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
ADAPT Community Network

Report 2017-S-86
December 2018

Executive Summary

Purpose

To determine whether the costs reported by ADAPT Community Network (ADAPT), formerly known as United Cerebral Palsy of New York City, Inc., on its Consolidated Fiscal Reports (CFRs) were reasonable, necessary, directly related to the special education program, and sufficiently documented pursuant to the State Education Department's (SED) Reimbursable Cost Manual (RCM) and the Consolidated Fiscal Reporting and Claiming Manual (CFR Manual). The audit focused primarily on expenses claimed on ADAPT's CFR for the fiscal year ended June 30, 2015, and included certain expenses claimed on ADAPT's CFRs for the two fiscal years ended June 30, 2014.

Background

ADAPT is a New York City-based not-for-profit organization authorized by SED to provide full-day Special Class and full-day Special Class in an Integrated Setting preschool special education services to children with disabilities who are between the ages of three and five years. For purposes of this report, these programs are collectively referred to as the SED preschool cost-based programs. During the 2014-15 school year, ADAPT served about 548 preschool students. In addition to the preschool cost-based programs, ADAPT operated three other SED programs: Evaluations and 1:1 Aides, which are based on fixed fees as opposed to the cost-based rates established through financial information reported on the CFRs, and a School Age - Special Class program.

The New York City Department of Education (DoE) refers students to ADAPT based on clinical evaluations and pays for ADAPT's services using rates established by SED. The rates are based on the financial information ADAPT reports to SED on its annual CFRs. SED reimburses the DoE for a portion of its payments to ADAPT based on statutory rates. For the three fiscal years ended June 30, 2015, ADAPT reported approximately $53 million in reimbursable costs for the SED preschool cost-based programs.

Key Findings

For the three fiscal years ended June 30, 2015, we identified $5,418,457 in reported costs that did not comply with the RCM and the CFR Manual's requirements and recommend such costs be disallowed. These ineligible costs included $578,363 in personal service costs and $4,840,094 in other than personal service (OTPS) costs, as follows:

- $3,342,387 in non-allowable occupancy costs related to a leased building that ADAPT did not occupy during the audit period;
- $670,715 in unsupported depreciation costs;
- $437,052 in interest costs;
- $207,703 in compensations costs for six employees that should not have been charged to the SED cost-based programs. These nine employees performed work related to fundraising activities, research activities, and non-SED programs;
- $144,538 in incorrectly allocated agency administration costs;
- $192,428 in non-reimbursable OTPS expenses that were either insufficiently documented,

not related to the preschool cost-based programs, or ineligible;
- $149,949 in executive compensation above the median;
- $100,127 in ADAPT's Family Support Services program costs that were improperly allocated to the preschool cost-based programs;
- $86,273 in unsupported vehicle expenses;
- $53,505 in overstated investments costs (broker fees); and
- $33,780 in property costs that were incorrectly charged to the preschool cost-based programs.

Key Recommendations

To SED:

- Review the recommended disallowances resulting from our audit and make the appropriate adjustments to ADAPT's CFRs and reimbursement rates, as warranted.
- Work with ADAPT officials to help ensure their compliance with the provisions of the RCM and the CFR Manual.

To ADAPT:

- Ensure that costs reported on future CFRs comply with SED's reimbursement requirements.

Other Related Audits/Reports of Interest

New York League for Early Learning, Inc.: Compliance With the Reimbursable Cost Manual (2015-S-43)

Brookville Center for Children's Services, Inc.: Compliance With the Reimbursable Cost Manual (2016-S-75)

State of New York
Office of the State Comptroller

Division of State Government Accountability

December 31, 2018

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

Mr. Edward Matthews
Chief Executive Director
ADAPT Community Network
80 Maiden Lane, 8th Floor
New York, NY 10038

Dear Ms. Elia and Mr. Matthews:

The Office of the State Comptroller is committed to helping State agencies, public authorities, and local government agencies manage their resources efficiently and effectively. By so doing, it provides accountability for the 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 ADAPT Community Network 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

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State Government Accountability Contact Information:
Audit Director: Kenrick Sifontes
Phone: (212) 417-5200
Email: StateGovernmentAccountability@osc.ny.gov
Address:
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

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

Background

ADAPT Community Network (ADAPT), formerly known as United Cerebral Palsy of New York City, Inc. is a New York City-based not-for-profit organization authorized by the State Education Department (SED) to provide full-day Special Class and full-day Special Class in an Integrated Setting preschool special education services to children with disabilities who are between the ages of three and five years. For purposes of this report, these programs are collectively referred to as the SED Preschool cost-based programs. During the 2014-15 school year, ADAPT served about 548 preschool students. In addition to the preschool cost-based programs, ADAPT operated three other SED programs: Evaluations and 1:1 Aides, which are reimbursed based on fixed fees, as opposed to the cost-based rates established through financial information reported to SED on the Consolidated Fiscal Reports (CFRs), and a cost-based School Age - Special Class program.

ADAPT is composed of four related entities: United Cerebral Palsy of New York City; United Cerebral Palsy of New York City Community Mental Retardation Services Company, Inc.; the New York City Foundation for Cerebral Palsy, Inc. (Foundation); and the United Cerebral Palsy Housing Development Fund Corporation, Inc. All corporations, except the Foundation, were under the control of a common board of directors. ADAPT also provides services to approximately 21,000 individuals who have developmental disabilities. These services, which are funded by the New York State Office for People with Developmental Disabilities (OPWDD), include residential programs, day programs, vocational programs, and medical and support services.

The New York City Department of Education (DoE) refers students to ADAPT based on clinical evaluations and pays for ADAPT's services using rates established by SED. The rates are based on the financial information ADAPT reports to SED on its annual CFRs. To qualify for reimbursement, ADAPT's expenses must comply with the criteria set forth in SED's Reimbursable Cost Manual (RCM) and its Consolidated Fiscal Reporting and Claiming Manual (CFR Manual), which provide 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. Reimbursable costs must be reasonable, necessary, directly related to the special education program, and sufficiently documented. The State reimburses DoE 59.5 percent of the statutory rate it pays to ADAPT.

Section 4410-c of the Education Law requires 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 ending June 30, 2015, ADAPT reported approximately $53 million in reimbursable costs for the cost-based programs. Our audit focused primarily on fiscal year 2014-15. However, we expanded our review to include certain items claimed on the CFRs for the two fiscal years 2012-13 and 2013-14.

Audit Findings and Recommendations

For the three fiscal years ended June 30, 2015, we identified $5,418,457 in reported costs that did not comply with SED's requirements for reimbursement. These ineligible costs included $578,363 in personal service costs and $4,840,094 in other than personal service (OTPS) costs (see Exhibit at end of this report). SED, pursuant to a desk review, previously disallowed some of these costs.

Personal Service Costs

Costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the special education program, and sufficiently documented pursuant to the guidelines in the RCM and the CFR Manual. In addition, personal service costs, which include all salaries and fringe benefits paid or accrued to employees on the agency's payroll, must be reported on the CFRs as either direct care costs (e.g., teachers' salaries) or non-direct care costs (e.g., administrators' salaries). The RCM also states that costs associated with fundraising and general research activities are not reimbursable. For the three fiscal years ended June 30, 2015, ADAPT reported approximately $35 million in personal service costs for its SED preschool cost-based programs. We identified $578,363 in personal service costs, including the $76,173 that is recommended for disallowance in the Other Than Personal Service section of this report, that did not comply with the RCM's guidelines for reimbursement.

Compensation Costs Related to Other Programs

For the three fiscal years ending June 30, 2015, we identified $207,703 in compensation costs for six employees whose compensation should not have been charged to the SED preschool cost-based programs, as follows:

- $199,564 ($150,435 in salaries and $49,129 in fringe benefits) in compensation costs for four employees who worked in ADAPT's OPWDD programs. For example, a portion of the Director of Program Services' compensation was charged to the SED preschool cost-based programs. However, documentation in her personnel files (e.g., employee master change form, an evaluation, position control database form) indicated she worked for one of the OPWDD programs; and
- $8,139 ($6,475 in salaries and $1,664 in fringe benefits) in compensation costs for two employees who were responsible for fundraising activities.

Although requested, ADAPT officials could not provide documentation to show that the six employees performed work for the SED preschool cost-based programs. Consequently, we recommend that SED disallow $207,703 in compensation costs allocated to the SED preschool cost-based programs.

Incorrectly Allocated Agency Administration Costs

According to the RCM, agency administration costs are defined as those expenses that are not directly related to a specific program but are attributable to the overall operation of the agency. These include costs for: the overall direction of the organization; general record keeping, budget, and fiscal management; and public relations (non-fundraising). Agency administration costs that relate to the overall operation of the agency and not to a specific program are reported on Schedule CFR-3. Expenses relating to a specific program that are directly associated with the provision of services in that program are reported on Schedule CFR-1. In addition, the RCM states that allocation of non-direct care compensation among various direct care job titles is not allowable and that staff should be reported in the job code titles supported by salary agreements and job descriptions.

For three fiscal years ending June 30, 2015, ADAPT officials directly charged $144,538 in compensation for one of its agency administration staff to the SED preschool cost-based programs. The costs for the services provided by these employees should have been allocated to all of ADAPT's programs. Our determination was based on a review of the employees' job descriptions, documents in their personnel files, information from board minutes, and interviews with ADAPT employees. For example, a portion of the Chief Operating Officer's (COO) compensation was charged to one of the SED preschool cost-based programs. However, documentation in her personnel records clearly stated that she was responsible for performing work for all of ADAPT's programs and not just the SED preschool cost-based programs. We recommend SED disallow $144,538 in compensations costs that were incorrectly allocated to the SED preschool cost-based programs.

Executive Compensation Above The Regional Median

According to the RCM, compensation (i.e., salaries plus fringe benefits) for an entity's staff whose function is that of Executive Director, Assistant Executive Director, or Chief Financial Officer (CFO) will be directly compared to the regional median compensation for comparable administration job titles of public school districts, as determined and published annually by SED's Basic Educational Data System. Reimbursement of employee compensation for these job titles shall not exceed the median compensation paid to comparable personnel in public schools for similar work and hours of employment in that region.

For the three fiscal years ended June 30, 2015, ADAPT reported $3,081,768 as the total compensation for its Chief Executive Officer, Chief Administration Officer (who functioned as an Assistant Executive Director), and CFO. However, the total regional median reimbursement limit for the three executives for the three years was $2,202,789. Consequently, the executives' compensation exceeded SED's limits by $878,979 ($3,081,768 - $2,202,789). We recommend that SED disallow $149,949, the portion of the excess compensation allocated to the SED preschool cost-based programs. SED, pursuant to a desk review, previously disallowed some of these costs.

Other Than Personal Service Costs

According to the RCM, OTPS costs must be reasonable, necessary, directly related to the special education program, and sufficiently documented. For the three fiscal years ended June 30, 2015, ADAPT reported approximately $18 million in OTPS expenses for the SED preschool cost-based programs. We identified $4,840,094 of these expenses that did not comply with SED's reimbursement requirements, as outlined below.

Non-Allowable Occupancy Costs

According to the RCM, occupancy costs of a new location are not reimbursable if the costs are incurred before the date the program actually occupies the space, unless such costs are incorporated in an approved tuition rate. Similarly, occupancy costs for a prior location are reimbursable up to the actual date of the occupancy of the new location, unless prior SED approval allows an exception.

