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
Hawthorne Foundation, Inc.

Report 2017-S-3

October 2017

Executive Summary

Purpose

To determine whether the costs reported by Hawthorne Foundation, Inc. (Hawthorne) on its Consolidated Fiscal Report (CFR) were properly calculated, sufficiently documented, and allowable under the State Education Department's (SED) guidelines, including the Reimbursable Cost Manual (RCM). The audit covered the fiscal year ended June 30, 2015.

Background

Hawthorne is an SED-approved, not-for-profit special education provider located in Westchester County, New York. Hawthorne provides preschool special education services to children with disabilities who are between three and five years of age. Hawthorne is reimbursed for preschool special education services through rates set by SED. The reimbursement rates are based on financial information, including costs, that Hawthorne reports to SED on its annual CFR. To be eligible for reimbursement, reported costs must comply with RCM requirements. For the fiscal year ended June 30, 2015, Hawthorne reported approximately $2.8 million in reimbursable costs on its CFR for one rate-based preschool special education program that it operated.

Key Findings

For the fiscal year ended June 30, 2015, we identified $75,189 in ineligible costs that Hawthorne reported on its CFR for the rate-based preschool special education program that it operated. The ineligible costs included:

- $56,619 in personal service costs for insufficiently documented staff time; and
- $18,570 in other than personal service costs, which consisted of $11,419 in expensed equipment that was not properly capitalized and depreciated; $4,483 in non-program-related expenses; $1,378 in real estate taxes that were not properly allocated; and $1,290 in other non-reimbursable expenses.

We also determined Hawthorne did not disclose related-party transactions with three entities on its CFR, as required.

Key Recommendations

To SED:

- Review the disallowances identified by our audit and, if warranted, make the necessary adjustments to the costs reported on Hawthorne's CFR and to Hawthorne's tuition reimbursement rates.
- Remind Hawthorne officials of the pertinent SED requirements that relate to the deficiencies we identified.

To Hawthorne:

- Ensure that costs and staff hours reported on annual CFRs fully comply with SED's requirements, and communicate with SED to obtain clarification as needed.
- Ensure related-party transactions are properly disclosed on the CFR in accordance with SED's requirements.

Other Related Audits/Reports of Interest

The Alcott School: Compliance With the Reimbursable Cost Manual (2015-S-97)

Westchester Community Opportunity Program, Inc.: Compliance With the Reimbursable Cost Manual (2016-S-33)

State of New York
Office of the State Comptroller

Division of State Government Accountability

October 6, 2017

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

Dr. Tina Covington
Chief Executive Officer
Hawthorne Foundation, Inc.
5 Bradhurst Avenue
Hawthorne, NY 10532

Dear Ms. Elia and Dr. Covington:

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

Following is a report of our audit of the costs submitted by Hawthorne Foundation, Inc. to the State Education Department for the purpose of establishing the preschool special education tuition reimbursement rates used to bill public funding sources that are supported by State aid payments, entitled *Compliance With the Reimbursable Cost Manual*. The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution; Article II, Section 8 of the State Finance Law; and Section 4410-c of the State Education Law.

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

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

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Albany, NY 12236

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

Background

Hawthorne Foundation, Inc. (Hawthorne) is a not-for-profit organization located in Westchester County, New York. Hawthorne is authorized by the State Education Department (SED) to provide, among other programs, preschool special education services to children with disabilities who are between the ages of three and five years. During our audit period, Hawthorne operated one rate-based preschool special education program: Preschool Special Class – over 2.5 hours per day (referred to as the Program). The Program provided services to 91 children with special education needs from Westchester County and New York City. Hawthorne is managed by an Executive Director, and is overseen by a Board of Directors.

The counties that use Hawthorne's preschool special education services pay tuition to Hawthorne using reimbursement rates set by SED. The State, in turn, reimburses the counties 59.5 percent of the tuition that the counties pay. SED sets the special education tuition rates based on financial information, including costs, reported by Hawthorne on the annual Consolidated Fiscal Report (CFR) that it submits to SED. Costs reported on the CFR must comply fully with the guidelines in SED's Reimbursable Cost Manual (RCM) regarding the eligibility of costs and documentation requirements, and must meet the reporting requirements prescribed in the Consolidated Fiscal Reporting and Claiming Manual (CFR Manual). For the fiscal year ended June 30, 2015, Hawthorne reported approximately $2.8 million in reimbursable costs on its CFR for the Program.

