable, necessary, program-related, and supported by sufficient and appropriate documentation. For the three fiscal years ended June 30, 2013, Gingerbread reported approximately \$1.7 million in OTPS expenses to the SED Programs. We identified \$321,642 of these expenses that did not comply with the Manual's requirements.

Non-Reimbursable Expenses

The Manual states that OTPS costs must be reasonable, necessary, program-related, and supported by sufficient and appropriate documentation. In addition, the Manual expressly states that certain costs, such as all personal expenses, gifts of any kind including flowers, fines and penalties, food, and holiday parties provided to staff, are not reimbursable. However, we identified \$297,702 in expenses that did not comply with the Manual's requirements. These non-reimbursable costs included \$243,693 in inadequately documented and undocumented expenses and \$54,009 in ineligible expenses.

The \$243,693 in inadequately documented and undocumented expenses included:

- \$185,629 in expenses that were not adequately documented. Among these expenses were \$46,615 in school supplies, \$41,601 in depreciation (capital improvements), \$21,575 in Costco purchases, \$16,225 in contracted services, and \$6,395 in advertising costs.
- \$58,064 in expenses that had no supporting documentation. Among these expenses were \$12,366 in interest charges, \$9,897 in legal expenses, and \$6,108 in general insurance expenses. Gingerbread officials did not provide any documentation, such as invoices, receipts, or contracts, to support these charges.

The \$54,009 in expenses that were not eligible for reimbursement included \$15,922 in food purchases, \$1,687 in liquor store purchases, and \$1,124 for staff holiday parties. We also found \$7,693 in gifts, including gift cards (e.g., American Express and Starbucks); \$5,304 in loan procurement fees; \$3,973 in civil penalties (e.g., building violation fines); and \$1,880 in tuition reimbursements for employees who did not provide services to the SED Programs.

Unoccupied Building Expenses

According to the Manual, a program's occupancy costs at a prior location are reimbursable up to the actual date of the program's occupancy in the new location, unless prior approval allows an exception. Similarly, other related costs (e.g., mortgage payments) are also reimbursable up to the actual date of occupancy in the new location.

In addition to its primary location on Woodrow Road, Gingerbread operated SED Programs at two other buildings, including one located on North Gannon Avenue. In December 2012, Gingerbread moved its SED Programs out of the North Gannon Avenue building and into other buildings (e.g., Woodrow Road). Gingerbread officials informed us that renovations to the North Gannon Avenue

building were scheduled to start in January 2013.

Although the SED Programs did not operate at the North Gannon Avenue location from January 2013 through the end of our audit scope, June 30, 2013, Gingerbread officials reported \$23,940 in expenses (e.g., rent, maintenance) to the SED Programs for that time period. Further, we saw no evidence that any exceptions to the Manual's guidelines were approved by SED. Consequently, we recommend that SED disallow \$23,940 in expenses corresponding to time periods when Gingerbread was not operating SED Programs at the North Gannon Avenue building.

Recommendations

To SED:

1. Review the recommended disallowances resulting from our audit and make the appropriate adjustments to the costs reported on Gingerbread's CFRs and to Gingerbread's reimbursement rates.
2. Work with Gingerbread officials to help ensure their compliance with Manual provisions.

To Gingerbread:

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

Audit Scope and Methodology

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

To accomplish our objective, we reviewed the Manual, the Consolidated Fiscal Reporting and Claiming Manual, Gingerbread's CFRs, and other relevant financial records for the audit period. We also interviewed Gingerbread officials, staff, and the independent auditors to obtain an understanding of Gingerbread's financial and business practices. To complete our audit work, we selected and reviewed a judgmental sample of costs reported by Gingerbread. We selected a judgmental sample of expenses that were at a higher risk of being ineligible for reimbursement based on the nature of the transaction, such as personal service costs, food expenses, depreciation, and gift card expenses. We assessed the sample of reported costs to determine whether they were supported, program-appropriate, and reimbursable.

Our review of Gingerbread's internal controls focused on the controls over Gingerbread's CFR preparation process. Section 200.9 (d) of the Commissioner's Regulations requires entities operating approved programs to retain all pertinent accounting, allocation, and enrollment/attendance records supporting reported data directly or indirectly related to the establishment

of tuition rates for seven years following the end of each reporting year. We noted that, in certain instances, information was not readily available and that some of requested information was not provided to us until after the closing conference. Nevertheless, we reviewed and considered all information provided to us when preparing this report.

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

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

Authority

The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution; Article II, Section 8 of the State Finance Law; and Section 4410-c of the State Educational Law.

Reporting Requirements

We provided a draft copy of this report to SED and Gingerbread officials for their review and formal comment. Their comments were considered in preparing this final report and are attached to it in their entirety. SED officials agreed with our recommendations and indicated that they will take certain steps to address them. Gingerbread officials, however, disagreed with our findings and recommendations. Their response is replete with incorrect and false assertions as well as misleading statements, some of which were intended to impugn the professional integrity of the auditors. Our rejoinders to certain Gingerbread comments are included in the report's State Comptroller's Comments.

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

Contributors to This Report

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Vision

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

Mission

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

Exhibit

**Gingerbread Learning Center
Schedule for Submitted and Disallowed Program Costs
For the 2010-11, 2011-12, and 2012-13 Fiscal Years**

	Reported	Disallowed	Remaining	Notes to Exhibit
Personal Services				
Direct	\$9,331,880	\$589,458	\$8,742,422	
Agency Administration	1,145,800	31,898	1,113,902	
Total Personal Services	\$10,477,680	\$621,356	\$9,856,324	A-C,J,K,L
Other Than Personal Services				
Direct	\$1,143,524	\$212,381	\$931,143	
Agency Administration	586,354	109,261	477,093	
Total Other Than Personal Services	\$1,729,878	\$321,642	\$1,408,236	A,D-I
Totals	\$12,207,558	\$942,998	\$11,264,560	

Notes to Exhibit

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

- A. Section II - Costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the education program, and sufficiently documented.
- B. Section II.13.A(10) - Bonus compensation may be reimbursed if based on merit, as measured and supported by employee performance evaluations. Also, bonus payments are restricted to direct care titles/employees.
- C. Section II.13.B(2)(c) - Benefits including pensions, life insurance, and tax sheltered annuities for individual employees or officers/directors must be proportionately similar to those received by other classes or groups of employees.
- D. Section II.20.A-B - All personal expenses and costs incurred for entertainment and holiday parties for officers or employees, flowers, and for activities not related to the program are not reimbursable.
- E. Section II.21 - Costs resulting from violations of, or failure by, the entity to comply with Federal, State, and/or local laws and regulations are not reimbursable.
- F. Section II.22.C - The cost of food provided to staff are not reimbursable.
- G. Section II.24 - Gifts of any kind are not reimbursable.
- H. Section II.28.C(4) - Other related costs such as mortgage are reimbursable up to the actual date of occupancy in the new location.
- I. Section II.41.B(1) - The program's occupancy costs of the prior location are reimbursable up to the actual date of the program's occupancy in the new location unless prior approval allows an exception.
- J. Section III.1.A - Compensation costs must be based on approved and documented payrolls. Payroll must be supported by employee time records prepared during, not after, the time period for which the employee was paid. Payrolls must be supported by employee time and attendance records, which must be signed by both the employee and his/her supervisor and completed at least monthly.
- K. Section III.1.B - Compensation of the employees who do not work solely for SED Programs must be allocated based on their actual work effort for the SED Programs or other allocation methods that are fair and reasonable, as determined by SED's fiscal representative.
- L. Section IV.2.F - Direct care expenses incurred by the provider should be charged to the appropriate programs on CFR-1. For example, the Manual states: "All 1:1 aide costs (salaries, fringe benefits of the aide and allocated direct and indirect costs) should be reported in one separate cost center on the providers' financial reports."

Agency Comments - State Education Department



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

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July 26, 2016

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

Dear Mr. Sifontes:

The following is the New York State Education Department's (SED) response to the draft audit report, 2014-S-79, Compliance with the Reimbursable Cost Manual: Gingerbread Learning Center, Inc.

In addition to the actions that will be taken in response to the specific recommendations described below, SED will closely examine the circumstances that led to the findings described in the audit report. This examination will include an assessment of the programmatic oversight and fiscal management employed at Gingerbread Learning Center, Inc. (Gingerbread) and will be a factor in the consideration of the continued approval of this provider and the corrective action or enforcement actions that may be warranted.

Recommendation 1: Review the recommended disallowances resulting from our audit and make the appropriate adjustments to the costs reported on Gingerbread's CFRs and to Gingerbread's reimbursement rates.

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

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

We agree with this recommendation. SED will continue to provide technical assistance whenever requested and will strongly recommend the Gingerbread officials take advantage of our availability to help them better understand the standards for reimbursement as presented in Regulation and the Reimbursable Cost Manual (RCM). Furthermore, Consolidated Fiscal Report (CFR) training is available both in person, at one of the six locations it is offered across the State, and online on SED's webpage. SED recommends that all individuals signing the CFR certification statements, namely Executive Directors and Certified Public Accountants, complete this training. At the direction of the Board of Regents, the Department intends to require that this training be mandatory and will require individuals to verify that they have completed the training.

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

Sincerely,

Sharon Cates-Williams

c: Monica Short
Belinda Johnson
Suzanne Bolling

Agency Comments - Gingerbread Learning Center, Inc.

SHEBITZ BERMAN COHEN & DELFORTE, P.C.