For the two fiscal years ended June 30, 2015, ADAPT reported $21,340,514 in occupancy costs such as rents, utilities, building maintenance, insurance and other costs for a leased building located at 80 West End Avenue in Manhattan. However, we found that ADAPT did not occupy the building until September 2015. Moreover, SED did not approve this location until September 2015. Therefore, the $3,342,387 in occupancy costs for the two fiscal years was not reimbursable. Further, we noted that ADAPT reported $690,398 in occupancy costs for its building at 122 East 23rd Street in Manhattan, where the preschool programs had operated during the two fiscal years ended June 30, 2015. Consequently, we recommend that SED disallow the $3,342,387 in non-allowable occupancy costs that were allocated to the SED preschool cost-based programs. SED, pursuant to a desk review, previously disallowed some of these costs.

ADAPT officials disagree with our recommended disallowance, asserting that during the time when the program was not yet operating in the space, the expenses were charged to agency administration and not directly to the SED preschool cost-based programs. We disagree with this assertion, as the costs were not reimbursable regardless of whether they were allocated or directly charged to the SED preschool cost-based programs.

Unsupported Depreciation Expense

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. Information relating to the acquisition of fixed assets, equipment, land or building improvements, and any related financing arrangements and grants must be retained as long as the facility is used by any education program the provider operates if this period exceeds seven years. In addition, provision for estimated salvage value must be made in accordance with Generally Accepted Accounting Principles when computing depreciation for vehicles, furniture, and equipment. Further, Appendix O of the CFR Manual requires providers, such as ADAPT, to maintain depreciation schedules that include the following minimum information: Description of Asset, Date of Acquisition, Cost at Acquisition, State/Federal Funding for Items, Salvage Value, Depreciation Method, Useful Life Used for Depreciation Purposes, Annual Depreciation Amount, and Accumulated Depreciation.

For three fiscal years ended June 30, 2015, ADAPT charged $1,399,179 in depreciation expenses to the SED preschool cost-based programs. These expenses included building, building and land improvements, vehicles, and equipment. We examined the depreciation schedules provided by ADAPT and determined that ADAPT did not estimate the assets' salvage values, as required by the CFR Manual. Consequently, the assets' depreciable bases and the period depreciation expense were inflated. Moreover, the depreciation schedules did not include the titles or the descriptions of assets with net book value of $1,762,862 – 50 percent of the total net book value of the $3,543,437 in assets ADAPT depreciated on its CFRs. We also requested the description of the assets, vendor names, and records confirming the acquisition costs and date of the acquisition (i.e., canceled invoices). However, ADAPT officials could not provide the requested depreciation records to support $670,715 in depreciation expenses.

We recommend SED disallow $670,715 in unsupported depreciation expenses that were charged to the SED preschool cost-based programs.

Interest Costs

According to the RCM, debt for capital expenditures, including capital projects, operations, equipment purchases, etc. shall be used only when financing from current revenue sources is not available. Borrowing transactions shall be evaluated on an overall level of reasonableness as they relate to interest costs and fees paid for professional services. Further, any income earned from investment of public funds resulting from the operations of approved programs will be considered applied income to reduce the costs of the programs. Interest expense is reimbursable only when there is a corresponding amortization of principal. In addition, the CFR Manual requires providers to report interest/dividend investment income earned on program/site assets on CFR-1, line 85.

In 1985, ADAPT took $3,000,000[1] in bank loans to finance the construction of the Millicent Hearst Children's Center (Project) at 160 Lawrence Avenue, Brooklyn, and the rehabilitation center at 281 Port Richmond Avenue, Staten Island, New York. Over the next 30 years, ADAPT refinanced the original loan amount through the issuance of several tax-exempt revenue bonds – each time borrowing significantly more than was needed to pay off the prior loan's outstanding principal, thus incurring additional interest and loan administration costs.

For example, in 1994, ADAPT borrowed $10,700,000 to refinance the outstanding principal amount of $2,200,000 of the original 1985 loan. Two years later, in 1996, ADAPT borrowed

1 Although we requested them, ADAPT did not provide records supporting the 1985 loans. Therefore, we could not verify the amount of the original construction loans. According to ADAPT's officials, in 1985, ADAPT undertook bank financing of $3,000,000. The subsequent construction loan refinancing starting from 1994 involved issuing of tax-exempt revenue bonds facilitated by the Dormitory Authority of New York (DASNY) and by Build NYC Resource Corporation (Build NYC), obtaining a $11,449,000 Letter of Credit from Chemical Bank to support the 1994 $10,700,000 DASNY bonds, and signing loan and mortgage agreements with DASNY, Build NYC, and Israel Discount Bank. The interest rates on the borrowings ranged between 3.2-5.5 percent per annum.

$12,210,000 to refinance the outstanding principal of the 1994 bonds. In 2013, ADAPT borrowed another $5,995,000 to refinance the 1996 loan. At that time, ADAPT had incurred an estimated interest expense of $10.5 million since the initial refinancing of the Dormitory Authority of New York (DASNY) 1994[2] bonds.

During the three fiscal years ended June 30, 2015 (our audited period), ADAPT's SED preschool cost-based programs occupied space in the two buildings. As of June 30, 2015, ADAPT had an outstanding $5,455,000 mortgage on the two buildings that was payable through July 1, 2024 at 3.2 percent interest per annum. For the three fiscal years ended June 30, 2015, ADAPT reported $1,846,583 in interest costs on its CFRs. Of that amount, $437,052 was charged to the SED preschool cost-based programs.

To determine whether the interest costs for the three fiscal years are in compliance with the requirements in the RCM, we reviewed ADAPT's general ledger accounts supporting the interest costs reported on the CFRs, analyzed ADAPT's audited financial statements and notes to the financial statements, reviewed Board meeting minutes, and reviewed the New York City property records pertaining to the aforementioned buildings. Based on our analysis, we determined that for the three fiscal years, ADAPT had significant surpluses in unrestricted net assets as well as in current assets (e.g., cash, cash equivalents, and investments) to pay off the outstanding loan and eliminate the interest costs charged to the SED preschool cost-based programs. This would have avoided millions of dollars in interest costs in future years, freeing up $485,000 that was restricted in the Debt Service Fund. Specifically, in the two fiscal years ended June 30, 2014, ADAPT's unrestricted net assets totaled $14,890,000 and $12,676,000, respectively (see Table 1). For example, in the fiscal year ended June 30, 2015, when ADAPT sold the building located at 122 East 23rd Street in Manhattan for $135,000,000, its unrestricted net assets totaled $123,186,000. Further, in the three fiscal years ended June 30, 2015, ADAPT had significant positions in cash, cash equivalents, and investments allowing the entity to pay off the outstanding 2013 loan of $5,995,000.

Table 1 - ADAPT's Cash, Cash Equivalents, and Unrestricted Net Assets

	FY 2014-15	FY 2013-14	FY 2012-13
Cash, Cash Equivalents, and Investments	$130,729,000	$20,936,000	$27,067,000
Unrestricted Net Assets	$123,186,000	$12,676,000	$14,890,000

Using ADAPT's audited financial statements, we calculated ADAPT's Quick Ratios[3] for the three fiscal years ended June 30, 2015. Based on these ratios, we determined ADAPT's short-term liquidity position was strong in each of the three fiscal years, thus enabling ADAPT to retire the DASNY financing related to the project on June 30, 2012 without distorting its ability to meet the short-term financial obligations.

2 Although we requested them, ADAPT did not provide amortization schedules for any DASNY-facilitated refinancing of the project. Therefore, based on ADAPT's audited financial statements, we calculated the interest expense ADAPT incurred since the first refinancing of the project in 1994 through the most recent refinancing in 2013.

3 Quick ratio is an indicator of a company's short-term liquidity position, and measures a company's ability to meet its short-term obligations with its most liquid assets. It is calculated as follows: Quick Ratio = (Cash + Marketable Securities + Accounts Receivable)/Current Liabilities.

At the beginning of fiscal year 2012-13, ADAPT's current ratio was 3.27, meaning that for each $1.00 in its current liabilities, the entity had $3.27 in its most liquid current assets. Moreover, had ADAPT retired the obligations related to the project at the beginning of fiscal year 2012-13, its Quick Ratio would still have remained healthy at 2.87 (see Table 2). According to CSIMarket, the highest average Quick Ratio in the U.S. economy is 2.5 in the technology sector, followed by 0.64 in the health care sector.

Table 2 – ADAPT's Quick Ratio

	6/30/2015	6/30/2014	6/30/2013	6/30/2012
Quick Ratio	2.42	1.84	2.95	3.27
Quick Ratio (if ADAPT retired DASNY and Build NYC bonds)	2.35	1.55	2.60	2.87

In addition, in the three fiscal years ended June 30, 2015, ADAPT generated interest and dividend income from its investments in marketable securities (see Table 3).

Table 3 – ADAPT's Investment Income

	FY 2014-15	FY 2013-14	FY 2012-13
Investment Interest and Dividends	$776,000	$379,000	$381,000

As specified by the RCM, income earned from public funds is considered applied (offset) income that should reduce the costs of the programs. Substantially all ADAPT's programs are funded through New York State reimbursement and Medicaid funding. However, ADAPT did not report interest and dividend income on CFR-1, line 85, as required by the CFR Manual, to any of its State-funded programs. By reporting investment income as an offset, as required, ADAPT would have reduced the costs of its programs, including its SED preschool cost-based programs.

Consequently, we recommend a disallowance of $437,052 in interest costs because ADAPT did not comply with the RCM's requirements by continuing to use debt financing in the three audited fiscal years instead of retiring the debt, thus avoiding unnecessary interest costs. Further, ADAPT did not offset the reported interest by the income earned from investment of the public funds, as required by the CFR Manual.

Non-Reimbursable Expenses

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. In addition, when direct care services are provided, the documentation must indicate the names of students served, actual dates of service, and number of hours of service to each child on each date. The RCM also states that consultant payments must be supported by itemized invoices that indicate the specific services actually provided. In addition, the RCM expressly states that certain costs, such as all personal expenses (e.g., personal travel expenses, laundry charges, beverage charges), fines and penalties, food and holiday parties provided to staff, gift certificates to staff and vendors, fundraising, and legal, accounting or consulting services and related costs incurred in connection with reorganization of the agency, including mergers and acquisitions, are not reimbursable. The RCM also requires that any cash receipts that reduce the cost of an item be applied against the item, except gifts, donations, and earned interest from other than public funds.

We selected a judgmental sample of OTPS expenses totaling $2,961,748 that were charged to the SED preschool cost-based programs. We determined that $192,428 in reported expenses were not in compliance with the requirements in the RCM, as follows:

- $138,625 in insufficiently documented expenses:
  - $114,130 in direct care service expenses, including $95,597 in vendor invoices that were missing the names of the students and $18,533 where no supporting documentation was provided.
  - $18,277 in insufficiently documented consultant expenses. The invoices in support of these expenses were not itemized and did not indicate the specific services actually provided.
  - $3,721 in contingency consulting fees where ADAPT officials could not provide documentation showing how the fees and associated revenue were accounted for.
  - $2,497 in miscellaneous expenses that were not adequately supported, including $1,240 for temporary staffing, $879 in travel (e.g., MetroCard) and travel benefit administration costs, and $378 in miscellaneous credit card and equipment/inventory expenses.

- $39,814 in expenses not related to the SED preschool cost-based programs:
  - $37,148 in legal and fiscal consultant expenses that were related to OPWDD programs.
  - $1,507 for items and services (e.g., ink cartridges, telecommunications) that were provided to a building where OPWDD programs were operated.
  - $1,159 in Staples purchases not related to the SED preschool cost-based programs. Instead, these costs were associated with ADAPT's Family Connect program.

