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**New York State Office of the State Comptroller**  
Thomas P. DiNapoli

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Division of State Government Accountability

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# **Compliance With the Reimbursable Cost Manual**

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**State Education Department  
New York League for Early  
Learning, Inc.**

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# Executive Summary

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## Purpose

To determine whether the costs reported by New York League for Early Learning, Inc. (NYL) 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 (Manual). The audit included expenses claimed on NYL's CFR for the three fiscal years ended June 30, 2014.

## Background

NYL is a New York-based not-for-profit organization authorized by SED to provide Special Education Itinerant Teacher (SEIT), full-day and half-day Special Class (SC), and full-day and half-day Special Class in an Integrated Setting (SCIS) preschool special education services to children with disabilities between the ages of three and five years. For purposes of this report, these programs are collectively referred to as the SED cost-based programs. During the 2013-14 school year, NYL served about 818 students. In addition to the SED cost-based programs, NYL operated three other SED-approved programs: Evaluations, Related Services, and 1:1 Aides. However, payments for services under these other programs were based on fixed fees, as opposed to the cost-based rates established through CFR-reported financial information. NYL also operated an Early Intervention, a private day care, and a Universal Pre-K program. During the three audited years, NYL shared space with Manhattan Star Academy (MSA), a private school that serves school-age children with special needs.

The New York City Department of Education (DoE) refers students to NYL based on clinical evaluations and pays for NYL's services using rates established by SED. The rates are based on the financial information that NYL reports to SED on its annual CFRs. SED reimburses DoE for a portion of its payments to NYL based on statutory rates. Reimbursable costs must be reasonable, necessary, directly related to the special education program, and sufficiently documented. For the three fiscal years ended June 30, 2014, NYL reported approximately \$138 million in reimbursable costs for the cost-based programs.

During the three fiscal years ended June 30, 2014, NYL was a member of the eight-member Young Adult Institute Network (Network), which also included the Young Adult Institute (YAI) and MSA. The relationships among the Network's members were intertwined. During the same three-year period, NYL was a signatory to a Management Agreement (or Agreement) with YAI, wherein YAI agreed to provide management services to NYL. In November 2015, after our audit fieldwork was underway, the Agreement with YAI was terminated.

## Key Findings

For the three fiscal years ended June 30, 2014, we identified \$5,771,008 in reported costs that did not comply with the requirements in the Manual and recommend such costs be disallowed. These ineligible costs included \$3,676,434 in personal service costs and \$2,094,574 in other than personal service costs, as follows:

- \$1,728,270 in duplicate administrative costs for NYL's Executive Director, Assistant Executive Director, and seven agency administrative staff. The costs for the functions performed by these individuals were covered under the Management Agreement and should not have been charged separately to NYL;
- \$1,209,263 in costs applicable to 1:1 Aides program. NYL incorrectly allocated these costs to its cost-based programs rather than to the fixed-fee 1:1 Aides program;
- \$1,132,895 in other than personal service costs, including \$801,660 in costs for services that were covered by the Management Agreement and \$331,235 in various adjusting entries that were insufficiently documented;
- \$738,901 in employee bonuses that did not comply with the requirements in the Manual;
- \$584,641 in various costs, including \$292,279 for food, \$270,879 in property costs, and \$21,483 in vehicle costs. These costs were unsupported and/or ineligible per the Manual's provisions and those in the Consolidated Fiscal Reporting and Claiming Manual as well; and
- \$377,038 charged to the SED cost-based programs for the services of two consultants. The consultant costs are duplicative as their functions should have been covered under the Agreement. Additionally, the costs for one of the two consultants were insufficiently documented.

## Key Recommendations

### To SED:

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

### To NYL:

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

## Other Related Audits/Reports of Interest

[Sunshine Developmental School: Compliance With the Reimbursable Cost Manual \(2012-S-64\)](#)

[Starting Point Services for Children: Compliance With the Reimbursable Cost Manual \(2014-S-64\)](#)

**State of New York**  
**Office of the State Comptroller**

**Division of State Government Accountability**

March 29, 2017

Ms. MaryEllen Elia  
Commissioner  
State Education Department  
State Education Building - Room 125  
89 Washington Avenue  
Albany, NY 12234

Ms. Margaret Chiara  
Executive Director  
New York League for Early Learning, Inc.  
460 West 34<sup>th</sup> Street  
New York, NY 10001

Dear Ms. Elia and Ms. Chiara:

The Office of the State Comptroller is committed to helping State agencies, public authorities, and local government agencies manage government resources efficiently and, by so doing, providing accountability for tax dollars spent to support government-funded services and 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 expenses submitted by the New York League for Early Learning, Inc. to the State Education Department for the purposes of establishing the tuition reimbursement rates. The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution; Article II, Section 8 of the State Finance Law; and Section 4410-c of the State Education Law.

This audit's results and recommendations are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. If you have any questions about this draft 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](http://www.osc.state.ny.us)

## Background

The New York League for Early Learning, Inc. (NYL) is a New York City-based not-for-profit organization authorized by the State Education Department (SED) to provide Special Education Itinerant Teacher (SEIT), full-day and half-day Special Class (SC), and full-day and half-day Special Class in an Integrated Setting (SCIS) preschool special education services to children with disabilities between the ages of three and five years. For purposes of this report, these programs are collectively referred to as the SED cost-based programs.

During the 2013-14 school year, NYL served about 818 students. In addition to the SEIT, SC, and SCIS cost-based programs, NYL operated three other SED-approved programs: Evaluations, Related Services, and 1:1 Aides. However, payments for services under these other programs were based on fixed fees, as opposed to the cost-based rates established through financial information reported on Consolidated Fiscal Reports (CFRs). NYL also operated an Early Intervention, a private day care, and a Universal Pre-K program, and shared space with Manhattan Star Academy (MSA), a private school that serves school-age special education students.

The New York City Department of Education (DoE) refers students to NYL based on clinical evaluations and pays for NYL's services using rates established by SED. The rates are based on the financial information that NYL reports to SED on its annual CFRs. To qualify for reimbursement, NYL's expenses must comply with the criteria set forth in SED's Reimbursable Cost Manual (Manual), which provides guidance to special education providers on the eligibility of reimbursable costs, the documentation necessary to support these costs, and cost allocation requirements for expenses related to multiple programs. Reimbursable costs must be reasonable, necessary, program-related, and sufficiently documented. The State reimburses the DoE 59.5 percent of the statutory rate it pays to NYL.

During the three fiscal years ended June 30, 2014, NYL was a member of the eight-member Young Adult Institute Network (Network), which also included the Young Adult Institute (YAI) and MSA. During the same period, certain members of the Network served on the Boards of Trustees (Board or Trustees) of other member-entities (see Exhibit B at the end of this report). YAI's Chief Financial Officer (CFO) also served as the CFO of NYL and MSA. Moreover, on its CFRs for the three fiscal years ended June 30, 2014, NYL disclosed a related-party relationship with YAI, as required by the Manual.

On March 1, 2010, NYL entered into a five-year Management Agreement (or Agreement) with YAI. This Agreement, which was automatically renewed for an additional five years beginning March 1, 2015, required YAI to provide services that included, but were not limited to, all business, management, fiscal, personnel, fundraising, planning, and program functions and services. In addition, YAI was required to coordinate the professional services functions of NYL inclusive of hiring and firing, and to conduct, supervise, and coordinate the day-to-day fiscal and/or operational functions of NYL. Further, YAI was responsible for billing and collecting from NYL's funding and third-party sources for services rendered. The Agreement was terminated on November 10, 2015, after our audit fieldwork was underway.

Chapter 545 of the Laws of 2013 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 ended June 30, 2014, NYL reported approximately \$138 million in reimbursable costs for the SED cost-based programs. Our audit included expenses claimed on NYL's CFR for the three fiscal years ended June 30, 2014.



## Audit Findings and Recommendations

The engagement letter for OSC's audit of the expenses NYL reported on the CFRs filed with SED for the three fiscal years ended June 30, 2014 was transmitted to NYL on May 6, 2015. This letter included a list of initial documents needed to facilitate the audit. The audit's opening conference was held on, and fieldwork began, May 28, 2015. Initially, NYL designated YAI's CFO and YAI's Assistant Director for Revenue Management as the audit liaisons for our audit of NYL. However, throughout the audit, we experienced significant difficulties obtaining requested documentation to support the expenses reported on the CFRs. At various times throughout the audit engagement, YAI and NYL provided some, but not all, requested documentation.

Based on documentation provided to auditors through early 2016, as well as interviews with NYL and YAI personnel, we issued six written preliminary audit findings to NYL, with the last preliminary finding issued on May 6, 2016. These preliminary audit findings recommended disallowances totaling about \$20.7 million due to pervasive non-compliance with the requirements in the Manual. At that time, NYL attributed much of its non-compliance to YAI's purported inability and/or refusal to provide required supporting documentation.

Subsequent to the issuance of the preliminary findings, NYL and YAI provided us with additional supporting documentation, which we examined at length. Based on the additional documentation, we significantly reduced the amounts of the recommended disallowances, particularly those pertaining to expenses related to services provided under the Management Agreement. Thus, at the conclusion of our audit fieldwork, we determined that \$5,771,008 in reported costs did not comply with the Manual's requirements for reimbursement, for the three fiscal years ended June 30, 2014. The costs recommended for disallowance included \$3,676,434 in personal service costs and \$2,094,574 in other than personal service (OTPS) costs (see Exhibit A). Most of the costs in question were insufficiently documented, duplicative in nature, and/or otherwise ineligible for reimbursement.

### Personal Service Costs

According to the Manual, 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 Manual. In addition, personal service costs, which include all taxable and non-taxable salaries and fringe benefits paid or accrued to employees on the agency's payroll, must be reported on the CFR as either direct care costs (e.g., teachers' salaries) or non-direct care costs (e.g., administrators' salaries). For the three fiscal years ended June 30, 2014, NYL reported approximately \$106.7 million in personal service costs for its SED cost-based programs. We identified \$3,676,434 in personal service costs that did not comply with the Manual's guidelines for reimbursement.

#### *Management Agreement*

Although the management fee was reported under the category of Other Than Personal



Services on the CFRs NYL filed with SED, we determined that NYL's reported Personal Service Costs were significantly impacted by the Management Agreement. Further, the Manual states that costs charged to programs receiving administrative services, insurance, supplies, technical consultants, etc. from a parent or related organization are reimbursable provided such costs are not duplicative in nature, provide a direct benefit, are based on actual direct and indirect costs allocated to all programs on a consistent basis, and are defined as reimbursable in the Regulations of the Commissioner of Education, the Manual, or the Consolidated Fiscal Reporting and Claiming Manual (CFR Manual).

NYL, a member of the Network, entered into the Agreement with YAI, another member of the Network, for a period of five years effective March 1, 2010. The Agreement required YAI to provide services that included, but were not limited to, all business, management, fiscal, personnel, fundraising, planning, and program functions and services; coordinate the professional services functions of NYL inclusive of hiring and firing; as well as to conduct, supervise, and coordinate the day-to-day fiscal and or operational functions of NYL. YAI was also responsible for billing and collecting from NYL's funding and third-party sources for services rendered. During the three fiscal years ended June 30, 2014, NYL claimed \$13.8 million in costs for services provided by YAI under the Management Agreement.

We requested support for the \$13.8 million in costs and were provided with a summary spreadsheet entitled "Support Service Allocation-Ratio Value Methodology" by one of the two audit liaisons. This spreadsheet listed each Network member's total administrative and direct expenses, as well as the percentages and amounts of YAI's administrative costs allocated to each Network member. However, NYL did not provide documentation to support the expenses listed on the spreadsheet. In a written preliminary audit finding issued to NYL on April 5, 2016, we recommended disallowance of the entire \$13.8 million in management fees NYL reported on its CFRs because NYL failed to provide sufficient documentation, as required by the Manual, to support these expenses. Subsequently, starting in May 2016, NYL began providing some documentation to support the costs pertaining to the Management Agreement fees.

We interviewed NYL's Executive Director and YAI's CFO to determine the relationship between NYL and YAI. They informed us that, despite being members of the same network, each entity was independent and had its own separate Board. However, when we reviewed NYL's Board minutes, we found the following:

- At the September 12, 2011 meeting, YAI's Chief Executive Officer (CEO) announced that there would be more integration between the YAI and NYL Boards with members of the YAI Board attending NYL meetings. In addition, a resolution requested by YAI's Senior Director of Legal Affairs and Compliance resulted in the revision of authorized signatories on certain NYL bank accounts;
- At the November 28, 2011 meeting, YAI's CEO discussed the composition of NYL's Board, as well as the composition of future Board meetings;
- At the June 4, 2012 Board meeting, YAI's CEO requested that the NYL Board approve a motion for NYL to be a signatory for a property lease by MSA (another member of the Network). The motion was unanimously approved by NYL's Board; and

- At the March 4, 2013 meeting, the Board passed resolutions that required NYL to guarantee a \$2 million construction loan and lease payments for MSA. These arrangements were in support of an initiative that allowed NYL students to receive services from the Network when NYL's preschool students turned five years old and were no longer eligible for services from NYL.

On January 14, 2011, YAI entered into a Stipulation Agreement with New York State for \$10,800,000 to resolve claims by New York State and a private party. In addition, Note 11 to NYL's June 30, 2012 Audited Financial Statements states, "As of June 30, 2012, YAI had an outstanding balance of \$5,585,688. Under the Stipulation Agreement with New York State, NYL issued an unconditional guaranty to New York State securing any defaults in YAI's annual repayment obligation to New York State in return for a release of any civil liabilities of the League and its current and former officers, directors, employees, affiliates and assigns arising under the claims and the common law out of the matters alleged in the investigation and the private party complaint. The maximum potential amount of future payments that the League could be required to make under the guaranty was \$6,049,601. On October 31, 2012, YAI voluntarily paid in full the State Settlement Amount, including interest. Therefore, effective November 27, 2012, the State of New York terminated the Guaranty Agreement between New York State and NYL for Early Learning, Inc. and released the League from the Guaranteed Obligation and any and all obligations and liability of any nature whatsoever under the Guaranty Agreement."

Also, we found that NYL's Executive Director certified the CFRs by stating that NYL has custody of records and allocation worksheets to support all the information contained in the CFRs. However, YAI's CFO was listed as the custodian for the books and records of both YAI and NYL for the three fiscal years ended June 30, 2014. In addition, YAI's CFO had primary responsibility for NYL's overall fiscal operations and was listed as the contact person on the CFR that NYL filed with SED for the fiscal year ended June 30, 2014. For the two fiscal years ended June 30, 2013, YAI's Assistant Director for Revenue Management was listed as the contact person. We questioned whether NYL would have accepted this degree of oversight, exposure, and liability if YAI officials did not exercise significant control or influence over NYL's management and operations. Based on the aforementioned governance and financial relationships among the YAI's network members, we determined that the business arrangements and transactions between NYL, YAI, and MSA constituted Less-Than-Arm's-Length (LTAL)<sup>1</sup> relationships, as defined by the Manual.

### *Administrative Costs*

To determine if NYL claimed costs that should have been covered under the Management Agreement, we requested and reviewed support for the costs NYL reported on its CFRs for administrative staffing. For the three fiscal years ended June 30, 2014, we determined that

<sup>1</sup>Section 1(4)(A) of the Manual states, in general, a less-than-arm's-length (LTAL) relationship exists when there are related parties and one party can exercise control or significant influence over the management or operating policies of another party, to the extent that one of the parties is or may be prevented from fully pursuing its own separate interests. In pertinent part, Section 1(4)(E) of the Manual defines a "related party" as "any party transacting or dealing with the agency/entity of which that party has ownership of, control over, or significant influence upon the management or operating policies of a program(s)/entity(ies) to the extent that an arm's-length transaction may not be achieved."

NYL claimed a total of \$2,129,521 in compensation costs for an Executive Director, an Assistant Executive Director, five Office Workers, and two Utilization Review/Quality Assurance employees. By claiming reimbursement for its own Executive Director, Assistant Executive Director, and seven agency administrative employees, NYL duplicated services and associated costs that were covered under the Management Agreement.

