



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 Children's Center for Early Learning



Executive Summary

Purpose

To determine whether the expenses reported on the Consolidated Fiscal Reports (CFRs) of the Children's Center for Early Learning (Center) were calculated properly, documented adequately, and allowable pursuant to the State Education Department's (SED) Reimbursable Cost Manual (Manual). Our audit primarily covered the two fiscal years ended June 30, 2009. In addition, we examined selected costs from fiscal years 2005-06 and 2006-07.

Background

The Center provides special education services to New York City-based children between three and five years of age. Pursuant to New York State Education Law, special education providers, such as the Center, are reimbursed for their services using tuition rates established by SED based on the financial information reported on their annual CFRs. For the three fiscal years ended June 30, 2009, the Center claimed approximately \$10.7 million in reimbursable expenses for the programs we audited (Programs). According to SED, the Center's special education operations ended on May 5, 2014.

Key Findings

We identified \$797,438 in reported costs that should not have been reimbursed, as follows:

- \$741,942 in salary and related personal service expenses for costs chargeable to Center affiliates; for time not worked; and for other undocumented personal service costs.
- \$55,496 in non-personal service costs that were either undocumented; not properly allocated between programs; or not Program-appropriate. Such costs include fees for undocumented professional services, income tax penalties, food purchases, and office-related expenses.
- The Center made interest-free loans to related parties using Program monies.

Key Recommendations

To the State Education Department:

- Review the disallowances addressed in our report and adjust the Center's CFRs and tuition reimbursement rates for the audit scope period as appropriate.
- Work with Center officials to help ensure that only allowable costs are included on any of their CFRs prepared after our scope period.
- Direct Center officials to disclose all "less-than-arm's-length" transactions on any CFRs prepared after the scope period and prior to ceasing operations.

To the Children's Center for Early Learning:

- Ensure that costs reported on any CFRs prepared after the scope period comply with Manual requirements.

Other Related Audits/Reports of Interest

[Bilingual SEIT and Preschool, Inc.: Compliance With the Reimbursable Cost Manual \(2011-S-13\)](#)
[Special Education Associates, Inc.: Compliance With the Reimbursable Cost Manual \(2010-S-31\)](#)

State of New York
Office of the State Comptroller

Division of State Government Accountability

December 29, 2014

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

Mr. Thomas Gelb
Executive Director
Children's Center For Early Learning
83 Marlborough Road
Brooklyn, NY 11226

Dear Dr. King and Mr. Gelb:

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

Following is a report of our audit of the State Education Department and the Children's Center for Early Learning entitled *Compliance With the Reimbursable Cost Manual*. This audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

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

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

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

Background

The Children's Center for Early Learning (Center) is a not-for-profit organization located in Brooklyn, New York, that is licensed to provide special education services to New York City-based children between three and five years of age. The Center's special education services include a full-day Center-based program, a half-day Center-based program, and a home-based Special Education Itinerant Teacher (SEIT) program. Center officials informed the State Education Department (SED) that they would be ceasing Center operations on May 5, 2014.

The New York City Department of Education (DoE) has paid the Center for its services using tuition rates established by SED. SED in turn periodically reimbursed the DoE for its statutory share (59.5 percent) of the tuition paid to the Center. SED periodically revises its tuition rates for special education providers based on the financial information reported on their annual Consolidated Fiscal Reports (CFRs). SED has issued a Reimbursable Cost Manual (Manual) to 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 and/or affiliates. For the three fiscal years ended June 30, 2009, the Center reported approximately \$10.7 million in Program-related costs.

One of the Center's affiliates, the Children's Center for Early Intervention (CCEI), operates at the same Brooklyn location. CCEI is a for-profit organization approved by the New York State Department of Health to provide early intervention services to children from birth to age three. In addition to sharing facility space, the Center's Executive Director and certain other Center employees also work for CCEI. In addition, the Center's Executive Director is the spouse of the Director of Clinical Programs at CCEI. Collectively, the Center and CCEI are known as the "Children's Center."

Manhattan Children's Center (MCC), also located in New York City, is another Center affiliate. MCC began operations in 2007 as a non-profit private school chartered by the New York State Board of Regents to educate children between 3 and 12 years of age who have been diagnosed with autism spectrum disorder. The Center's Executive Director is a founder and current President of MCC. His spouse is also one of MCC's founders and is on its Faculty Advisory Board. Some Center employees also work for MCC.