- $13,989 in ineligible expenses:
  - $9,243 in staff food costs, including $261 for alcoholic beverages.
  - $2,670 in staff entertainment costs and vendor outreach items (e.g., holiday cards).
  - $1,471 in merger/partnership fees related to ADAPT and the Cerebral Palsy Associations of New York State.
  - $401 in miscellaneous ineligible expenses, including $243 for first class airline accommodations and a $48 desk ornament purchased from Tiffany & Co.
  - $204 in costs incurred by an employee whose duties were related to fundraising activities.

We recommend that SED disallow $192,428 in OTPS expenses that did not meet the requirements of the RCM.

Improper Allocation of Family Support Services 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. In the three fiscal years ended June 30, 2015, ADAPT incorrectly allocated $100,127 in Family Support Services program costs to its SED preschool cost-based programs.

According to ADAPT officials, the costs charged to Family Support Services were reimbursable because the services offered by Family Support enhance the curriculum of the SED preschool cost-based programs. We disagree. According to the CFR Manual (Appendix G), Family Support Services is listed as an OPWDD-funded program. Also, according to Appendix N of the CFR Manual, OPWDD-funded entities are provided State aid up to 100 percent of the net operating costs related to the provision of family support services including, but not limited to, the following: respite, crisis intervention, family support training and counseling, home modification, transportation, recreation, and special adaptive equipment. In fact, in the three fiscal years ended June 30, 2015, ADAPT reported on its Schedule CFR - DMH-2 (Aid to Localities) a total of $2,277,119 in Family Support Services revenue it received from OPWDD. Since the Family Support Services' costs were related to an OPWDD-funded program, we recommend SED disallow $100,127 ($76,173 in personal service and $23,954 in OTPS) because these costs were not related to services provided to the SED preschool cost-based programs.

Unsupported Vehicle Costs

According to the RCM, 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 destination, purpose of travel, and the name of the traveler. If the vehicle was assigned to an employee, the list must include the name of the employee to whom it was assigned. The annual mileage for program purposes and repair and maintenance costs for each vehicle should be summarized and maintained.

For the three fiscal years ended June 30, 2015, ADAPT reported $86,273 in vehicle costs such as repairs, insurance, depreciation, leasing, rents for parking garages, and E-ZPass. To support these costs, we requested records including a list of vehicles, the names of employees to whom the vehicles were assigned, vehicle usage logs, summaries of the annual mileage for program purposes, repair and maintenance costs, and E-ZPass information. However, ADAPT officials could only provide the names of three employees and the vehicle identification numbers of the vehicles assigned to those employees. Absent appropriate records, we could not determine whether the vehicle costs were related to the SED preschool cost-based programs. Therefore, we recommend that SED disallow $86,273 in vehicle costs that were not in compliance with the requirements in the RCM.

Investment Costs

According to the CFR Manual, interest/dividend investment income earned on program/site assets is reported on line 85 of Schedule CFR-1. In addition, the expenses and revenues of all non-SED activities should be reported on Schedule CFR-2, column 7. Moreover, the RCM states that costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the special education program, and sufficiently documented.

During the three fiscal years ended June 30, 2015, ADAPT officials reported broker fees totaling $319,531 associated with investments on Schedule CFR-3. We reviewed ADAPT's fiscal year audited financial statements (i.e., Statement of Activities) and noted they showed investment and dividend income of $1,536,000. However, ADAPT did not report any investment income on Schedule CFR-1, line 85, as required by the CFR Manual. Thus, ADAPT's investment costs were overstated on the CFR because they were not offset by the corresponding investment revenue.

ADAPT's CFO asserted that no investment income was reported on line 85 of Schedule CFR-1 because these investments were non-program assets. Consistent with the CFO's statement, we determined that no portion of the investment-related expenses should have been charged to the SED preschool cost-based programs. Further, the CFR Manual requires that the expenses and revenues of all non-SED activities be reported on Schedule CFR-2, column 7. Therefore, we recommend SED disallow $53,505, the portion allocated to the SED preschool cost-based programs.

Property Costs Incorrectly Charged to the Preschool Cost-based Programs

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. We found that ADAPT reported $33,780 in property costs that were not related to the SED preschool cost-based programs.

For the three fiscal years ended June 30, 2015, ADAPT allocated $33,780 in property costs related to a building located at 175 Lawrence Avenue in Brooklyn to the SED preschool cost-based programs. We reviewed ADAPT's program approval letters, the Student Data Sheet provided by ADAPT, and Schedule CFR-1 Program/Site Data and determined that the 175 Lawrence Avenue building was not approved to operate the SED preschool cost-based programs. Moreover, ADAPT did not provide evidence that services for SED's preschool cost-based programs were provided at that site. Instead, the building was used by the School-Age program and an OPWDD-funded Day Habilitation program. Therefore, we recommend SED disallow $33,780 in costs that were incorrectly charged to the SED preschool cost-based programs.

Recommendations

To SED:

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

2. Work with ADAPT officials to help ensure their compliance with the provisions of the RCM and the CFR Manual.

To ADAPT:

3. Ensure that costs reported on future CFRs comply with SED's reimbursement requirements.

Audit Scope, Objective, and Methodology

We audited the costs reported on ADAPT's CFRs to determine whether they were reasonable, necessary, directly related to the special education program, and sufficiently documented pursuant to the RCM. The audit included all claimed expenses for the fiscal year ended June 30, 2015, and certain expenses claimed for the two fiscal years ended June 30, 2014.

To accomplish our objective, we reviewed the RCM, the CFR Manual, ADAPT's CFRs, and relevant financial records for the audit period. We also interviewed ADAPT's officials and staff to obtain an understanding of ADAPT's financial and business practices. In addition, we assessed a judgmental sample of reported costs to determine whether they were supported, program-related, and reimbursable. Specifically, we reviewed costs that were considered high risk and reimbursable in limited circumstances, such as management fees, fringe benefit expenses, and property expenses. Our samples were not designed to be projected to the entire population of reported costs. We also evaluated the internal controls over the costs claimed on and the schedules prepared in support of the CFRs submited to SED.

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

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

Authority

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

Reporting Requirements

We provided draft copies of this report to SED and ADAPT officials for their review and formal comment. Their comments were considered in preparing this final report and are attached to it. In their response, SED officials agreed with our recommendations and indicated that they will take steps to address them. However, in their response, ADAPT officials disagreed with most of our proposed disallowances. Our responses to certain comments are embedded within ADAPT's response. ADAPT officials also included a lengthy set of attachments with their response. Those attachments are not included in this report. However, they have been retained on file at the Office of the State Comptroller.

Within 90 days after 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 where the recommendations were not implemented, the reasons why.

Contributors to This Report

Kenrick Sifontes, Audit Director
Stephen Lynch, Audit Manager
Sheila Jones, Audit Supervisor
Dmitri Vassiliev, Examiner-in-Charge
Sam Carnicelli, Senior Examiner
Aurora Caamano, Senior Examiner

Division of State Government Accountability

Andrew A. SanFilippo, Executive Deputy Comptroller
518-474-4593, asanfilippo@osc.ny.gov

Tina Kim, Deputy Comptroller
518-473-3596, tkim@osc.ny.gov

Ken Shulman, Assistant Comptroller
518-473-0324, kshulman@osc.ny.gov

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

ADAPT Community Network
Summary of Submitted and Disallowed Costs
for the 2012-13, 2013-14, and 2014-15 Fiscal Years

Program Costs	Amount per CFR	Amount Disallowed	Amount Remaining	Notes to Exhibit
Personal Services				
Direct Care	$32,171,620	$420,275	$31,751,345	
Agency Administration	$2,518,506	$158,088	$2,360,418	
Total Personal Services	**$34,690,126**	**$578,363***	**$34,111,763**	A, B, C
Other Than Personal Services				
Direct Care	$13,385,915	$1,343,109	$12,042,806	
Agency Administration	$5,108,108	$3,496,985	$1,611,123	
Total Other Than Personal Services	**$18,494,023**	**$4,840,094**	**$13,653,929**	B, D - M
Total Program Costs	**$53,184,149**	**$5,418,457***	**$47,765,692**	

*Includes certain adjustments previously made by SED

Notes to Exhibit

The following Notes refer to specific sections of SED's RCM used to develop our recommended disallowances. Unless otherwise specified, all notes refer to all three years reviewed. We summarized the applicable sections to explain the basis for each disallowance. We provided the details supporting our recommended disallowances to SED and ADAPT officials during the course of our audit.

A. RCM Section I.9 - Agency administration is defined as those expenses that are not directly related to a specific program, but are attributable to the overall operation of the agency. These costs include: costs for the overall direction of the organization; costs for general recordkeeping, budget and fiscal management; costs for public relations (non-fundraising); and costs for parent agency expenditures.
B. RCM Section II - Generally, costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the special education program, and sufficiently documented.
C. RCM Section II.13.A.(4)(a) - Compensation (i.e., salaries plus fringe benefits) for an entity's staff whose function is that of Executive Director, Assistant Executive Director, or Chief Financial Officer will be directly compared to the regional median compensation for comparable administration job titles of public school districts, as determined and published annually by the Department's Basic Educational Data Systems (BEDS). Reimbursement of employee compensation for these job titles shall not exceed the median compensation paid to comparable personnel in public schools for similar work and hours of employment in the region in which the entity is located.
D. RCM Section II.28 - Debt for capital expenditures, including capital projects, operations, equipment purchases, etc., shall be used only when financing from current revenue sources is not available unless otherwise approved by the Commissioner's designated representative for fiscal issues. Borrowing transactions shall be evaluated on an overall level of reasonableness as they relate to interest costs and fees paid for professional services.
E. RCM Section II.28.C.(5) - Interest expense is reimbursable only when there are corresponding payments of principal on the working capital loans and only if there are no loans/notes receivable from related parties at any time during the entity's loan repayment period. Payments that represent "interest only" are not reimbursable.
F. RCM Section II.41.B.(1) - The program's occupancy 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. 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.
G. RCM Section II.44.A.(2) - Funding received from a governmental agency or unit for specific education programs or cost items will be offset by the Department against the appropriate program costs in the calculation of tuition rates so that costs will not be reimbursed more than once by public funds.
H. RCM Section II.44.A.(3) - Any income earned from investment of public funds (e.g., tuition)

resulting from the operations of approved programs will be considered applied income to reduce the costs of the program(s).

I. RCM Section III.1 - Costs will not be reimbursable on field audit without appropriate written documentation of costs.
J. RCM Section III.1.D. - All purchases must be supported with invoices listing items purchased and indicating date of purchase and date of payment, as well as canceled checks. Costs must be charged directly to specific programs whenever possible. The particular program(s) must be identified on invoices or associated documents.
K. 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. If the vehicle was assigned to an employee, also list the name of the employee to whom it was assigned. The annual mileage for program purposes and repair and maintenance costs for each vehicle should be summarized and maintained.
L. CFR Manual, page 14.2 - The expenses and revenues for all non-DMH/SED activities. Types of expenses and revenues to be reported in this column include those relating to all fundraising, special events, management services contracts, programs funded by non-CFRS participating State Agencies and other sources, unrealized gains and losses on investments, SED ACCES programs, etc.
M. CFR Manual, page 48.1 - The CFR does not include schedules detailing depreciation expense on assets such as buildings, equipment and vehicles. However, the service provider is required to maintain depreciation schedules that include the following minimum information: Description of Asset, Date of Acquisition, Cost at Acquisition, State/Federal Funding for Items, Salvage Value, Depreciation Method, Useful Life Used for Depreciation Purposes, Annual Depreciation Amount, and Accumulated Depreciation.