Audit Findings and Recommendations

According to the RCM, costs reported on the CFR are considered for reimbursement if they are reasonable, necessary, directly related to the special education program, and sufficiently documented. For the fiscal year ended June 30, 2015, we identified $75,189 in costs that Hawthorne reported on its CFR that did not comply with the RCM's requirements for reimbursement. The ineligible costs included $56,619 in personal service costs and $18,570 in other than personal service (OTPS) costs. We also determined that Hawthorne did not disclose related-party transactions with three entities on its CFR, as required.

Personal Service Costs

According to the RCM, compensation costs must be supported by employee time records prepared during the time period for which the employee was paid. For the fiscal year ended June 30, 2015, we identified $56,619 in insufficiently supported personal service costs ($46,669 in salary and $9,950 in associated fringe benefits) reported by Hawthorne on its CFR. Specifically, we determined the time records for 45 employees did not account for enough hours to support the costs and staff hours reported on the CFR.

Other Than Personal Service Costs

For the fiscal year ended June 30, 2015, we identified a total of $18,570 in OTPS costs that Hawthorne reported on its CFR that were either not related to the Program, not adequately documented, or otherwise not allowable under the RCM requirements.

Incorrectly Expensed Equipment

According to the RCM, items having a unit cost of $5,000 or more and an estimated useful life of two years or more must be capitalized. Furthermore, items purchased as a group or separate purchases of similar items in the same fiscal year should be treated as a single-unit purchase. Also, such assets are subject to the straight-line method of depreciation. For its computer and software purchases made during the fiscal year ended June 30, 2015, Hawthorne reported the entire expense on its CFR rather than capitalizing and depreciating the items as required. We calculated the allowable depreciation for the computers and software, and determined Hawthorne reported excess equipment costs of $11,419 on its CFR.

Non-Program-Related Costs

The RCM states costs will be considered for reimbursement if they are directly related to the special education programs. We identified $4,483 in costs reported by Hawthorne on its CFR that were not directly related to the Program and thus were ineligible for reimbursement. For example, we found Hawthorne reported $3,200 in cleaning expenses related to day habilitation programs that it operated and $508 in vehicle expenses related to a bus for its school-age program.

Allocation of Real Estate Taxes

According to the CFR Manual, when multiple programs share the same geographic location, property costs must be allocated among them. Hawthorne allocated property costs, including real estate taxes, between programs using the square footage method. However, we determined Hawthorne did not properly calculate the amount to be allocated to the Program. We recalculated the real estate tax costs using Hawthorne's allocation method, and determined Hawthorne reported excess real estate taxes of $1,378 on its CFR.

Other Ineligible Costs

According to the RCM, costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the special education program, and sufficiently documented. Also, costs associated with non-audit services provided by a registered public accounting firm within 365 days of required audit work, food for staff, and cell phone and travel expenses for consultants are not reimbursable. We identified $1,290 in costs reported by Hawthorne on its CFR that were ineligible for reimbursement because they were not in compliance with these RCM requirements. The ineligible costs consisted of:

- $996 in vehicle ($985) and accounting ($11) costs with insufficient documentation;
- $154 in non-audit CPA costs;
- $80 in ineligible consultant expenses;
- $54 in ineligible food; and
- $6 in unnecessary bank fees.

Other Matters

According to the CFR Manual, related-party transactions must be reported on the CFR-5 schedule. However, we determined Hawthorne did not disclose certain related-party transactions on its CFR, as required. Specifically, we found Hawthorne did not disclose the following:

- Costs for consulting services provided by EMCB, Inc. The owner of EMCB, Inc. was a former Hawthorne chief executive officer and also served as executive director of a related entity, the Hawthorne Foundation Development Corporation, whose purpose is to raise funds and awareness for Hawthorne's programs.
- Costs for legal services provided by Harley & Deickler, LLC. A principal of the firm served as secretary of Hawthorne's Board of Directors (Board).
- Costs for salary and fringe benefits paid to Hawthorne's chief financial officer (CFO). The CFO also served as treasurer of Hawthorne's Board during our audit scope. As a result of our audit, Hawthorne's Board voted to amend the bylaws to separate the duties of CFO and treasurer, and elected a new treasurer (from the existing Board members) on March 29, 2017.