Consequently, we determined that \$1,728,270 of the claimed \$2,129,521 in compensation should not have been allocated to the SED cost-based programs, as follows:

- \$701,899 in compensation, including \$3,004 in unsupported bonuses, for five NYL office workers;
- \$578,805 in compensation, including \$406 in unsupported bonuses, for NYL's Executive Director;
- \$339,877 in compensation for NYL's Assistant Executive Director; and
- \$107,689 in compensation for two NYL employees who performed Utilization Review/Quality Assurance duties and also served as MSA's trustees.

Therefore, we recommend that SED disallow \$1,728,270 (\$701,899 + \$578,805 + \$339,877 + \$107,689) in administration costs that were duplicative in nature.

### *1:1 Aides*

According to SED's "Guidelines for Determining a Student with a Disability's Need for a One- to-One Aide," a 1:1 aide is assigned to a specific student based on the recommendations in the student's Individualized Educational Program (IEP). The Manual and the CFR Manual state that all costs (salaries, fringe benefits, and allocated direct and indirect costs) for 1:1 aides should be reported in a separate cost center (as fixed fees) on providers' CFRs. Furthermore, actual hours of service is the preferred statistical basis on which to allocate salaries and fringe benefits for shared staff who work on multiple programs. In addition, providers must maintain appropriate documentation to support the hours used in this allocation. Acceptable documentation may include payroll records or time studies. If hours of service cannot be calculated or time studies cannot be completed, then alternative methods that are equitable and conform to Generally Accepted Accounting Principles (GAAP) may be utilized.

For the three fiscal years ended June 30, 2014, NYL claimed \$1,209,263 in compensation for 347 full-time and part-time employees who were reported on the CFRs as behavioral support staff and teacher aide/teacher assistant substitutes. However, a review of their personnel files, payroll records, and class rosters indicated that the 347 employees were 1:1 aides rather than behavioral support staff or teacher aide/teacher assistant substitutes. We queried this discrepancy and were told by NYL officials that the 347 employees worked in multiple positions/programs, such as 1:1 aides, behavioral support, and/or teacher aide/teacher assistant substitutes. Officials advised that when a student was absent, the student's 1:1 aide was reassigned to work with students in the SED cost-based programs. We requested documentation to show how the costs for the 347 employees were allocated among the various programs. However, NYL could not provide time and attendance records or time studies, as required by the Manual. Instead, officials provided

spreadsheets to show the reassignment of the employees.

We reviewed the spreadsheets which showed students' names, the 1:1 aides assigned to those students, the number of 1:1 sessions approved for each of the students, the days the students were absent, and the 1:1 aides' time and costs that were reallocated to the SED cost-based programs. However, the spreadsheets did not demonstrate that the 1:1 aides actually provided services to the SED cost-based programs. Further, we determined that the methodology used to reallocate time and costs to the SED cost-based programs for the reassigned 1:1 aides was arbitrary and non-compliant with the guidelines in the Manual and the CFR Manual. Therefore, we recommend that SED disallow the \$1,209,263 (\$966,640 for 287 employees who were claimed as behavioral support staff and \$242,623 for 60 employees who were claimed as teacher aides/teacher assistant substitutes) in compensation for the 347 employees because the costs were insufficiently documented. Such costs should have been charged to the fixed-fee 1:1 aides program rather than to the SED cost-based programs.

### *Employee Bonuses*

According to the Manual, a bonus is a non-recurring and non-accumulating (i.e., not included in base salary of subsequent years) lump sum payment in excess of regularly scheduled salary which is not directly related to hours worked. A bonus may be reimbursed if it is based on merit as measured and supported by employee performance evaluations. Beginning with the fiscal year ended June 30, 2014, providers were required to adopt a written employee performance evaluation policy and a form that sufficiently detailed the criteria and methods used to determine each employee's final evaluation rating. The written policy must describe how the final evaluation rating correlates to the amount of the merit award.

During the three years ended June 30, 2014, NYL's Board authorized 2 percent to 3 percent one-time lump sum payments to all salaried employees, including administrative and support staff. Based on NYL's records, the lump sum payments totaled \$803,039. For the same three-year period, NYL paid \$58,030 in staff awards to employees. Both the lump sum payments and the staff awards were non-recurring and non-accumulating, and were not included in the employees' base salaries in subsequent years. Therefore, the lump sum payments and staff awards met the Manual's definition of a bonus.

However, NYL could not demonstrate that the lump sum payments and staff awards were based on merit as measured and supported by employee performance evaluations. In fact, we found that NYL maintained employee evaluations for just 9 of the 624 employees who received lump sum payments and staff awards (i.e., bonuses) during the three fiscal years. Further, we reviewed the evaluations for the nine employees and found no correlation between the evaluation ratings and the payments. Therefore, we recommend that SED disallow \$738,901 (\$680,871 lump sum and \$58,030 staff awards) in bonus payments because these payments did not comply with the Manual's guidelines.

## Other Than Personal Service Costs

According to the Manual, costs must be reasonable, necessary, directly related to the special education program, and sufficiently documented. For the three fiscal years ended June 30, 2014, NYL reported approximately \$31.6 million in OTPS expenses for its SED cost-based programs. We identified \$2,094,574 of these expenses that did not comply with the requirements in the Manual.

### *Unsupported and Ineligible Costs*

The Manual provides guidance on the eligibility for reimbursement of costs and the documentation required to properly support such costs when reported on the CFR. According to the Manual, all purchases must be supported with invoices that list the items purchased, the dates of purchase and payment, along with copies of canceled checks. For the three fiscal years ended June 30, 2014, we identified \$1,132,895 in costs that did not meet the requirements in the Manual, as follows:

- \$801,660 in costs incurred by YAI for contracted services, staff food, staff recognition awards, vehicle-related expenses, moving expenses, bonuses, overtime, and Supplemental Executive Retirement Plan (SERP) expenses. These costs were claimed as part of NYL's \$13.8 million management fee reported on the CFRs for the three fiscal years ended June 30, 2014. However, NYL could not provide documentation, as required by the Manual, to support these costs; and
- \$331,235 in contracted services and food for students. The contracted service and student food expenses were recorded as adjusting entries on NYL's general ledger and claimed on the CFRs for the two fiscal years ended June 30, 2013. However, NYL officials could not provide documentation, as required by the Manual, to support these expenses.

Therefore, we recommend that SED disallow \$1,132,895 (\$801,660 + \$331,235), the amount of unsupported and/or ineligible costs allocated to the SED cost-based programs.

### *Consultant Costs*

According to the Manual, the costs for consultant's services are reimbursable provided the services could not have been performed by an appropriately certified school officer or an employee who possesses the necessary technical skills. Adequate documentation for consultants includes, but is not limited to, the consultant's resume, a written contract which includes the nature of the services to be provided, the charge per day, and the dates of service. Moreover, all payments must be supported by itemized invoices that indicate the specific services actually provided; and for each service, the date(s), number of hours provided, the fee per hour; and the total amount charged. As stated earlier in this report, NYL paid YAI, a related party, \$13.8 million in fees to provide certain services under the Management Agreement. The Agreement required YAI to provide services that included, but were not limited to, all business, management, fiscal, personnel, fundraising, planning, and program functions and services. In addition, the Agreement

required YAI to coordinate the professional service functions of NYL inclusive of hiring and firing and to conduct, supervise, and coordinate the day-to-day fiscal and/or operational functions of NYL. Also, YAI was responsible for billing and collecting from NYL's funding and third-party sources for services rendered.

Our review of NYL's CFRs for the three fiscal years ended June 30, 2014 found that NYL paid \$464,618 (\$362,956 and \$101,662, respectively) to two fiscal consultants. One of the consultants was contracted to perform reviews of NYL's operations, prepare CFRs, review and respond to SED's correspondence, identify and negotiate rate appeals, and modify and implement NYL's business plan. The other consultant was contracted to perform services in the areas of billing, accounts receivable, government reporting, and budgeting. We interviewed the consultants, who confirmed that the services they performed were consistent with the services listed in their respective contracts.

Further, our review of YAI's CFRs for the same period indicated that YAI's fiscal department included a CFO, two controllers, an accountant, two utilization review/QA staff, and other staff. However, NYL's representatives advised that YAI staff served NYL as well as the other members of the Network. As such, it should not have been necessary for NYL to engage the two consultants to provide business administrative services (otherwise provided by the Management Agreement) to NYL. In preparing the terms and conditions of the Agreement, both NYL and YAI should have determined whether YAI had sufficient resources to provide the services stipulated in the Agreement. If it was later determined that YAI's resources were inadequate, it was YAI's (and not NYL's) responsibility to hire the additional staff and/or to subcontract the services to meet YAI's obligations under the Agreement.

As a result, we determined that the consultant services were duplicative in nature to the services obligated under the \$13.8 million Agreement. Moreover, we reviewed the consultants' invoices, and determined that the invoices submitted to NYL by the second consultant were not itemized and did not describe the nature of the services provided, as otherwise required by the Manual. Therefore, we recommend that SED disallow \$377,038 in consulting services fees that were allocated to the SED cost-based programs, because these costs were duplicative and/or insufficiently documented.

### *Food Costs*

According to the Manual, the cost of food provided to staff, as well as the cost for food, beverages, entertainment, and other related costs for meetings, including Board meetings, are not reimbursable. During the three fiscal years ended June 30, 2014, NYL reported \$305,438 in food costs, such as restaurant charges, food for staff, and coffee expenses. We recommend that SED disallow \$292,279 in ineligible food costs, the amount allocated to the SED cost-based programs, because these costs are not reimbursable, per the Manual.



### *Property Costs*

According to the CFR Manual, when more than one program is served at the same geographic location, property and related costs must be allocated between the programs benefiting from those services. The CFR Manual also states that square footage is the approved method for calculating costs when agency administrative offices and program offices are located in the same building. During the three fiscal years ended June 30, 2014, NYL reported \$15,066,072 in total property costs (e.g., utilities, rent, leasehold improvements, real estate taxes, supplies and materials, lease and depreciation of equipment, repairs and maintenance, and telephone expenses). However, NYL could not provide documentation to support \$213,485 in property costs. Therefore, we recommend that SED disallow the \$213,485 in unsupported costs.

Also, during the same three fiscal years, NYL reported \$2,497,914 in property costs for space it shared with MSA, a private school that is a member of the Network. However, NYL allocated just \$134,307 (rent, utilities, and real estate taxes) to MSA. Based on our calculations, we determined that NYL should also have included leasehold improvements, supplies and materials, lease and depreciation of equipment, repairs and maintenance, and telephone expenses in its calculation of MSA's property cost - for a total allocation of \$191,701. Therefore, we recommend that SED disallow \$57,394 in property costs, the difference between \$191,701 and \$134,307, because these costs did not comply with the requirements in the CFR Manual.

Thus, in total, we recommend the disallowance of \$270,879 (\$213,485 + \$57,394) in ineligible property costs.

### *Vehicle Costs*

According to the Manual, vehicle use must be documented with individual vehicle logs that include, at a minimum: the date and time of travel to and from each destination, the mileage between each destination, the purpose of travel, and the name of the traveler. The Manual also states that costs associated with the personal use of a program-owned or leased automobile are not reimbursable. In addition, the costs of vehicles used by program officials, employees, or Board members to commute to and from their homes are not reimbursable. For the three fiscal years ended June 30, 2014, NYL claimed \$26,489 in vehicle-related costs, such as lease payments, gas, E-ZPass, and parking for the company vehicle driven by the Executive Director.

However, NYL officials advised us that vehicle logs, required by the Manual, were not maintained. They advised that the Executive Director used her personal calendar to make vehicle-related usage entries. We reviewed the entries on the calendar and determined, nonetheless, that the entries did not meet the Manual's requirements because they did not include the time of the trip, the "from" location, mileage, and the purpose of the travel. We also reviewed travel and expense reimbursement forms, E-ZPass statements, parking receipts, and other documentation provided by NYL and determined that these documents were not acceptable substitutes for the required detailed vehicle logs. Therefore, we recommend that SED disallow \$21,483 in vehicle-related expenses, the amount allocated to the SED cost-based programs, because these costs were inadequately documented and did not comply with the Manual's guidelines.



## Recommendations

### To SED:

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

### To NYL:

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

## Audit Scope and Methodology

We audited the costs reported on NYL's CFRs to determine whether they were properly documented, program related, and allowable pursuant to the Manual. The audit included claimed expenses for the three fiscal years fiscal ended June 30, 2014.

To accomplish our objective, we reviewed the Manual and the Consolidated Fiscal Reporting and Claiming Manual, NYL's CFRs, and relevant financial records for the audit period. We also interviewed NYL officials, staff, and independent auditors to obtain an understanding of its 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 salary expense, food expense, and property expense. Our sample was based on the relative materiality of the various categories of costs reported and their associated levels of risk. Our samples were not designed to be projected to the entire population of reported costs. Also, our review of NYL's internal controls focused on the controls over NYL's CFR preparation process.

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

## Reporting Requirements

We provided draft copies of this report to SED and NYL 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.

In their response, however, NYL officials disagreed with our report's findings. They attributed deficiencies in required supporting documentation to YAI, notwithstanding the affiliation between NYL and YAI, as cited in the report and detailed by Exhibit B. (Note: YAI's CFO was the custodian of both YAI's and NYL's books and financial records during the audit period.) Further, NYL's response is replete with false, inaccurate, and/or misleading assertions. Our rejoinders to many NYL comments are included in the report's State Comptroller's Comments.

On February 22, 2017, more than two months after formally responding to the draft audit report, NYL submitted an additional 2,475 pages of employee performance evaluations to support lump sum/bonus payments claimed for the 2013-14 fiscal year. For the period July 30, 2011 through June 30, 2014, NYL's Personnel Practices Manual (which NYL provided to us at the outset of the audit) did not prescribe performance evaluations as a basis and/or a prerequisite for lump sum/bonus payments. However, on March 10, 2016, about 10 months after our audit's fieldwork started, NYL provided auditors with an addendum to the Personnel Practices Manual that stated: "NYL may choose to award employees a bonus based upon merit and supported by the employee's most recent Annual Staff Evaluation form..." There is material risk that NYL officials added this statement to the Personnel Practices Manual due to the auditors' multiple requests for performance evaluations to support lump sum/bonus payments. Moreover, auditors determined that a majority of the payments in question did not comply with the pertinent provisions of SED's Reimbursable Cost Manual, as payments were made as many as 392 days before employees signed and/or dated their evaluations<sup>2</sup>. In such instances, we maintain that payments were not based on performance evaluations, and therefore did not comply with the Reimbursable Cost Manual.

Based on the aforementioned circumstances, we lack sufficient assurance that the evaluations were prepared contemporaneously with the audit period, are sufficiently reliable, and are consistent with the Reimbursable Cost Manual. Therefore, we will provide SED officials with a detailed analysis of the documents provided on February 22, 2017, which SED can use in its assessment of the recommended audit disallowances pertaining to lump sum/bonus payments

<sup>2</sup>We determined that the date an employee signed and dated the evaluation was more reliable than the date the evaluation was prepared as the evaluation date could be erroneous.

claimed by NYL.

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

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## 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 A

**New York League for Early Learning, Inc.  
Summary of Submitted and Disallowed Costs  
for the 2011-12, 2012-13, and 2013-14 Fiscal Years**

<b>Program Costs</b>	<b>Amount Per CFR</b>	<b>Amount Disallowed</b>	<b>Amount Remaining</b>	<b>Notes To Exhibit</b>
Personal Services				
Direct Care	\$104,933,638	\$1,948,164	\$102,985,474	
Agency Administration	1,728,270	1,728,270	0	
<b>Total Personal Services</b>	<b>\$106,661,908</b>	<b>\$3,676,434</b>	<b>\$102,985,474</b>	A-G, K, N, O
Other Than Personal Services				
Direct Care	\$17,751,535	\$410,052	\$17,341,483	
Agency Administration	13,829,540	1,684,522	12,145,018	
<b>Total Other Than Personal Services</b>	<b>\$31,581,075</b>	<b>\$2,094,574</b>	<b>\$29,486,501</b>	A-F, H-J, L, M
<b>Total Program Costs</b>	<b>\$138,242,983</b>	<b>\$5,771,008</b>	<b>\$132,471,975</b>	

## Notes to Exhibit A

The following Notes refer to specific sections of SED's Reimbursable Cost Manual (Manual) for the three fiscal years ended June 30, 2014, that were used to develop our recommended disallowances. We summarized the applicable sections to explain the basis for each disallowance. We provided the details supporting our recommended disallowances to SED and NYL officials during the course of our audit.