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July 21, 2016

Office of the New York State Comptroller
 Division of State Governmental Accountability
 59 Maiden Lane, 21st Floor
 New York, NY 10038

Attn: Brian Mason, Assistant Comptroller

Re: Gingerbread Learning Center, Inc.
Your Draft Audit Report 2014-S-79

Dear Sir:

This letter is in response to the draft audit report, issued on June 14, 2016, with respect to the audit of Gingerbread Learning Center, Inc. ("Gingerbread") by the Office of the New York State Comptroller ("OSC").

I. Preliminary Matters

Before proceeding to discuss OSC's specific proposed disallowances, we reiterate at the outset that Gingerbread has several procedural objections to the audit. First, Gingerbread does not agree that OSC has authority to conduct the audit at issue under the New York State Constitution, as interpreted by the New York Court of Appeals in *Blue Cross & Blue Shield of Cent. N.Y. v McCall*, 89 N.Y.2d 160 (1996), *New York Charter Schools v. DiNapoli*, 13 N.Y.3d 120 (2009) and *Handler v. DiNapoli*, 23 N.Y.3d 239 (2014). Gingerbread's cooperation with OSC's audit and this response to OSC's draft report do not waive any of its rights to challenge OSC's authority to conduct this audit or any decision by any authority to act upon a final audit report, and Gingerbread expressly reserves all such rights.

Second, Gingerbread believes that OSC's "audit" was not really an audit at all, but rather was conducted from the outset as an investigation, which OSC had no authority to do. In this regard, OSC had an "investigator", a Mr. Raymond Louie, as part of the "audit" team from the

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 Comment
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 Comment
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*See State Comptroller's Comments, page 38.

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

Office of the New York State Comptroller
July 21, 2016
Page 2 of 22

beginning of the “audit.” Among other things, Mr. Louie wandered the premises asking low level employees where various equipment was, but he never asked the Executive Director, who directed Gingerbread’s purchases and was the person who would know which equipment corresponded to which purchase order. Rather than sharing concerns and issues with Gingerbread’s management as the audit team examined records, in a collaborative effort to arrive at an accurate report, as an audit is supposed to be conducted, there was an obvious effort on the audit team’s part to prevent Gingerbread’s management from knowing what the audit team’s concerns were, rather than addressing the issues with Gingerbread’s management. Almost none of the issues OSC identified in its prior preliminary reports were discussed with Gingerbread’s management before the preliminary reports were issued. Gingerbread reserves its rights to challenge OSC’s authority to conduct an investigation, rather than an audit, or any decision to act on it.

*
Comment
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We also note that Mr. Louie’s actions in going anywhere he chose at Gingerbread’s sites whenever he chose, and talking to anybody he chose whenever he chose, all without authorization, not only was patently improper audit procedure, it also nearly caused a tragic accident. During the audit, a renovation project was being conducted at one of Gingerbread’s sites. Mr. Louie walked onto the construction site, which violated construction site safety rules, and startled a construction worker who fell into a manhole. Fortunately, the worker was able to catch himself by his elbows on the outside of the hole or he could have been seriously injured or even killed. Mr. Louie showed no remorse or concern. We also note that Mr. Louie had no legitimate reason to be on the construction site at all, much less at a time when work was ongoing and when it violated construction site safety rules for him to be there. The construction project was not a subject of the audit; the audit was of fiscal reports covering years ending June 30, 2013, more than two years earlier. Moreover, even if payments for the construction project were within the scope of the audit, which they were not, there would be no need or reason for Mr. Louie or anyone else from OSC to talk to workers on the construction site to perform such an audit.

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Third, the audit initially was announced as an audit of the 2012-13 year. In the course of the audit, OSC expanded the scope of the audit to the 2010-11 and 2011-12 years, although OSC did not issue a revised engagement letter reflecting the expanded scope and OSC refused to disclose to Gingerbread what OSC had discovered in its audit of the 2012-13 year that led OSC to expand the scope of the audit for prior years when Gingerbread asked for such information. We believe that this was improper, and that OSC had no right to expand the scope of the audit without a formal change in the engagement letter and without disclosing the reasons for doing so, even after Gingerbread expressly asked for them. Again, Gingerbread’s cooperation with the expanded scope of the audit and this response to the draft audit report do not waive its objections to the expanded scope of the audit, and Gingerbread expressly reserves its rights to challenge OSC’s authority to expand scope of the audit without issuing a new engagement letter and without disclosing reasons, and to challenge any decision to act on findings related to the 2010-11 and 2011-12 years.

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

Office of the New York State Comptroller
July 21, 2016
Page 3 of 22

Fourth, we note that at the opening conference, Gingerbread's Executive Director asked that all requests by the audit team for information be directed to him. Nevertheless, early in the audit, at a time when the Executive Director was out of the office, the auditors insisted that they be provided immediate access to Gingerbread's personnel files and other files and took whatever original files they chose. They did not even allow Gingerbread's staff to look at the files before OSC took them to see what files were taken or what was in them, much less to make a record of what documents were taken. The auditors told Gingerbread's staff that only OSC personnel could see the files. OSC kept the original files and did not return them until the end of the field work months later, and returned them in disarray. It took Gingerbread's staff days to reassemble its files, and numerous documents were missing. The most significant missing documents, for purposes of this audit, were employee evaluations taken from the personnel files, every Staples advantage invoice during the audited period and copies of checks that Gingerbread had specifically obtained from its bank to respond to the auditor's requests. Other files requested by OSC were in storage. When Gingerbread retrieved them from storage, OSC's auditors similarly insisted upon being provided the entire boxes, rather than allowing Gingerbread to first review the contents and then provide copies of what OSC wanted. OSC did not even allow Gingerbread to inventory the boxes before OSC control of them. Written statements from Gingerbread administrative employees who handled its documentation, describing what happened and attesting that documents were missing when the files were returned, will be provided to OSC under separate cover.

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These actions by OSC were improper for many reasons. First, they ignored Gingerbread's express instructions as to how documents should be requested. Second, they gave OSC access to documents beyond the scope of the audit. Third, they gave OSC exclusive possession and control of original documents for which Gingerbread is legally responsible without Gingerbread's consent. Fourth, they deprived Gingerbread of any opportunity even to make a record of what files were taken by OSC or what was in them to enable Gingerbread to assure that everything taken was returned.

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OSC apparently acknowledges that it is not entitled to take original documents, as at the exit conference. OSC's Audit Manager said that OSC "never" takes original documents. We are skeptical of that statement, as we have heard numerous reports of OSC's doing so and threatening agencies who refused to provide original documents, in connection with other audits. However, we do agree that it is improper for OSC to do so under any circumstances, much less to bully an agency into allowing OSC to take its original documents without even first reviewing or inventorying what was being given to OSC, as was done in this case.

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In this case, OSC's actions also have created substantive issues. Many of the proposed disallowances are based on OSC's contentions that documents are missing. Gingerbread believes that many of the documents that OSC claims are missing were in files taken by OSC, and if they are now missing it is because OSC misplaced them. It is unfair and inappropriate for OSC to recommend disallowances based on purportedly "missing" documentation when OSC took original

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Comment
9

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

Office of the New York State Comptroller
July 21, 2016
Page 4 of 22

documents without giving Gingerbread any opportunity to review files taken by OSC or to make a record of what was in the files, as described above.

In any event, Gingerbread reserves its rights to object to OSC's use of documents obtained in this inappropriate way. Gingerbread also objects to any disallowance based on OSC's contention that documentation which Gingerbread believes was contained in the files that OSC took is purportedly missing. We also note that OSC's commandeering of Gingerbread's original files in this way was yet another manifestation of OSC's conducting an unauthorized investigation, not an audit. This is not the way an audit, which is supposed to be a cooperative and collaborative process to discern the facts accurately, should be conducted.

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Fifth, OSC's process was faulty because it did not allow for meaningful dialogue. Proper audit procedure requires full disclosure and discussion of issues. As mentioned above, most of the issues were never raised by OSC before issuing its preliminary reports. After Gingerbread responded to the preliminary reports, there still was little meaningful dialogue at the exit conference, because OSC refused to disclose whether it agreed or disagreed with what Gingerbread had said in its lengthy and detailed written responses to the preliminary reports. OSC just listened, asked no questions and said it would consider the issues. There could be no meaningful dialogue because only one party, Gingerbread, stated its positions, both in writing in its responses to the preliminary reports and again verbally at the exit conference. Gingerbread left the exit conference having no idea whether OSC agreed or disagreed with its positions or why, because OSC would not disclose that. Even now, while Gingerbread now knows that OSC has rejected many of its contentions, because the draft report includes many of the same proposed disallowances, Gingerbread has no idea why. With limited exceptions, OSC has not addressed Gingerbread's contentions at the exit conference, or in any discussion thereafter, or in the draft report. For the most part, the draft report consists of unexplained conclusions and does not even mention Gingerbread's contentions, much less explain why OSC thinks they are incorrect.

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Sixth, OSC has not provided Gingerbread adequate time to prepare its response to the draft report. OSC gave Gingerbread no advance information as to when it would issue the draft report, so that Gingerbread and its counsel could keep their schedules clear during the response period. As a result, Gingerbread's counsel had scheduled a long-planned two week vacation abroad during what turned out to be the response period. Gingerbread asked for a two week extension of its response time to make up for that time. OSC, without explanation, granted only one week. Then, when Gingerbread could not make up the time in part because the associate attorney it was relying on to do so was ill and out of the office undergoing medical tests for most of the last two weeks, OSC denied a request for three additional business days, again without any explanation. There clearly was no good reason for OSC's refusal; it was completely arbitrary. OSC has not stated that it would be prejudiced in any way by the short additional time Gingerbread requested, much less explained why, and OSC clearly would not be prejudiced. Gingerbread was prejudiced by the

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Comment
12

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

Office of the New York State Comptroller
July 21, 2016
Page 5 of 22

denial of its request, because it did not have adequate time to consider and integrate all information relevant to its response and to fully develop and review its response.