Recommendations

To SED:

1. Review the disallowances identified by our audit and, if warranted, make the necessary adjustments to the costs reported on Hawthorne's CFR and to Hawthorne's tuition reimbursement rates.

2. Remind Hawthorne officials of the pertinent SED requirements that relate to the deficiencies we identified.

To Hawthorne:

3. Ensure that costs and staff hours reported on annual CFRs fully comply with SED's requirements, and communicate with SED to obtain clarification as needed.

4. Ensure related-party transactions are properly disclosed on the CFR in accordance with SED's requirements.

Audit Scope, Objective, and Methodology

We audited the costs that Hawthorne reported on its CFR for the fiscal year ended June 30, 2015. The objective of our audit was to determine whether the reported costs were allowable, properly calculated, and sufficiently documented in accordance with applicable SED requirements.

To accomplish our objective and assess internal controls related to our objective, we reviewed the RCM that applied to the year we examined as well as the CFR Manual and its related appendices. We became familiar with Hawthorne's internal controls as they related to costs it reported on the CFR. We also interviewed Hawthorne personnel to obtain an understanding of the practices for reporting costs on the CFR. We reviewed Hawthorne's CFR for the fiscal year ended June 30, 2015 and relevant financial records for the audit period. We obtained accounting records and supporting information to assess whether certain costs claimed by Hawthorne on the CFR, such as costs that we considered high risk and reimbursable in limited circumstances, were allowable, properly calculated, and sufficiently documented.

We conducted our performance audit in accordance with generally accepted government auditing standards. Those 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 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 functions do not affect our ability to conduct independent audits of program performance.

Authority

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

Reporting Requirements

We provided a draft copy of this report to SED and Hawthorne officials for their review and formal comment. We considered their comments in preparing this report and have included them in their entirety at the end of the report. In SED's response, officials agreed with our audit recommendations and indicated the actions they will take to address them. In Hawthorne's response, officials disagreed with our proposed audit disallowances related to unsupported personal service costs and non-audit CPA costs. Our rejoinders to these Hawthorne 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

Andrea Inman, Audit Director
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Brian Krawiecki, Audit Supervisor
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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

Hawthorne Foundation, Inc.
Schedule of Submitted and Disallowed Program Costs
for the Fiscal Year Ended June 30, 2015

Program Costs	Amount per CFR	Amount Disallowed	Amount Remaining	Notes to Exhibit
Personal Services	$2,119,780	$56,619	$2,063,161	A
Other Than Personal Services	689,911	18,570	671,341	B–I
Total Program Costs	**$2,809,691**	**$75,189**	**$2,734,502**	

Notes to Exhibit

The following Notes refer to specific sections of the RCM or the CFR Manual that we used as a basis for 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 Hawthorne officials during the course of the audit.

A. RCM Section III.1.A: Compensation costs must be supported by employee time records prepared during the time period for which the employee was paid.
B. RCM Section II: Costs are considered for reimbursement if they are reasonable, necessary, directly related to the special education program, and sufficiently documented.
C. RCM Section II.14.F: Costs associated with non-audit services provided by a registered public accounting firm during or within 365 days of required audit work are not reimbursable.
D. RCM Section II.17.A.(1): Items having a unit cost of $5,000 or more and an estimated useful life of two years or more must be capitalized, and group or separate purchases of similar items in the same fiscal year should be treated as a single unit purchase.
E. RCM Section II.17.A.(4): The straight-line method of computing depreciation is required for all classes of assets.
F. RCM Section II.22.C: Costs of food provided to staff are not reimbursable.
G. RCM Section II.59.F: Travel expenses for consultants are not reimbursable.
H. RCM Section III.1.J.(2): Vehicle use must be documented with individual vehicle logs that include at a minimum: the date, time of travel, to and from destinations, mileage between each, purpose of travel, and name of traveler.
I. CFR Manual Appendix J – Allocating Expenses for Shared Program/Site, Section 43.0, page 43.3: Property costs must be allocated between programs when multiple programs share the same geographic location. The most common method uses square footage unless using this method in a specific situation does not result in a fair allocation of costs.