Audit Findings and Recommendations

We identified \$797,438 of reported costs that should not have been reimbursed. Most of the ineligible costs were claimed during the two fiscal years ended June 30, 2009, and the balance were claimed during fiscal 2005-06. The ineligible costs were either unrelated to Center operations or insufficiently documented (See Exhibit).

Personal Service Costs

According to the Manual, personal service costs, which include all taxable salaries and fringe benefits paid to or accrued by employees on an agency's payroll, must be reported on the CFR as either direct care costs (e.g., teachers' salaries) or non-direct care costs (e.g., administrators salaries). Costs are to be allocated between all of the provider's entities/affiliates and programs based on a fair and reasonable method. We identified \$741,942 in personal service costs that do not comply with the Manual guidelines for reimbursement.

Unallocated Salary and Fringe Benefits

We identified \$629,924 in salaries and fringe benefits charged to the Center's CFRs that pertained to 27 individuals who worked for Center affiliates and not the audited Programs, as follows:

- The Center claimed personal service expenses of \$235,056 on its CFR for fiscal 2005-06 for four employees who, based on their personnel records, worked exclusively for CCEI, and for the time spent at CCEI by 13 employees who worked for both the Center and CCEI. The entire salaries of these 17 employees were charged to the Center;
- The Center similarly overcharged SED and DoE for \$204,501 in personal service expenses on its CFRs for 2007-08 and 2008-09 for two individuals who worked for CCEI, MCC, or both, and not the Center;
- We identified another eight employees whose entire personal service expenses were claimed on the Center's 2007-08 and 2008-09 CFRs even though they spread their time between the Center, CCEI, and/or MCC. There were no records denoting the actual time spent by these employees at each of the affiliates. Using an allocation methodology approved by the Manual (ratio value), we calculated \$157,261 as the overcharge to the Center; and
- The health insurance and pension-related costs for 17 other employees who worked for both the Center and CCEI were charged in their entirety to the Center for 2007-08 and 2008-09. Based on the allocation methodology used by the Center to allocate their salaries, we determined that \$33,106 of these health and pension-related costs should have been allocated to CCEI.

When we asked Center officials why they charged the personal service costs of CCEI and MCC employees to the Center, they asserted that the work performed at CCEI and MCC by these employees was on their own time and outside of their regular Center work hours. To support their assertion, they provided us with undated time studies prepared by the 17 individuals denoting

the average amount of time each spent at each affiliate. However, they could not provide us with any time and attendance records maintained by these individuals for their work at the affiliates during the audit scope period.

Excess Compensation

According to the Manual, salary reimbursement for any employee is limited to 1.0 full-time equivalent (FTE), exclusive of overtime, etc. We found Center officials were claiming more than 1.0 FTE (ranging from 1.03 FTEs to 2.14 FTEs) for seven full-time employees during the audit scope period. When queried, Center officials said these employees were working 40-hour weeks although they were required to work only 35. However, the time records for these seven employees show that during the audit scope period, none ever worked more than 35 hours a week. As a result, we disallowed \$69,896 in compensation paid to these seven employees for hours claimed but not worked.

Unsupported Payroll Costs

Reimbursable compensation costs must be based on documented payrolls and supported by time and attendance records. We disallowed \$22,565 in undocumented and/or insufficiently documented payroll costs, as follows:

- \$16,000 (eight payments of \$2,000 each) in salary expenses claimed on the 2007-08 CFR for a psychologist who had no time and attendance records for the period in question. Center officials claimed that they allowed this employee (the daughter of the Executive Director) to work from home between November 7, 2007 and March 28, 2008 while she was on maternity leave. However, there was no evidence that she performed any Center-related work during this period; and
- \$2,708 in undocumented custodial expenses for work reportedly performed on the weekend, and a \$3,857 payment for dental expenses for one of the Center's employees. These unsupported expenses total \$6,565.

Ineligible Vacation Accruals

According to the Manual, accrued expenses are not reimbursable until paid. We disallowed \$19,557 in accrued vacation expense that Center officials claimed on their 2007-08 and 2008-09 CFRs for 11 employees. These expenses were not paid during the noted fiscal years.