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

II. Personal Service Costs

A. 401(k) Retirement Plan Contributions

We disagree with OSC's proposed disallowance of \$160,206 of contributions to Gingerbread's profit-sharing plan for two of Gingerbread's employees for three reasons.

First, OSC assumes that Section II.13.B.2 of the Reimbursable Cost Manual ("RCM"), which requires fringe benefits to be "proportionately similar" for all classes or groups of employees, applies to pension benefits in isolation. It does not. There is a specific separate section of the RCM expressly governing pensions, Section II.C. It provides that: "Costs of employer funded pension plans which are approved by the Internal Revenue Service and accounted for under generally accepted accounting principles (GAAP) are reimbursable," subject to various listed specific exceptions and limitations that are not applicable to Gingerbread's situation. Gingerbread's plan indisputably was approved by the IRS and accounted for under GAAP. Therefore, contributions under the plan were reimbursable pursuant to Section II.13.C. That section of the RCM, specifically applicable to pensions, does not require contributions to be "proportionately similar". Neither does the IRS. The IRS does have anti-discrimination provisions to assure that the plan does not discriminate in favor of certain classes or employees, and Gingerbread's plan also indisputably met the IRS anti-discrimination test.

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

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Comment
14

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

Office of the New York State Comptroller
July 21, 2016
Page 6 of 22

Second, even if RCM Section II.13.B.2 did apply, which it does not, that section does not define what “proportionately similar” means. “Proportionately similar” does not mean “the same as”, which is how OSC applies it. OSC has recognized as much in other audits. In the absence of more specific guidance, we believe that the most reasonable construction is that the plan must meet the IRS anti-discrimination rules. Gingerbread’s plan was approved by the IRS, and the benefits provided met the IRS anti-discrimination rules. If SED intends for the RCM to impose a more stringent test than the well-established and universally understood IRS rules, which serve the same purpose, it is incumbent on SED to specify much more specifically exactly what its test is. In the absence of such guidance, it was perfectly reasonable for Gingerbread, and many other providers, to assume that “proportionately similar” meant only that the IRS guidelines must be met. It is grossly unfair to Gingerbread, and contrary to proper audit procedure, for OSC to propose retroactive disallowances based on its after-the-fact interpretations of RCM provisions that also reasonably could be interpreted as Gingerbread did. A proper audit recommendation would be a recommendation to NYSED to clarify (i) whether pensions standing alone are subject to the “proportionately similar” provision and (ii) if so, what “proportionately similar” means in the context of pension contributions so that clear rules can be applied prospectively. Gingerbread and other providers strive to follow the reimbursement rules, but for them to be able to do so, the rules have to be clear, so that they know what they can and cannot do.

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We are aware that OSC has stated in this and other audits that its position is based on guidance from NYSED. Even assuming that is true, it does not justify the proposed disallowance, because NYSED should be providing clear guidance as to what the RCM requires in the published guidance to the providers, who have to apply the RCM in making financial decisions, not in closed door secret meetings with OSC years after the relevant financial decisions have been made. In addition, if OSC consulted with NYSED about what the RCM means, it is yet another procedural irregularity that such meeting took place without notice to Gingerbread and without giving Gingerbread any opportunity to participate. This again is contrary to the transparency and opportunity for dialogue that proper audit procedure requires. Moreover, OSC still has not disclosed specifically what it asked NYSED and what NYSED said, or provided copies of any written guidance OSC received from NYSED, even though Gingerbread expressly asked for the same.

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Third, OSC’s proposed disallowance is inconsistent with NYSED’s own interpretation of the RCM by NYSED’s Rate Setting Unit (“RSU”) as part of the rate-setting process. RSU very specifically examined the Gingerbread pension contributions. RSU noted that the contributions were heavily weighted in favor of the two employees at issue, but accepted in part Gingerbread’s explanation that it was reasonable to do so given that the no contributions had been made for much of the past 20 years, so that the employees had missed large amounts of benefits during those years of no contributions. Accordingly, NYSED made some disallowances, but not all of the disallowances now proposed by OSC. Documentation of this was provided to OSC in response to

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Comment
17

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

Office of the New York State Comptroller
July 21, 2016
Page 7 of 22

its prior preliminary report (Attachments 4 and 5 to our prior October 5, 2015 response to OSC's preliminary report).

Since RSU actively examined this expense as part of its own rate-setting process, and had the same information that OSC relies on, OSC cannot substitute its interpretation as to what the RCM requires for RSU's determination. Moreover, if OSC now is relying on undisclosed guidance from NYSED, as OSC claims, then NYSED is providing guidance to OSC that is inconsistent with its own determination when it reviewed Gingerbread's CFRs for the audited years. If NYSED has made inconsistent determinations, that in and of itself demonstrates how arbitrary the determination of the meaning of "substantially proportionate" becomes in the absence of a clear and specific definition. Of course, another possibility is that OSC is misinterpreting NYSED's undisclosed secret guidance on this issue.

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

B. "Unsupported" and "Ineligible" Expenses

We disagree with OSC's proposed disallowance of \$11,258 of "unsupported" payroll taxes and other miscellaneous mandated fringe benefits and of \$2,683 of medical co-pay reimbursements.

With respect to the payroll taxes and "other miscellaneous fringe benefits," Gingerbread believes it provided OSC documentation supporting all payroll taxes and other mandated fringe benefits. We also advised OSC multiple times that unless OSC identified more specifically for which of the hundreds of thousands of dollars of payments for those items OSC had documentation or for which items documentation purportedly is "missing," Gingerbread could not identify which payment records OSC does not have. OSC never did so. It is unreasonable for OSC to recommend a disallowance without a more specific identification of which payments purportedly are not documented that would enable Gingerbread to identify the payments at issue and find the relevant documentation.

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With respect to co-pay reimbursements, which were for medical drug expenses, OSC's draft report offers no reason why the payments purportedly are "ineligible." In its prior preliminary report, OSC claimed that these were perks, not employee benefits. That was and is incorrect. As Gingerbread explained to OSC previously, these reimbursements were part of the package of health insurance benefits that Gingerbread provided across the board to all employees who participated in Gingerbread's medical insurance plan. Gingerbread did this because, in light of large increases in insurance premiums, it agreed to a much higher drug plan co-pay to keep the premium costs down. In order to mitigate the adverse effect on its employees' drug plan benefits, it instituted the policy of reimbursing up to \$100 of co-pays for all employees participating in the drug plan.

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19

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

Office of the New York State Comptroller
July 21, 2016
Page 8 of 22

OSC has never explained why it believes this is not a valid reimbursable employee health benefit, and there is no reason. The RCM does not require Gingerbread to document why it chose to increase its drug plan co-pay. The fact that Gingerbread increased the co-pay and chose to self-insure up to \$100 of co-pays, so as to preserve employee morale by mitigating the adverse effect of that decision on its employees, does not somehow change the self-insurance component of that benefit into a “perk.”

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At the exit conference, OSC asked Gingerbread to provide documents regarding its decision to self-insure a portion of the drug plan co-pays. Gingerbread provided documentation showing that its renewal options were very expensive. Nonetheless, OSC did not remove its proposed disallowance. While OSC does not explain why, OSC apparently believes that the documentation provided was not a sufficient “cost-benefit” analysis of the savings self-insurance would produce. Such contention is baseless. Nothing in the RCM required Gingerbread to document why it decided to self-insure or to maintain written records showing why it chose the benefits scheme it did. Absent such an RCM provision, OSC has no authority to impose such a requirement. The only thing that is relevant is whether the costs Gingerbread incurred were reasonable. OSC has not claimed that the total costs (premium plus self-insurance) were not reasonable, much less offered any evidence of the same, because they were reasonable. In this regard, in the modern world of skyrocketing health insurance premiums, it is hardly unusual for businesses to raise co-pays to enable them to reduce the premium cost, while at the same time self-insuring some of the resulting costs to minimize the adverse impact on its employees. That is exactly what Gingerbread indisputably did. That does not make the self-insured part of the prescription drug benefits a “perk”, and there is no basis for OSC’s unexplained contention to the contrary.

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For all these reasons, OSC’s proposed disallowances described above should not be included in OSC’s final report.

C. Life Insurance Premiums

We disagree with OSC’s proposed disallowance of costs for two life insurance policies on the life of the Executive Director. As we explained previously, this life insurance was not a perk or a fringe benefit; rather, it was specific compensation given to the Executive Director for his and his wife’s personally guarantying the mortgage financing on one of Gingerbread’s properties. As we explained previously, in 1995 an opportunity arose for Gingerbread to buy property, which was then under construction, rather than rent it as previously contemplated. However, the mortgage lender was unwilling to provide mortgage financing without a personal guaranty of the approximately \$825,000 mortgage loan and a related \$500,000 line of credit by the Executive Director and his wife. The Executive Director was willing to do so only if Gingerbread would agree to maintain life insurance on his life, with his wife as beneficiary, so that she would be protected from possible liability as a guarantor on Gingerbread’s debt if he died. Gingerbread agreed to do so, and the Executive Director and his wife provided the personal guaranties required

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20

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

Office of the New York State Comptroller
July 21, 2016
Page 9 of 22

by the mortgage lender. A copy of the agreement among Gingerbread, the Executive Director and his wife was provided to OSC. While OSC has not changed its position after receiving this explanation, it has not explained why not, and there is no good reason. Simply stated, this was not a fringe benefit provided under a benefits program; it was direct compensation given to entice the Executive Director and his wife to provide a financial guaranty to Gingerbread's creditor that resulted in Gingerbread's being able to make a very favorable purchase.