- A. Section I.3.D - The entity will be required to retain all pertinent accounting, allocation, and enrollment/attendance records for at least seven years.
- B. Section I.4.A - In general, a Less Than Arm's Length (LTAL) relationship exists when there are related parties and one party can exercise control or significant influence over the management or operating policies of another party, to the extent that one of the parties is or may be prevented from fully pursuing its own separate interests. These relationships must be disclosed in the notes to the audited financial statements.
- C. Section I.4.F.7- All LTAL transactions will be reimbursed using actual documented costs of the owner or vendor. Invoices presented to the approved special education provider by the LTAL party do not constitute "actual costs." Actual costs are those the LTAL party incurs, and it is expected upon audit or review that the LTAL party will produce evidence of its costs.
- D. Section II - Costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the education program, and sufficiently documented.
- E. Section II.2.C - Entities that contract for administrative services must review their own administrative costs to avoid duplicate services that can be disallowed during the rate-setting process or upon audit.
- F. Section II.10 - Charges to programs receiving administrative services, insurance, supplies, technical consultants, etc. from a parent or related organization are reimbursable provided they are not duplicative in nature, provide a direct benefit to subsidiary charged and based on actual direct and indirect costs, allocated to all programs on a consistent basis, and defined as reimbursable in the Regulations of the Commissioner of Education, the CFR Manual, or the Manual.
- G. Section II.13.A. 10 - A merit award (or bonus compensation) shall mean a non-recurring and non-accumulating (i.e., not included in base salary of subsequent years) lump sum payment in excess of regularly scheduled salary which is not directly related to hours worked. A merit award may be reimbursed if it is based on merit as measured and supported by employee performance evaluations. For fiscal year 2013-14, the Manual was amended to include the following requirement: In order to demonstrate that a merit award is based on merit and measured and supported by employee performance evaluations, the provider's governing entity must adopt a written employee performance evaluation policy and form that contains sufficient detail as to the criteria and methods used to determine each employee's final evaluation rating. The written employee performance evaluation policy must also describe how the final evaluation rating will directly correlate to any amount of a merit award should funds be available for such an award. In addition, merit awards are restricted to direct care titles/employees, as defined by the Manual's Appendix A-1, and

those in the 100 position title code series and position title code 505 and 605, as defined by the Consolidated Fiscal Report's Appendix R.

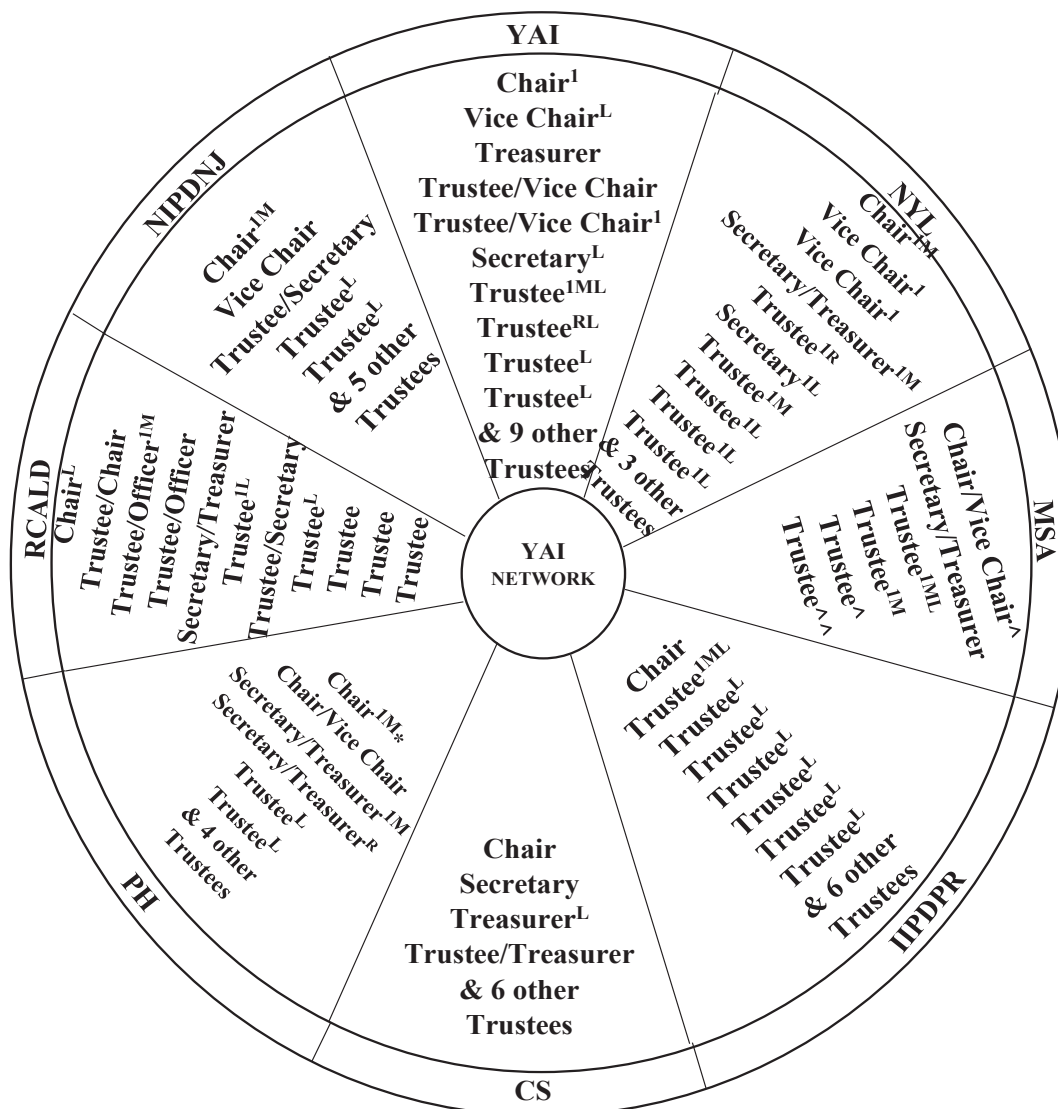
- H. Section II.14.A.2 - Costs of consultants' services are reimbursable provided that the services could not have been performed by an appropriately certified school officer or employee who possesses the necessary technical skills or by the Department's staff.
- I. Section II.22.C - Costs of food provided to any staff including lunchroom monitors are not reimbursable.
- J. Section II.41.B.4 - The share of rental expense allocated to programs funded pursuant to Article 81 and/or Article 89 is based on documented and reasonable criteria, such as square footage utilization, when more than one program is operated in a rented facility.
- K. Section III.1.B - Actual hours of service are the preferred statistical basis upon which to allocate salaries and fringe benefits for shared staff who work on multiple programs. Entities must maintain appropriate documentation reflecting the hours used in this allocation. Acceptable documentation may include payroll records or time studies.
- L. Section III.1.C.2 - Adequate documentation includes, but is not limited to, the consultant's resume, a written contract which includes the nature of the services to be provided, the charge per day, and service dates. All payments must be supported by itemized invoices that indicate the specific services actually provided; and for each service, the date(s), number of hours provided, the fee per hour; and the total amount charged.
- M. Section III.1.J.2 - Vehicle use must be documented with individual vehicle logs that include at a minimum: the date and time of travel, to and from destinations, mileage between each destination, purpose of travel, and name of traveler.
- N. Section III.1 .M.1(i) - Compensation of employees who perform tasks for more than one program and/or entity must be allocated among all the programs and/or entities for which they work.
- O. Section IV.2.F - All 1:1 aide costs (salaries, fringe benefits of the aide, and allocated direct and indirect costs) should be reported in one separate cost center on the providers' financial reports.



## Exhibit B

### TRUSTEES: YAI NETWORK Fiscal Year July 1, 2011 through June 30, 2014

*The Network consists of eight member entities*



Source: Federal Form 990, CHAR 500 reports filed with New York State Attorney General Office Charities Bureau, and NYL Board Meeting Minutes for the three Fiscal Years ended June 30, 2014.

#### Notes:

I Attended NYL's board meetings

M Served on multiple boards

R Related Parties

L Left board during FY 2011 to 2014

\* Chair Through Nov. 2011

^ Served on MSA board and employee of NYL

^^ Served on MSA board and consultant of NYL

#### Legends:

YAI - Young Adult Institute

NYL - New York League

MSA - Manhattan Star Academy

IIPDPR - International Institute for People with Disabilities of Puerto Rico

CS - The Corporate Source

PH - Premier Healthcare

RCALD - Rockland County Association for Learning Disabilities

NIPDNJ - National Institute for People with Disabilities of New Jersey

#### Notes:

YAI's Chief Financial Officer (CFO) was also the CFO of NYL and attended NYL's board meetings.

YAI's Chief Executive Officer (CEO) attended NYL's board meetings.

# 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  
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December 19, 2016

Mr. Kenrick Sifontes  
Audit Director  
Office of the State Comptroller  
Division of State Government Accountability  
59 Maiden Lane, 21<sup>st</sup> Floor  
New York, NY 1038

Dear Mr. Sifontes:

The following is the New York State Education Department's (Department) response to the draft audit report, 2015-S-43, Compliance with the Reimbursable Cost Manual: New York League for Early Learning, Inc. (NYL).

**Recommendation 1:** Review the recommended disallowances resulting from our audit and make the appropriate adjustments to NYL's CFRs and reimbursement rates.

We agree with this recommendation. The Department 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 NYL officials to help ensure their compliance with Manual provisions.

We agree with this recommendation. The Department will continue to provide technical assistance whenever requested and will strongly recommend that the NYL officials take advantage of our availability to help them better understand the standards for reimbursement as presented in Regulation and the Reimbursable Cost Manual. In addition, Consolidated Fiscal Report (CFR) training is available at six locations across the State and online on the Department's webpage. The training is recommended for all individuals signing CFR certification statements, namely Executive Directors and Certified Public Accountants, and is required for preschool special education providers upon approval and reapproval. Furthermore, the Department intends to require that the training be mandatory for all providers.

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: Christopher Suriano  
Suzanne Bolling

# Agency Comments - New York League for Early Learning, Inc.

## SHEBITZ BERMAN COHEN & DELFORTE, P.C.

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December 19, 2016

† (ALSO ADMITTED IN DC)  
†† (ALSO ADMITTED IN NJ)

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

Re: New York League for Early Learning, Inc.  
Your Draft Audit Report #2015-S-43

Dear Mr. Sifontes:

This letter is in response to the draft audit report, dated November 2016, with respect to your audit of New York League for Early Learning (“NYL”) by the Office of the State Controller (“OSC”).

At the outset, we note that NYL 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). NYL’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 NYL expressly reserves all such rights.

### I. Preliminary Matters

We also note that we believe that proper audit procedure was not followed in several respects. First, OSC has proposed numerous new disallowances in the draft report that were not mentioned in the prior preliminary reports, at the closing conference, or at any time prior to the draft report other than by an email advising NYL of two new proposed disallowances, with no meaningful description or detail, a few days before the draft report was issued. While OSC met with NYL on November 18, 2016 to discuss the new claims, OSC still provided no meaningful explanation of the proposed disallowances at that conference. Additional information was provided by OSC after that conference, on November 21, 2016 and on December 4, 2016, but

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\*See State Comptroller’s Comments, page 61.

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

Kendrick Sifontes  
December 19, 2016  
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some of the explanations requested by NYL still have not been provided. NYL was deprived of the normal audit process of OSC's issuing a preliminary report, NYL's having an opportunity to respond in writing, having a closing conference when the issues can be discussed after OSC's contentions have been fully disclosed to NYL and investigated and responded to by NYL, all before a draft report is issued. As a result, there was not the same opportunity for full development and consideration of these issues, and NYL was forced to investigate and respond to the new contentions in a very compressed time frame, and at the same time it was preparing its responses to the other disallowances in the draft report. As stated previously, we believe that this was improper audit procedure and contrary to OSC's own normal audit procedure. OSC should have issued additional preliminary reports on these matters, allowed NYL to respond, and held a conference after that, before issuing its draft report. These were not minor issues either; cumulatively, they amount to more than 60 percent of the dollar amount of the proposed disallowances in the draft report.

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Second, OSC changed its positions even after the draft report was issued and after the November 18, 2016 conference. By email, dated December 4, 2016, OSC advised NYL of two new recommended disallowances that were not included in the draft report and had not been mentioned at the November 18, 2016 conference. OSC also presented additional contentions in that email, relating to the "duplicative" expenses, that were not mentioned in the draft report or at the November 18, 2016 conference. All of these further new positions were based on information provided to OSC before it issued the draft report, and if OSC still was considering that information, it should have completed its review, issued a preliminary report, allowed NYL to respond and conducted a closing conference before issuing the draft report.

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As a result of the foregoing, NYL's preparation of its response to the draft report necessarily has been hurried in order to meet the time frame imposed by OSC. NYL reserves the right to supplement this response as needed.

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Third, in October 2016, YAI began to communicate directly with OSC regarding OSC's requests for information held by YAI. OSC apparently provided a list of open requests to YAI and when YAI provided information to OSC, it referenced request numbers on that list. NYL asked OSC multiple times to provide its list to NYL as well, so that NYL could know what items OSC viewed as open, and what requests YAI was responding to when it provided information. OSC refused to do so.<sup>1</sup> There was no good reason for OSC to cloak its list in secrecy and refuse to provide it to NYL, and we submit that it was improper audit procedure to do so. We find it curious, to say the least, that on the one hand OSC holds NYL responsible for documents YAI did not provide, yet on the other hand refused to take the simple step of providing NYL with the

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<sup>1</sup> YAI also did not provide the list to NYL, despite multiple NYL's requests for the same, and NYL advised OSC of that.

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

Kendrick Sifontes  
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list OSC knew YAI was working from and referencing in its responses, so that NYL could know what information OSC still was expecting and could better monitor YAI's responses and determine whether they were complete and/or responsive to OSC's requests.

Additionally, your draft report states that "at various times throughout the audit engagement, YAI and NYL provided some, but not all, requested documentation." That is misleading. NYL promptly provided documentation in its possession, custody and control. As the draft report notes, NYL and YAI had entered into a Management Services Agreement (the "Agreement"), by which YAI performed certain management services for NYL, including management of its payroll, accounts payable and accounting functions. As a result, YAI held most of NYL's fiscal records. NYL terminated the agreement on November 2015, despite YAI's objections to the termination. As the auditors were advised, after the termination, NYL asked YAI to deliver all of NYL's fiscal records that it was holding to NYL, but YAI wrongfully refused to do so. Therefore, NYL necessarily had to rely on YAI to provide -most of the documents OSC requested. YAI was unhappy about the termination of the Agreement, and its responses to NYL's and OSC's requests were both slow and incomplete. NYL could not control that because short of litigation, it had no way to compel YAI to provide requested information, and it is unreasonable to blame NYL for YAI's failure to cooperate. NYL suggested to OSC that OSC use its subpoena power to obtain documents requested from YAI, but OSC did not do so.

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## **II. Background**

To begin, NYL is a New York based not-for-profit organization approved by SED to provide various center-based and SEIT special education services to disabled children between the ages of three and five years, and funded under the New York State tuition rate setting methodology. As the draft report notes, NYL also operates numerous programs that are not funded under the New York State tuition rate setting methodology. NYL is a very large special education service provider. Its annual revenues are approximately \$55 million overall and approximately \$45 million for its programs funded under the New York State tuition rate setting methodology. As stated by the OSC in the Executive Summary section of its draft audit report, during the audited years NYL served 818 students solely in its preschool center-based programs, and many more in its other programs, and it had approximately 1,500 staff working within nine approved sites, as well as homes and daycare centers throughout the boroughs.

During the audit years, NYL was part of the YAI network of agencies supporting individuals with developmental disabilities. However, NYL was the only member of the network that received an approved school provider code to provide preschool services. Neither YAI, MSA nor any other member of the network provided such services. Pursuant to Section 4410 of the Education Law, preschool special education programs approved by SED must follow

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the methodology used to determine the annual tuition rate based on a program's reimbursable costs for providing special education and related services to students enrolled in the programs.

The existing tuition rate setting methodology serves to monitor program spending through the establishment of reimbursement requirements including, but not limited to, requiring at least 70 percent of total reimbursement to be targeted to the direct care of students, a non-direct cost parameter limiting such costs to 30 percent of total program costs, and restricting the amount of executive compensation that may be eligible for reimbursement to compensation commensurate with regional averages for public school officials.