Non-Personal Service Costs

According to the Manual, reimbursable costs must be reasonable, necessary, Program-related, and properly documented. Standard procurement documentation includes vendor invoices, purchase requests, independent receiving reports, and proof of payment. Collectively, these documents describe the item(s) purchased, from whom, the dates of purchase and payment, and the payee. Certain costs, such as those of a personal nature, are specifically not allowed. We

disallowed \$55,496 of the Center's non-personal service costs for the 2007-08 and 2008-09 fiscal years as noted:

- \$14,000 for professional (audit and legal) services claimed on the Center's CFR for fiscal year 2005-06. Center officials could not tie these costs to the audited Programs;
- \$23,955 in unsupported recruiting expenses;
- \$8,465 in interest expenses on outstanding loans, federal income tax penalties, bank fees, the purchase of food, car service fees, and parking expenses;
- \$7,916 in rent and telephone expenses charged to the Center that should have been allocated to CCEI based on square footage; and
- \$1,160 in office-related expenses for which there was no supporting documentation.

Other Matter

Undisclosed Less-Than-Arm's-Length Transactions

For purposes of full disclosure and transparency, SED requires providers to disclose any and all transactions between the providers and related parties on their CFRs. Likewise, an entity must disclose the same in the notes to their audited financial statements. Related parties consist of any individuals or entities, including principal owners, their immediate families, and all affiliates doing business in any manner with the provider.

For example, the Center made several interest-free loans to its MCC affiliate that were not disclosed on the CFRs. One such loan was in the amount of \$74,000. Center officials told us that the interest-free terms were made in exchange for an in-kind benefit, a full digital Applied Behavior Analysis Curriculum.

Nevertheless, we question the propriety of loaning Program funds to other parties for activities that are not necessary or related to the Programs. Such funds are designated for a specific purpose, and the premise for the government awarding such funds to a provider is that they are needed to provide the contracted services. Further, there was no evidence provided that shows the digital curriculum received from MCC equates to the estimated interest the Center would have received on the loan. Moreover, no reasons were offered by Center officials regarding the nondisclosure of these transactions.

Recommendations

To the State Education Department:

1. Review the disallowances addressed in our report and adjust the Center's CFRs and tuition reimbursement rates as appropriate.
2. Work with Center officials to help ensure that only eligible costs are included on any of their CFRs prepared after the audit scope period.

3. Direct Center officials to disclose all less-than-arm's-length transactions where CFRs have been prepared.

To the Children's Center for Early Learning:

4. Ensure that costs reported on the CFRs prepared after our audit scope period and prior to ceasing operations comply with Manual requirements.

Audit Scope and Methodology

We audited the support for, and the propriety of, the expenses reported on the Center's annual CFRs for the two fiscal years ended June 30, 2009. We also looked back to fiscal 2005-06 and 2006-07 for specific unallowable expenses brought to our attention during our field work. The objective of our audit was to determine whether the reported costs were calculated properly, documented adequately, and reimbursable pursuant to the Manual.

To accomplish our objective, we reviewed the Center's CFRs and relevant financial records for the audit period and interviewed Center officials, staff, and independent auditors to gain an understanding of the Center's financial and business operations. We also interviewed SED and DoE officials regarding their own reviews of Center records and any concerns they might have as a result thereof. In addition, we reviewed the available supporting documentation for a sample of expenses reported on the CFRs to determine their Program-propriety and compliance with the Manual. The scope of our audit work on internal controls focused on gaining an understanding of the procurement and disbursement procedures related to the Center's personal service and non-personal service expenditures as it relates to the CFRs.

We conducted our audit in compliance with generally accepted government auditing standards. Those standards require that we plan and perform our 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 the 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.

Authority

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

Reporting Requirements

We provided a draft copy of our report to SED and Center officials for their review and comment. Their comments were considered in preparing this final report and are attached in their entirety at the end of the report. In their response to our draft report, SED officials agreed with our recommendations and indicated that they would take certain actions to address them. Center officials, however, disagreed with most of our report's findings. Our rejoinders to certain Center comments are included in the report's State Comptroller's Comments.

Within 90 days after release of our final 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. We also request that Center officials advise the State Comptroller of actions taken to implement the recommendation addressed to them and, if the recommendation was not implemented, the reasons why.