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
F: 518.474-5392

December 21, 2018

Mr. Kenrick Sifontes
Audit Director
Division of State Government Accountability
NYS Office of the State Comptroller
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, 2017-S-86, Compliance with the Reimbursable Cost Manual: ADAPT Community Network (ADAPT).

Recommendation 1: Review the recommended disallowances resulting from our audit and make the appropriate adjustments to ADAPT's CFRs and tuition reimbursement rates, as warranted.

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 ADAPT officials to ensure their compliance with SED's reimbursement requirements.

We agree with this recommendation. SED will continue to provide technical assistance whenever requested and will strongly recommend the ADAPT 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, 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. This training is a requirement for preschool special education providers upon approval and reapproval.

If you have any questions regarding this response, please contact James Kampf, Supervising Accountant at (518) 474-3227.

Yours truly,

Sharon Cates-Williams

Sharon Cates-Williams
Deputy Commissioner

c: Karla Ravida
Christopher Suriano
Suzanne Bolling
James Kampf
Harold Matott

Agency Comments - ADAPT Community Network and State Comptroller's Comments

SHEBITZ BERMAN & DELFORTE, P.C.
ATTORNEYS-AT-LAW
1325 AVENUE OF THE AMERICAS, 27TH FLOOR
NEW YORK, NEW YORK 10019
TEL: (212) 832-2797
FAX: (212) 832-2782 – NOT FOR SERVICE
http://www.shebitzlaw.com
E-mail: info@shebitzlaw.com

GEORGE SHEBITZ (1947-2006)
FREDERICK J. BERMAN
MATTHEW J. DELFORTE
JACOB S. CLAVELOUX††

†† (ALSO ADMITTED IN NJ)

December 28, 2018

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

Re: ADAPT Community Network
Your Draft Audit Report #2017-S-86

Dear Mr. Sifontes:

This letter is in response to the draft audit report, dated November 2018 and issued on November 23, 2018, with respect to your audit of ADAPT Community Network ("ADAPT") by the Office of the State Controller ("OSC").

At the outset, we note that ADAPT 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). ADAPT's cooperation with your audit and this response to your draft report do not waive any of its rights to challenge your office's authority to conduct this audit or any decision to act upon it, and ADAPT expressly reserves all such rights.

State Comptroller's Comment - The State Comptroller's legal authority to audit the costs ADAPT submitted on its CFRs to the State Education Department (SED) is expressly cited on pages 3 and 15 of the report.

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We also note at the outset that we do not believe that the audits your draft report cites as "Other Related Audits/Reports of Interest" are "related" or similar to this report at all. While ADAPT now is the parent company of New York League for Early Learning, Inc., it had no relationship to New York League at the time of audited years for that agency and had no involvement in the practices at issue in that audit. ADAPT had no relationship at any time to Brookville Center for Children's Services, Inc. Moreover, the substantive issues raised by OSC in its audit of ADAPT are completely different from the substantive issues raised in those audits.

State Comptroller's Comment - "Other Related Audits/Reports of Interest" is simply a list of other complex SED preschool special education audits issued by the State Comptroller's Office (OSC).

We now will address the substantive proposed findings in OSC's draft audit report.

I. <u>Personnel Service Costs</u>

A. <u>Compensation Costs Related to Other Programs</u>

ADAPT disagrees with OSC's proposed findings relating to six of the nine employees for whom OSC contends that compensation should not have been charged to the SED pre-school programs. In each case, the cost was properly charged to the pre-school program because it was compensation for work done for that program.

First, as a procedural matter, the statement in the draft report that ADAPT "could not provide documentation to show that the nine employees performed work for the SED pre-school cost-based programs" is inaccurate. The facts are as follows.

These findings were made as preliminary findings in the last preliminary report, dated October 11, 2018, based mainly on documents that had been provided to OSC eight months earlier at the beginning of the audit. OSC had issued another preliminary report, on depreciation, two days earlier. At the same time OSC pressed to schedule an exit conference, which was scheduled for November 6, 2018 despite the fact that ADAPT had not yet responded completely to the two final preliminary reports. ADAPT had time to provide only informal preliminary responses to those two preliminary reports before the exit conference. ADAPT met with the auditors on October 16, 2018 and provided responsive information and provided an informal preliminary written response to the OSC preliminary report on personal services on October 24, 2018.

State Comptroller's Comment - This statement is misleading. The Opening Conference for this audit was held on January 11, 2018. The documentation provided by ADAPT during the eight months was often insufficient to support the expenses reported on the CFRs. Consequently, it

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was often necessary to request additional and/or clarifying documentation from ADAPT. Moreover, preliminary reports are fact-finding requests. ADAPT was given the customary 14 days to respond to each of the five preliminary reports. However, ADAPT took between 12 days and 44 days to reply to the preliminary reports. The exit (closing) conference was held after ADAPT's responses were received.

At the exit conference, OSC could not identify, when asked, what it thought was inadequate about the information provided by ADAPT on October 16 and 24, 2018, and OSC stated that it would provide such explanations in writing after the exit conference. OSC provided a list of what additional information OSC thought was missing on November 8, 2018, and ADAPT provided information in response on November 21, 2018. Accordingly, OSC's statement that ADAPT "could not provide documentation to show that the nine employees performed work for the SED pre-school cost-based programs" is incorrect. ADAPT did provide such information on November 21, 2018.

State Comptroller's Comment - This statement is also misleading. The documents ADAPT provided on October 16 and October 24, 2018 were insufficient to show that the six employees worked for the SED preschool cost-based program. At the November 6, 2018 exit conference, we informed ADAPT that additional documentation will be requested to support certain expenses. Based on the documentation subsequently provided by ADAPT, we reduced the recommended disallowances for the affected employees.

Nevertheless, OSC issued its draft report on November 23, 2018, the Friday after Thanksgiving, without reviewing the information submitted by ADAPT on November 21, 2018 at all. OSC "explained" that because the information had been sent by a secure email, and OSC could not open the email, OSC did not know who sent the email and thought it was a "phishing" email. This "explanation" makes no sense because the secure email on its face ADAPT as the sender, even if OSC could not open it. One would think that OSC would contact ADAPT to ask what it was. As part of its "explanation", OSC also claimed that ADAPT never had sent OSC a secure email before. That is irrelevant, but it also is untrue. ADAPT has in its files an email chain reflecting that a similar secure email had been sent to the auditors on January 2, 2018, at the beginning of the audit, and that the auditors acknowledged receipt of the same on January 3, 2018.

State Comptroller's Comment - OSC has protocols in place to address suspicious emails. The email in question, while appearing to come from a domain known to the audit team, appeared suspicious. Therefore, we followed our office's protocols since ADAPT had not informed the audit team that an email was being sent by a secured link and required a password.

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In any event, even if OSC really did not know that ADAPT had sent responsive information on November 21, 2018, one would think that OSC would check back with ADAPT to see if ADAPT intended to provide the information listed on OSC's November 8, 2018 email before issuing the draft report. After all, less than two weeks had passed. OSC did not do so.

State Comptroller's Comment - Throughout the audit, the audit team experienced numerous delays in receiving responses from ADAPT. Therefore, not "checking back" immediately with ADAPT was not unusual. OSC issued a secure Draft Report to SED and ADAPT on Friday November 23, 2018. On Monday, November 26, 2018, ADAPT emailed OSC requesting support for the recommended disallowances in the Draft Report. On Tuesday, November 27, 2018, the audit team communicated with ADAPT and was informed that an email containing certain files was sent to OSC on November 21, 2018. The audit team visited ADAPT on Tuesday, November 27, 2018 and retrieved these documents that were purportedly sent on November 21, 2018.

OSC's proposed disallowances are incorrect in any event for the reasons stated in the November 21, 2018 submission and summarized below.

1. Employees OSC Claims Worked in OPWDD Programs

With respect to employee E.E., as was explained to the auditors by E.E.'s supervisors when the auditors interviewed them, and as the auditors should have observed when they visited the site, this employee worked exclusively in the Bronx preschool as a physical education specialist. The auditors also were provided with a copy of his schedule, showing the classes with which he worked, as part of the November 21, 2018 submission. There is no factual basis for OSC's conclusion that he worked at all for other programs, which he did not, much less that he worked exclusively for other programs as OSC's disallowance suggests.

State Comptroller's Comment - Documentation provided by ADAPT was insufficient to show that employee E.E. provided services to the SED preschool cost-based program.

With respect to the employee J.R., OSC claimed he worked in part for the after-school program from October I, 2013 to February 15, 2015, (per documents in personnel files) and that such time was charged incorrectly to the pre-school program. In its November 21, 2018 submission, ADAPT provided a time and attendance timesheet report for this employee. The times reported as clocked in and out during school hours fully supported his compensation charged to the pre-school program. Thus, there is no basis for the proposed disallowance.

On December 3, 2018, OSC advised ADAPT that OSC now claims that a larger disallowance is justified. OSC contends that the hours on the timesheets are less than what was reported on the CFR. OSC's contention is incorrect.

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For FY14, the hours reflected on the ADP timesheet report and the hours reported on the CFR were substantially the same (2,010.50 on the timesheet report as compared to 2,017.75 on the CFR). The slight difference was due to the accrual calculation for the last payroll of each year. In its calculation, OSC did not include hours for summer leave, sick days and holidays. That exclusion was incorrect. J.R. was a salaried employee who was entitled to be paid for sick days, summer leave and holidays, and those hours, therefore, must be included. According to the timesheet report however, 183.75 hours of J.R.'s time was worked in the afternoon for the OPWDD program, and that time was correctly coded to the OPWDD program on the CFR.

With respect to J.R.'s compensation for FY15, as the auditors know, ADAPT changed its payroll provider in March 2015. ADAPT did not include in its November 21, 2018 submission reports from the new payroll provider, Ultipro, which covers the time from and after March 16, 2015, because the time period where OSC was claiming that J.R.'s time had not been allocated properly ended in February 2015. Accordingly, the time period covered by the Ultipro system was not relevant to the auditors' contentions. Copies of the Ultipro timesheet reports from March 16, 2015 through the end of FY2015 will be provided under separate cover. When that time is added (551.50 hours), J.R.'s hours on the timesheet reports are consistent with the total hours charged on CFR. ADAPT does concede, however, that 117 hours of J.R.'s time, or $1,779.60, worked in the evening for the OPWDD program was mistakenly transferred to the pre-school program. That is the only appropriate adjustment with respect to J.R.'s compensation.

State Comptroller's Comment - Based on additional information provided by ADAPT, we revised our report to reduce the recommended disallowances related to employee J.R.

With respect to employee T.P., OSC claimed that the employee master forms reflect that for the first three months of 2015 she worked for OPWDD programs, but her time was charged to the SED pre-school program. The calculation of the prepared disallowance is incorrect. ADAPT provided ADP payroll records to OSC on November 21, 2018. Those records showed that her compensation for the period she worked for the OWPDD program during the first three months of FY15 was only $4,559.84 of her $32,230.40 compensation. The rest was reported correctly as a pre-school program expense.

On December 3, 2018, OSC advised ADAPT that OSC believes that the ADP report reflects only 910 hours, or $17,859 of compensation, rather than $32,230.40 reported and that OSC therefore has increased the amount of its disallowance. That contention is incorrect. Similarly to J.P., the portion of this employee's time that was reported on Ultipro after the change in payroll providers was not included in the November 21, 2018 submission, because that time period was not at issue. Also similarly to J.P., OSC improperly excluded sick days, vacation and summer leave time in its calculation. T.P. too was a salaried employee who was entitled to be paid for that time. Copies of an ADP report and an Ultipro report reflecting the entire year, with explanatory notations by ADAPT on the ADP report, will be provided under

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separate cover. The time shaded in pink on that document is the only time that was OPWDD program time that was charged incorrectly to the pre-school program and is the only time that should be disallowed.