NYL has reviewed the results and recommendations in the draft audit report. For the reasons stated below, NYL disputes the following proposed audit findings:

- \$1,728,270 in administrative costs for NYL's Executive Director, Assistant Executive Director and other NYL agency administrative staff that OSC incorrectly claims were duplicative of YAI's services under the Agreement;
- \$1,209,263 in costs applicable to 1:1 aides;
- \$331,235 in various adjusting entries that OSC incorrectly contends were insufficiently documented;
- \$861,046 in employee bonuses that did not comply with the requirements in the manual; and
- \$377,038 charges to SED cost-based programs for the services of two consultants that OSC incorrectly contends were not necessary because YAI purportedly was obligated to provide such performing services.
- \$696,339 of YAI management fee charges that OSC incorrectly contends were not allowable charges under the RCM, plus an additional \$315,271 of management fee charges that OSC advised NYL on December 4, 2016 that it would recommend for disallowance, also because the expenses purportedly were not allowable expenses under the RCM.

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

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**III. Personal Services Costs**

**I. "Duplicative" Administrative Costs**

**A. NYL Employees**

NYL disagrees completely with OSC's proposed disallowance of purportedly "duplicative" agency administration costs. OSC incorrectly and belatedly contends that the salaries and benefits paid to NYL's own Executive Director, Assistant Executive Director, and other agency administrative employees are not reimbursable because their services purportedly duplicated services that were provided by YAI under the Agreement. This contention by OSC is completely baseless for many reasons.

First, it is untimely. OSC made no reference to these allegedly "duplicative" costs in its preliminary report or at the closing conference held in August 2016. Rather, OSC asserted this contention for the first time in the draft report. This in and of itself is a violation of proper audit procedure.

Although the draft report claims that OSC "reviewed support for the costs NYL reported on its CFRs for administrative staffing" for the employees identified above and concluded that "NYL essentially duplicated services and associated costs what were covered under the Management Agreement", it does not identify which services performed by the enumerated NYL employees purportedly duplicated what YAI did, who at YAI did the same thing, or how OSC determined that. The report also does not identify what documentation OSC considered in reaching its completely unsupported conclusion.

A conference was held on November 18, 2016 at NYL's request. At the conference, OSC could not identify what work the NYL employees did that was purportedly duplicated by YAI or who at YAI had done the purportedly duplicative work. To the contrary, OSC admitted that it did not know either what the NYL employees did or what YAI did. Rather, OSC assumed that what they did was "duplicative" based on the wording of the Agreement. OSC stated that it believed, based on the Agreement, that YAI was obligated to perform all overall agency administration work for NYL, so that any work NYL charged to overall agency administration must be duplicative. OSC further took the ludicrous position that since OSC made the finding that the services were "duplicative", albeit with no factual foundation whatsoever, it was NYL's burden to prove that they were not duplicative. That position is incorrect. It is OSC's burden under proper audit procedure to provide factual foundation for its findings, and it has provided none for this finding.

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

Kendrick Sifontes  
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In an email from its counsel on December 4, 2016, OSC changed its position somewhat from what it had said at the November 18, 2016 conference. Then it stated for the first time that its position was based on: (1) auditors' communications with NYL's agency administrative staff, which were not identified except for certain statements purportedly made by NYL's Executive Director, which were not accurately presented and did not reflect duplication in any event, (2) auditors review of the Agreement, and (3) auditors examination of YAI's general ledgers.

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As this history reflects, OSC has presented no plausible reason for not presenting this claim in a preliminary report long ago, if OSC truly believed that there was duplication, which there so clearly was not. OSC had the Agreement from the beginning of the audit. Its interviews of NYL staff were conducted during field work completed before any of the preliminary reports were issued. OSC also interviewed YAI's CFO, the current Assistant Director of NYL Revenue Management, who is a YAI employee who works exclusively for NYL,<sup>2</sup> and one or more YAI employees from every YAI department that provided services that OSC now contends NYL's own employees' services "duplicated". The YAI general ledgers were provided to OSC in May 2016, three months before the closing conference.<sup>3</sup> Accordingly, OSC had all the information it needed to determine whether the work of NYL's employees whose compensation was reported as overall agency administration expenses duplicated YAI's work long before the closing conference. YAI has not stated any reason for its long delay in presenting this contention, and there is no plausible explanation for OSC's failure to present this contention in a preliminary report issued before the closing conference, if OSC truly believed the services were "duplicative".

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Second, the fundamental flaw in OSC's position is that it is based on an absurdly broad and incorrect interpretation of what YAI purportedly was obligated to do under the Agreement, which is not supported by the contract language and is not how either party, NYL or YAI, interpreted the Agreement. In discussions at the November 18, 2016 conference, OSC relied exclusively on one clause of the Agreement paragraph 3(a) that says YAI shall serve as "NYL's manager of all business, management, fiscal, personnel, fundraising, planning and program functions and services of NYL." That is the only clause in the entire Agreement that uses the word "all". Paragraph 1, defining the engagement, says that NYL "engages YAI to provide management services." It does not use the word "all". Paragraph 3(f) reads: "YAI shall render such business and financial management, consultation, analysis, advice and planning as it

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<sup>2</sup> The salary and expenses for this position were one of the positions disallowed by OSC. The person in this position during the audit (C.G.) was not the same person as during the audited years (D.C.), but the responsibilities of this position remained substantially the same.

<sup>3</sup> It is unclear what relevant information the auditors purportedly got from the YAI general ledgers, as the general ledgers tell nothing about what work NYL and YAI personnel performed.

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determines to be necessary in connection with operation of NYL.” This language clearly contemplated that YAI would not perform all of the administrative work described, but rather would perform only that portion that YAI deemed necessary. The fact that the word “all” was used in one clause and not in the other must be presumed to be purposeful. YAI was required to manage NYL’s fiscal and business operations, not to provide” or “render” every business and fiscal function itself. YAI could choose to provide or render services itself, if necessary, but it also could choose to have NYL’s own employees or consultants “render” or “provide” fiscal or business services where NYL employees and/or consultants were available to do so and/or YAI did not have personnel to perform these tasks itself. In a similar vein, paragraph 3(d) states that YAI “shall assist in establishing billing/reimbursement rates for services rendered by NYL,” and paragraph 3(i) states that YAI “shall prepare the financial data necessary for NYL to prepare annual information return and such other tax and information returns...” These provisions also clearly contemplate that YAI would assist in preparation of the CFR and tax and information returns, but would not prepare the CFR and returns itself.

In short, YAI did exactly what it was supposed to do; manage NYL’s fiscal and business operations. It did not perform all fiscal and business operations work; rather it provided some, and managed NYL employees and consultants who provided the rest. OSC basically has rewritten the Agreement by inappropriately cutting and pasting wording from the contract to support its argument that YAI should have provided all services, and then relying on its improper interpretation to disallow compensation of NYL’s own administrative staff and the two consultants. OSC’s conclusion that all agency administrative work that NYL performed was “duplicative”, because YAI purportedly was obligated to perform that work under the Agreement, is flat out wrong.

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Tellingly, OSC’s incorrect contract interpretation also is not the way either NYL or YAI, the two parties to the contract, interpreted the contract. In this regard, with all due respect to OSC, the relevant inquiry is not what OSC thinks “should be covered by the Management Agreement,” as OSC suggests in its December 4, 2016, email. What the parties to the Agreement thought it required, and how they in practice implemented it, is far more relevant to its interpretation than what OSC should be covered.

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Third, in the final analysis, even if OSC’s incorrect and self-serving interpretation of the Agreement were correct, and the parties’ own interpretation of their Agreement were wrong, which clearly is not the case, it would make no difference to the end result. The fact remains that YAI did not in fact provide the administrative services that NYL’s own employees and its consultants did, because YAI and NYL did not interpret the contract to require it to do so. There is not a shred of factual support for OSC’s preposterous contention that the services were “duplicative”. YAI was well aware of what NYL’s administrative employees and consultants were doing, and it had no reason to, and did not, perform the same work. If YAI had performed

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that work, instead of NYL's own employees and consultants, the management fee would have been higher, because the cost of the YAI employees would have been charged to NYL through the management fee. The fact that NYL's own employees and consultants performed this work did not cost NYL more; if anything, it saved money because NYL had employees and consultants available who had the requisite expertise and training; YAI did not. In this regard, significantly, NYL's overall agency administration expenses, which included both the YAI management fee and the compensation of NYL's own employees charged to overall agency administration and the two consultants, did not violate any of the RCM cost screens.

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One example of this is OSC's misleading citation of paragraph 3(d) for the proposition that YAI "was responsible for the bills and collections for NYL's funding and third party services for services rendered". Read together with paragraphs 3(a) and 3(f), such language contemplated only that YAI would manage that billing, not necessarily perform it itself. In any event, that is how the parties interpreted the agreement, as YAI indisputably did not perform that billing; NYL's staff did. OSC's interview with, and the affidavit of, the person who was the Assistant Director of NYL Revenue Management (D.C.) during the audited years, who supervised the administrative group, that included the billers, makes this clear. YAI managed that work, as the Assistant Director of NYL Revenue Management reported to YAI's Controller. YAI was fully aware that NYL's staff was doing the billing; indeed, NYL's Accounts Receivable Manager sent journal entries reflecting the billing to YAI staff for entry into NYL's accounting books and ledgers. NYL's billing staff did not duplicate YAI work, because the fact remains that NYL did this billing and YAI did not, irrespective of what OSC thinks the Agreement required.

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If OSC suspected there was "duplicative" work, it should not have simply proposed a disallowance based on its parsing words in the Agreement; it should have investigated what the NYL administrative employees actually did and whether anybody at YAI did the same thing. If OSC had done that, which by the auditors' own admission they made no attempt to do, OSC would have found that there was no duplication.

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Fourth, before discussing the specific employees and consultants at issue, we also note that OSC's position is inconsistent with the conclusions of the Rate Setting Unit ("RSU") of SED during its annual reviews of NYL's CFRs. RSU specifically questioned whether the compensation of NYL's administrative staff was duplicative of the management fees and why compensation of the Assistant Director of NYL Revenue Management was charged entirely to NYL. After receiving NYL's explanations, SED did not propose any disallowances. SED's questions have been provided to OSC previously. OSC has not cited any material information it considered that was different from what RSU considered.

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Fifth, while it is not NYL's burden to prove the negative, and to show why there was no duplication when OSC has provided no evidence that there was duplication, NYL nevertheless can show that there was no duplication. We will address the responsibilities of the personnel whose compensation OSC has proposed to disallow in the following paragraphs.

The Executive Director and Assistant Executive Director's responsibilities did not duplicate what YAI did. Their work was predominantly programmatic; YAI's was fiscal and business operations (HR, IT, payroll, accounts payable, bookkeeping and accounting). We are providing under separate cover an affidavit of the Executive Director explaining her duties and those of the Assistant Executive Director under separate cover. The Executive Director's responsibilities included the following, among other things:

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Executive Director (NYL Employee) 1.000 FTE

- Direct and oversee the overall administration of New York League programs including: Center Based Pre-School Programs, Center Based Early Intervention Programs, Home and Community Based Program, Evaluation sites for Early Intervention and Preschool Evaluations.
- Directly oversee activities of Assistant Directors and Principals of NYL schools. Coordinate management team meetings to discuss and review procedures and policies. Conduct monthly staff meetings at each school for quality assurance.
- Responsible for the review of operating budgets, the final approval of grant request and the review of all fiscal contracts and final reports.
- Responsible for the writing and administering of two Federal Grants (IDEA) for the EI and Pre-K programs.
- Act as a liaison with the State Education Department, the Department of Education, the Department of Health and the Office of Pupil Transportation and the New York League.
- Plan and conduct discipline specific meetings for the following: Occupational Therapists, Physical Therapists, Speech and Language Therapists, Social Workers, School Psychologists.
- Complete PD forms, and oversee the development of Plans of Corrective Action.

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- Responsible for all planning of future projects, including enhancement of current programs, the development of new programs, and the pursuit of new opportunities for the agency.
- Define and communicate NYL's mission, policy and direction.
- Report to the Board of Directors at quarterly meetings in areas to include, but not limited to: Fiscal, Programmatic, Human Resources and other related matters.
- Perform these responsibilities as they exist, or may change under the supervision of NYL Board of Directors.

The NYL Assistant Executive Director's responsibilities (.855 FTE) were as follows:

- Assist the Executive Director in program administration of the agency.
- Assist the Executive Director on special projects relating to the agency.
- Review NYL program policies and procedures for compliance with federal, state and municipal laws and regulations.
- Assist in the development of new NYL programs.
- Provide program support for the implementation of standards of practice.
- Represent NYL at regional meetings.
- To be familiar with SED codes and regulations to ensure preparation of audits.

While OSC has not identified who at YAI purportedly rendered services duplicated by NYL's Executive Director and Assistant Executive Director, the closest analogous YAI employees whose compensation was allocated in part to NYL as part of the management fee, were its CEO (0.22 FTE) and three Executive Vice Presidents and COO (0.70 FTE total). Their responsibilities were as follows:

- Manage administrative and support departments to provide adequate resources to NYL so that it can meet NYL's mission under the Board of Trustees guidance and directives, including but not limited to:

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- Prepare and present quarterly reports for Director of NYL and Board of Trustees regarding NYL's financial operations, personnel, staffing and benefits.
- Responsible to the Board for long-range financial matters and the strategic mission of the agency.
- Carry out company-wide financial and administrative objectives, policies, programs, and practices, which ensure the Agency of a continuously sound financial and programmatic structure in accordance with NYL's Board governance.
- Manage the cash flow, maintains the integrity of funds, securities and other valuable documents to ensure the going concern of NYL.
- Manage NYL's cash flow daily, monthly and annually to ensure there are adequate cash receipts to meet payment obligations, including but not limited to: payroll, rent, taxes and supplies.
- Ensure adequacy of bank lines of credit for working capital and secure financing for long term needs for program expansions and renovations.
- Assure protection for the assets of the business through internal control, internal auditing and assuring proper insurance coverage.
- Direct the accounting and control functions
- Report results of operations and provides chronological systems.

As this shows, there are no duplicative responsibilities as between YAI's CEO, Executive Vice Presidents and COO and NYL's Executive Director and Assistant Executive Director. The YAI executives supervised the fiscal and operational administrative functions that YAI was responsible for managing, not the programmatic functions that NYL's own executives oversaw. OSC's December 4, 2016 email set forth various fiscal functions that NYL's Executive Director purportedly did not perform that OSC believes would "normally expected to be in the purview of an Executive Director." We disagree. As is explained in detail in the Executive Director's affidavit, she was familiar with NYL's fiscal functions, but she did not perform or supervise them; YAI did. That supervision is not normally within the purview of a CEO; it is work within the purview of a CFO.

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Moreover, NYL elected to solely utilize PTC 601 for NYL's Executive Director instead of applying a combination of PTC 501 and 601, which would be acceptable. Both positions definitions (PTC 601 and 501) describe the job responsibilities performed under the Executive Director in Appendix R of the Claiming Manual as follows:

Code 501 – Program or Site Director: an individual responsible for the overall direct administration of: (1) a specific program type that operates at more than one site; or (2) multiple program types at a single site; or (3) a specific program type at a single site.

Code 601 – Executive Director/Chief Executive Officer: Responsible for the overall administration of the agency. This position is usually appointed by and is under the general direction of the governing board of the agency.

NYL does not typically split CFR agency and program administrative codes on its cost reports but schedule CFR-6 of the cost report provides a section where a provider is permitted to mark "x" for dual reporting purposes. However, since the Executive Director role is considered an agency administrative position, even though she performs comprehensive programmatic responsibilities, NYL believed it would be more appropriate to report her time and costs on schedule CFR-4 in the agency administrative section of the cost report; therefore, the costs would be distributed to each program cost center through the ratio value methodology. NYL did not report any employees in the PTC 501 or PTC 502 cost centers, although its Executive Director and Assistant Executive Director's compensation could have been reported in part under these position codes. YAI's management fee was reported on schedule CFR-3.

Similarly, for the Assistant Executive Director, NYL elected to utilize only PTC 602 instead of using a combination of PTC 502 and 602, which also would be acceptable. Both position definitions (PTC 602 and 502) in Appendix R of the Claiming Manual describe the job responsibilities performed under the Assistant Executive Director role at NYL:

Code 502 – Assistant Program or Assistant Site Director: Assists either the Program Director or the Site Director in the direct administration of a specific program type. Job title may include: Assistant Education Director.