Contributors to This Report

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Vision

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

Mission

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

Exhibit

Children Center for Early Learning
Schedule of Submitted, Disallowed, and Allowed Program Costs
Fiscal Years 2005-06, 2007-08, and 2008-09

Program Costs	Amount Per CFR	Amount Disallowed	Amount Allowed	Notes to Exhibit
Personal Services				
Direct Care	\$5,568,238	\$623,421	\$4,944,817	
Agency Administration	<u>\$1,176,856</u>	<u>\$118,521</u>	<u>\$1,058,335</u>	
Total	\$6,745,094	\$741,942	\$6,003,152	A - C
Non-Personal Services				
Direct Care	\$3,364,491	\$2,630	\$3,361,861	
Agency Administration	<u>\$589,224</u>	<u>\$52,866</u>	<u>\$536,358</u>	
Total	\$3,953,715	\$55,496	\$3,898,219	A, D - K
Total Program Costs	\$10,698,809	\$797,438	\$9,901,371	

Notes to Exhibit

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

- A. Section I - Costs must be reasonable, necessary, program-related, and sufficiently documented.
- B. Section I.14 - Compensation for personal services includes all salaries and wages, as well as fringe benefits and pension plan costs.
- C. Section I.14.B - Costs of benefits for employees who provide services to more than one program and/or entity must be allocated to separate programs and/or entities in proportion to the salary expense allocated to each program.
- D. Section I.21.A - Costs incurred for entertainment of officers or employees, or for activities not related to the program, or any related items such as meals, lodging, rentals, transportation, and gratuities, are not reimbursable.
- E. Section I.21.B - All personal expenses, such as personal travel expenses, laundry charges, beverage charges, gift certificates to staff and vendors, flowers or parties for staff, holiday parties, repairs on a personal vehicle, rental expenses for personal apartments, etc., are not reimbursable unless specified otherwise in this Manual.
- F. Section I.23.C - Costs of food provided to any staff including lunchroom monitors are not reimbursable.
- G. Section I.30. (3) - Costs for food, beverages, entertainment, and other related costs for meetings, including Board meetings, are not reimbursable.
- H. Section II A.1 - Compensation costs must be based on approved and documented payrolls. Payrolls must be supported by employee time records prepared during, not after, the time period for which the employee was paid. Employee time sheets must be signed by the employee and a supervisor, and must be completed at least monthly.
- I. Section II A (4) - 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.
- J. Section II.B (1) - Entities operating programs must maintain accounts in accordance with generally accepted accounting principles and Section 200.9 (d) of the Commissioner's Regulations.
- K. Section II.C (10) - A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost.

Agency Comments - State Education Department

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NYS ED AUDIT SERVICE

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

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October 31, 2014

Mr. Frank Patone
Audit Director
Office of the State Comptroller
Division of State Government Accountability
110 State Street - 11th Floor
Albany, NY 12236

Dear Mr. Patone:

The following is the New York State Education Department's (Department) response to the draft audit report, (2011-S-21) of the State Education Department: Children's Center for Early Learning Inc.

It is important to note, that although the Children's Center for Early Learning Inc. has voluntarily closed its special class, special class in an integrated setting program, special education itinerant services and multidisciplinary evaluation programs, and pursuant to Section 200.9(e)&(g) of the Regulations of the Commissioner of Education (Regulations) the provider is required to submit financial reports and financial statements on an annual basis and no later than 90 days following the closedown of its operation. The Department Rate Setting Unit (RSU) will provide technical assistance to Children's Center for Early Learning Inc. regarding the expectations of the financial reporting requirements and for reimbursement as presented in Regulation and the Reimbursable Cost Manual (RCM) for the Center's remaining financial submissions to the Department.

Recommendation 1: Review the disallowances addressed in our report and adjust the Center's Consolidated Fiscal Report (CFRs) and tuition reimbursement rates as appropriate.

We agree with this recommendation. The Department will review the expenses and costs as noted in the report and make adjustments to the reimbursable costs to recover any overpayments as appropriate by recalculating tuition rates.

Recommendation 2: Work with Center officials to help ensure that only eligible costs are included on any of their CFRs prepared after the audit scope period.

We agree with this recommendation. The Department will continue to provide technical assistance whenever requested and will strongly recommend the Children's Center for Early

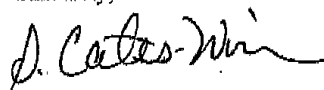
Learning Inc. officials take advantage of our availability to help them better understand the standards for reimbursement as presented in the Regulations and the RCM. Furthermore, CFR training is available both in person, at one of the six locations it is offered across the State, and online on the Department's webpage. The Department recommends that all individuals signing the CFR certification statements, namely Executive Directors and Certified Public Accountants, complete this training. At the direction of the Board of Regents, the Department intends to require that this training be mandatory and will require individuals to verify that they have completed the training.

Recommendation 3: Direct Center officials to disclose all less-than-arm's-length transactions where CFRs have been prepared.