State Comptroller's Comment - Based on additional information provided by ADAPT, we revised our report to reduce the recommended disallowances related to employee T.P.

With respect to the fourth employee, A.B., the pre-school program also was charged only for time she actually worked in the pre-school program. However, ADAPT does not have documentation reflecting how that time was determined and, therefore, does not dispute this part of the disallowance. As explained below, this proposed disallowance is duplicative of the proposed disallowance of Family Support expenses in any event.

State Comptroller's Comment - ADAPT officials did not provide evidence to show that these costs were duplicative.

2. <u>Employees OSC Claims Performed Fundraising Activities</u>

With respect to employee M.Q., OSC claimed that "documents in personal records and information told to us indicates her work involved grant writing/fundraising which are non-reimbursable expenses." Those contentions are incorrect. Specifically, this employee wrote and maintained all ADAPT policies and was the Chair of the Agency Policy Committee. She also prepared grants which were programmatic in nature and sought government support. M.Q. was not part of the development department, and she reported to the Chief Administrative Officer, who also was not part of the development department. At no time during the course of the audit did any ADAPT staff indicate that her functions were a part of any fundraising activities or department; nor was she ever engaged in lobbying. Nothing in her personnel records reflected that she performed fundraising or lobbying activities, because she did not. OSC's document request, dated November 8, 2018, included guidance pertaining to non-allowable lobbying costs associated with grants. That is not applicable to her work because that is not what she did. She prepared applications for government grants; she did not lobby government agencies to support such grants. The work she did is specifically allowed by Section 11.26A of the RCM, which provides:

> "26. Grants
>
> A. Costs of staff or consultants to prepare a proposal to obtain a government grant or to administer the activities or projects funded by such grants may be reimbursable within the tuition rate as a non-direct care expense to the extent that such costs remain net of all administrative expenses allowed by the grantor."

This employee's entire salary was always expensed to Agency Administration and never was

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covered under a grant until FY2015, when a portion was administered to a grant, as was reflected on the CFR.

There is no factual basis for OSC's continuing contention that M.Q. engaged in "fundraising" activities. We can only assume that OSC is conflating government grant applications with "fundraising". In so doing, OSC is ignoring the express RCM provision regarding government grants quoted above. We will submit under separate cover documentation of work M.Q. did to secure FEMA grant money for ADAPT after Hurricane Sandy as an example of her work. We also will submit a series of emails as a sample of documentation of her work on ADAPT's policies. Other examples of her work on grants and policies could be provided upon request.

State Comptroller's Comment - Based on additional information provided by ADAPT, we revised our report to allow the expenses related to employee M.Q.

With respect to employee S.L., as was explained to the auditors, S.L. was the Senior Vice President of Marketing and Development. Her job consisted half of marketing activities, which are reimbursable, and half of fundraising activities (development), which ADAPT agrees are not reimbursable. Accordingly, ADAPT charged only the marketing half of her compensation to Agency Administration. The marketing she oversaw all was directed to the entire Agency.

As ADAPT explained to the auditors, the 50/50 allocation of her compensation was based on the structure of the department she supervised. Two Vice-Presidents reported to her, the Vice President of Marketing and Communication and the Vice President of Development. Those two positions have two distinct and separate job duties. The Vice President of Development deals with all fundraising activities and events, which are not allowable expenses, which is why the half of S.L.'s work spent overseeing this group was not reported as an allowable expense. The Vice President of Marketing and Communication deals with all external and internal communication and marketing materials, which are allowable expenses, so the half of S.L.'s time spent overseeing this group was charged to Agency Administration as an allowable expense.

The auditors have not stated any reason why the portion of her work overseeing marketing and communications activities should not be allowable. The auditors also have not stated any reason why the allocation of her compensation based on the structure of the department, allocating half to each of the two groups that she oversaw, each headed by a Vice-President reporting to S.L., should not be acceptable. There are no sound reasons for OSC's conclusions, and there is no basis for the proposed disallowance.

State Comptroller's Comment - Based on additional information received from ADAPT, we revised our report to allow the expenses related to employee S.L.

With respect to employee M.W., the auditors correctly stated in their November 8, 2018

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request that M.W.'s "personnel records indicate she did marketing work." ADAPT agrees with that. Marketing work is not fundraising and is reimbursable under Agency Administration. OSC never has stated that M.W. performed fundraising work, much less offered any explanation as to why OSC would believe that, and there is no factual basis for any such belief. M.W. indisputably worked in the marketing group, not in the development group; she was the Vice President of Marketing and Communication described above, and all of her work related to the marketing function the group performed.

OSC asked ADAPT on November 8, 2018 to provide records supporting the marketing work M.W. did for the pre-school programs and amount claimed on the CFR. As ADAPT explained, that was a misguided request. Her compensation was reported as overall Agency Administration and allocated by the ratio value method, because it was directed to promoting the Agency as a whole, not to specific programs. As the draft report acknowledges, marketing activities directed to the overall agency are expressly included as Agency Administration under the RCM. Specifically, the draft report states "according to the RCM Agency Administration are defined as those expenses which are not directly related to a specific program but are **attributable to the overall operation of the agency.** (emphasis added). These costs include costs for the overall direction of the organization; costs for general recordkeeping; budget and fiscal management; costs for public relations (non-fundraising); and costs for parent agency expenditures." Accordingly, there is no basis for the proposed disallowance regarding M.W.

State Comptroller's Comment - Based on additional information received from ADAPT, we revised our report to allow the expenses related to employee M.W.

B. <u>"Incorrectly" Allocated Agency Administration Costs</u>

ADAPT disagrees with OSC's contention that salary and fringe benefits charged to the pre-school program should have been charged to Agency Administration for two of the employees at issue.

With respect to employee M.G., as ADAPT explained to the auditors multiple times, for part of the year from July 15 through December, M.G. worked on preparation of the CFR, and that part of her compensation was reported as Agency Administration. For the rest of the year, her work was to prepare analyses of the costs and spending of the pre-school program. Her compensation for this period was properly charged to the pre-school program because that work related to the pre-school, not to the agency as a whole. The auditors asked for documentation of the work she specifically did for the pre-school program, and ADAPT produced a sample of the cost and spending report she prepared. ADAPT could provide additional such reports if necessary. OSC has offered no justification as to why her compensation during the January 1st to July 15th period, when her primary responsibility was to prepare cost and spending reports relating to the pre-school program, should be charged to Agency Administration instead, and there is no such justification.

State Comptroller's Comment - Based on additional information received from ADAPT, we revised our report to allow the expenses related to employee M.G.

With respect to employee R.E., as ADAPT explained to the auditors, this employee was promoted to Director of Operations for Education and Recreation in September 2014. However, due to the concurrent promotion of the Director of the Brooklyn pre-school, R.E. served as Acting Director of the Brooklyn pre-school during FY15. Her compensation was properly reported as pre-school expense, because her work related entirely to the Brooklyn pre-school. OSC asked on November 8, 2015 for documentation to support that she worked for the pre-school program. In response, ADAPT provided the announcements in September 2014 of the two promotions, which stated in relevant part that R.E. would be supervising the Brooklyn pre-school while the selection of a permanent replacement for the outgoing Director of the Brooklyn pre-school was completed. ADAPT also provided a requisition request form for the Brooklyn pre-school that R.E. had signed as a sample reflecting her work for the Brooklyn pre-school. Other examples could be provided if necessary. Once again, OSC has not provided explanation of why it nevertheless still believes that R.E.'s compensation should have been reported as overall agency administration, and there is no factual basis for that belief. Her work in FY15 was for the pre-school program, as Acting Director of the Brooklyn pre-school, not for the overall operation of the Agency.

State Comptroller's Comment - Based on additional information received from ADAPT, we revised our report to allow the expenses related to employee R.E.

C. Executive Compensation Above the Regional Median

There is no good reason for OSC to include this proposed disallowance at all in its report, as the appropriate adjustments were made by the Rate Setting Unit of the New York State Education Department ("NYSED") during its annual desk reviews. Any compensation above the regional medians of school district personnel that the RCM sets as the compensation cap for these executives were not included in ADAPT's costs when its tuition rates were determined. Accordingly, the auditors did not "discover" anything.

State Comptroller's Comment - Our audit is independent of reviews and adjustments performed by SED. In addition, the report (page 7) indicates that, prior to our audit, SED's Rate-Setting Unit had previously disallowed some of these costs.

Moreover, the draft audit report misleadingly implies that ADAPT did something wrong, when in fact ADAPT did nothing wrong. Agencies are allowed to pay their executives more than the regional medians of school district personnel's compensation. Most large agencies operating multiple programs like ADAPT in the New York City area do so, as it would be

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impossible to attract high quality executives to lead those kinds of agencies if they did not. The consequence of doing so is that a portion of the salary will not be allowed as part of the agency's cost base in determining its tuition rates. Similarly, ADAPT did nothing wrong in reporting these executives' full compensation on the CFR. Indeed, the CFR Claiming and Reporting Manual requires ADAPT and other agencies that pay compensation above public school personnel's district public regional median compensation to do so. The process is that the full compensation must be reported, and NYSED makes the appropriate adjustments to exclude the portions of such compensation that exceed the allowable amounts when it performs its annual reviews and determines the agency's tuition rates. That is exactly what happened in this case.

Accordingly, nothing abnormal or improper occurred, there is no further adjustment to be made, and there is no good reason for OSC's audit report to mention these costs at all.

State Comptroller's Comment - Our report is not misleading. We acknowledge that the CFR Manual does not restrict the reporting of full compensation. However, our report recommended disallowances for compensation in excess of the regional median.

II. Other Than Personal Services Costs

A. "Non-Allowable" Occupancy Costs

ADAPT disagrees with OSC's proposed disallowance of occupancy costs of the building located at 80 West End Avenue prior to ADAPT's actual occupancy of the building. As ADAPT explained to the auditors, ADAPT's building at 122 East 23rd Street in Manhattan was sold, as it could no longer meet the needs of the program. In order to relocate the pre-school program which had been operating at that site to a more appropriate building, ADAPT rented 80 West End Avenue, a building which required substantial work before the pre-school could be transferred there. Unlike the property availability in other parts of New York State, availability in New York City for a property that was able to be modified for services for people with disabilities are rare, and ADAPT was extremely fortunate to find this site.

During that time, rent for 80 West End Avenue location was recognized per section 840-20-25 FASB guidance. That section requires that rent expenses be recognized on a straight line basis even though rental payments are not made on a straight line basis. During the time when the program was not yet operating in the space, the expense was charged to Agency Administration and not directly to the pre-school program. The treatment of these expenses was discussed with the accountant at the NYSED Rate Setting Unit responsible for the reconciliation of the cost reports. NYSED accepted and agreed to this allocation as evidenced by its finalization of the reconciliation rates for FY14 and FY15. During their interview, ADAPT staff referred the OSC auditors to review the relevant rate sheets for these fiscal years which supported this treatment.