The State should be grateful that Gingerbread did this, not criticize it for doing so, as this arrangement has been very beneficial both for Gingerbread and the State. The combined costs of the mortgage payments (approximately \$62,500/year) and the life insurance premiums (approximately \$20,000/year) are much less than what it would cost to rent the building in today's market (approximately \$375,000/year based on a rental value of \$30/square foot). Thus, Gingerbread is saving approximately \$300,000 a year, and the expenses for mortgage payments and life insurance premiums included in this SEIT tuition rate are much less than the expense of renting the building or a comparable building would be. In addition, Gingerbread also has substantial equity in the property, which would not have been possible without the personal guaranties that agreeing to provide this life insurance enabled Gingerbread to obtain.

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

D. "Unsupported" and "Ineligible" Bonuses

We disagree with OSC's proposed disallowance of \$67,339 in bonuses and related fringe benefits that purportedly were not supported by employee performance evaluations and purportedly were paid to "ineligible" administrative staff members. OSC's contentions not only are incorrect, its constant shifting positions on this issue reflect a pre-determination that OSC was going to disallow bonuses, whether or not this is a valid reason to do so, which there is not.

Initially, OSC took the position that Gingerbread's bonuses were not based on merit. After Gingerbread responded to the preliminary reports, OSC shifted its position and took the position that there were not evaluations for many of the employees, even though Gingerbread believes it gave OSC all such evaluations. OSC agreed at the exit conference to provide a list of employees for whom performance evaluations were missing, and ultimately it did so. Gingerbread subsequently produced performance evaluations for most of the employees. Gingerbread since has found more staff evaluations, and they will be provided to OSC by separate cover.

OSC's contention that performance evaluations are "missing" is incorrect for several reasons. As explained above, OSC's auditors took Gingerbread's original personnel files early in the audit, without allowing Gingerbread even to review or read what was in them, and when OSC

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

Office of the New York State Comptroller
July 21, 2016
Page 10 of 22

returned the files months later, many documents, including performance evaluations, were missing. Gingerbread knows that evaluations were prepared and put in the files for every employee, and Gingerbread assumes that the "missing" evaluations were in the files taken by OSC because there is no reason why they would not be. It is OCS's own fault that there is no record of what was in the files taken by OSC, as OSC's actions deprived Gingerbread of any opportunity to make such a record. We also are providing employee attestations that OSC kept the personnel files in disorganized piles during the audit and returned them in disarray, which further suggests that it is OSC who misplaced or failed to return any "missing" documents. Apropos to this point, we have heard complaints from numerous other clients that OSC also returned their original documents in complete disarray at the end of the audit. Under these circumstances, it is not reasonable or fair for OSC to make any disallowances based on contentions that performance evaluations are missing.

Second, OSC has improperly changed and expanded its claim after the exit conference. In this regard, schedules provided by OSC relating to the draft report identified 19 employees for whom performance evaluations purportedly were "missing" when OSC had not claimed performance evaluations were missing in its previous schedules provided to Gingerbread a few months earlier, in April 2016, after the exit conference. Gingerbread provided OSC a list of these 19 employees by email on July 14, 2016. As OSC's Audit Manager has acknowledged in the context of other audits, OSC cannot change its contentions or make new contentions at or after the exit conference, and it was improper for OSC to do so in this case. Accordingly, no disallowances should be made of the bonuses and related fringe benefits for those 19 employees. Moreover, the fact that OSC did not claim that performance evaluation for those 19 employees were missing when it sent Gingerbread schedules in April 2016 strongly suggests that OSC, in its continued disorganization, lost the performance evaluations for those 19 employees sometime after it provided the April 2016 schedules to Gingerbread.

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Third, OSC now contends in its schedules that bonuses for other employees for whom it admits there are evaluations nevertheless should be disallowed, apparently because the written evaluations are dated after the date the bonuses were paid. This contention also is improper procedurally because it is being made for the first time in the draft report and, therefore, is an entirely new position not previously raised with Gingerbread. These proposed disallowances should be removed for that reason alone. Moreover, OSC's position is substantively incorrect as well.

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Gingerbread conducts evaluations of its staff throughout the year. It begins in the fall, because it is important to identify problems early in the school year. Evaluations continue throughout the year. Typically, written evaluations are not given to teachers until the spring. The date of the written evaluation does not reflect the date the evaluation was performed, which began in the fall. Rather, it reflects the date the written evaluation was given to the employee to sign. Typically, Gingerbread paid its bonuses at Christmas time. It did so only after the Executive Director confirmed with the supervisor for each teacher receiving a bonus that the teacher's work to

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

Office of the New York State Comptroller
July 21, 2016
Page 11 of 22

date would merit a rating of satisfactory or better. Indeed, if that were not the case, the employee most likely would have been terminated before Christmas time, as Gingerbread runs an excellent program and does not keep substandard teachers.

The RCM does not require that a written performance evaluation be prepared and signed before a bonus is paid. That is another non-existent “requirement” made up by OSC, which OSC has no authority to impose. The RCM requires only that a merit award be “based on merit, as measured and supported by employee performance evaluations.” The bonuses for these employees met that requirement. They were based on the merit criteria adopted by Gingerbread that performance be satisfactory or better, which OSC now has accepted. They were supported by the performance evaluations conducted prior to Christmas time, confirmed by verbal reports to the Executive Director before bonuses were paid and further supported by the written performance evaluations given to the employees in the spring, which were based on the evaluations conducted earlier.

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We note that OSC’s contention on this point confirms that OSC did not return performance evaluations that it took. In this regard, 14 of the evaluations that OSC says were not dated properly were for employees for whom Gingerbread does not have performance evaluations in its files, because they were not returned by OSC. Obviously, OSC has or had them, since its schedules refer to their duties. This further reflects why it is inappropriate for OSC to recommend any disallowances based on “missing” performance evaluations. We also note that we provided OSC with a list of those 14 employees on July 14, 2016, and asked OSC to provide copies of these evaluations to Gingerbread, but OSC did not do so.

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With respect to OSC’s contention that bonuses were given to “ineligible” employees, the proposed disallowance of administrative staff bonuses for 2010-11 is incorrect. The RCM provision which limited bonuses to direct care employee titles did not apply until the 2011-12 year. The 2010-11 RCM merely provided that “bonus compensation restricted to only administrative staff is not reimbursable.” Gingerbread’s 2010-11 bonuses were not restricted solely to administrative staff and, therefore, were reimbursable. We also note that the administrative staff who received bonuses in 2010-11 and 2011-12 were administrative assistants, not supervisors or executives.

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

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

Office of the New York State Comptroller
July 21, 2016
Page 12 of 22

E. "Unsupported" Compensation for Teacher Assistants

We disagree with OSC's proposed disallowance of \$17,770 of "unsupported" compensation costs for certain teaching assistants. As Gingerbread advised the auditors previously, and as the draft audit report reflects, one of these employees was a permanent employee who was a "floater", who was assigned to a classroom or classrooms for all or part of each day as needed to maintain ratios in light of absences or teaching assistants' leaving the room temporarily. During days or portions of days where she was not needed to maintain the minimum class ratio in any class, she was assigned to a room as an extra teaching assistant as management determined. Having her available in case she was needed to maintain the proper mandated ratios, which usually was the case for at least a portion of the day because of breaks or other reasons why teaching assistants had to leave a classroom temporarily, was a necessary and prudent expense.

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The other two teaching assistants for whom Gingerbread disputes the proposed disallowances were part-time substitutes who worked only on days when they were needed to maintain mandated class ratios on account of absence. They were called in only when necessary, and the expenses were reasonable. Gingerbread had no conceivable reason to call them in and pay them for their services if they were not needed, as Gingerbread would not benefit from that in any way.

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The statement in the draft report that Gingerbread did not maintain records reflecting the classrooms in which these teaching assistants worked is irrelevant for two reasons. First, that information could be reconstructed by reviewing the absence records of other teaching assistants. Second, and more importantly, Gingerbread was not required by the RCM or any other rule or regulation to maintain documentation of that. If OSC believes otherwise, it has not cited any such regulatory guidance in the draft report or any of its prior preliminary reports. This is yet another instance where OSC is making up a non-existent purported "requirement" to support a disallowance OSC wants to make, but which is not justified by the facts.

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The fact that the affidavits Gingerbread provided to OSC were not "contemporaneous" is irrelevant; they are sworn evidence corroborating what these teaching assistants did. Again, the RCM does not require contemporaneous records, or any records at all, substantiating in which specific classroom a "floater" or substitute worked on any given day.

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Gingerbread does not know with certainty which classroom the draft report is referring to as already having three teaching assistants, as OSC has not identified that. However, we note that one of the classrooms had an "over-tally" (a thirteenth child), which required an additional teaching assistant to maintain required ratios, and therefore would require a floater or substitute to maintain the required ratios if any of the three required teaching assistants were absent for all or part of the day. It is also possible that one of the "teaching assistants" OSC is referring to actually was

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

Office of the New York State Comptroller
July 21, 2016
Page 13 of 22

functioning as a 1-to-1 aide for one of the children in the classroom, not as a teaching assistant, but Gingerbread cannot determine this without knowing to which classroom OSC is referring.