We agree with this recommendation. The Department's RCM requires entities receiving public funding to develop written Code of Ethics (which must include a specific conflict of interest policy) and Code of Conduct policies. The conflict of interest policy must include a requirement and process for identifying and fully disclosing all less-than-arms-length relationships and transactions on an ongoing basis as well as on the CFR.

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

Sincerely,



Sharon Cates-Williams

c: James P. DeLorenzo
Suzanne Bolling
Maria Guzman

Agency Comments - Children's Center for Early Learning

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September 23, 2014

BY EMAIL (FPatone@osc.state.ny.us)
AND FEDERAL EXPRESS

Frank Patone, Audit Director
 State of New York Office of the State Comptroller
 123 William Street, 21st Floor
 New York, NY 10038

Re: Children's Center for Early Learning
Your Draft Audit Report # 2011-S-21

Dear Mr. Patone:

This letter is in response to your draft audit report with respect to your audit of Children's Center for Early Learning ("CCEL"). We note at the outset that CCEL previously had advised you of the reasons it disagrees with your proposed disallowances in its responses to your preliminary reports and in our December 10, 2012 letter further addressing your prior preliminary conclusions, and we refer you to those documents for a more complete response.

As a preliminary matter, we also note that CCEL does not agree that your office 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). CCEL's cooperation with your audit, its prior responses to your preliminary reports and this response 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 CCEL expressly reserves all rights to do so.

*

Comment

1

*See State Comptroller's Comments, page 22

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

Frank Patone
September 23, 2014
Page 2 of 7

We also note as a preliminary matter that your draft report mis-names CCEL as CCEL, "Inc." "Inc." is not part of the company's name. This error should be corrected in your final report.

*
Comment
2

Our response below is organized by headings that correspond to the headings of your draft audit report containing the matters addressed in this response.

Background (Draft Report page 4)

The third paragraph of the "Background" section on page 4 of the draft report contains inaccurate statements concerning the relationship between CCEL and Manhattan Children's Center ("MCC"). MCC is not, and during the audited years was not, an affiliate of CCEL. MCC is a separate corporation from CCEL with a different Board and different officers. CCEL's Executive Director was a founder of MCC, but contrary to your draft report, he is not, and during the audited years was not, the President or any other officer of MCC. While his spouse is on MCC's Faculty Advisory Board as your draft report states, that is a volunteer position, and in that position she exercises no control over the action or policies of MCC. Your statement that "some Center employees also work for MCC" is misleading. As is discussed below, one CCEL administrative employee also worked for a short time after business hours for MCC, and one part-time CCEL therapist who worked two days a week at CCEL worked at MCC on other days. Other than that, no CCEL employees worked at MCC. Thus, there is no factual foundation for your conclusory statement that CCEL and MCC "are closely intertwined." Those errors should be corrected in your final report.

*
Comment
3

Unallocated Salary And Fringe Benefits (Draft Report page 5)

CCEL disagrees with your first bullet point in this section on page 5 of the draft report and requests that it be deleted from your final report. Despite the difficulty in culling very old records relating to the 2005-06 year, CCEL provided your auditors documentation showing that the four employees that your draft report states worked exclusively for Children's Center for Early Intervention ("CCEI") also worked for CCEL. CCEL also provided documentation reflecting the work done by each employee referred to in this bullet point and showing that allocations between CCEL and CCEI used by CCEL were appropriate, based on class assignments for teachers and teaching assistants and therapy sessions for therapists. Contrary to your unsubstantiated and unexplained assertions, the documents show that CCEL only paid for work done for CCEL, not for work done for CCEI. We also note that any claims relating to the 2005-06 are barred by the statute of limitations.

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Comment
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CCEL disagrees with your second bullet point and requests that it be deleted from your final report for the same reasons as the first bullet point. CCEL provided your auditors with

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ATTORNEYS-AT-LAW

Frank Patone
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documentation and explanations demonstrating that in every case you cite, the employee worked at CCEL and that CCEL was charged only for work done at CCEL. *See*, December 10, 2012 letter, pages 5-7. Your draft report ignores all of that evidence and concludes, without any explanation or substantiation, that those employees did not work for CCEL. Your completely unexplained, unsubstantiated and unjustified conclusions are incorrect.