Code 602 – Assistant Executive Director: Assists the Executive Director in the overall administration of the agency and acts on their behalf when necessary.

As stated previously, NYL does not typically split CFR administrative codes on its cost reports even though schedule CFR-6 provides a section where a provider is permitted to mark "x" for dual reporting purposes. However, since the Assistant Executive Director's responsibilities provide for more comprehensive programmatic requirements across all programs,

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NYL believed it would be appropriate to report its time and costs on schedule CFR-4 in the agency administrative section; therefore, these costs were distributed to each program cost center through the ratio value methodology.

We also note that the total FTEs of NYL's employees and of those of YAI employees allocated to NYL was 2.995 FTE. That hardly is excessive for an agency of NYL's scope and size. We are aware of other agencies that have reported more FTEs than that for PTC 601 and PTC 602 on their CFRs. We also note that OSC's implicit assumption that the functions of an Executive Director and Assistant Executive Director at NYL were performed by a YAI CEO devoting 0.22 FTE and Executive Vice Presidents and a COO devoting a total of 0.70 FTE is ludicrous. No agency of NYL's size and scope functions, or could function, with so little executive oversight.

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The compensation of the Assistant Director of NYL Revenue Management (D.C) whose salary and fringe benefits were charged entirely to NYL, and the staff that worked under her also did not duplicate services provided by YAI under the Agreement. OSC interviewed D.C. on December 12, 2016, and during that interview she explained as much. Her affidavit further explaining what she and her staff did and how it was different from what YAI did will be provided under separate cover. To the extent that OSC is contending that the fact that the Assistant Director of NYL Revenue Management did only NYL work was not adequately supported, that contention is incorrect. Her job description provided to OSC plainly reflected on its face that the work she did was all for NYL. That information now has been supplemented by her interview responses and her affidavit, both of which confirm that everything she did was for NYL. If the auditors had asked anybody else from YAI or NYL having knowledge of what she did, which they did not do, they would have heard the same thing.

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Again, comparison of the responsibilities of her and her staff's work and responsibilities of YAI employees doing fiscal work reflects no overlap. The work performed by NYL's personnel and the Assistant Director of NYL Revenue Management related to programmatic fiscal functions and billing for NYL's services. The work performed by YAI staff related to payroll, accounts payable and maintaining NYL's general ledgers and other accounting needs.

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Agency Administrative Staff (NYL Employees) 3.311 FTE

- Budget Analyst - Prepare UPK and IDEA grant budgets and reports and monthly reallocation entries.
- Budget Manager – Prepare monthly financial reports, budget variance analysis, assist in the preparation of annual budget.

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- Accounts Receivable Manager - Oversee billing and collection/ perform A/R reconciliations, supervision of other billing staff.
- Accounts Receivable Clerk - Process billing and post cash receipts and perform other fiscal administrative duties.
- Office Worker/Administrative Assistant – Executive Director’s Administrative Assistant.
- Assistant Director of Revenue Management – 1.000 FTE’s (In addition to her individual responsibilities provided on her LOU, she supervised all agency administrative staff at NYL in the following positions; Budget Analyst, Budget Manager, Accounts Receivable Manager and Accounts Receivable Clerk.

Financial Services (YAI)

- Payroll – 0.65 FTEs
- General Ledger – 2.260 FTEs
- Accounts Payable – 1.23 FTEs
- Budget Director - .035 FTEs

General Accounting, including but not limited to:

- Perform general accounting activities and maintain books and records for NYL.
- Prepare accounting and financial reports and maintain accounting record keeping and systems for NYL.
- Prepare audit schedules for outside audit firm.
- Prepare audited financial statements, tax returns and other government filings for NYL for review by NYL Board of Trustees.
- Perform general ledger account reconciliations for NYL.
- Maintain Fixed Assets and depreciation schedules for NYL.
- Prepare monthly cash projection for NYL.
- Prepare reports for the bank pursuant to the line of credit for NYL Accounts Receivable.

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- Prepare internal quarterly Financial Statements, Bank Covenant Calculation and quarterly reports for NYL as required by the bank and other lenders.
- Prepare quarterly fiscal reports regarding NYL programs for presentation to the Director of NYL and the Board of Trustees.
- Execute quarterly work papers for NYL.
- Maintain Accounting Policy and Procedures for NYL.

This is a case where YAI could have chosen to have its own employees do what NYL's employees did under paragraph 3(f) of the Agreement, but it chose instead to have NYL's staff do this work. Whether YAI did so because YAI did not have qualified staff available, or because NYL already had trained and experienced staff available to do this, or both, does not matter. The fact remains that there was no duplication. The total FTEs expended on this work was reasonable for an agency of the size and scope of NYL.

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Similarly, the utilization review/quality assurance work performed by NYL employees did not overlap with work performed by YAI personnel, as reflected by their responsibilities as follows:

Utilization Review/Quality Assurance (NYL Employee) .400 FTE

The staff trainer assigned to this program has the responsibility to engage in child-centered and effective practices. Such activities include:

- Responsible for monitoring the adequacy and/or appropriateness of the agency's services for each location.
- Collaborate with the teacher and other instructional staff in the classroom to facilitate the scaffolding of functional language/feeding/motor/social skills.
- Work in the classroom with the teacher and provide strategies on how to achieve classroom/therapy IEP goals.

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Comment  
18

Quality Assurance and Compliance (YAI) 1.29 FTE

Technical assistance in operating a compliance program, including but not limited to:

- Develop compliance program and manual for NYL.
- Conduct compliance training for NYL.
- Provide regulatory explanations for NYL.

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- Maintain compliance hotline for NYL.
- Implement conflict of interest policy NYL.

Respond to compliance issues in accordance with NYL Compliance Manual. Conduct Mandatory Trainings for NYL, including but not limited to:

- HIPAA (Health Insurance Portability and Accountability Act)
- OSHA (Occupational Safety and Health Administration)
- Policies and Procedures
- Child Abuse
- Medicaid in Education
- Infection Control in the Classroom
- New Staff Orientation

Based on the foregoing, there are no duplicative responsibilities with respect to the services provided directly by NYL and under those provided by YAI. It is clear that the program compliance performed by NYL personnel was different from the agency compliance performed by YAI. This was explained to, and accepted by, RSU. In addition, NYL elected to solely use PTC 621 instead of using a combination of PTC 521 and 621, which would be acceptable. Both position definitions (PTC 621 and 521) in Appendix R of the Claiming Manual describe responsibilities performed under their respective codes:

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Code 521 – Utilization Review/Quality Assurance (Program Administration):

An individual responsible for monitoring the adequacy and/or appropriateness of program participant services and for compliance with all applicable federal, state and local laws, regulations and policies.

Code 621 – Utilization Review/Quality Assurance (Agency Administration):

An individual responsible for monitoring the adequacy and/or appropriateness of the agency's services for compliance with all applicable federal, state and local laws, regulations and policies.

As stated previously, NYL does not typically split CFR administrative codes on its cost reports even though schedule CFR-6 provides a section where a provider is permitted to mark "x" for dual reporting purposes. Rather, since Program and Agency Compliance services are

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considered administrative, NYL believed it would be more appropriate to report its time and costs on Schedule CFR-4 in the agency administration section and distribute to each program cost center using the ratio value methodology.

**B. Consultants**

OSC also has recommended disallowance of amounts paid to two consultants, based on the same incorrect interpretation of the Agreement described above. OSC's contention that the work these consultants did should have been done by YAI under the Agreement is both incorrect and irrelevant.

It is incorrect because, as explained above, the Agreement required YAI to manage fiscal and business services, not to perform them itself. YAI was fully aware that the consultants had been retained and of what they were doing; indeed, YAI's CFO signed the consulting agreements on behalf of NYL. The consultant's work did not duplicate what YAI did. OSC's contention also is irrelevant because, even if the Agreement were interpreted (incorrectly) to require YAI to perform these services, YAI indisputably did not do so. Thus, these consultants' fees were not duplicated in any event. If YAI had performed the work itself either directly (if it had qualified personnel available, which it did not) or by hiring the consultants themselves, the cost would have been charged to NYL through the Agreement anyway, so the end result would be the same.

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The reasons why it was necessary for NYL to retain these consultants already has been explained to OSC in detail in NYL's response to OSC's preliminary report covering these consultant expenses. With all due respect, OSC's statement that it was not necessary to use these consultants is completely arbitrary; OSC has cited no facts whatsoever to support its contention, and there aren't any. The reasons why these consultants' services were needed included:

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- YAI did not have enough personnel to perform all of the functions, as their time was fully occupied by their relating to workload requirements;
- NYL and YAI experienced vacancy issues and, as a result, outside resources were necessary in order to fulfill program and fiscal mandates;
- NYL and YAI requested the services of an outside resource with more experience and/or knowledge to assist with fiscal management services that current staff at NYL and YAI did not possess;
- One of the consultants was hired to avoid spending costs to recruit and train a new employee to fulfill the same responsibilities because the consultant had worked for NYL for many years and understood its systems. In fact, NYL referred OSC to the section in the RCM relating to recruitment costs at the closing conference, which

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provides that costs relating to recruiting of personnel required to meet program and fiscal mandates are reimbursable; the contract provided a detailed description of the services, such that a repetitive description of the same on her invoices would serve no purpose; and

- The other consultant was hired to perform interim reviews of NYL's operations, assist with the reporting of operations in the CFR, review and respond to SED's correspondence relating to rates and reimbursement issues and changes to SED reimbursement methodologies that may affect the programs, assist with the identification, preparation and negotiation of any rate appeals, assist in the implementation or modification of NYL's business plan, provide guidance and analysis of the impact on NYL of the changes proposed by SED regarding rate setting, including the proposed rate reconciliation methodology and proposed staffing standards, based on their 40 years of experience in the field and work with the rate-setting methodology since its inception. The foregoing responsibilities are listed in the consultant's engagement agreement, which was provided to OSC. However, in OSC's draft audit report, OSC "edited" those responsibilities to create a misleading impression of what the consultant did, to manufacture false "support" for its position, much the same way it edited the Agreement to suit its purposes.

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The consultant's fees also were consistent with other providers in the region and met all other applicable RMC requirements governing consultant compensation.

In sum, OSC's contention that the work of the NYL employees and consultants at issue "duplicated" YAI's services is based entirely on an incorrect interpretation of the Agreement which is contrary to how the parties themselves interpreted and implemented the Agreement, and a completely unsupported and false assumption that YAI provided services that it did not provide. OSC's contention lacks any factual foundation whatsoever and should not be included in OSC's final report.

## 2. 1:1 Aides

NYL strongly disagrees with OSC's proposed disallowances relating to 1:1 aides.

On April 22, 2016, NYL received a preliminary report finding proposing to disallow \$1,209,264 relating to the utilization of 1:1 aides who both performed responsibilities as a 1:1 aide in program cost center 9230 and provided Behavioral Support functions in other cost-based programs (Programs 9100, 9118, 9160 and 9165). More specifically, OSC claimed that they reviewed employees' files, which included supporting documentation relating to their time and attendance records and other information, such as their responsibilities and acceptable position title codes indicated in the New York State Consolidated Fiscal Reporting and Claiming Manual

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(NYSCFRM) under Appendix R. The position title codes utilized by NYL were PTC 228 (Teacher Aide) and PTC 243 (Behavioral Support Staff) in order to distinguish the type of work assigned to each provider.

In the April 22, 2016 preliminary audit report, OSC acknowledged that an employee can work in multiple positions during the course of a school year: “In response, NYL officials stated that these individuals were hired as behavior management paraprofessionals and that within this job title, they can serve as dual positions, including that of a 1:1 aide or a behavioral support staff. We do not dispute that employees can work in dual positions.” Rather, OSC incorrectly contended that the documentation maintained by NYL was not sufficient to meet RCM requirements for allocation of time between the different positions.

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In addition, OSC issued a preliminary finding for NYL’s reporting of 1:1 aides as Teacher Aide/Substitutes, and claimed that “these individuals only worked as 1:1 aides – Not as teacher aides/assistants (substitutes), as claimed on the CFR’s.” The position title codes utilized by NYL were PTC 228 (Teacher Aide), 230 (Teacher Aide/Substitute) and 232 (Teacher Assistant) in order to distinguish the work performed by various providers throughout the school year.

On November 16, 2016, the OSC issued its draft audit report and maintained its incorrect recommendation of disallowance totaling \$1,209,263, based on “insufficient” documentation provided by NYL and its review of their employees’ files. NYL completely disagrees with all of OSC’s findings. NYL in fact maintained all of the records necessary to be compliant with the RCM, NYSCFRM and Part 200 Regulations of the Commissioner for program compliance purposes.

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The following are the relevant RCM provisions in Section III of the RCM for each audited school year, which NYL followed in order to report each employee’s time and costs to the appropriate cost centers and in each employee’s respective position title code.

**“Recordkeeping**

Section 200.9 (d) of the Commissioner’s Regulations requires entities operating approved programs to retain all pertinent accounting, allocation and enrollment/attendance records supporting reported data directly or indirectly related to the establishment of tuition rates for seven years following the end of each reporting year. 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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Costs will not be reimbursable on field audit without appropriate written documentation of costs. Documentation includes but is not limited to:

A. Payroll

Compensation costs must be based on approved, documented payrolls. Payroll must be supported by employee time records prepared during, not after, the time period for which the employee was paid. Employee time sheets must be signed by the employee and a supervisor, and must be completed at least monthly.

B. Time Distribution

Actual hours of service are the preferred statistical basis upon which to allocate salaries and fringe benefits for shared staff who work in multiple programs. Entities must maintain appropriate documentation reflecting the hours used in this allocation. Acceptable documentation may include payroll records or time studies. If hours of service cannot be calculated or a time study cannot be completed, then alternative methods that are equitable and conform to generally accepted accounting principles may be utilized. Documentation for all allocation methods (bases and percentages) must be retained for a minimum of seven years. Guidelines for acceptable time studies for CFR filers are provided in Appendix L - "Acceptable Time Studies" of the CFR Manual.

Accounting Requirements

- Entities operating programs must maintain accounts in accordance with generally accepted accounting principles and Section 200.9 (d) of the Commissioner's Regulations."

To begin with, OSC did not ask for documentation regarding every 1:1 aide who also worked in another position, as the draft report implies. Rather, OSC selected a sample of employees who were reported and performed services as 1:1 aides and behavioral support and a sample of employees who provided 1:1 aide services and teacher aide/substitute services on each of the last three cost reports (FYs 2014, 2013 and 2012). NYL provided documentation for that sample.

Also, as was explained at length in NYL's response to the preliminary report, OSC is misleading in its draft report by referencing the number of employees (347) providing behavioral support services instead of actual staff FTE's reported on the cost report for behavioral support staff services. The actual staff FTE's for each school year are as follows:

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- 2011-12 – 14.972
- 2012-13 – 15.223
- 2013-14 – 11.150

The staff FTEs (11.150) reported during school year 2013-14 in each of the respective program cost centers serviced (160,514 care days) or 764.352 student FTEs, is the equivalent to one full-time employee for every 69 full-time children. That information is similar for the other two audited school years. These staffing costs and ratios adhere to program compliance regulations.

A. 1:1 Aides Who Also Worked As Behavioral Support Staff

As was explained in detail in NYL's response to the preliminary report, NYL met the substantial need for behavioral support staff that its challenging student population required in a cost-efficient way by using 1:1 aides as behavioral support staff on days when the student they served as a 1:1 aide was absent. This was reflected in the Letters of Understanding ("LOU") describing the job responsibilities for those employees, which included responsibilities that clearly correlated to the behavioral support staff classification (PTC 243) in the CFR Manual. NYL provided spreadsheets with supporting documentation that included, among other things, a sample LOU for one such employee, monthly time sheets showing who the 1:1 aides in each student's classrooms were, the time each such person spent in each position and student time records showing when the student was absent.