For all these reasons, OSC's proposed disallowances of teaching assistant compensation for the employees at issue are incorrect and should not be included in the final report.

F. Maintenance Supervisor

Gingerbread disagrees with OSC's proposed disallowance of \$13,027 of "unsupported" compensation paid to its maintenance supervisor. There is no evidence of his "approving leave requests for cleaning staff" because that was not his job. He did not oversee day-to-day routine cleaning. His job was to oversee the performance of substantial repair work by maintenance personnel when such repair work was needed. We do not agree with OSC that time records were required in this circumstance. This employee was paid a set salary to be available if repairs were needed. His compensation was not based on hours actually worked. We believe that the sentence in RCM Section III.1(a) stating that payroll "must be supported by employee time records" cannot reasonably be construed to require time records for an employee, like this person, whose compensation was not based on hours worked and did not require him necessarily to have performed any work during the payroll period if no substantial repairs were required during the payroll period.

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

III. Other Than Personal Service Costs

We disagree with many of OSC's disallowances for other than personal services expenses ("OTPS"). Unfortunately, at this point we cannot identify with certainty exactly what OSC proposes to disallow. In this regard, OSC provided schedules with its preliminary report in October 2015 and revised schedules after the exit conference in April 2016. In response to Gingerbread's request that OSC identify the expenses that were not enumerated on page 10 of the draft report, OSC provided a schedule of those expenses on July 7, 2016, but it has not provided a schedule of the entire \$302,837 of expenses that purportedly were not adequately documented or purportedly were not eligible for reimbursement. Similarly, with respect to the categories of expenses that the draft report describes on page 10, the numbers have changed since the preliminary report, but the draft report does not identify which expenses on the prior schedule still are recommended for disallowance to produce the new numbers. Accordingly, Gingerbread is not sure which expenses still are recommended for disallowance. We request that OSC provide its complete current schedule that will explain exactly what items OSC still proposes to disallow, and that OSC allow Gingerbread to submit a further response, if Gingerbread so chooses, to items not presently specifically identified. We will base Gingerbread's response that follows on that schedule and the

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

Office of the New York State Comptroller
July 21, 2016
Page 14 of 22

descriptions in the draft report, although OSC obviously should assume that Gingerbread also disputes any similar items that were not included in the schedule provided on July 7, 2016 for the same reasons.

Before proceeding to the specific proposed disallowances, we also note that OSC's process imposed an incredible burden on Gingerbread's small financial staff and further reflected the investigatory nature of the "audit". With respect to American Express bills, OSC initially itemized the specific expenses it questioned for only one of the three years. Although Gingerbread had provided copies of the American Express statements and its bookkeeper's itemized reconciliations for all three years, OSC's schedules for the other years were aggregate numbers which did not correlate to specific items on the statements, which made it impossible for Gingerbread to identify what items OSC questioned. Functionally, OSC was requiring Gingerbread to produce documentation of every single purchase over three years. More generally, throughout the audit, OSC did not use samples in other areas as well; rather it required Gingerbread's small financial staff to pull documentation for every single small purchase over the three year "audit" period years ago.

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OSC also gave inconsistent advice as to what documentation would be sufficient. In February 2015, at the beginning of the audit, OSC advised Gingerbread in writing that acceptable support for purchases included "purchase order, invoice/receipt, shipping report, cancelled check/credit card payment, written clarification *or* service contract." (Emphasis added.) Gingerbread understood that the disjunctive "or" meant that not every listed item was required for every purchase, but rather that any one or more items that reasonably demonstrated payment for the item was sufficient. However when Gingerbread produced cancelled checks for most items listed on the Amex statements, OSC wanted invoices for the specific purchase in addition to the Amex statement listing it. This imposed an unreasonable burden, as it required another search for multiple items of documentation for every small purchase over a three year period. In addition to the burden being unnecessary and unfair, we submit that an Amex statement or other vendor statement listing items purchased, combined with a cancelled check or checks for the total amount of the statement, is sufficient documentation of any purchase under any reasonable standard. Such documentation proves that the purchase was made and paid for. To the extent that OSC has recommended disallowance of expenses where such documentation was provided as "inadequately documented" because a separate Amex or Costco or Staples receipt or other documentation for the purchase was not produced as well, we submit that such disallowance is improper and should not be included in OSC's final report.

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32

We will now address specific items in the draft report and in the incomplete schedule provided to Gingerbread on July 7, 2016.

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

Office of the New York State Comptroller
July 21, 2016
Page 15 of 22

A. Unoccupied Building Expense

We disagree with OSC's proposed disallowance of costs related to the North Gannon building while it was under renovation and not occupied. This is another example where OSC has changed its positions, struggling to come up with a reason to disallow an expense it wants to disallow, when there is no valid reason.

In its preliminary report, OSC took the positions that this expense was not reimbursable because there purportedly was not evidence that Gingerbread intended to return to the building and because Gingerbread purportedly had caused the project to be delayed. In our response, we conclusively rebutted those false contentions, and now OSC has abandoned them. Now OSC says instead that "we saw no evidence that any exceptions to the Manual's guidelines were approved by NYSED."

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OSC's new contention is improper for two reasons. First, it is a new position asserted for the first time in the draft report, which itself is procedurally improper. Second, it is incorrect substantively. The fallacy of OSC's new contention is that there are no guidelines in the RCM that would preclude reimbursement of these expenses absent some explicit "exception" from NYSED. If OSC believes otherwise, it has not identified any such provisions in the RCM.

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If OSC is analogizing these costs to "rent" and applying RCM Section II.41.B(1), relating to rent, stating that "the program's operating costs of the new location are not reimbursable before the actual date of the program's occupancy unless such costs are incorporated in an approved tuition rate," that RCM provision does not support OSC's contention for three reasons. First, these expenses are not rent. Second, the renovated building was not a "new" location. It was an existing approved location under renovation to enable it to better support programs NYSED wanted Gingerbread to provide. Third, such costs were "incorporated in an approved tuition rate." The costs associated with this building were incorporated in Gingerbread's tuition rate, approved by the NYSED and the Division of the Budget, both before and during the construction. In our response to the preliminary report, we also submitted documentation (Enclosure 22) clearly showing that NYSED was aware of and approved the renovation project.

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For all of these reasons, OSC's proposed disallowance is baseless and should not be included in its final report

B. Depreciation

We disagree with OSC's proposed disallowance of \$41,601 in depreciation expenses. OSC's preliminary report proposed disallowance of \$43,836 for depreciation charges and another \$52,558 disallowance for depreciation relating to the North Gannon building. We provided OSC voluminous documentation (Enclosure 1) supporting all of those depreciation expenses. At the exit

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

Office of the New York State Comptroller
July 21, 2016
Page 16 of 22

conference, OSC advised that while it had not yet fully reviewed the large box of enclosures submitted with Gingerbread's response to the preliminary report, the depreciation documentation looked "okay" on first review, but that if OSC on further review believed that it was not sufficient in any way, OSC would advise Gingerbread what was wrong or missing and provide Gingerbread an opportunity to address the deficiency. OSC never did so. Accordingly, we do not know which of the depreciation charges OSC thinks were not properly documented, much less why OSC believes the documentation presented was inadequate. Unfortunately, this is all too typical of the lack of meaningful communication and identification and discussion of issues by OSC that has characterized this "audit". We request that OSC identify exactly which depreciation charges it believes still are not documented and what was wrong with the documentation submitted. Only if OSC does so can Gingerbread meaningfully respond.

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C. School Supplies

Gingerbread disagrees with OSC's disallowance of \$46,801 in school supplies. Again, because we do not have complete itemized schedules, we do not know exactly which items these are, but we will respond based on our present understandings.

Some of the school supplies were purchased using American Express. As explained above, Gingerbread could not match OSC's proposed disallowances to specific items on American Express statements in some cases because OSC aggregated amounts and the aggregated amounts did not match items on the invoices so that Gingerbread could not identify what OSC was proposing to disallow. It is not reasonable for OSC to disallow items it did not identify with specific particularity to enable Gingerbread to address them.

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We also note that Gingerbread previously provided a package of documentation relating to school supplies in response to the preliminary report (Enclosure 9), to the extent Gingerbread could identify what items OSC was proposing to disallow. We cannot tell whether OSC has credited Gingerbread for these items, as we cannot tell what items OSC still proposes to disallow. If OSC believes that any of the documentary support in Enclosure 9 was not sufficient and still proposes to disallow those items, we request that OSC identify which of those items it still proposes to disallow and why the documentation submitted was not adequate, so that Gingerbread can respond meaningfully. We note that OSC committed at exit conference to do so.

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D. Costco Purchases and Food

We disagree with OSC's proposed disallowance of Costco purchases. Gingerbread provided documentation to support its purchases from Costco, so we do not understand what OSC thinks is missing. There also may be some overlap between this proposed disallowance and the proposed disallowance of \$15,922 in food purchases that OSC claims were "not eligible for reimbursement," because food purchases were made at Costco.