*
Comment
4

CCEL disagrees with your third bullet point in this section and requests that it also be deleted from your final report. The eight employees you refer to were employees shared by CCEL and CCEI (not MCC, which did not share any employees with CCEI). The allocation of their time was supported by time studies. Contrary to your assertion, the time studies were dated. The only contention your auditors raised concerning these time studies during the audit was that they were not signed by supervisors. CCEL thereafter provided statements signed by the supervisors attesting to the time studies. The fact that CCEL did not provide records of employees' work at CCEL is irrelevant, as only the time they spent on CCEL work was charged to CCEL, and records of that work were provided to you.

*
Comment
5

Finally, in addition to the inaccuracies described above, the last paragraph of this section of the draft report is completely inaccurate, and it should be deleted from your final report, or at the very least the inaccuracies described below should be corrected. First, the paragraph falsely suggests that MCC and CCEL had shared employees and that their work for MCC was charged to CCEL. CCEL and MCC had no shared employees – that is, employees who were employed and paid by one or the other and, in that capacity, performed work for both entities so that their salaries had to be allocated between the two employers. To the contrary, one full-time CCEL employee also worked after hours for a brief period at MCC. She was employed by MCC and paid by MCC for that after-hours work, and that work did not make her a shared CCEL/MCC employee. Similarly, one part-time CCEL therapist worked two days a week at CCEL and at MCC on other days. She was paid by CCEL for her work at CCEL and by MCC for her work at MCC. That did not make her a shared employee. *See*, December 10, 2012 letter at pages 5-6. As stated above, no other CCEL employee worked at MCC. As this also makes clear, contrary to your draft report, CCEL was not charged for any MCC work.

*
Comment
6

In addition, this paragraph inaccurately links together completely unrelated statements. The CCEL "assertion" you describe in the first sentence relates to the one CCEL employee who briefly also worked after hours at MCC and the one part-time CCEL employee who also worked part-time at MCC, as discussed above. The second sentence has nothing to do with those two employees, as the time studies you refer to were not offered to support allocation of their time, which was all correctly charged to CCEL. The time studies were offered to support allocation of time of employees who truly were employees shared by CCEL and CCEI. This error also should be corrected in your final report.

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Comment
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Excess Compensation (Draft Report page 6)

CCEL disagrees with your proposed disallowance and requests that it be deleted from your final report. As was explained to you in our December 20, 2012 letter (#6 at page 4), whether or not these employees worked more than 35 hours a week is irrelevant; they were hired to work 40 hours a week and CCEL legally was required to, and did, pay them for 40 hours a week. Accordingly, it is appropriate to compute FTEs based on a 40-hour work week.

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Comment
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Unsupported Payroll Costs (Draft Report page 6)

CCEL disagrees with your proposed disallowance of \$ 2,708.00 of compensation paid to a custodian for work done on the weekend and requests that it be deleted from your report. The expense was not "undocumented" as your draft report claims. CCEL provided your auditors with copies of an invoice for the work showing what was done, which invoice was signed by the employee and his supervisor.

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Comment
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Ineligible Vacation Accruals (Draft Report page 6)

CCEL disagrees with your proposed disallowance of \$19,557 in accrued vacation expense and requests that it be deleted from your final report. As your auditors were advised, CCEL acknowledged that it did not expend these amounts during the years in question, but it reversed those accruals in subsequent years. For you to disallow them now would be double-dipping, as it would reverse the same cost entry twice. In our December 20, 2012 letter, we expressly stated CCEL's understanding that you agreed that no adjustment beyond the subsequent reversals of the accruals was necessary or appropriate. You did not indicate anything to the contrary then, and you still have not explained why you believe that reversing the same entry twice is appropriate.

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Comment
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Non Personal Service Costs (Draft Report pages 6-7)

CCEL disagrees with almost all of your proposed disallowances in this section and requests that they be deleted from your final report. The reasons are as follows.

CCEL provided you full documentation as to the 2005-06 audit and legal costs. They all were tied to the audited program, and your auditors did not even raise any issue as to that during the audit. The issue you raised was that some of those expenses were not paid until the following year, and CCEL demonstrated that while they were not paid until the following year, they were incurred in 2005-06 and therefore were properly reported in that year. In addition, this proposed disallowance, like all of your proposed disallowances of 2005-06 costs, is barred by the statute of limitations.

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Comment
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Contrary to your conclusory contention otherwise, the \$23,955 of recruiting expenses were supported. CCEL provided documentation of the expenses, explained why they were necessary and demonstrated that other agencies incur similar expenses. No support beyond that was asked for or is required by the Reimbursable Cost Manual.