We now are providing OSC under separate cover additional documentation, including LOUs for the other personnel at issue and time sheets for these personnel reflecting their own attendance. NYL also is providing a revised spreadsheet more clearly indicating the days the students served by each employee as a 1:1 aide were absent and containing explanatory notes. NYL has provided for each employee the following documentation, which is more than sufficient to meet the RCM requirements:

- Name of the provider performing 1:1 aide and behavioral support services;
- Employee timesheets signed by the employee and a supervisor (YAI Payroll Form Temporary Adjustment or Substitute Employee forms), which includes the dates and times each employee worked throughout the school year (attendance records);
- Location of the site where the children received 1:1 aide and behavioral support services to ascertain which programs were in operation and support the allocation of staff to the appropriate program cost center;

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- Letter of Understanding and/or Job description, which explains the responsibilities the provider performed and corresponds with the appropriate CFR code in the NYSCFRM under Appendix R;
- Program approval letters for all of the audited school years, which provides information relating to which cost-based programs operated during each school year at their respective sites;
- Monthly attendance sheets, which include the name of the child, the provider performing 1:1 aide services, the dates the child was in attendance, the date the child was not in attendance, the OSIS student identification number which defines the program cost centers in which they received services (cost-based and 1:1 aide), the name of the site and classroom ratio, which defines the cost-based program in which each child was enrolled and corresponds with schedule SED-1 on the CFR (Defines program cost center of cost-based programs and type of classroom ratio);
- Schedule for all three audited school years including the name of the provider, name of the student receiving services, and dates each child was absent during the school year on a monthly basis; and
- The spreadsheets provided to OSC, which substantiate the reassignment of the employees.

Accordingly, the statements in the draft report that NYL “could not provide time and attendance records or time studies,” that NYL “did not demonstrate that the 1:1 aides actually provided services to the cost-based programs” and that “the methodology used was arbitrary and non-compliant with the guidelines in the Manual and the CFR Manual” all are grossly inaccurate. The spreadsheets and supporting documentation provided previously were adequate time studies. However, NYL now has provided more than just time studies (which document just a small sample of time); it has provided actual time and attendance records for the entire school years showing when these personnel worked as 1:1 aides (the days the student and they both attended, which was most days) and when these personnel worked as behavioral support staff (the days when they attended but the student they served as a 1:1 aide was absent).

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The time sheets are pre-prepared forms and list each person’s primary position, which was 1:1 aides for these employees. The employees and the supervisors did not cross that off and substitute behavioral support staff on the days that the student was absent. There was no need to do so to comply with the above RCM requirements, as on days when their student was absent, these staff clearly worked as behavioral support staff. Not only has NYL told the auditors this,

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but it is documented by (1) the LOUs describing their responsibilities, which include PTC 243 work and (2) their time sheets and student attendance records, which show when they worked but the student they served as a 1:1 aide was absent. The documentation demonstrates that on those days they performed behavioral support staff work, because that is the only work within their job responsibilities set forth on their LOUs that they possibly could do. They could not serve as 1:1 aides on those days because there was no student present for them to serve as a 1:1 aide. To accept OSC's position that NYL has not documented that these employees did work for the SED cost-based programs, as behavioral support staff, on those days, one would have to believe that NYL required these employees to come in to work and to do nothing, as there was nothing else within their job descriptions that they could do on those days. It would be preposterous to believe that.

NYL's methodology was not "arbitrary and non-compliant." To the contrary, it was based on actual hours of service supported by time and attendance records, which not only is compliant, it's what the RCM states is "the preferred statistical basis upon which to allocate salaries and forge benefits for shared staff who work on multiple programs."

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For all these reasons, OSC's proposed disallowances for these NYL employees are incorrect. We do note, however, that NYL performed an attendance analysis which reflected that the staff in the OSC-selected sample was absent themselves on approximately 10 percent of those days when the student for whom they served as a 1:1 aide was absent. Therefore, NYL would agree that an adjustment to reduce the allocation of their salary and fringe benefits to be SED cost-based programs by 10 percent would be appropriate.<sup>4</sup>

**B. 1:1 Aides Who Also Worked As Teacher Assistant/Substitutes**

The second group, 1:1 aides who also served as substitute teaching assistants, were not "shared employees" at all. They were staff who worked for part of the year in one position (1:1 aides) and for part of the year in another position (substitute teacher/TA). NYL previously submitted documentation showing for which part of the year these employees worked in each position. OSC advised NYL in an email on November 21, 2016 that it considered such documentation to be incomplete. NYL is submitting under separate cover additional documentation that NYL believes addresses OSC's concerns, together with an explanatory spreadsheet.

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<sup>4</sup> We also note that one person selected by OSC for its sample, L.R., was not included in NYL's response because OSC selected her for 2013-14 only and she did not perform any 1:1 aide services in 2013-14; she did so in 2012-13, but not 2013-14. Accordingly, no supporting documentation was needed for her.

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In compliance with the requirements set forth in the RCM under Recordkeeping relating to payroll and time distribution, NYL utilized time sheets (YAI Payroll Form Temporary Adjustment or Substitute Employee forms), which includes the dates and times each employee worked throughout the school year (attendance records) and which were signed by the employee and supervisor, monthly attendance sheets, which includes the name of the child and the provider or providers sharing and performing 1:1 aide services either during specified monthly periods or only a few days instead of the entire week. For some employees, typically salaried employees, no time sheets were available, and NYL has provided a time card report instead to demonstrate attendance. The following is a summary explanation of the time spent as either a substitute teacher assistant or providing 1:1 aide services for each person in the sample selected by OSC:<sup>5</sup>

- A.M.G. – Timesheets show she performed 1:1 aide services for student S.G. in the summer of 2011; then starting on September 13, 2011, her time card reported her as a teacher assistant throughout the remaining part of the school year, where she performed multiple duties. They included, but were not limited to, sharing 1:1 aide assignments with D.W., whose time support is included with her package. Other services included a teacher aide sub when that 1:1 aide assignment was filled by D.W.
- M.S. – Timesheets show he worked as a substitute teacher from September through June. He did not provide 1:1 aide services during the ten-month school session.
- S.F. – Timesheets support her substitute Teacher Aide position from July until January; from February-June she provided 1:1 aide services Monday through Wednesday for student I.N., as indicated on the monthly attendance sheet.
- E.S. – Timesheets show she provided 1:1 aide services in the summer to student C.A.; her payroll memo line change form and time sheet changed to a Sub TA until October 12<sup>th</sup>, when she began providing 1:1 aide services to student S.H. for the remaining part of the school year.
- S.R. – Timesheets show that she provided 1:1 aide services to student D.J. in the summer and sub teacher assistant services the remainder of the year. We spoke with the Educational Coordinator, and she verified that C.V., not S.R., provided 1:1 aide services to student D.J. during the ten-month school period. A mistake was made on her timesheet. Please refer to the monthly attendance sheet, which is included in S.R.'s documentation provided under separate cover.

<sup>5</sup> For some staff, largely salaried employees, there were no timesheets available. For those employees, NYL used time card reports to validate attendance.

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- I. W. – Timesheets show that she worked as a sub teacher assistant in the summer and thereafter until November; then she provided 1:1 aide services for student M.H. from December 3, 2012 until March 2013.
- C.B. – Timesheets show she provided 1:1 aide services to student K. C. only in the summer and sub teacher assistant services during the ten-month school session.
- A.M.G.– Timesheets show the position assigned was a teacher assistant and records indicate she shared 1:1 aide services to student C.Z. during the summer session with L.D. when the other was available and provided 1:1 aide services from January 2014 to June 2014 to student C.Z.; she shared 1:1 aide responsibilities with T.B., who provided these services from September 9 to September 17; K. R. provided 1:1 aide services to student C.Z. from September 2013 to January 2014; according to attendance sheets, A.M.G. provided 1:1 aide services from November 25, 2013 to December 2013 to student M.S.N. J.T. provided 1:1 aide services from September to October 2013 and in January 2014 to student M.S.N. When A.M.G. was not providing these services, her time was allocated to a sub-teacher assistant position and is reflected on the position control under PTC 230 for 219 hours.
- Z.M.S. – Timesheets show that she worked as a teacher assistant substitute during the entire year. However, according to the monthly attendance sheets, she did provide 1:1 aide services to student K.C. from April 2014 to June 2014 when a 1:1 aide was not available. J.R. provided 1:1 aide services to student K.C. from January 2014 to March 2014. Based on the foregoing, Z.M.S. provided substitute assistant teacher services throughout the majority of the school year.
- H.G. – Timesheets and monthly attendance sheets show that during the summer session he provided 1:1 aide services to student T.S. The attendance sheet shows that, during the 10-month school session, he shared providing 1:1 aide services with L.R. and his timesheets reflect that he provided sub teacher assistant services from April-June.
- R.T. – The payroll-line change form reflects that she changed from a 1:1 aide to a sub teacher assistant in January 2014 and her timesheets support this role from January 2014 to March 2014; then another payroll-change was made from sub teacher assistant to a 1:1 aide in March 2014 for student J. B. who was enrolled for only fourteen weeks and received services from R.T. on Tuesday, Wednesday and Thursday.

These conclusions support NYL's allocations. The documentation shows that NYL complied with all RCM requirements by documenting each employee's time records through its timesheets

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and included monthly attendance sheets to support each employee's reporting as a 1:1 aide and a sub teacher assistant for the relevant periods. As with the 1:1 aides who also worked as behavioral support staff, NYL used these personnel as needed to fulfill multiple needs efficiently, while giving priority to meeting mandated staffing needs for the students.

### 3. Employee Bonuses

NYL strongly disagrees with OSC's proposed disallowances of employee bonuses.

OSC's draft report correctly notes that commencing with the 2013-14 year, providers were required to adopt a written policy and detailed evaluation form and that the written policy must describe how the final evaluation rating correlates to the amount of the merit award. NYL did that. NYL provided the auditors a copy of its written policy and its detailed evaluation form. NYL also provided the auditors a copy of the addendum to the policy adopted to meet the new requirement for 2013-14 that the policy must explain the correlation between the final rating and the amount of the merit award. Specifically, NYL's policy provided:

"NYL may choose to award employees a bonus based upon merit and supported by the employee's most recent Annual Staff Evaluation form. The employee must achieve a minimum rating of Level 2 in order to be eligible; however, in cases involving extraordinary circumstances, the Executive Director will determine the employee's eligibility. The bonus amount, if any, is based on the funds available, and approved by the Board of Directors. These funds should be distributed no later than September of that year. Finally, employees who are terminated may be exempt from bonuses for that year."

OSC has not contended that NYL's policy does not meet what the RCM requires, and there would be no conceivable basis to do so.

OSC's statement that in each of the audited years, "NYL's Board authorized 2 percent to 3 percent one-time lump sum payments..." is misleading. First, NYL's Board did not authorize a range of payment amount in each year as OSC's draft report implies. Rather, NYL's Board authorized 2% lump sum payments for FYs 2012 and 2014 and 2-3% payments only for FY 2013. Second, the Board did not authorize different payment percentages for different employees. Rather, what it authorized was the same percentage lump sum payment for all qualifying employees, which lump sum percentage would be between 2-3%, the exact percentage amount to be set later "based on the availability of funds." The percentage ultimately was set at 2%, and that is what was paid.

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In its prior preliminary report, OSC proposed to disallow the lump sum payments for different reasons from those stated in the draft report. Essentially, OSC contended that NYL had



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not provided complete information as to who received lump sum payments and that OSC's review showed that the payments ranged from 1% to 56%, not the percentages authorized by NYL's Board. In its response presented to OSC on June 7, 2016, NYL provided complete lists of persons who received lump sum awards and showed that the payments were the 2% authorized. At the closing conference on August 3, 2016, the auditors said that they still were reviewing the response to verify that the amounts were correct, but the auditors raised no other issue regarding the lump sum payments. Now, in the draft report OSC contends for the first time that the lump sum payments are not supported by employee performance evaluations because only seven were provided. Prior to the draft report, OSC's only request for employee evaluations had been a request for fifteen employee personnel files on March 15, 2016, which NYL made available, except for two that were in YAI's possession and two that were in MSA's possession, in late March and OSC reviewed in early April 2016. OSC did not raise any issues regarding the need for NYL to provide additional employee evaluations in the preliminary reports or at the closing conference on August 3, 2016. Once again, for the reasons described in the Preliminary Matters section above, it was procedurally improper for OSC to raise this new contention for the first time in the draft report.

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At the conference held on November 18, 2016 at NYL's request, OSC advised NYL for the first time that it now required production of employee evaluations for all employees who had received lump sum payments, rather than the small sample of employee personnel files it had asked for and reviewed previously. NYL advised OSC at the conference and again in writing on December 12, 2016, that doing so would be a huge undertaking that would take months. It would require NYL to review more than 600 personnel files located in nine different school sites (and some in storage), pull more than 1,500 evaluations and organize and copy thousands of pages of evaluations.<sup>6</sup>

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We also note that at the November 18, 2016, conference, the head of the audit team claimed that OSC had asked for evaluations previously beyond the fifteen employee personnel files NYL knew had been requested. NYL did not recall any such requests and asked OSC verbally at the conference and again in writing on November 28, 2016 to provide copies of any such requests. OSC has not provided any, because there weren't any such requests.

<sup>6</sup> At the conference, OSC claimed that it was willing to send personnel to NYL's sites to pull and review the employee evaluations that day. We believe this "offer" was disingenuous, as we doubt OSC had the necessary personnel available to do so. In any event, NYL refused to allow OSC to send personnel to do so because NYL is responsible for protecting the integrity of its files. NYL could not allow OSC personnel to rummage through its files, so that NYL would have no control of what they looked at or took. For this reason, throughout the audit, NYL gave OSC copies, not original documents, or if OSC wanted originals, NYL pulled the documents requested and allowed OSC to review them in the presence of NYL officials. What OSC proposed at the conference was contrary to normal audit procedure and contrary to the procedures followed throughout this audit.

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NYL advised OSC in writing on December 12, 2016, that although NYL considered OSC's position that all employee evaluations must be provided to be patently unreasonable for an organization of NYL's size, NYL would provide them if OSC agreed to give NYL the several months it would take and not to issue a final audit report until (1) NYL provided the evaluations and (2) if OSC still intended to recommend disallowances based on claimed deficiencies relating to the evaluations after reviewing them, OSC would advise NYL of its reasons for the same and provide NYL a reasonable opportunity to respond. NYL also offered to provide a smaller sample, which would require less time to collect, with the same two conditions, if OSC preferred that. OSC has not responded to NYL's proposal.

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Thus, there is no factual basis whatsoever for OSC's contention that there are no evaluations to support the lump sum payments. There are such evaluations, but NYL did not provide them to OSC previously because OSC never asked for them and such evaluations were not necessary or relevant to rebuttal of the contentions regarding the lump sum payments that OSC did raise.

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Similarly, there is no factual basis whatsoever for OSC's statement that there is "no correlation between the evaluation ratings and the payments." There is a correlation, and it is exactly the correlation that NYL's policy requires--that each employee for which evaluations were provided who had a rating of 2 or better received the 2% lump sum set by NYL's Board.

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Given this, we do not understand what OSC's quoted language in the draft report is referring to. In the preliminary report OSC had taken the position that an employee with a rating of 3 should get a larger bonus than one with a rating of 2 and one with a rating of 4 should get a still higher bonus, etc. We do not understand OSC to still be taking that position, because we directly asked at the November 18, 2016 conference if OSC was disputing the propriety of the criteria set in NYL's written policy--that each employee having a rating of 2 or better receives the designated percentage amount set by the Board-- and OSC answered "no". If that is nevertheless what OSC means by this sentence, OSC's position is patently wrong for the reasons stated in NYL's response to the preliminary report. The RCM requires that bonus awards be based on merit. The RCM does not state, or remotely suggest, that an agency must differentiate the amount of bonus payments paid to employees who meet the performance criteria established by the agency based on their relative "merit" (for example, that NYL must pay a larger percentage of salary as bonus or a larger dollar amount as a bonus to an employee who receives an overall evaluation score of level 3 or 4 than to one who receives an overall evaluation score of level 2). If OSC is requiring such a differentiation, OSC is imposing a requirement that the RCM does not. There is no legal basis for OSC to do that. Moreover, in our experience, it is a common practice among special education providers, and in the education world generally, for employers to give bonuses of the same percentage of salary for all employees who meet a minimum performance criteria. In fact, it is our understanding that the New York City

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Department of Education determines the amounts of bonuses for its qualifying employees that way.