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Comment
38

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

Office of the New York State Comptroller
July 21, 2016
Page 17 of 22

OSC's proposed disallowances of food purchases, whether described as "Costco" or "Food" in the draft report, are incorrect. As we have explained previously, food is a necessary part of Gingerbread's educational programs for several reasons. First, feeding is a first step in development of language for severely disabled children. Also some disabled children have feeding disorders and need to learn feeding as a life skill. For this reason, some IEPs expressly require feeding instruction, which of course requires food. Second, autistic and other severely disabled children require enforcement of positive behaviors to help modify inappropriate behaviors and replace them with positive behaviors. Food is a primary reinforcement mechanism. We also will provide under separate cover, as a representative sample, a list of some of the children whose IEPs expressly require feeding instruction or behavior reinforcement requiring food, together with relevant portions of their IEPs.

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Third, children, and particularly severely disabled children, who are at school for a long day get hungry and need food to maintain attention. Accordingly, Gingerbread serves them snacks. Fourth, Gingerbread uses food in parts of its curriculum; for example, for a Thanksgiving meal to teach children about the holiday. Fifth, many of Gingerbread's children come from poor families and come to school without having had breakfast. Gingerbread provides breakfast for these children, as they need it to help maintain the focus and attention that is critical to their ability to learn.

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38

The auditors did not ask about any of this during the audit. With all due respect, OSC's proposed disallowance of food as "not program elected" or "ineligible" reflects OSC's own lack of understanding of special education, not any failure by Gingerbread. Indeed, this is one of the reasons why the New York State Constitution does not allow OSC to conduct audits where other specialized state agencies (NYSED in this case) already have authority to do. OSC is not qualified to make judgments about what expenses are reasonable or necessary for a special education program because it has no expertise or understanding of what special education programs need to do. Only NYSED, which understands what special education requires, is qualified to make these judgments.

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E. Contracted Services

The draft report does not identify what "contracted services" purportedly were not adequately documented or why. We assume that OSC is referring to Zecon, the cleaning service used during construction at the North Gannon building. As was explained to OSC previously, Zecon was responsible for cleaning both the temporary replacement location and the North Gannon building which required cleaning in the parts not being renovated to clean the concrete, dirt, plaster and dust generated by the construction. The forced air system also needed to be cleaned, and filters had to be changed regularly.

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Comment
39

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

Office of the New York State Comptroller
July 21, 2016
Page 18 of 22

For reasons explained at length in Gingerbread's response to the preliminary report, OSC's completely unsupported prior contention that two staff people could have cleaned all three locations during the year of construction is incorrect. As with so many of its positions, OSC never has addressed Gingerbread's stated reasons for incurring these cleaning expenses, and there is no valid reason for disallowing them. To say that these "were not adequately documented," which is all the draft report says, is not an explanation. If OSC believes that additional documentation is required, it has never disclosed what additional documentation OSC thinks is required or why.

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If OSC is referring to some other "contracted services," we do not know what expenses the draft report is referring to. The preliminary report proposed disallowances relating to contracted services for computer consultation, website development, floor polishing and school photography. Gingerbread provided documentation for such expenses in its response to the preliminary report (Enclosure 18). Again, OSC committed at the exit conference to advise Gingerbread if it found the documentation provided insufficient in any way. OSC never did so. Accordingly, if OSC is continuing to recommend disallowances for any of these contracted services, Gingerbread has no idea why and requests that OSC disclose for which services it found the documentation inadequate and why.

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F. Advertising Costs

Gingerbread disagrees with the proposed disallowance of \$6,395 in advertising costs. Gingerbread provided documentation of every advertising expense. If OSC's disallowance is based on the fact that in some cases Gingerbread could not produce a copy of the advertisement, that is incorrect. The RCM does not require the provider agency to maintain a copy of the advertisement itself in its records. If OSC is disallowing expenses for some other reason, we do not know why, since OSC has not explained its proposed disallowances. We request that OSC explain which of the advertisement expenses it continues to propose to disallow and why.

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G. Expenses That Purportedly "Had No Supporting Documentation"

Gingerbread disagrees with the proposed disallowance of interest charges. The preliminary report referred to \$10,078 in unsupported interest charges. As Gingerbread explained, that interest expense was in connection with the refinancing of the North Woodrow location and was documented in the closing documents provided to the auditors. If OSC still believes those expenses were not documented, OSC never told Gingerbread that or explained why, and we request an explanation. Additional interest charges beyond that amount were not mentioned in the preliminary report, and it is improper to add to claim now. Gingerbread does not know exactly what interest charges those are or why OSC thinks they were not documented.

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Comment
42

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

Office of the New York State Comptroller
July 21, 2016
Page 19 of 22

Gingerbread also disagrees with OSC's proposed disallowance of legal expenses. As explained previously, Gingerbread gave these invoices to the auditors during the audit, and they were not returned. Accordingly, it is not appropriate to disallow these expenses as "undocumented". Gingerbread could not obtain duplicate invoices after OSC did not return them because the lawyers have retired and the law firms no longer exist.

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H. Expenses "Not Eligible For Reimbursement"

We already have explained above why OSC's proposed disallowances of food purchases are incorrect.

Gingerbread also disagrees with OSC's proposed disallowance of tuition reimbursement expenses. The expenses were related to the 4410 program because they were for reimbursement of tuition for training needed to enable the employee to work as a special education teacher in the 4410 program. As explained previously, that employee had a regular teaching license and was working in both Gingerbread programs, Early Intervention and 4410. Gingerbread needed a special education teacher, and she was willing to receive special training to obtain her special education license so that she could work as a special education teacher. It is very difficult to find teaching staff on Staten Island with the right credentials, and Gingerbread is constantly in competition with other programs and the New York City Department of Education to hire or train these qualified individuals. Gingerbread agreed to pay for 20% of this teacher's tuition for her to receive her certification because Gingerbread knew she was an excellent teacher. She is now working in the 4410 program in a 12:1:2 classroom, where Gingerbread always had planned to put her when she got her degree as a special education teacher. Once again, if OSC continues to believe that this expense was "not program-related" in light of these facts, it has stated no reason for its position, and there is no valid reason for the proposed disallowance.

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I. Other Items On OSC's Schedule

There are various other items listed on OSC's partial schedule provided to us on July 7, 2016, that Gingerbread disputes and would like to discuss. They are as follows.

1. Storage Space Rental. Gingerbread required storage space for storage of records, and it rented space for that purpose. The pre-school contract expressly requires records to be retained. Accordingly, there is no factual basis for OSC's contention that this expense was not program-related. If OSC believes otherwise, it has not stated any factual basis for its position, and there is none.

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2. Toys. Gingerbread purchased toys from Toys 'R Us. Gingerbread modifies these toys when needed, and they are all used for educational purposes, whether they are computer games or box games or otherwise. They all are used for instruction by certified teachers for educational

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Comment
46

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

Office of the New York State Comptroller
July 21, 2016
Page 20 of 22

purposes; they are not there for children to play with on their own. For example, video games that children are familiar with from home, including a Play Station 1 game center, are used both for positive reinforcement and to improve fine motor skills. Sponge Bob Toothpaste is used to help teach a necessary life skill, tooth brushing, and fine motor skills. A bean bag chair is used for a quiet center, which all special education programs need to have. Again, OSC has stated no reasons for its conclusion that these items are “not program-related,” and there are no valid reasons. Once again, we believe that these proposed disallowances reflect OSC’s lack of understanding of what a special education program entails and requires, not any non-reimbursable expenditures by Gingerbread.

3. Desk. OSC proposes to disallow the cost for two large desks purchased for use in the main office for \$5,000 each when the office was renovated for the first time in 20 years. That was the cost of the desks. OSC knows that, as it specifically questioned the carpenter about them. While the draft report does not mention the desks, or explain why their cost was disallowed, the schedule reflects that OSC apparently believes that the cost was excessive. That unsupported and unexplained contention is baseless. The desk was custom made to Gingerbread’s specifications to promote efficiency. Gingerbread believes that custom carpentry work typically costs \$1,800 per linear foot and the desks are 72” long, so Gingerbread believes that the \$5,000 price was a good value, less than half of what custom work normally costs. If OSC believes otherwise, once again, OSC has stated no reason for its position. With all due respect, we do not think that it is OSC’s prerogative to substitute its judgment for Gingerbread management’s judgment as to what Gingerbread needs. To spend \$5,000 each on two well-made desks, that were custom designed to meet Gingerbread’s needs for efficient use of its space, once every 20 years hardly is unreasonable.

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4. Equipment. OSC’s schedule recommends disallowance of the costs of a jackhammer, claiming it was the contractor’s responsibility to provide this. It was not the contractor’s responsibility because it was not needed or used for the contractor’s construction project. Gingerbread uses it for its own purposes for work Gingerbread does itself. It was used to fix concrete in the outdoor play yard, repair playground equipment and to remove play equipment no longer needed, among other things. Again OSC has not stated any basis, and there is no basis, for OSC’s contention that the equipment was not needed for program purposes or that it was the contractor’s responsibility.

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48

5. Computers. OSC proposes to disallow the costs of two computers “not found” and printers “not dispensed of properly.” As was explained in our April 15, 2016 letter to OSC, when we first became aware of these contentions, the two computers exist and were shown to the auditors. The Staples documentation erroneously was off by one digit in the serial numbers. Gingerbread cannot be held responsible for minor typographical errors in the vendor’s documentation. OSC cannot seriously believe, based on these typographical errors, that these were not the computers to which the documentation relates. With respect to the old printers, Gingerbread disposed of them and had logs reflecting the same. Nothing else was required. If OSC believes

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Comment
49

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

Office of the New York State Comptroller
July 21, 2016
Page 21 of 22

otherwise, it again has stated no reasons for its unsupported and unreasonable belief; OSC has said nothing beyond the notations in its schedules quoted above. There is no valid reason for OSC's contentions, and these proposed disallowances should not be included in the final report.