Agency Comments - State Education Department

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

DEPUTY COMMISSIONER
Office of Performance Improvement and Management Services
O: 518.473-4706
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September 26, 2017

Ms. Andrea Inman
Audit Director
Office of the State Comptroller
Division of State Government Accountability
110 State Street – 11th Floor
Albany, NY 12236

Dear Ms. Inman:

The following is the New York State Education Department's (Department) response to the draft audit report, 2017-S-3, Compliance with the Reimbursable Cost Manual: Hawthorne Foundation, Inc. (Hawthorne).

Recommendation 1: Review the disallowances identified by our audit and, if warranted, make the necessary adjustments to the costs reported on Hawthorne's CFR and to Hawthorne's tuition 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: Remind Hawthorne officials of the pertinent SED requirements that relate to the deficiencies we identified.

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

Yours truly,

Sharon Cates-Williams

Sharon Cates-Williams
Deputy Commissioner

cc: Thalia Melendez
Christopher Suriano
Suzanne Bolling

Agency Comments - Hawthorne Foundation, Inc.

Hawthorne Foundation Inc.
A Behavioral Approach to Lifelong Care®

September 13, 2017

VIA ELECTRONIC MAIL

Andrea Inman, Audit Director
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, New York 12236-0001

Re.: Hawthorne Country Day School
OSC Audit 2017 –S-3

Dear Ms. Inman:

We are in receipt of your draft Audit Report 2017-S-3 dated August 2017. Please accept this letter as our response to the Office of State Comptroller Audit of Hawthorne Foundation Inc.

Audit Findings and Recommendations

Personal Service Costs

Insufficiently supported personal service costs

Hawthorne does not agree with the $56,619 ($46,669 in salary and $9,950 in fringe benefits) Audit assessment that Hawthorne insufficiently supported personal service costs.

Hawthorne asserts that employee compensation was calculated and paid correctly for work performed by employees during the approved school calendar, and is supported by approved, documented payroll time sheets and based on Hawthorne's attendance policies, as well as its Personnel Policies, with full intent to meet Federal and State Department of Labor guidelines and regulations. Hawthorne compensated its employees in accordance to the criteria established by SED RCM which provides that compensation costs must be based on approved, documented payrolls. Hawthorne's payrolls are supported by employee timesheets which are prepared during the time period for which employees are paid and verified and approved by the program coordinator.

* Comment 1

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Hawthorne Foundation Inc. - Est. 1984
A 501(c)3 Not-for-Profit Organization

*See State Comptroller's Comments, page 17.

Hawthorne Foundation Inc.
A Behavioral Approach to Lifelong Care®

The majority of Hawthorne's employees are paid on a "salary" basis in accordance with applicable federal and state wage and hour laws; teachers are paid on a "salary" basis. Being paid on a salary basis means an employee regularly receives a predetermined amount of compensation each pay period. The predetermined amount cannot be reduced because of variations in the quality or quantity of work. Significantly, employees must receive the full week salary for any week in which employee performs any work, regardless of the number of hours or days worked. In addition, to paying employees on an hourly or salaried basis, employees are classified as either "exempt" or "non-exempt" from the minimum wage and overtime provisions of federal and state wage payment laws. Employees are informed as to their classification at the time of hire. All employees, including salary exempt are required to punch in and out using Hawthorne's time management system any time they arrive or depart from the school. Such records however, do not, necessarily reflect all hours worked by employees in connection with our pre-school program. Using the basis of "minute by minute" to calculate payments to salaried employees would result in an improperly calculated salary amount. We note that employees who are paid on a salary basis are entitled to be paid their entire weekly salary for any weeks in which they perform work. Moreover, any reduction in these employees' wages on days where they did not work the eight full hours would be improper under federal and state wage payment laws. Hawthorne employees who are paid on a "salary" basis who may not have completed a full 40 hour work week , the "deficit" time is accounted for by applying the employees available paid time off such as vacation , personal time or sick time.