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State Comptroller's Comment - We agree with ADAPT that FASB section 840-20-25 requires amortization of leases on a straight line basis. However, the same FASB section requires lessees to expense rents as they become payable during the term of the lease. According to the lease agreement provided by ADAPT, the rents first became payable on June 1, 2016 (fiscal year 2015-16). However, ADAPT charged $21,340,514 to its rent expense in the two fiscal years ended June 30, 2015 – even though the rents were not yet payable. During our audit, we sought and obtained assistance from SED's Rate Setting Unit (RSU) and was advised that they have no evidence of ADAPT requesting or RSU approving the incorporation of occupancy costs, associated with the unoccupied space, into their tuition rates.

The RCM does not require or justify this disallowance. The RCM states: "In addition, the program's occupancy 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." In this case the costs were incorporated in an approved tuition rate to the extent that the Rate Setting Unit included these costs in setting ADAPT's tuition rates for FY14 and FYI 5, as the Rate Setting Unit knew from discussions with ADAPT that these costs were attributable to 80 West End Avenue and that ADAPT had not yet occupied that location. Accordingly, they are allowable under the RCM.

State Comptroller's Comment - We disagree. According to RSU, they have no evidence that ADAPT requested or RSU approved ADAPT to incorporate the occupancy costs associated with the unoccupied space into their tuition rates.

We also note that if these kinds of costs were not allowed, it would be very difficult, and in many cases impossible, for an agency to take on new space requiring renovation, as virtually all new space does, because unless the agency could finance the occupancy costs from fundraising, it would have no source of funding even to pay for the renovations. Again, as stated above, it is difficult in New York City to find space which, with renovations, can be made suitable for programs for children with disabilities; it is virtually impossible to find suitable programmatic space that does not require renovation.

We also note that even if these costs were not allowable as OSC contends, the vast majority of the costs that OSC proposes to disallow were not included in setting ADAPT's tuition rates in any event. In fact, only $114,080 of those costs for FY14 and $304,283 for FY15 were included in the costs on which the tuition determined by NYSED was based. Even those costs were further reduced by the total cost screen.

State Comptroller's Comment - Our audit is independent of SED's process.

More specifically, first OSC's calculation of the unoccupied rent costs reported on CFR-3 was incorrect. ADAPT properly offset rental income from 80 West End Avenue against rental

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expenses on CFR-3. The rental income offset on CFR-3 was $767,237.51 in FY14 and $152,140 in FY15. OSC's calculation does not reflect the offset for rental income. Back up documentation for the rental income can be provided upon request. Second, review of NYSED's rate sheets clearly reflects that for FY14 NYSED itself took out the $6,488,000 of unoccupied rental expense ($1,099,716 of which was allocated to the preschool programs by ratio value method). This is reflected in the Property expense lines of the rate sheets, which were only $150,237 for the 9100 program and $12,484 for the 9160 program. Thus, the $1,099,716 of the unoccupied rental expenses allocated to these programs by ratio value on the CFR ($1,229,354.70 in OSC's calculation, which did not net out the rental income), clearly was taken out by NYSED. Moreover, the other expenses related to 80 West End Avenue that NYSED did not take out caused ADAPT to exceed the non-direct cost screen by $44,088 in FY14, which costs were not included in the tuition rate. Therefore, of the $1,387,592 OSC proposes to disallow for FY14, only $114,080 in fact was included in the costs on which the tuition rates determined by NYSED were based.

State Comptroller's Comment - We revised our calculations to include the $767,237.51 and $151,140 in offset revenue. This resulted in a reduction in the recommended disallowances. In addition, our audit is independent of SED's process.

For FY 2015, NYSED did include the unoccupied rental expense in the Property lines, net of the $152,140 rental income reported on CFR-3 (that OSC incorrectly ignores in its calculation). However, the very large size of this expense caused ADAPT to exceed the non-direct cost screen by a total of $1,846,417 total for the two programs. Therefore, of the $2,150,700 OSC proposes to disallow for FY2015, only $304,263 actually was included in the costs on which the tuition rates were based.

State Comptroller's Comment - Our audit is independent of any actions SED may have previously taken on certain costs. Therefore, we are not aware of the costs SED used when setting ADAPT's tuition rates.

Copies of the NYSED rate sheets for FY14 and FY15 already were given to the auditors but will be provided again under separate cover. We also note that the year to year total cost screen limitation resulted in another $313,736 and $552,317 of ADAPT's otherwise allowable costs being screened out in FY2014 and FY2015, respectively. If you take that into consideration, the $3,538,402 OSC proposes to disallow barely had any impact at all on ADAPT's tuition rates.[1]

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[1] The only small impact it had was on the FY14 allowable program costs and resulting tuition rates for ADAPT's much smaller 9160 program because the $313,736 total cost screen deduction for that year was all in the 9100 program.

State Comptroller's Comment - Our audit is independent of any screen limitation that SED made to certain CFR-reported costs prior to our audit. The purpose of our audit was to determine ADAPT's compliance with the RCM.

B. <u>"Unsupported" Depreciation Expense</u>

ADAPT disagrees with OSC's proposed disallowances of depreciation expenses. Most of the disallowance relates to purportedly inadequate descriptions and documentation of the acquisition of depreciable assets. As ADAPT explained to the auditors, when ADAPT converted to its present FAS system in 2007, balances were carried forward without detailed descriptions for assets acquired in 2006 and earlier. ADAPT has not kept old acquisition records, as they were discarded in accordance with its normal document retention policies. However, that does not mean that there was not support for these entries, and the proposed disallowances are inappropriate for several reasons.

First, most of depreciation proposed for disallowances relates to buildings acquired back in the l980's and renovations of the same. ADAPT did not retain those records, in accordance with its customary document retention policies. The RCM provision requiring retention of acquisition records so long as the facility is used for an education program did not exist back when ADAPT discarded such records. In fact, the RCM itself did not yet exist at that time. To now hold ADAPT to a document retention requirement that did not exist at the time ADAPT discarded the documents is an unjustified retroactive application of a subsequent administrative rule.

State Comptroller's Comment - The purpose of our audit was to determine ADAPT's compliance with the RCM – not compliance with ADAPT's document retention policies.

Second, there is ample support to assure that the pre-2007 expenses for which ADAPT claims depreciation expense were appropriate. One, the buildings and renovators at issue still exist and can be seen. Two, ADAPT provided the auditors with a certified report of $7,590,720 of costs for acquisition and renovation of the Port Richmond building when the site opened in 1988. A portion of the depreciation of those costs were allocated to pre-school programs during the audited years, since they were used during those years in part for the pre-school programs. This provides considerable and reliable support for the cost basis for those assets. Three, ADAPT explained to the auditors that prior to initiation of FAS in 2007, ADAPT analyzed assets acquired each year and prepared schedules breaking them out in categories based on useful life. ADAPT provided a sample schedule for 175 Lawrence Avenue for the 2006 year which, by happenstance, had not been discarded and it had on site. The auditors' response was to allow two of the items reflected on that schedule. While ADAPT appreciated that change, that was not the primary purpose of providing that schedule. The primary purpose was to show the auditors what kind of documentation was generated for every asset for each year prior to 2007, so that the auditors would understand what documentation was generated for each depreciable asset at the time to determine its scheduled depreciation. ADAPT will be happy to provide this sample schedule again if the auditors so desire. Fourth, ADAPT's financial statements were audited every year by a nationally recognized and highly respected independent certified accounting firm, and part of the annual audit process was to test the basis for the depreciation reported.

State Comptroller's Comment - The RCM is quite clear. Information relating to the acquisition of fixed assets, equipment, and land or building improvements must be retained as long as the facility is used by any education program the provider operates, if this period exceeds seven years.

For all these reasons, the support offered does show that the depreciation reported was accurate and reliable. There certainly is no rational basis to assume, as OSC does, that none of the items were appropriate and to disallow all of them. Even OSC must know that the depreciation numbers were not pulled out of thin air and that in light of the indicia of reliability provided by ADAPT, all or substantially all of the depreciation claimed was justified and appropriate.

Finally, with respect to the comments in the draft report about salvage value, the RCM requires an estimate of salvage value only with respect to vehicles, furniture and equipment. Very little of the overall depreciation claimed related to vehicles, furniture or equipment, and the salvage value, if any, of those few assets would have been negligible and would have no material impact on the depreciation expenses claimed.

State Comptroller's Comment - Our recommended disallowances were not based on salvage value.

For all those reasons, the recommended disallowances for depreciation are incorrect.

3. Interest Costs

ADAPT disagrees with OSC's proposed disallowance of mortgage interest costs, which is based on OSC's completely unjustified conclusion that the interest costs were "unnecessary".

a. Background

The background contained in the draft audit report with respect to the loans which ADAPT undertook in connection with its properties at 160 Lawrence Avenue in Brooklyn and 281 Port Richmond Avenue in Staten Island is incorrect. The narrative implies that ADAPT unnecessarily refinanced its original loan, incurring interest and fees that could have been avoided. That is patently untrue.

In 1985 the Agency undertook bank financing of $3,000,000 for the acquisition and

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renovation of these properties. This amount needed to be increased to $6,000,000 in 1988 along with a supplemental line of credit totaling $10,000,000 for all borrowing to cover capital needs. Commercial interest was charged at the prime rate for the first $8,000,000 and a prime rate plus 0.25% for amounts over $8,000,000 for these loans. During this time period the prime rate increased substantially to 8.50% by November 15, 1994.[2] In December 1994 ADAPT had an opportunity to convert the then outstanding bank loan of $9,404,000 into tax exempt bonds at an effective interest rate of 6% per annum, which was a substantial savings over the prime plus rate charged by the bank. The bond indebtedness totaled $10,700,000. The additional funds were necessary to fund the cost of the bond and required reserve funds. In 1996, ADAPT refinanced the bond to capture an even lower interest rate of 5.3%. Bond proceeds of $12,210,000 were used to refund the 1994 bonds, fund the cost of issuance for the 1996 bond and make a deposit to the debt reserve. The foregoing information is evidenced by ADAPT's audited financial statements from 1994 and 1996, which were provided to the auditors. Finally, in 2013 ADAPT re-financed the bonds, the outstanding amount of which then was $5,995,000, to obtain a lower interest rate of 3.2% per annum and a lower reserve requirement.

This history reflects fiscal prudence. Each time ADAPT entered into a new bond issue or otherwise refinanced the loans, it was to lower the costs charged to the program and keep the same maturity date of 2024. These prudent fiscal decisions lowered the interest charged each year to the pre-school programs. They also reduced bond or mortgage reserve requirements, and the principal amount of indebtedness was reduced from over $12 million in 1994 to under $6 million by 2013.[3]

State Comptroller's Comment - ADAPT provided no documentation to support this assertion. However, between 1985 and 2015, we noted that ADAPT incurred an estimated $10.5 million in interest expenses.

ADAPT's financing of the project was prudent in other ways as well. ADAPT chose to buy the buildings, rather than rent the needed space, because space appropriate for school use is in very short supply in New York City, and owning space would provide greater flexibility to

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[2] ADAPT provided the auditors a chart of the historical prime rate showing this in its response to the third preliminary report.

[3] The draft audit report states that ADAPT did not provide records "supporting the 1985 loans." ADAPT did not retain those loan documents, and no law or regulation required ADAPT to do so.

State Comptroller's Comment - Our recommended disallowance was not based on the fact that ADAPT did not retain records pertaining to the 1985 financing. Rather, it was based on the RCM's requirements, which state that information relating to the acquisition of fixed assets, equipment, land or building improvements, and any related financing arrangements and grants must be retained as long as the facility is used by any education program the provider operates, if this period exceeds seven years.