6. Clothing. OSC's schedule also refers to "clothing" items, which the prior draft report incorrectly described as having been bought as a men's clothing store, as non-program related. That is incorrect. The store is a beach store, and Gingerbread bought items there for water play for its children, primarily flip-flops because many of them do not have them. The children should use flip-flops for water play to protect them and other children from possible fungus infection, which is why Gingerbread provided the flip-flops.

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7. Staples Purchases. OSC has proposed to disallow various purchases of office supplies from Staples. Again, Gingerbread cannot identify which of the items previously recommended for disallowance these are, because OSC has not provided complete updated schedules.

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As was explained by the auditors previously, originals of the Staples invoices were taken by the auditors and were not returned to Gingerbread. Staples could not provide duplicate invoices going back that far, but it did supply lists of every item Gingerbread purchased during the audited years. OSC's prior schedules said it is "unable to review documentation in current format." If that is the reason for the disallowance of items purchased from Staples, it is incorrect and unreasonable for two reasons. First, OSC was given the original invoices and OSC itself apparently lost them, or at least did not return them to Gingerbread. Second, even if OSC itself had not lost the original invoices, Gingerbread provided the same information in a different format, which was the only format in which Staples could provide it so long after the purchases were made. The fact that OSC does not like this alternative format is not a basis for allowance, because it contains the same information in a different format. In addition to the lists of purchases obtained from Staples, Gingerbread has given the auditors cancelled checks which reflect payments to Staples in amounts that account for every one of the purchases. This conclusively demonstrates that the items were purchased and paid for. There is no further documentation that OSC could reasonably require.

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52

OSC's schedules also appear to reflect that OSC objects to the Staples purchases in part because Gingerbread did not provide documentation proving that items purchased actually were brought to the school. That is preposterous; no such documentation is required by the RCM or any accounting rule, and businesses do not typically maintain such records. In any event, Gingerbread did not send employees to Staples to buy these items and then bring them to the school. Orders were placed by telephone, and the items purchased were delivered to the school by Staples.

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IV. Conclusion

OSC's report is misleading, legally incorrect and factually inaccurate and falls short of a proper and fair audit report. We trust that OSC's final report will modify the draft report

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54

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

Office of the New York State Comptroller
July 21, 2016
Page 22 of 22

appropriately in light of this response. We also trust that OSC will provide the complete OTPS disallowance schedules requested and explain numbers that have changed since the preliminary reports, and give Gingerbread further opportunity to comment when Gingerbread fully understands exactly which items OSC continues to recommend for disallowance.

Sincerely,



Frederick J. Berman

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State Comptroller's Comments

1. The State Comptroller's legal authority to audit the costs submitted by Gingerbread on the CFRs submitted to the State Education Department (SED) is expressly cited on pages 3 and 11 of the report.
2. OSC conducted an audit based on Generally Accepted Government Auditing Standards (GAGAS or Standards) – and not an “investigation.” Further, Mr. Louie is a career auditor – and not an investigator. We are perplexed that Mr. Berman was not aware of this, as Mr. Louie worked on the audit of the Milestone School for Child Development, a special education provider that Mr. Berman also represented.
3. OSC auditors regularly discussed audit issues with Gingerbread officials and documented those discussions. Moreover, audit findings were discussed in detail with Gingerbread officials prior to the issuance of the preliminary audit reports.
4. OSC auditors take issues of public safety very seriously. As we told Mr. Berman when he first brought this incident to our attention, there is significant disagreement as to the underlying facts regarding Mr. Louie's interaction with contractors at the site, the occurrence of any incident while Mr. Louie was on site, and the correlation between Mr. Louie's site visit and the purported incident. Moreover, Mr. Berman's current description of this incident materially differs from what he originally conveyed to us. In an email dated July 8, 2015, Mr. Berman stated, “Mr. Liu [*sic*] started questioning a contractor while he was working. That contractor became distracted and forgot to cover a dry-well hole on the site. Another worker backing up did not realize that the hole was not covered and fell into it. By good fortune, he was holding onto netting which caused his elbows to catch the top of the hole and keep him from falling all the way.” In response to the draft report, Mr. Berman now says “Mr. Louie walked onto the construction site, and startled a construction worker who fell into a manhole. Fortunately, the worker was able to catch himself by his elbows on the outside of the hole... .” Moreover, we maintain that both versions of this allegation are rather inaccurate.
5. We advised Gingerbread officials at the opening conference that we would expand the audit scope to the two prior fiscal years if we identified material non-compliance in fiscal year 2012-13. Further, we issued a revised engagement letter, extending the audit scope to fiscal years 2010-11 and 2011-12, to Gingerbread. That letter was sent to Mr. Berman on April 3, 2015, and Mr. Berman acknowledged receiving that letter and responded to it on April 8, 2015.
6. To ensure the integrity and reliability of evidence used for audit, it is OSC's practice for auditors to personally retrieve files or to have files retrieved in the auditors' presence. In addition, according to GAGAS, examination of original documents is generally more reliable than an examination of copies. Mr. Berman, in his response, states that Gingerbread staff were unable to “look at the files before OSC took them to see what files were taken or what was in them... .” He then states that when Gingerbread staff reviewed the documents that were returned, “numerous documents were missing.” OSC agrees that the documents were not in the files, as that is the basis of our finding. However, the documents were not “missing,” as they were never in the file. Moreover, as noted in Mr. Berman's own correspondence of March 3, 2015, Gingerbread gathered the files for the auditors and had ample time to inventory and copy them. In January, auditors informed Gingerbread

that they would like to pull the sample selected themselves, which they did on February 24, 2015. Gingerbread gathered the files in one location, and had over a month to copy and inventory them. However, according to Mr. Berman's response, Gingerbread did not do so, as the staff were unaware of the contents of the files when they provided them to the auditors.

7. OSC follows GAGAS in conducting audits. While OSC attempts to be as courteous as possible to providers, in some instances, the requests of the providers are not compatible with audit standards. Moreover, OSC is unaware of any request by Gingerbread to inventory or copy the documents retrieved from storage, which were not provided to auditors when originally requested. In the case cited above, in January 2015, the audit team advised Gingerbread that the normal audit procedure is for auditors to pull the files themselves, and that the auditors would do it soon but they could not provide an exact date. On February 24, 2015, the audit team began pulling the files. OSC not only gave Gingerbread notice of their plans, but allowed Gingerbread significant opportunity to both inventory and copy the files.
8. Mr. Berman appears to have misunderstood information conveyed to him. Paragraph 6.61 c of GAGAS states that "Examination of original documents is generally more reliable than examination of copies." We advised Gingerbread officials that we do not take original documents "off site" – not that we do not take original documents for examination while on site. It would be inconsistent with standards to not examine original documents if they are available. Moreover, the Reimbursable Cost Manual (Manual) requires agencies to retain documentation to support costs claimed on their CFRs and to produce those documents upon audit. The presence of copies rather than originals to support procurements is a well-known red flag of fraud and/or abuse, and an agency that provides only copies of documents to support its CFR would be considered to be of higher relative risk.
9. Throughout the audit, Gingerbread had considerable difficulty in producing the required documentary support for the costs claimed on its CFRs. Further, based on Mr. Berman's own statements, he has no support for his allegations. Mr. Berman, on page 3 of his response, repeatedly argues that Gingerbread was unaware of what information was provided to OSC. However, in correspondence sent to OSC during the audit, Mr. Berman acknowledged that Gingerbread gathered the requested information for the auditors, providing Gingerbread officials with ample opportunity to both inventory and copy the information provided if they chose to do so. He further acknowledged that Gingerbread had difficulty finding requested information. Consequently, based on Mr. Berman's own statements, the factual basis for his allegation that OSC misplaced documents is quite unclear.
10. All documents were requested in an appropriate and professional manner from Gingerbread. Also, as previously noted, the audit was conducted in accordance with GAGAS.
11. The assertion is inaccurate. We brought all reported issues to Gingerbread's attention prior to the issuance of preliminary reports. Further, there was significant communication between Gingerbread and OSC prior to and after the exit conference and issuance of the draft report. We used written responses to our preliminary audit findings, information derived from the exit conference, and multiple communications with Gingerbread thereafter to prepare the draft report.