* Comment 1

It is our request that the OSC take all of the above into consideration before finalizing its audit findings.

Other Than Personal Service Costs (OTPS)

Incorrectly Expensed Equipment

Hawthorne does not challenge the auditor's findings of $11,419 regarding incorrect expensing of equipment that should have been depreciated. This amount is eligible for reimbursement over three years. Hawthorne will capitalize this amount and work with SED, so that these costs that were incurred in 14/15 are correctly depreciated and reimbursed in the subsequent two years.

Non-Program Related Costs

Hawthorne does not challenge the Auditor's findings of $4,483 regarding non-program related costs. $ 3,200 in cleaning expenses was a posting error. $508 were expenses incurred for School Bus which was for the use of School Age Program. This amount was incorrectly charged to the Pre-School Program on the CFR. Going forward, Hawthorne will ensure that proper care and due diligence is exercised and expenses are categorized to the correct cost center.

Hawthorne Foundation Inc.
A Behavioral Approach to Lifelong Care®

Allocation of Real Estate Taxes

Hawthorne does not challenge the auditor's determination of excess real estate taxes of $1,378. Hawthorne will ensure accuracy in posting to the correct cost center by ensuring that stringent internal reviews of the coding used when posting transactions are performed.

Other Ineligible Costs

Hawthorne does not challenge the auditor's assessment of $1,236 in ineligible costs. Hawthorne does not agree with the disallowance of $154 in non-Audit CPA costs. These costs were incurred for Tax filing services -Form 990 and Char 500, which are a requirement of our 501(c)3 Tax Exempt status. Hawthorne retained the Tax division of the independent accounting firm that does audit of Hawthorne's financials to prepare and electronically file the tax returns. Hawthorne requests that this disallowance be removed from the final report as this was a required and necessary expense.

* Comment 2

Other Matters – Reporting "related party" transactions

We do not challenge the auditor's assertions that the nature of the relationship between EMCB Inc. and Hawthorne should have been disclosed. Going forward, Hawthorne will ensure that this relationship is disclosed on the CFR-5 schedule.

We do not challenge that the nature of the relationship between the Board Secretary of Hawthorne, who is a principal of Harley and Deickler, LLC law firm, should have been disclosed. Going forward, this information will be disclosed on the CFR-5.

We do not challenge that the information regarding Hawthorne's CFO who also served as the Treasurer of Hawthorne should have been disclosed on the CFR-5 schedule.

Again, we appreciate the opportunity to provide comment and context to the auditor's findings and recommendations.

Very, truly yours,

Tina Covington

Dr. Tina M. Covington, Executive Director
Hawthorne Foundation Inc. d/b/a Hawthorne Country Day School

cc.: Thomas Sunkel, OSC
Suzzane Bolling, NYSED
Thalia Melendez, NYSED

State Comptroller's Comments

1. The objective of our audit, in part, was to determine whether costs reported by Hawthorne on its CFR were sufficiently documented. According to the RCM, compensation costs must be supported by employee time records. Contrary to Hawthorne's assertions, the time records for 45 employees did not account for enough hours to support the costs and staff hours reported on the CFR. Our analysis took into consideration all paid time off, such as vacation, sick, personal, and holiday time. Despite accounting for all paid time off, the hours reported for these individuals did not support the claimed amounts. For instance, for one employee, the unsupported time amounted to 173.75 hours. Therefore, we maintain that the $56,619 in personal service costs is not reimbursable.
2. According to the RCM, costs associated with non-audit services provided by a registered public accounting firm during or within 365 days of required audit work are not reimbursable. The accounting firm that prepared Hawthorne's financial statements also provided $154 of non-financial audit services (e.g., tax form preparation) within 365 days of required audit work, which is not reimbursable per the RCM. Therefore, we maintain that the $154 in costs is not reimbursable.