If OSC is contending that there is no “correlation” because some employees for whom there was no evaluation in their file, or their personnel file could not be obtained, received payments,<sup>7</sup> that also is not correct. The fact that a file could not be obtained--that evaluations from three, four or five years earlier could not be found years later--does not mean that no such evaluations were generated for those employees. At most, it would be appropriate to disallow lump sum payments only for those employees for whom a personnel file was requested, but no evaluation was in the file pertaining to the relevant year. It would not in any way justify disallowing all of the lump sum payments on account of a purported lack of correlation between the evaluations and the payments.

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Finally, OSC’s schedule of recipients of “bonus” payments for 2013-14 lists various persons in PTC 218 whose percentage payments were greater than 2%. These personnel received teacher retention grants authorized by SED, which are completely different from the lump sum bonus payments and which were reported on CFR-1, line 87. It appears that OSC incorrectly has included the teacher retention grants on its schedule of lump sum payments. We believe that some of the payments listed on OSC’s schedule for PTC 238 also include teacher retention grants which is why they are more than 2% of salary.

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Additionally, the draft report recommends disallowance of \$58,030 of “staff awards”. This proposed disallowance also is procedurally improper, because it also is a new contention not made in any prior preliminary report, at the closing conference or at any other time before the draft report was issued. Moreover, NYL cannot meaningfully respond to this OSC contention, because OSC has not provided sufficient detail. Since receiving the draft report, NYL has asked OSC twice in writing to provide detail as to who received these awards, what they were for and why OSC believes they are not allowable. OSC has not provided such information, and without it NYL cannot meaningfully respond.

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We also note that RSU in its desk reviews questioned staff awards and, after receiving NYL’s response, made no adjustments for them. Accordingly, OSC’s contention may be inconsistent with RSU’s prior determination, although without receiving the information we have requested from OSC to allow NYL identify what awards OSC is referring to and why OSC thinks they are not allowable, we cannot tell for sure if they are the same awards reviewed and approved by RSU.

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<sup>7</sup> Two of the employees’ files were held by either YAI, and two were MSA employees. NYL has since provided evaluations for two of these persons. Only one employee file that could be obtained did not contain any employee evaluations.

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For all of the foregoing reasons, OSC's proposed disallowances of the "employee bonuses" are incorrect, and those proposed disallowances should not be included in the final report.

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**IV. Other Than Personnel Services Costs**

**1. YAI Expenses**

NYL strongly disagrees with OSC's proposed disallowance of \$756,553 of costs incurred by YAI included in its management fee. On December 4, 2016, OSC provided a spreadsheet reflecting that this amount had been reduced to \$696,339 after reviewing documentation provided by YAI. However, in that same email, OSC advised for the first time that YAI was making additional disallowances for contributions to a YAI SERP and for of agency administration bonuses paid by YAI to its employees. The proposed disallowances are not justified for several reasons.

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First, all of these proposed disallowances are procedurally improper because they were raised for the first time in the draft report (or in an email a few days before it) and in the case of the SERP and bonuses, not until December 4, 2016, nearly four weeks after the draft report was issued. If OSC wanted to pursue these claims, it should have deferred issuing a draft report until it had completed its review of information provided by YAI and issued preliminary reports based on it, so that there could be a full review, response and discussion of these contentions before a draft report was issued.

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Second, OSC has not provided sufficient detail to enable NYL to respond meaningfully. The largest item is contracted services, which accounts for \$516,498 of the amount proposed for disallowances. The \$516,498 number is followed with a notation on the spreadsheet provided by OSC stating that "After the review, these disallowances based on insufficiently documented invoices, e.g., not specific description of work performed, lack of documentation, unexplained YAI and NYL intracompany journal entries." There is no identification as to which items within the contracted services account for those comments portion to, much less which comments pertain to which entries. NYL asked OSC for clarification on December 8, 2016. OSC provided some partial clarification on December 9, 2016. NYL asked for further clarification that same day, but OSC has not responded. YAI has advised NYL that it too does not understand what OSC is referring to. NYL has authorized YAI to communicate directly with OSC to obtain necessary clarification. Absent the clarification requested by NYL on December 8 and 9, 2016, so that NYL and YAI can understand which items OSC thinks still are not properly documented and why, NYL cannot meaningfully respond. NYL also asked for clarification of remaining staff recognition disallowances within the management fee. That has not been provided either. OSC

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has responded that the remaining disallowances are for gifts, holiday parties and staff food, but has not identified which items within the account those purportedly are.

Third, the proposed disallowances are incorrect for substantive reasons as well. The management fee charged by YAI under the agreement was based on YAI's costs incurred rendering the services. OSC's proposed disallowances all are based on the premise that allowance of YAI's costs used to determine the management fee are based are subject to the same RCM rules governing allowances as NYL's own costs. That contention is based on RCM section 1.10, which provides:

"Charges to programs receiving administrative services, insurance, supplies, technical consultants, etc. from a parent or related organization are reimbursable provided they are not duplicative in nature, provide a direct benefit to a subsidiary charged and based on actual direct and indirect costs, allocated to all programs on a consistent basis and defined as reimbursable in the Regulations of the Commissioner of Education, the CFR Manual or this Manual. (Refer to Section 1.1.B.(5). Less-Than-Arm's-Length (LTAL) Relationships.)"

OSC's contention is incorrect because YAI was not NYL's "parent or related organization" and the management agreement was not a less than arm's-length transaction ("LTAL"). YAI was not NYL's "parent". At all relevant times, a majority of NYL's directors had no relationship whatsoever to YAI or any other agency that was part of the YAI "network". In fact, during the audited years, only one YAI Board member served on NYL's Board. Moreover, only one other NYL Board member also concurrently served on the Board of any of the other "network" agencies having management agreements with YAI. In fact, when the YAI "network" was formed in 1957, the agencies deliberately were kept independent of one another, not subsidiaries or affiliates. This is why a majority of NYL directors are, and always have been, completely independent of YAI and the other YAI "network" agencies. NYL never was reported as a related entity on NYL's Form 990 or vice versa. Thus, this clearly was no "parent" relationship.

YAI was not a "related organization" to NYL either. The RCM defines "related party" as follows:

"E. Related parties consist of all affiliates of an entity, including but not limited to:

- (1) Its management and their immediate families;
- (2) Its principal owners and their immediate families;

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(3) Any party transacting or dealing with the agency/entity of which that party has ownership of, or control over, or significant influence upon the management or operating policies of a program(s)/entity(ies) to the extent that an arm's-length transaction may not be achieved."

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The NYL-YAI relationship does not meet any of these criteria.

NYL and YAI are not "affiliates". Affiliates are organizations which are under common ownership or control. YAI and NYL were not, again because a majority of NYL's Board at all times was completely independent of YAI. The common YAI Board member exercised no control whatsoever over NYL. If he wanted NYL to do something, he had to persuade a majority of NYL's independent directors that it was in NYL's interest to do so. YAI did not have "ownership of" NYL and it did not have "control over" NYL. While YAI had influence regarding NYL's management by virtue of the Agreement, it did not have "significant influence upon the management or operating policies" of NYL *"to the extent that an arms-length transaction may not be achieved."* (Emphasis added.) This is what the definition requires.

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The RCM further defines a LTAL transaction as *"where there are related parties and one party can exercise control or significant influence over the management or operating policies of another party, to the extent that one of the parties is nor may be prevented from fully pursuing its own separate interest."* (Emphasis added.) This is where OSC's contention that the parties are affiliates, and the Agreement was a LTAL transaction, clearly fail. The Agreement was not an LTAL agreement, and the YAI-NYL relationship never posed any risk that a LTAL transaction "may not be achieved" because NYL's governing body, its Board, at all times was independent of YAI. Accordingly, there was no possibility that YAI could exert influence over NYL that could prevent NYL from pursuing its own separate interest, which is what the definitions of "related parties" and "LTAL" require. This should be obvious from the fact that almost all of NYL's Board was independent of YAI. Moreover, the Agreement expressly assured that the NYL Board would maintain control over YAI's activities under the Agreement, providing in paragraph 3 that "YAI shall be responsible to the Board of NYL with respect to those decisions affecting NYL." While the fact that YAI could not prevent NYL from pursuing its own independent interests should be obvious from those facts, it could not have been demonstrated more clearly than by the fact that in November 2015, NYL terminated the management agreement, over YAI's objections and to its great displeasure. That could not have happened in a real LTAL relationship.

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While all of the foregoing facts were pointed out to OSC previously, OSC's draft report does not address them at all. Rather, the draft report ignores them. It also does not discuss the RCM definitions discussed above, because OSC knows full well that the facts do not come anywhere close to establishing a "related party" status or LTAL under those definitions.

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As we explained previously in response to the preliminary report, none of the “facts” the draft report cites demonstrate the existence of any control at all, much less the degree of control that would be necessary for a LTAL relationship to exist.

YAI’s CEO was invited to attend NYL Board meetings in September and November of 2011 because in light of well-publicized legal claims being made against YAI, NYL was not comfortable with developments at YAI and how they might affect NYL. The meeting in essence was “damage control” by YAI. It was necessary precisely because NYL was independent of YAI and was not comfortable with recent developments. The increased “integration” discussed was to address NYL’s concerns that it was out of the loop of what was happening at YAI and other agencies that were part of the “network” and that NYL needed to have more information about what was happening at YAI, not vice versa. The authorized signatories had to be changed on NYL’s bank accounts because the YAI CEO had changed, and under the management agreement YAI was required to be a signatory on NYL’s bank accounts. That was not some requirement imposed by YAI at the Board meeting.

The November 28, 2011 meeting was a follow-up to that meeting. The discussion of the composition of the Board was consideration of expanding the Board to facilitate the greater integration with YAI that NYL desired (which never happened). There also was discussion of holding a future Board meeting at a school site, so that Board members could see the site. Neither reflected any YAI control over NYL.

With respect to the June 2012 Board meeting, YAI’s CEO asked was invited to the meeting because YAI and one of the other “network” agencies, MSA, had advised NYL that they would like NYL to be a standby guarantor for a MSA lease. MSA needed this because it did not have a financial history on which a lessor would accept MSA without a guarantor. NYL’s Board agreed to provide the guaranty because the Board determined that it was in NYL’s self-interest to do so. As the minutes reflect, the school that MSA wanted to open was for school age children that NYL students could attend after they aged out of NYL’s pre-school programs. The lease could not be obtained without a guarantor, and NYL’s Board believed that it was in NYL’s best interests to have such a “feeder” school available for its students when they aged out of NYL. The Board also believed that the guaranty presented minimal financial risk. This transaction was not an indication of YAI control over NYL. It was an example of one of the potential benefits to NYL of having opportunities available to it by being part of a wider “network” of organizations serving the developmentally disabled, which opportunities NYL, in its discretion, could choose to pursue or not to pursue in accordance with its interests. In this case, NYL’s Board chose to provide the guaranty, because its Board believed that the benefits of having a “feeder” school for school age children that otherwise would not exist available for NYL’s families outweighed the risks of providing the guaranty. The guaranty of the construction loan and lease payments approved at the March 4, 2013 Board meeting were part of the same arrangement, and were

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approved by NYL's Board because the Board believed that it was in NYL's interests to do so for the same reasons. This also did not in any way reflect YAI control over NYL.

Finally, NYL was willing to guaranty YAI's payments under YAI's settlement agreement was because NYL's Board again considered that to be in NYL's best interests, not because of any YAI "control" over NYL, which did not exist. The government parties would not agree to an extended payment for YAI without a guaranty from NYL. Without an extended payment schedule, YAI might collapse, and NYL's Board was very concerned about the adverse impact on NYL that such a collapse, and the resulting need for NYL to change its whole financial management structure, would have on NYL. NYL's Board agreed to have NYL provide the guaranty, because it believed that the continuation of the management agreement that the guaranty would allow was in NYL's best interests, and that providing the guaranty involved minimal financial risk that NYL actually would end up having to pay anything. NYL in fact did not end up paying anything as a result of the guaranty.

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The fact that NYL entrusted YAI with its fiscal management and records also does not in any way reflect YAI control over NYL. Many organizations, including special education providers, enter into arms-lengths management agreements, as NYL did, by which they entrust part of their management, and the records relating to that, to the organization with which it contracts. There were many reasons why the economies of scale that Agreement offered, together with the opportunities for beneficial associations that being part of "network" of independent organizations providing different kinds of services to developmentally disabled persons might offer to NYL, were attractive to NYL, and that is why NYL entered into the arrangement. It did so only with the protection that it would remain independent, with an independent governing Board. In fact, YAI's subsequent desire to change that relationship and have NYL become a controlled subsidiary of YAI was one of the major reasons why NYL terminated the Agreement in November 2015.

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The draft report is also inaccurate when it says that YAI's CFO was listed as the contact person "on the annual CFRs filed with SED." He was listed as the contact person only for FY 2014. The Assistant Director of NYL Revenue Management, who was technically a YAI employee but worked exclusively for NYL,<sup>8</sup> was the contact person for FY 2012 and FY 2013. It was changed in FY 2014 only because she had left before the CFR was filed. In any event, this also does not reflect YAI control over NYL. These people did not provide any information to SED without the review and approval of NYL's Executive Director, in consultation with NYL's expert consultant. Also, the CFR was signed in every year by NYL's Executive Director, not by any YAI employee.

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<sup>8</sup> As her affidavit explains, the only reason she was not made an NYL employee altogether was to preserve her vested pension rights.

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Finally, while NYL may have reported the Agreement as a related party relationship on its CFR, out of an abundance of caution, it did not have to do so. The fact remains that YAI was not a related party of NYL as defined in RCM for all the reasons discussed above. We also note that the RCM does not require LTAL relationships to be disclosed on the CFR; it requires such disclosure in the notes to the financial statements. Moreover, while NYL referred to the Agreement in the notes to the financial statements, it did not identify the Agreement as a LTAL transaction, and in any event it did not have to be disclosed as a LTAL transaction, because it was not one.

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For all these reasons, there was no related party relationship, and therefore Section II.10 of the RCM does not apply to the management fee. What does apply is the requirement of the RCM requiring costs to be reasonable. Reasonable costs are defined as follows:

“Reasonable Cost

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. In determining reasonableness of a given cost, consideration shall be given to:

- A. Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the approved special education program. Public special education funding shall be used in accordance with Article 89 of Education Law Section 4401 and Section 4410.
- B. The restraints or requirements imposed by such factors as: sound business practices; arm's length bargaining; Federal, State or local laws and regulations.
- C. Prices for comparable goods or services determined by reviewing similar entities.
- D. Whether the individuals concerned acted with prudence given their responsibilities to the entity's Board of Directors, its employees, the public at large and the State government.
- E. Significant deviations from the established practices of the entity or similar entities which may unjustifiably increase the cost of the approved program.”

The management fees clearly met this test, as the services were provided at YAI's cost, with no profit margin added, which was a very favorable arrangement for NYL. OSC never has contended that the management fee was not reasonable, much less identified facts that would

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support such a contention. It also bears repeating that NYL's overall agency administration expenses which included the management fee, were within all applicable RCM cost screens.

Since the Agreement was not a LTAL transaction, the fact that the management fee was based on YAI's costs, as opposed to being based on hourly rates or a flat fee or other arrangement agreeable to the parties, does not make YAI's costs subject to RCM reimbursement rules that apply to NYL's own personnel costs and other costs. Yet, that is exactly why OSC has done, applying RCM criteria for reimbursement of a provider's own costs to YAI, as though YAI, which had no programs for which SED sets tuition rates, itself was the provider seeking reimbursement through a SED-set tuition rate. Nothing in the RCM requires or allows that when the transaction was an arms-length arrangement between independent entities, as it was in this case. Indeed, virtually all businesses set their rates in contracts in consideration of their own costs. For example, our law firm bills based on hourly rates, but we set our hourly rates at levels that allow us a reasonable profit above our own costs. That does not mean that SED or OSC can disallow amounts paid to us by our clients that are SED tuition rate special education providers if our pension contributions, bonuses, vehicle expenses and other costs would not be allowable if we ourselves were an SED tuition rate special education provider, even though our rates would be lower if we did not incur those costs. There is no justification for holding YAI's expenses to that standard either.

For all of these reasons, OSC's proposed disallowances of portions of YAI's management fee are unjustified and should not be included in the final report.