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Comment
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With respect to your \$8,465 proposed disallowance, CCEL provided documentation showing the bank charges. CCEL could not provide back-up detail, because the bank did not provide any to CCEL, and no such back-up detail was required. Your auditors never contended, and could not contend, that the fees were not charged to CCEL or that \$2,718 of bank fees on an account having more than \$5 million in transactions was unusual or unreasonable. CCEL conceded that your proposed disallowances of \$710 of car service expense, \$56.78 of parking expenses, and \$2,247.21 and \$1,011.35 of interest expense were appropriate. Other than the above items, CCEL does not understand what else is included in your \$8,465 number, as we cannot correlate such numbers to items raised by your auditors during the audit.

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Comment
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With respect to the \$7,916 in rent and telephone expense allocation, CCEL provided your auditors with documentation, including floor plans of its 80:20 allocation of these expenses based on square footage. While your auditors have contended that the allocation should be 78.5/21.5, they never have explained how they calculated that allocation or provided any substantiation for it whatsoever, and CCEL continues to believe that your unexplained contention is incorrect.

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Comment
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The \$6,979 in computer and copier related expenses were CCEL expenses. As was explained to your auditors in detail, the invoices include MCC's name on it because they were purchased under a joint purchasing program with MCC with the account name "Children's Center MCC" to achieve better pricing. As also was explained to your auditors, MCC purchases under the joint program were shipped to MCC and paid for by MCC, and CCEL purchases, including the \$6,979 you cite, were shipped to CCEL and paid for by CCEL. As also was explained in detail to your auditors, the invoices at issue reflect on their faces (the mailing address) that the equipment at issue was shipped to CCEL, not MCC, and that the nature of the equipment was for 2 to 5 year olds, which is the age group that CCEL serviced but MCC did not. Thus, "based on vendor invoices" the equipment should have been charged to CCEL, as it was. You have provided no explanation or substantiation for your incorrect contention to the contrary.

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CCEL cannot correlate the proposed \$1,160 in office-related expenses "for which there was no supporting documentation" to any items your auditors raised previously, and CCEL is not certain to what you are referring. If you are referring to the \$1,155 SEIT payroll expenses your auditors raised previously, which is the number to which it correlates most closely, we provided your auditors supporting documentation, including the employee's course transcript and the employee's certification as a Board Certified Behavior Analyst, showing that the expense was a

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partial reimbursement of tuition for a professional development course program. If your report is referring to some other expense, CCEL cannot identify the expense.

Undisclosed Less-Than-Arm's-Length Transactions (Draft Report page 7)

CCEL disagrees with your statements in this section and requests that the entire section be deleted, or at least that the inaccurate statements be corrected, in your final report. Your inaccuracies are as follows.

First, your first sentence is inaccurate. The Reimbursable Cost Manual for the years in question did not require disclosure of less-than-arm's-length ("LTAL") relationships in the CFR; it required such disclosure only in the notes to the company's financial statement. Moreover, it required disclosure of LTAL "relationships," not of "all LTAL transactions" as your draft report states.

Your second paragraph of this section is inaccurate because, as stated above, MCC was not an affiliate of CCEL. They did not have the same Board members, officers or management.

Your third paragraph in this section also is completely inaccurate. Nothing in the law, applicable regulations or Reimbursable Cost Manual in place during the audited years precluded a company receiving public funding from making loans to other not-for-profit entities. You cite no authority for your statement that providers "should not be making loans of any kind," and there is no such authority. The premise of government funding for these services is that such funding will fully reimburse the program for its reimbursable costs of providing services, no more and no less, not that the funds necessarily are immediately needed for a particular use at any particular time. If a program for any reason has funds not immediately needed for program costs at any given time, it is free to lend them to another not-for-profit company. Second, MCC showed you the digital curriculum it received from MCC and explained that it was worth more than the relatively small amount of interest that would have been earned had interest been charged on the loan, which should have been evident to your auditors from the nature of the curriculum they saw. Third, the only reason that "no reasons were offered by Center officials regarding non-disclosure of these transactions" is that your auditors never asked for any such reasons. Your auditors asked for documentation regarding the loan to MCC and MCC's repayment of the loan, which documentation was provided by CCEL. Disclosure or non-disclosure of the loan to MCC on CCEL's CFR or financial statement never was discussed at all. In any event, disclosure of the loan to MCC was not required in the notes to CCEL's financial statements because for all the reasons discussed above, CCEL and MCC were not "related parties and one party can exercise control or significant influence over the management or operating policies of another party," which is what the Reimbursable Cost Manual defines as an LTAL relationship requiring disclosure in the notes to the financial statement.