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expand and otherwise adapt the space as program needs changed over the years. Moreover, ADAPT has been fortunate to own the properties which house the pre-school programs. The carrying costs of the buildings have been much less than rent for comparable space would have been, particularly in light of the tight real estate market in New York City. Accordingly, leasing over the same time period would have resulted in significantly higher costs passed onto the State. ADAPT's prudence has thereby saved the State large amounts of money. It also has left ADAPT with valuable assets due to appreciation in the value of the buildings.

State Comptroller's Comment - We are not questioning the financing of the project. However, based on our analysis of ADAPT's audited financial statements, we determined that, during fiscal years 2012-13 through 2014-15, ADAPT could have paid off some of its debt, thus avoiding certain interest costs.

b. The Interest Expense Was Allowable Under the RCM

The RCM provides that debt for capital projects shall be used "only when financing from current revenue sources is not available." That cannot reasonably be read to mean that financing from current revenue sources is "available" every time the Agency has more cash and cash equivalents on hand than would be needed to pay the debt, irrespective of the Agency's upcoming needs for cash and other fiscal needs. Rather, funds can only be deemed "available" when it would be prudent for the Agency to fund the capital expenditure without debt (or pay off existing debt as the auditors would require in this case) consistent with the Agency's overall fiscal needs. For all the reasons explained below, that was not the case.

ADAPT could not afford to buy these buildings for all cash. There is nothing surprising about that, as few agencies are able to prudently pay for multi-million dollar buildings in all cash. Long-term debt for such expenses is the norm. Nor could ADAPT prudently afford to pay off the long-term financing early, as the draft report suggests, consistent with meeting its other financial needs. Again, there is nothing surprising or abnormal about that.

The conclusion to the contrary stated in the draft audit report is based solely on looking at ADAPT's fiscal year end cash, cash equivalents and investments and unrestricted net assets as follows:

ADAPT'S CASH, CASH EQUIVALENTS AND UNRESTRICED NET ASSETS

	FY2015	FY2014	FY2013
Cash, cash equivalents and investments	$130,729,000	$20,936,000	$26,067,000
Unrestricted Net Assets:	$123,186,000	$12,676,000	$14,890,000

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Looking at the cash position at June 30th each year does not tell you anything about whether an agency can prudently pay down debt, because it fails to take into account any current liabilities and other contingencies or the necessary future cash planning considerations. Any assets on paper at the end of the fiscal year are not necessarily available to eliminate any borrowing. There could be, and in ADAPT's case always are, payroll, pension and other upcoming expenses that are not reflected on the year-end balance sheet at all. In fact, paying off debt with funds needed for other operating purposes and which would impact the Agency's ongoing financial flexibility would be fiscally imprudent and even could result in a "going concern" letter from the Agency's auditors, thereby foretelling a possible failure of the Agency.

State Comptroller's Comment - We disagree. We did consider ADAPT's current liabilities. If ADAPT, because of its strong liquidity position, had paid off the debt in question during the audit scope years, it could still have been able to meet its short-term obligations.

As OSC's audit team must understand, determining whether debt prudently can be paid down is a far more complex determination than looking at the year-end balance sheet. It involves a careful consideration of the Agency's business plans and all of the factors which impact on the Agency's cash flow planning and fiscal needs. ADAPT's management and Board are always looking to reduce costs, including interest costs, where it prudently can be done consistent with the Agency's overall needs, and they constantly review ADAPT's finances to determine the most cost-effective ways to meet its needs. The history described above reflects that. If ADAPT's management and Board believed that it would be prudent to pre-pay this debt to eliminate the interest cost, and that doing so would have left the Agency in a stronger position by eliminating interest expense while still maintaining a strong position to meet its anticipated upcoming cash needs, they would have done so. They had no conceivable reason to weaken ADAPT by paying interest unnecessarily.

State Comptroller's Comment - We did not find any evidence that ADAPT's Board discussed the prepayment of debt and/or elimination of interest costs and the impact of doing so on ADAPT's liquidity position.

With all due respect to OSC, it is not the role of auditors to second-guess the business judgment of the Agency's management and Board regarding what its cash needs would be and how to manage those needs. While that would be true in any case, it is all the more true in this case, where the audit team had no knowledge of ADAPT's overall plans and operating issues impacting on its cash needs. The auditors had no idea as to what year-end cash would have to be used almost immediately for payroll, pension or other expenses not reflected on the balance sheet. Furthermore, the auditors had no idea as to whether ADAPT had plans to expand its programs, to acquire new assets, to enter into new associations for additional programs, to incur other anticipated expenses not reported on the balance sheet, or any of the myriad of factors that

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could impact on its future fiscal needs. We also note that there is nothing terribly surprising, much less inappropriate, about an agency the size of ADAPT, with annual expenses over $100 million and debt in excess of $70 million, having the year end cash on hand and unrestricted net assets in the amounts it did. Unrestricted net assets in the $12 to $14 million range is less than two months of average outgoing cash flow. The cash, cash equivalents and investments were less than three months of average outgoing cash needed. Indeed, for an Agency highly dependent on government funding, which unfortunately sometimes results in delayed payments and unexpected changes in funding determinations, it would be imprudent not to maintain that level of liquidity. In this regard we note that both ADAPT's OPWDD programs and its SED-funded programs often encounter delays in payment, stressing cash flow. Moreover, both programs are based on reimbursement of costs, and both are subject to caps on year to year increases that over time cause its reimbursement rates to represent a loss, which must be covered by fundraising. Moreover, OPWDD-funded and SED-funded programs are subject to after-the-fact reconciliations and changes in funding methodology that can cause large unexpected liabilities, which its reimbursement rates do not generate cash reserves to cover. Indeed, this audit is one example of that.

State Comptroller's Comment - We are not second guessing the Board's business judgment. Our position is that an entity that receives State funds must exercise fiscal prudence and use those funds efficiently and effectively and for the purposes for which those funds were provided. For example, we deemed it inappropriate that taxpayer funds were used to purchase alcohol, instead of paying off the debt.

To the extent that the draft audit report contends that the proceeds from the sale of ADAPT's building at 123-130 East 23rd Street, which is what produced the large cash balance reflected on the FY2015 balance sheet, was available to use to pay down the mortgage, that is incorrect. Before it could sell the building, ADAPT needed to obtain a court order, on notice to the Attorney General. The Court order, a copy of which was provided to the auditors, expressly stated the purposes for which the proceeds could be used: 1) to fund relocation of the programs and services previously provided in the building being sold, and 2) to transfer funds the ADAPT's Foundation to be used for the long-term development and fiscal stability of ADAPT, including expansion of and improvements to ADAPT's programs, services and facilities and to benefit future generations of persons with developmental disabilities. The order did not authorize, nor permit, ADAPT to use such proceeds to pay off this or any other debt, and those proceeds were not available to ADAPT for that purpose. While these proceeds cannot be considered as available for debt repayment in any event for that reason, we also note that no payments from the audited programs were used to purchase the building sold, so that the sale proceeds could not be considered as derived in any way from State funding of the pre-school programs.

State Comptroller's Comment - We disagree. The court order allowed the proceeds from the

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sale of the building to be used for long-term development and the fiscal stability of ADAPT. Elimination of the long-term debt and the associated interest costs would be contributing factors in ADAPT's fiscal stability. In each of the three audit years, ADAPT consistently had net asset surpluses ($14,890,000 in fiscal year 2012-13, $12,676,000 in fiscal year 2013-14, $123,186,000 in fiscal year 2014-15) and high liquidity ratios (2.95 in fiscal year 2012-13, 1.84 in fiscal year 2013-14, and 2.42 in fiscal year 2014-15).

In its draft report, OSC now cites ADAPT's "quick ratio", which it did not mention in its prior preliminary report. In calculating the "quick ratio", OSC has disregarded the Other Liabilities line of ADAPT's balance sheets, which were significant ($21,358.000 on 6/30/15, $10,424,000 on 6/30/14 and $9,934,640 on 6/30/13.) Almost all of the dollar amounts of those other liabilities were short-term liabilities, which should be included in a "quick ratio" calculation. Specifically, one short term liability was the Recovery of Funds (non Ed Programs), which represented overpayments by OWPDD which needed to be refunded, which were $19,443,109, $8,134,687 and $6,050,954, respectively during those three fiscal years. Another short-term liability was the Deferred Revenue PL 94-142 account, which were employee benefit reimbursements which would be due whenever the employees put through the reimbursement requests. Those amounts were $1,041,236, $1,552,021 and $3,029,871 for the three fiscal years, respectively. OSC's "quick ratio" calculation therefore is not correct. A chart showing the composition of the "Other Liabilities" on the balance sheets will be provided under separate cover.

State Comptroller's Comment - Other Liabilities are not detailed in ADAPTs financial statements. Moreover, ADAPT provided no evidence to show that items listed in Other Liabilities were current and should be included in the calculation of current ratios.

In any event, for all the reasons explained above, looking only at year-end numbers on a financial statement, without any understanding of the Agency's overall needs and plans, gives no meaningful understanding as to what the Agency can afford in terms of debt reduction. In fact, by OSC's reasoning, New York State is paying bond interest that is "unnecessary." In this regard, New York State's FY18 Comprehensive Annual Financial Report on OSC's website reflects (pages 34, 39) billions of dollars of current assets greater than current liabilities. Yet OSC, as the steward of New York State's finances, did not cause New York State to pre-pay long-term debt to avoid "unnecessary" interest. We are not suggesting that New York State should have done so. What we are suggesting is that OSC, in looking only at ADAPT's fiscal year-end balance sheet to make its determination as to what ADAPT purportedly should have done, is applying an inconsistent and irrational analysis that neither OSC nor any other rational fiscal decision-maker would employ in making its own fiscal decisions.

State Comptroller's Comment - The objective of our audit was not to determine New York State's payment of bond interest. Rather, it was to determine whether the costs reported by

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ADAPT on its CFR were reasonable, necessary, directly related to its special education program, and sufficiently document.

There is a second reason why OSC's proposed disallowance is incorrect. The RCM precludes allowance of such interest only when "financing from current revenue sources is available." None of ADAPT's "extra" cash came from "current revenue sources." Indeed, it did not come from the SED-funded programs at all. Any such cash came from private donations accumulated over the years. We would submit that these are not "current revenue sources" within the meaning of the RCM, as the RCM does not purport to, and cannot, dictate to an agency how it must spend funds not derived from the SED-funded programs.[4]

State Comptroller's Comment - We have no assurance that these revenue sources were not from public funds. According to ADAPT's audited financial statements, which were prepared by their "nationally recognized and highly respected independent certified accounting firm," all of ADAPT's programs are substantially funded through New York State reimbursement or Medicaid funding.

c. <u>Interest income did not have to be offset against interest expense</u>

OSC's further contention that interest income should have been offset against the interest expense also is incorrect. As explained by ADAPT previously, ADAPT's interest income earned is not attributable to any public funds resulting from operation of the SED-funded programs, as demonstrated by the program deficits in both the 9160 and 9100 programs in all three years:

[4] We also note that ADAPT had over $12 million of other bond and mortgage debt during the audited years. If ADAPT really had sufficient excess revenue sources to pre-pay loans or capital expenditures (which it didn't) and ADAPT pre-paid the loans included in the pre-school programs' tuition base, OPWDD might complain that ADAPT should have paid the loans attributable to its programs instead.