12. OSC's standard policy is to allow providers 30 calendar days to respond to a draft report. We advised Gingerbread officials of the 30-day response period at the opening conference, during the audit, at the exit conference, and in the transmittal letter that accompanied the draft report. The draft report was issued on June 14, 2016. We provided Gingerbread officials with an additional 7 days to respond and advised them that we would examine any additional supporting information until the time the final report was issued.
13. We disagree. Section II.13.B(2) of the Manual clearly states that benefits, including pensions for individual employees or officers/directors, must be proportionately similar to those received by other classes or groups of employees. Further, SED officials concur with our interpretation of this provision of the Manual. Also, nothing in the Manual obviates Gingerbread from following the requirements of Section II.13.B(2).
14. Contrary to Gingerbread's contention, Section II.13.B(2) does not refer to fringe benefits "generally" or "as a group."
15. As detailed in the report, the pension contributions of all but the two employees in question were between 5 percent and 8 percent of their respective gross salaries, while the two employees received contributions of 24 percent to 33 percent of their gross salaries. Given the magnitude of the differences in the contribution rate ranges, we maintain that the contributions were not proportionately similar.
16. Gingerbread officials could have sought guidance and/or clarification from SED officials. Further, SED officials provide periodic Manual training. Also, in response to the draft report, SED officials stated that they will continue to provide technical assistance whenever requested and strongly recommend that providers take advantage of SED's availability to help them better understand the standards for reimbursement as presented in the Regulations and the Manual.
17. SED's desk reviews do not include the level of detail of OSC's on-site audits of the source and supporting records for the costs reported by providers on their CFRs. Consequently, the fact that a particular cost was allowed pursuant to SED's desk review does not mean that the same cost will be recommended for disallowance upon on-site audit of the required supporting documentation.
18. We provided Gingerbread with a detailed listing of all claimed costs that were not adequately documented. In some instances, invoices were missing; in other instances, we could not determine what was purchased. Without adequate supporting documentation, the costs in question did not meet the Manual's requirements for reimbursement.
19. We revised our report to delete the recommended disallowance related to medical co-pay reimbursements.
20. We disagree. Life insurance is listed as a fringe benefit in the Manual.
21. The assertions are incorrect. The fiscal year 2010-11 bonuses paid to administrative staff were recommended for disallowance because of missing evaluations. Subsequently, Gingerbread provided the evaluations for the administrative staff, and the recommended disallowances were deleted. We revised our report to reflect this.
22. The assertion is incorrect. In fact, auditors did not shift their position. We allowed bonuses that were based on merit, as required by the Manual.
23. Refer to Comment No. 9. Further, we did not maintain Gingerbread's files in a disorganized manner. Moreover, all records and files Gingerbread provided to auditors were returned to Gingerbread in an orderly manner.

24. The assertion is baseless. OSC did not misplace Gingerbread's documentation. Further, we traced all 19 employees in question to lists (for fiscal years 2010-11 and 2011-12) of employees who received bonuses, as provided to us by Gingerbread officials. Thus, the 19 employees were included correctly in our sample of bonus recipients. Also, as Gingerbread provided employee evaluations to OSC auditors, the auditors deleted 17 of the 19 employees from the recommended disallowance summary.
25. Performance evaluations are prescribed requirements for awarding bonuses. Thus, an evaluation should be performed prior to, not after, the award of a bonus. Further, auditors recommended bonuses for disallowance only when there was no evidence that the bonuses were based on merit.
26. The Manual states that bonuses may be reimbursed if based on merit, as measured and supported by employee performance evaluations. In its response to the draft report, Gingerbread asserted that bonuses were paid and supported by written performance evaluations that were given to employees. However, absent the purported written evaluations, we were unable to verify that the evaluations were in fact performed and, consequently, there was insufficient evidence that the bonuses in question were merit-based.
27. Initially, auditors recommended for disallowance fiscal year 2010-11 bonuses for administrative staff because Gingerbread did not provide evidence that they were based on merit. Subsequently, auditors allowed the bonuses after Gingerbread provided the required evaluations for the employees in question. Further, the Manual clearly states that staff receiving bonuses in fiscal year 2011-12 must be direct care employees. Direct care employees are in job codes reportable on CFR 1. All administrative employees are reported on CFR 3, which includes executive and clerical staff job codes.
28. We revised our report to delete the recommended disallowances related to Unsupported Compensation for Teacher Assistants.
29. We disagree. The Manual requires that payroll be supported by employee time records prepared during, not after, the time period for which the employee was paid. Employee timesheets must be signed by the employee and a supervisor, and must be completed at least monthly. Moreover, the Manual provides no exception to these requirements simply because an employee works irregular hours and/or on an as-needed basis.
30. During the course of the audit, auditors provided Gingerbread with a detailed listing of all other than personal service costs recommended for disallowance. Nevertheless, OSC provided Gingerbread officials with a second copy of the detailed listing previously given to them.
31. The Manual states that costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the education program, and sufficiently documented. Moreover, providers are required to retain documentation for seven years. Costs will not be reimbursed upon field audit without appropriate written documentation. Thus, we asked Gingerbread to provide supporting invoices, receipts, and any other pertinent support for a sample of payments. We did not require "Gingerbread's small financial staff to pull documentation for every single small purchase" over the three-year audit period.

Also, certain entries on the General Ledger and the crosswalk consisted of multiple

transactions that Gingerbread's bookkeeper lumped into a total. To verify this amount, we requested Gingerbread to identify the individual transactions that comprised this total. However, Gingerbread did not provide the AMEX statements and the bookkeeper's itemized reconciliations for fiscal year 2010-11 until several months after our requests for the documentation.

32. It is not the auditors' function to advise providers on CFR preparation and submission. Further, we did not provide Gingerbread officials with inconsistent advice regarding what documentation would be sufficient, and note that the Manual details the documentation that is required. Also, Gingerbread officials should have obtained and retained such supporting documentation prior to the audit.
33. The assertions are incorrect. In fact, auditors recommended the stated costs for disallowance because they were incurred **after** the special education classes moved out of the building – and not because Gingerbread had no intention of returning to the building. Further, the finding reported in the draft audit report was also included in a preliminary finding auditors issued to Gingerbread. Likewise, the criteria auditors applied was the same in both the preliminary finding and the draft report.
34. Gingerbread's statement is incorrect. In fact, the draft report did not propose a new location. As shown on page 14 of the report, Section II.41.B(1) specifically states that the program's occupancy costs for the prior location are reimbursable up to the actual date of the program's occupancy in the new location unless prior SED approval allows an exception. Also, refer to Comment No. 33.
35. We disagree. Section II.41.B(1) refers to occupancy costs. Rent is part of occupancy costs.
36. During the course of the audit, auditors provided Gingerbread with a detailed listing of the disallowed depreciation costs. We provided Gingerbread with another copy of this detailed listing on August 17, 2016.
37. During the course of the audit, we provided Gingerbread with a detailed listing of all school supply claimed costs that we recommended for disallowance. We provided Gingerbread with another copy of this detailed listing on August 17, 2016.
38. Gingerbread officials did not provide support for all of their Costco purchases. Food was disallowed not because it was purchased from Costco, but because it was food for adults – and not for the students. Some of the food items purchased by Gingerbread included coffee, artificial sweeteners, and diet soda (items not routinely given to students ages 3 to 5 years for their consumption). Further, Gingerbread staff informed us that students routinely brought lunches from home, and Gingerbread provided only snacks such as cereal, cookies, juice, and milk. We also noted that Gingerbread has only a small lunchroom with a hot plate that is used by employees. The school does not have food preparation and storage (refrigerator) space to prepare and serve more complex meals for children. Further, there was no overlap with our proposed food purchase disallowances.
39. The invoices submitted by the cleaning company did not meet the requirements of the Manual, which requires that all payments be supported by itemized invoices that indicate the specific services actually provided and, for each service, the date(s), number of hours provided, the fee per hour, and the total amount charged.
40. During the course of the audit, we provided Gingerbread with a detailed listing of all disallowed contracted services. We provided Gingerbread with another copy of this detailed listing on August 17, 2016.

41. We disagree. The Manual requires advertisements to meet specific criteria. Without a copy of the advertisement, we could not determine if the Manual's requirements were met. In addition, Gingerbread failed to provide any documentation for certain advertising expenses it claimed.
42. We maintain that Gingerbread did not provide any supporting documentation for the interest charges, including the \$6,972 related to an adjusting entry on the general ledger.
43. Gingerbread did not provide us with documentation to support the recommended disallowances for legal services referenced in the report. Furthermore, OSC auditors did not misplace Gingerbread's files, nor did auditors take original documents off site.
44. The tuition reimbursement expenses we recommended for disallowance pertain to employees who did not provide services to the SED Programs under audit.
45. The storage space rental was recommended for disallowance because there was no supporting documentation to substantiate the expense.
46. We revised our report to delete the recommended disallowance associated with the toys.
47. We revised the report to delete the recommended desk disallowance.
48. The Manual defines a reasonable cost as a cost that is generally recognized as ordinary and necessary for the operation of the approved special education program. However, Gingerbread officials did not provide sufficient evidence of the need for and relationship of a jackhammer to the education program.
49. Gingerbread officials were not able to show us either computer. Gingerbread's disposal log indicated that one computer was disposed of. However, the model number was not the same as the model number indicated on the Staples invoice. Further, the other computer was not located, nor was it listed in Gingerbread's disposal log. Also, because the printers were listed in Gingerbread's equipment disposal log, we revised the report to delete the printers from the recommended disallowance.
50. The Manual specifically states that ordinary living expenses, such as the cost of clothing and uniforms that are normally assumed by parents or legal guardians of students attending day care centers or public day schools, are not reimbursable.
51. During the course of the audit, we provided Gingerbread with a detailed listing of all disallowed Staples purchases. We provided Gingerbread with another copy of this detailed listing on August 17, 2016.
52. We disagree. We did not take any original documents off site. Moreover, Gingerbread officials were responsible for maintaining sufficient supporting documentation of the costs they reported on their CFR. However, the supporting documentation did not describe the item purchased.
53. We disagree. In fact, we did not recommend for disallowance any purchases due to a lack of evidence that the items in question were not brought to the school.
54. We maintain that our report is both factually and legally correct. Further, the specific regulatory references, including the applicable provisions of the Manual, are detailed in the report's Notes to Exhibit. Also, we reviewed and considered all evidence and information provided by Gingerbread officials. As such, we maintain that the evidence obtained during the audit provides a reasonable basis for our findings and conclusions. In addition, SED officials agreed with our report's findings and recommendations.