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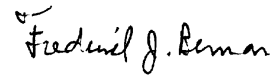
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Finally, we note that the loan to MCC did not result in any expenditure of public funds that would not have occurred in the absence of such loan.

CCEL thanks you in advance for your anticipated careful consideration of this response. We are confident that you will modify your draft report to take account of this response.

Very truly yours,

A handwritten signature in cursive script that reads "Frederick J. Berman".

Frederick J. Berman

FJB:jp

State Comptroller's Comments

1. We reference the Comptroller's statutory audit authority on page 2 of the report. Moreover, this authority has been affirmed by the Supreme Court of the State of New York.
2. We revised the final report by deleting "Inc." from the Center's official name wherever it is referenced.
3. We acknowledge that the Center is corporately separate from the other entities referenced in our report. Nevertheless, the entities in question are clearly programmatically affiliated. As detailed in our report, the Center and CCEI operate at the same business location and share facility space. Further, the Center's director and certain other Center employees also work for CCEI. In addition, the Center's Executive Director is the current President of MCC.
4. Center officials did not provide us with adequate documentation, including payroll, personnel or other records, to refute our conclusions as cited in the report. We maintain that our observations and conclusions are accurate based on the evidence provided to us by the Center.
5. Center officials provided no analysis or rationale for the allocation percentages purportedly derived from such studies. As noted in our report, there were no records which indicated the actual amount of time employees spent working at the Center's program affiliates (including CCEI and MCC). In addition, the supervisory statements cited by Center officials were signed and dated after the completion of our audit field work - and at least two years after the time periods in question. Thus, the statements were not contemporaneous with the periods in question, and therefore, are not sufficient to support the allocations in question.
6. Based on the available evidence, we concluded that certain employees worked for CCEI and MCC, but were charged to the Center. Further, there was no evidence of Center-related work efforts of the employees in question. Moreover, Center officials did not provide us with evidence that contradicted our findings.
7. The statements in question are in fact related. The question we posed to Center officials was a general reference to all four circumstances detailed in the bullets on page 5 of our report. It was not limited to the two employees cited by the Center in its response. Thus, our report accurately reflects the assertions made to the auditors by Center officials during the course of the audit's fieldwork.
8. We acknowledge that Center officials may choose to pay staff for time neither worked nor charged to leave accruals. However, for CFR reporting purposes, claiming compensation for hours not worked is inconsistent with the Reimbursable Cost Manual.
9. The custodial employee in question is required to maintain time and attendance records for the periods he works and the corresponding compensation that is charged to the audited programs. Moreover, there was no actual "invoice" for the work time purportedly provided to the Center. The "invoice" was a document prepared by a Center official stating the services in question were provided. The document was prepared as a result of our audit and, therefore, was not contemporaneous with the services and corresponding payment in question.

10. At the time Center officials prepared the CFR in question, they should have known that the accrued vacation expenses (totaling \$19,557) had not in fact been paid, and therefore, such expenses were ineligible for reimbursement. Regarding the subsequent years' CFRs, the Center should adjust them as appropriate and advise SED to determine if such adjustment would change the Center's tuition reimbursement rates.
11. The \$14,000 of charges in question were not supported by payments in either the audited or subsequent fiscal year.
12. The supporting documents noted by Center officials do not relate to the \$23,955 in question. These documents pertained to other recruitment expenses made during the audit period, which we did allow as eligible costs.
13. The bank fees noted by Center officials are not reimbursable per the Manual (whether or not they were actually paid). The unreconciled disallowance relates to ineligible charges for food.
14. Our calculation was based on the actual square footage of the areas in question as provided to us by Center officials during the audit. Furthermore, we provided our analysis and calculations of the allocation percentages to Center officials during our audit fieldwork.
15. Based on information provided by Center officials, we have allowed the \$6,979 in costs claimed for computers and copiers. We revised our final report by deleting this matter from our findings.
16. We provided the specific details for the \$1,160 disallowance for office expenses to Center officials during the course of the audit, and we will resend those details to Center officials.
17. Our report does not state that the Reimbursable Cost Manual required disclosure of related party transactions. Rather, Section 18, page 18.1 of SED's Consolidated Fiscal Reporting and Claiming Manual requires disclosure of related party transactions on Form CFR-5.0. Further, program funds should be used for activities that are reasonable, necessary, and related to the program. We questioned their use as loans to fund activities of other programs. Also, we revised certain language in our report to make it more technically accurate.