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		Revenue	Expenses	Deficit
CFR 2013	9100	$15,470,394.00	$15,825,860.00	$355,466.00
	9160	$1,061,624.00	$1,162,589.00	$100,965.00
CFR 2014	9100	$15,004,451.00	$16,408,959.00	$1,404,508.00
	9160	$1,233,828.00	$1,364,044.00	$130,216.00
CFR 2015	9100	$14,621,428.00	$16,831,004.00	$2,209,576.00
	9160	$1,203,077.00	$1,474,247.00	$271,170.00

The pre-school programs always have operated at deficits. In fact, any interest income in each of those three years is attributable to fundraising income from those years and prior years, Fundraising income in the three audited years was:

Fundraising Revenue

FY2015	$1,759,000.00
FY2014	$1,599,000.00
FY2013	$1,298,000.00

Accordingly, ADAPT was not required to offset its interest expense by any of its interest income, because none of its interest income was income earned from the investment of public funds resulting from operations of approved programs.

For all the foregoing reasons, OSC's proposed disallowance of interest expenses is incorrect.

State Comptroller's Comment - ADAPT officials provided no evidence to show that their SED preschool cost-based program had a net deficit during our audit period. In fact, one of the objectives of this audit was to determine whether the costs submitted by the entity on its CFRs

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directly related to the special education program. We also question ADAPT's assertion that the interest income was attributable to fundraising income. We noted that, in all three years, ADAPT consistently reported $0.00 in fundraising income on its IRS Form 990 (Return of Organization Exempt From Income Tax).

D. "Non-Reimbursable" Expenses

ADAPT disagrees in part with OSC's proposed disallowances of "non-reimbursable" expenses. In response to OSC's preliminary reports, ADAPT submitted additional information and documentation on October 22, 2018 (response to third preliminary report) and October 24, 2018 (preliminary response to fifth preliminary report). To the extent that OSC continues to propose to disallow the items ADAPT previously disputed, ADAPT continues to disagree and submits that the documentation previously submitted is sufficient. For those items, we refer OSC to ADAPT's prior response and will not repeat here detailed responses to a large number of items involving small amounts. We will, however, address several items where OSC's position appears to be different from its prior preliminary reports.

With respect to consultant services provided by B.J., the spreadsheets with OSC's preliminary report said that the expense was not properly documented. ADAPT provided documentation in response. Now the spreadsheet says for the same proposed disallowance that the problem is that ADAPT purportedly did not explain the purpose of this contractor. That contention is incorrect. In response to a prior inquiry from the auditors, ADAPT explained such purpose to the auditors in writing on August 8, 2018. That response stated in relevant part that B.J. "provided supports specific to the Education Department" and that her "support included training for teachers in the areas of team building and teacher leadership." Another copy of that August 8, 2018 ADAPT response will be provided again to the auditors under separate cover. We also will provide copies of agenda for certain of the training sessions that she provided as additional support.

State Comptroller's Comment - We disagree. ADAPT officials were not able to provide us with sufficient documentation to support the services the consultant provided to SED's preschool cost-based programs. For example, the agenda provided to us did not include the name of the consultant. Moreover, the consultant's contract did not specify how the services to be provided were related to the SED preschool cost-based programs.

OSC's proposed disallowance of expenses of Professionals for Non-Profits is new; it was not included in the preliminary reports. We will provide documentation supporting this expense under separate cover.

State Comptroller's Comment - Based on the documentation provided by ADAPT, we revised our report to allow the expenses for Professionals for Non-Profits.

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ADAPT continues to disagree with most of OSC's disallowances of Chase Credit card expenses. A spreadsheet showing with which items ADAPT disagrees and explaining why will be provided under separate cover. Supporting documentation where additional back-up was requested also will be submitted under separate cover.

We note that several of the proposed disallowances on the Chase Credit card related to expenses attributable to S.L., which OSC apparently views as "fundraising". As explained above, S.L.'s responsibilities included oversight of marketing, which is reimbursable, not just development, and all of those expenses related to marketing activities.

State Comptroller's Comment - Based on additional information received from ADAPT, we revised our report to allow the expenses related to employee S.L.

We also note that several of the items are expenses for taxis staff used to travel home when they worked late. OSC has proposed to disallow this as "commuting", citing RCM Section 11.59.D(l). That section is not applicable for two reasons. One, it pertains to use of a personal vehicle, which these taxi expenses were not. Two, those were not routine "commuting" expenses. These were particular situations where the employee worked late and, therefore, the expense of a taxi, which these staff did not normally use to "commute", was reasonable and necessary as a safety concern.

State Comptroller's Comment - These costs should have reported as non-allowable expenses on the applicable line of the CFR.

ADAPT also continues to disagree with the proposed disallowances of legal and accounting fees not related to the pre-school program. As was previously explained to the auditors, ADAPT, like many other agencies, charges all legal and accounting fees to overall Agency Administration, as they are expenses that are incurred to benefit the agency as a whole. It does not attempt to parse through the invoices of such professionals to try to identify on an invoice by invoice or line by line basis whether particular work they did benefitted only a specific program or programs. We are not aware of any provision in the RCM that requires an agency to do so, and in fact doing so would require additional resources to do that which would cause additional unnecessary agency administration expenses. We also note that if the Agency were required to do so, which it is not, services that benefitted solely the pre-school programs also should be reclassified as pre-school expenses, not Agency Administration, which would increase the reported costs.

State Comptroller's Comment - We disagree. The RCM defines agency administration as "those expenses which are not directly related to a specific program but are attributable to the overall operation of the agency. These costs include: costs for the overall direction of the organization;

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costs for general recordkeeping, budget and fiscal management; costs for public relations (non-fundraising); and costs for parent agency expenditures." The costs we recommended for disallowance were directly related to a specific non-SED cost-based program.

E. "Improper" Allocation of Family Support Services

ADAPT disagrees with this proposed disallowance. The expenses allocated to the pre-school program were for counseling and training to assist parents in the pre-school program. We will provide under separate cover descriptions of such family conferences held on October 15, 2012 and November 20, 2014 which explain the necessary activities to organize the conferences. The families referred to in those descriptions and served by the conferences included pre-school families. The RCM expressly allows these kinds of costs of parent counseling and training:

> "'(5) The costs or parent counseling and training to assist parents in understanding the special needs of their child; providing parents with information about child development; and helping parents to acquire the necessary skills that will allow them to support the implementation of their child's IEP are reimbursable."

Accordingly, there is no basis to disallow those expenses as not being allowable pre-school expenses.

State Comptroller's Comment - We disagree. According to the CFR Manual (Appendix G), Family Support Services (FSS) is an OPWDD-funded program. Moreover, ADAPT did not provide any documentation to show that services were provided to the SED preschool cost-based programs.

Contrary to the implication of the draft report, these costs were not, and could not be, reimbursed by OPWDD. These costs were not submitted to OPWDD for reimbursement by OPWDD as part of OPWDD Family Support Services, because they were attributable to the pre-school program, not to Family Support Services for families served by the OPWDD program. It would not have been proper for ADAPT to ask OPWDD to pay for that, and OPWDD would not have done so. We also note that OPWDD did not in fact reimburse 100% of ADAPT's OPWDD Family Support Services expenses that were submitted to OPWDD for reimbursement. There were non-funded OPWDD approved Family Support Services expenses of $10,211 in FY13, $70,942 in FY14 and $133,798 in FY15. ADAPT will submit documentation reflecting that under separate cover.

State Comptroller's Comment - The reimbursement of Family Support Services costs by OPWDD should be addressed to OPWDD.

In any event, even if the proposed disallowances were correct (which they are not), they

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are overstated by $72,904.04. OSC based its calculation solely on the general ledger. As ADAPT explained to the auditors multiple times during the audit, that is not accurate, because allocations of salaries and fringe benefits from the Family Support Services account to other programs are reflected on other supporting schedules, not the general ledger. Review of the supporting schedules reflects that compensation of only two employees included on the Family Support Services general ledger, A.B. and D.P., were allocated to the pre-school education programs. A.B. cannot be included in this disallowance, because her compensation allocated to the pre-school programs already was disallowed as part of OSC's personal services disallowances discussed above. Doing so again here would be duplicative. Therefore, the only personal services expenses which could be included in this disallowance would be for D.P. This adjustment reduces the disallowance, if any disallowance were proper in the first place (which it is not), by $72,904.04 to $27,223.25. Documentation supporting this calculation will be provided under separate cover.

State Comptroller's Comment - ADAPT provided no evidence to show that the recommended disallowances in Family Support Services were already disallowed in the personal services section of the report. Moreover, the schedules provided by ADAPT did not support the amounts allocated from Family Support Services.

F. Investment Costs

ADAPT does not dispute this proposed disallowance. However, we note that OSC is being inconsistent when it says that for this purpose, where it would support the proposed disallowance, OSC accepts that the investments were non-SED-funded program assets, but for purposes of its contention that interest income should have been offset against interest expense (see pp. 17-18 above), OSC treats the same investments as SED-funded program assets.

State Comptroller's Comment - We were consistent. In our discussions with ADAPT, we questioned why ADAPT did not report any investment income on CFR-1, line 85, as required by the CFR Manual. ADAPT officials agreed that the assets were not program related and advised us that the associated brokers fees should not have been charged to the SED preschool cost-based programs.

G. "Unsupported" Vehicle Expenses

ADAPT disagrees with this proposed disallowance. Most of these expenses related to building services vehicles owned by ADAPT. The sole use of those vehicles was by building service personnel to provide services for buildings used by all of ADAPT's programs. ADAPT provided the general ledgers and its allocation methodology based a percentage square footage of the space used by the various programs in the buildings serviced by these personnel. Admittedly, ADAPT did not maintain vehicle logs for usage of these vehicles. While the RCM, read literally,

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appears to require that, unlike the more common situation of personally owned vehicles used in part for business use or company owned vehicles provided to a single employee for both personal and business use, which this is not, vehicle logs would serve no practical purpose. Unless travel was to a building used by only one program, vehicle logs would not tell you for which program the vehicle was being used. Under these circumstances, we submit that ADAPT's allocation methodology is reasonable and should be acceptable, as vehicle logs would not enable auditors (or anyone else) to determine any more accurately the proportionate use of the vehicles for each program.

State Comptroller's Comment - The RCM explicitly states that vehicle logs are require to be maintained. ADAPT acknowledges in its response that it did not maintain these logs. Consequently, these reported costs were not documented in compliance with the requirements of the RCM.

H. Property Costs "Incorrectly" Charged To the Preschool Programs

ADAPT disagrees with this disallowance. As was previously explained to the auditors, the space used by the pre-school programs at this location was a gym and office space. The regulations, which were provided by ADAPT to the auditors, mandate that physical education activities must be provided. NYSED approval letters are required only for classroom space. They are not required for gym space or office space. Nothing in the RCM or any other law or regulation mandates that non-classroom space must be approved. Therefore, OSC's point that the building "was not approved to operate the SED pre-school cost-based programs" is irrelevant. ADAPT will provide under separate cover a schedule for the current year as a sample schedule showing when the gym was used by the pre-school program. While the similar schedules for the three audited years have not been retained, the relative use of the gym by the pre-school programs has not changed since the audited years, as the relative numbers of approved classes for the programs using the gym has not changed.

State Comptroller's Comment - The RCM clearly states that a provider needs to obtain prior SED approval for an education program expansion requiring additional staff, property-related costs, classroom equipment, etc., when the cost is expected to be reimbursed fully or partially through the tuition rate established by SED. In addition, as stated on page 14 of our report, ADAPT could not provide any evidence that services for the SED preschool cost-based program were provided at that site during the audited period.

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III. Conclusion

We hope and trust that OSC will carefully review and consider the points set forth above and the additional documentation being provided under separate cover before issuing its final audit report, and that OSC will change its final audit report accordingly.

Very truly yours,

Frederick J. Berman

Frederick J. Berman