**2. Contracted Services and Food for Students**

The other "unsupported costs" proposed for disallowance include \$259,675 of salary and benefits paid to the Assistant Director of NYL Revenue Management, and "unsupported adjusting journal entries" for student food. As already has been fully explained above, the Assistant Director for NYL Revenue Management was a YAI employee who worked exclusively for NYL, and her salary and fringe benefits were properly charged to NYL. This was fully supported by her job description, her interview by OSC and her affidavit which we are submitting under separate cover. At her interview on December 12, 2016, OSC asked NYL to provide sign-in sheets supporting that she attended NYL's principals' meetings, and these also are being provided under separate cover. There is no justification whatsoever for OSC's proposed disallowances of her salary, and they should not be included in the final report.

NYL provided OSC with YAI's explanations of the adjusting journal entries transferring certain expenses to student food, which did explain those entries. OSC has asked for back-up documentation. NYL has requested this documentation from YAI multiple times, but YAI has not provided it to date.

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3. Consultant Costs

NYL has fully explained both above in the discussion of expenses OSC incorrectly contends are “duplicative” and in its response to the preliminary report why the costs of the consultants proposed for disallowance by OSC were necessary, as neither YAI nor NYL had personnel available to could perform the tasks they did, and were not duplicative of anything YAI did under the Agreement. For these reasons, there is no basis whatsoever for the proposed disallowances and they should not be included in the final report. Here again, OSC’s position not only lacks any factual foundation, it also is inconsistent with RSU’s determinations. As we explained previously to OSC, RSU expressly questioned whether these costs were duplicative of the management fee and, after receiving NYL’s explanation, RSU made no disallowances.

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4. Property Costs

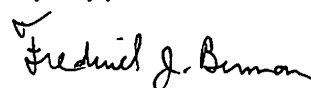
The property costs OSC proposes for disallowance include \$213,485 as expenses relating to space rented by YAI and shared with NYL. NYL does not have the information needed to show why the allocation was appropriate because only YAI has the documentation supporting its rent and related property costs and how the allocation to NYL was made. NYL has asked YAI for this documentation multiple times, but to date, YAI has not provided it.

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V. Conclusion

NYL hopes and trusts that OSC will carefully review and consider the points above and the additional supporting documentation being provided under separate cover before issuing its final audit report.

Very truly yours,



Frederick J. Berman

FJB:ea

## State Comptroller's Comments

1. The draft audit report was electronically transmitted to New York League for Early Learning (NYL) on November 8, 2016. Initially, we granted NYL until December 8, 2016 (the customary 30-day period) to formally respond to the draft report. Subsequently, NYL requested and auditors granted an extension, until December 15, to respond. On December 19, 2016, auditors received an electronic response to the draft report. This response was accompanied by 1,495 pages of additional documentation.
2. The State Comptroller's legal authority to audit the costs NYL reported on the CFRs submitted to the State Education Department (SED) is expressly cited on pages 3 and 16 of the final audit report.
3. The assertion is inaccurate. The audit of expenses submitted to SED by NYL was conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS) and followed standard OSC audit procedures. The auditors' concerns and findings were discussed with NYL officials on numerous occasions throughout the audit. Further, NYL's refusal and/or inability to provide basic business records and/or to provide such records in a timely manner significantly extended the duration of the audit's fieldwork. Consequently, it was necessary to amend the amounts of certain audit disallowances multiple times, as additional documentation was provided by NYL and later by the Young Adult Institute (YAI). Based on all the information provided, including the aforementioned 1,495 pages of documentation, we reduced the total amount of the audit's recommended disallowance by \$83,579 (from \$5,854,587 in the draft report to \$5,771,008 in the final report).
4. This assertion is inaccurate. Section III of the Reimbursable Cost Manual (Manual), requires entities, such as NYL, to retain all pertinent accounting, allocation and enrollment/attendance records supporting reported data directly or indirectly related to the establishment of tuition rates for seven years following the end of each reporting year. This audit commenced on May 6, 2015 and the draft report was issued on November 8, 2016. During the intervening period, we repeatedly requested required records that should have been readily available from NYL. Despite numerous delays and obstacles in obtaining such documentation, we consistently followed our standard audit protocol, including the communication of preliminary audit findings. We shared our audit concerns and observations with NYL's representatives during our audit fieldwork, in six detailed preliminary audit findings, prior to and during the closing conference, as well as prior to and after the issuance of the draft report. The six preliminary findings were issued to NYL between February 24, 2016 and May 6, 2016 and the closing conference was held on August 3, 2016. Information and documentation received in response to the preliminary findings, the closing conference, and thereafter were reviewed and considered in the preparation of the draft audit report.
5. The audit process is not complete until the final audit report is issued. It is standard audit procedure and practice to amend preliminary findings and draft audit reports based on the auditors' review and verification of additional documentation provided by agencies. The information, including records and supporting documentation which auditors needed, was conveyed to NYL at the opening conference and throughout the audit engagement. Further, auditors provided NYL with opportunities to formally respond to the aforementioned six

written preliminary findings and other transmittals sent to NYL. NYL's responses, as well as documentation provided during and after the closing conference, were reviewed and considered in the preparation of the draft audit report. Based on additional verifiable information, and consistent with GAGAS, we adjusted our findings as appropriate for this final report.

6. This statement is misleading. As noted previously, NYL was initially granted the customary 30 days to respond to the draft report, and, at NYL's request, auditors granted NYL an additional seven days to respond. Even then, NYL took an additional four days, beyond the extended deadline, to respond.
7. Our report is not misleading. This is an audit of the expenses submitted to SED by NYL. Therefore, it was NYL's responsibility to provide the auditors with documentation supporting the claimed expenses. However, throughout the audit, NYL's representatives repeatedly refused to provide requested documentation or claimed they were having difficulty providing certain documents because YAI, a related party, was not always responsive. We informed NYL's representatives that excessive delays could cause us to question the reliability of documents provided. Further, the Management Agreement between NYL and YAI did not obviate NYL from compliance with the Manual's requirements. In October 2016 (about 18 months after the audit commenced), YAI requested a list of the documents that NYL had not yet provided to OSC.
8. Based on additional documentation provided by NYL and YAI, we reduced the recommended disallowances for employee bonuses by \$122,145. This amount includes \$106,266 for Teacher Turnover Prevention grants and \$15,879 in lump sum payments, for which NYL provided employee evaluations.
9. Based on additional documentation provided by YAI, we revised our report to reflect a recommended net disallowance of \$801,660 as follows: the \$756,553 disallowance reported in the draft report less \$214,308 plus \$259,415.
10. As previously stated, NYL failed to provide requested documentation in a timely manner (refer to Comments No. 4 and 7). In our second preliminary finding, issued on April 5, 2016, we recommended a disallowance of the entire \$13.8 million management agreement fee because NYL failed to provide requested information to support the fee. The documentation was finally received on June 27, 2016. After reviewing the documentation and the Management Agreement, we determined that the services of nine NYL agency administrative employees duplicated services that were covered by the Management Agreement. Similarly, in our third preliminary finding, issued on April 12, 2016, we recommended disallowances for two consultants on the basis that their services should have been covered under the Management Agreement. Appropriate adjustments were then made to our recommended disallowances and included in the draft report.
11. The Management Agreement between YAI and NYL obligated YAI to manage services that included "all business, management, fiscal, personnel, fundraising, planning, and program functions and services." We interviewed NYL's executives and reviewed relevant documentation. As a result, we determined that NYL's agency administrative functions (the services performed by the NYL's Executive Director, Assistant Executive Director, five Office Workers, and two Utilization Review/Quality Assurance employees) were duplicative as they were covered under the Management Agreement.
12. NYL's assertions are false. In fact, auditors did not admit that they "did not know either



what the NYL employees did or what YAI did.” The duplicative agency administrative service disallowances were based on a comparison of the services prescribed by the \$13.8 million Management Agreement with the responsibilities performed by NYL administrative staff, as determined through interviews of relevant NYL administrative staff and a review of pertinent accounting records. Further, our position at the November 18, 2016 conference was the same as the position noted in the December 8, 2016 email.

13. Our audit findings are based on the explicit language of the Management Agreement, which states that YAI “shall serve as NYL’s manager of *all* business, management, fiscal, personnel, fundraising, planning, and *program* functions and services of NYL” [emphasis added]. In addition, YAI was required to “coordinate the professional services functions of NYL inclusive of hiring and firing,” and to “*conduct*, supervise, and coordinate the day-to-day fiscal and/or operational functions of NYL” [emphasis added]. As stated on page 8 of our audit report, the CFRs indicate that for the three fiscal years ended June 30, 2014, \$13.8 million in fees were paid to YAI for such services. To ensure that costs were reasonable and necessary, NYL should have required YAI to fully comply with the provisions of the Management Agreement rather than find reasons to justify YAI’s non-compliance.
14. We disagree. The explicit written provisions of the Management Agreement provides the most reliable evidence of the parties’ respective obligations. Also, refer to Comment No. 13.
15. We contend that there is a risk that NYL’s and YAI’s interpretation of the Management Agreement places an improper fiscal burden on taxpayers. Because NYL employees and consultants performed work prescribed by the Agreement with YAI, we concluded that NYL incurred additional costs above and beyond those incurred per the Management Agreement.
16. The fact that the billings were performed by NYL staff misses the point and did not obviate YAI from complying with the terms of the management agreement. (Also, refer to Comment No. 13.) Moreover, the interview of the Assistant Director of Revenue Services and that individual’s affidavit (which was created for OSC) were not sufficient to demonstrate that the services in question were not duplicative.
17. SED’s desk reviews do not include the level of examination provided by OSC’s on-site audits. Consequently, the fact that a particular cost was allowed pursuant to SED’s desk review does not mean that the same such cost will not be recommended for disallowance upon on-site audit of the documentation supporting the cost claimed on the CFRs. According to Section 200.18 of the Regulations of the Commissioner of Education and the Manual, a provider’s final costs are determined upon field audit, such as the one conducted by OSC.
18. The assertion by NYL that the services required by YAI under the Management Agreement were limited to fiscal and business operations and the services of the Executive and Assistant Executive Director were programmatic is misleading. (Also, refer to Comment No. 13.) Further, after review of NYL’s response to the draft and the additional documentation that was provided, there was no compelling evidence to change our finding that the responsibilities of NYL’s Executive Director, Assistant Executive Director, and other agency administrative staff duplicated the services YAI was obligated to perform (and was paid for) under the Management Agreement. Moreover, the affidavits and Letters of Understanding provided by NYL on December 19, 2016 were insufficient, contradictory, and not supported by documentation. Further, since they were prepared nearly two and



- a half years after the audit period (and solely in response to the audit), they have limited evidential value.
19. NYL provided no evidence, contemporaneous with the audit period, to support this statement. Further, the CFR Manual defines the 601 position title code as responsible for overall administration of the agency and the 602 position title code as assisting in overall administration of the agency.
  20. NYL's conclusion is speculative. Moreover, the fact remains that NYL staff performed administrative work that was prescribed by the Management Agreement with YAI and also contracted with a third party for similar services. NYL's and YAI's failure to determine appropriate staffing for YAI to fulfill its obligations under the Agreement should not result in additional cost to NYL for staff and consultants.
  21. NYL provided no contemporaneous audit evidence to support the affidavit provided by the former Assistant Director for Revenue Management to the effect that she worked solely for NYL. Further, the job description, interview, and affidavit do not provide sufficient evidence that this YAI employee actually performed worked for NYL – or, if so, the details (including dates and times) that such work was purportedly performed.
  22. NYL's assertion that "the Agreement required YAI to manage fiscal and business services, not to perform them itself" is misleading. In fact, the management agreement required YAI to "*conduct, supervise, and coordinate the day-to-day fiscal and/or operational functions of NYL*" [emphasis added]. The two consultants were retained to provide fiscal functions and/or operational reviews, services that should have been covered under the Management Agreement.
  23. NYL's assertion is false. In fact, OSC did not "edit" the consultant's responsibilities or the Management Agreement. Further, as previously noted, the Agreement required YAI to "*conduct, supervise, and coordinate the day-to-day fiscal and/or operational functions of NYL*" [emphasis added] and not to simply manage them.
  24. We again acknowledge that employees can work in multiple positions. Nevertheless, as detailed on page 11 of the report, NYL's documentation was insufficient to meet the Manual's requirements for the allocation of time for shared staff positions. Consequently, we maintain that our finding is correct.
  25. NYL's assertion is summarily dismissive and incorrect. In fact, NYL did not provide the necessary documentation to show compliance with the Manual, as otherwise required.
  26. NYL's assertion is false. In fact, in an email to OSC on April 4, 2016, NYL stated: "The amount of material requested regarding the support for the time studies is massive. However, NYL is conveying the request to YAI but believes that amount of material will not be able to be provided in 2 days, and we suspect YAI will need longer than that. Is there some smaller sample size that would be satisfactory?" In an email dated April 19, 2016, OSC replied, "Let's start with a small sample - I will email you the names shortly. However, at some point, we will need the information for each person."
  27. We can neither confirm nor dispute NYL's assertions regarding the numbers of FTE behavioral support staff NYL employed during the audit period. Nevertheless, the fact remains that NYL claimed costs for 347 full-time and/or part-time employees as behavioral support staff.
  28. Auditors reviewed the 1,495 pages of additional documentation provided by NYL and found no cause to revise the audit's finding/conclusion pertaining to costs claimed for the

1:1 aides.

29. NYL's assertion is false. In fact, NYL's methodology was not based on actual hours of service supported by employee time and attendance records. Instead, it was based on student absences. Further, although time and attendance records showed the hours employees worked, they did not provide any other pertinent details, such as the names of students who were actually served. Further, the documentation did not show that 1:1 aides actually rendered services as behavior support staff when their assigned students were absent.
30. A timecard report is not an acceptable substitute for a time and attendance sheet, which must be signed by the employee and his/her supervisor (as otherwise required by the Manual).
31. The documentation does not show that any of the 11 employees listed provided services to SED's cost-based program. Further, we were not provided with documentation showing that any of these employees substituted for another employee.
32. We disagree. Time sheets and monthly attendance sheets generally did not indicate which classrooms and/or specific students the employees in question served. Therefore, there was insufficient evidence that these employees provided services to SED's cost-based programs.
33. We deleted the word "each" from the report. Nevertheless, the fact remains that during the three fiscal years ended June 30, 2014, NYL's Board authorized one-time lump sum payments in the range of 2 percent to 3 percent.
34. According to the Manual, "a merit award (or bonus compensation) shall mean a non-recurring and non-accumulating (i.e., not included in base salary of subsequent years) lump sum payment in excess of regularly scheduled salary which is not directly related to hours worked. A merit award *may be reimbursed if it is based on merit as measured and supported by employee performance evaluations*" [emphasis added]. This requirement was brought to NYL's attention, as a criterion, in the April 22, 2016 preliminary report. At the May 28, 2015 opening conference, NYL's Executive Director informed the auditors that lump sum payments were made to employees. However, the Executive Director stated that the lump sum payments should not be considered to be bonuses. We asked NYL to provide payroll registers and other documentation that would assist us in determining which employees received the lump sum payments, as well as the amount each employee received. On February 17, 2016, NYL provided a list showing employees and the amount of their lump sum awards for the fiscal year ended June 30, 2014, but not for the prior two fiscal years under audit. In a preliminary report dated April 22, 2016, OSC recommended disallowances for the lump sum payments made for the fiscal year ended June 30, 2014, because the payments were insufficiently documented and, therefore, did not comply with the requirements in the Manual. As stated in NYL's response to the draft, on June 7, 2016, the auditors were provided with a list of employees who received lump sum payments. However, this information was incomplete and could not be relied upon.
35. We disagree. According to the Manual, lump sum payments that are not included in the base salary of subsequent years may be reimbursed, if based on merit as measured and supported by employee evaluations. On December 28, 2015, we requested supporting accounting records for the lump sum payments approved by NYL's Board and paid during the three audited fiscal years. According to the Manual, the lump sum payments, since

they were reimbursed, should have been supported by evaluations. In February 2016, to determine if NYL had maintained evaluations to support the payments, the audit team requested and reviewed personnel files of 32 employees. The following month, we reviewed personnel files of an additional 15 employees. On March 29, 2016, we visited the Greenpoint School (an NYL entity) to interview the school's principal and 13 other employees. The objectives of these interviews were to obtain information on the lump sum payments/bonuses paid to the principal and to the 13 employees, as well as to determine if they received formal performance evaluations. We interviewed the principal. However, NYL's Executive Director and its counsel precluded us from interviewing the 13 employees at that time.

36. NYL's assertion is speculative and incorrect. In fact, the auditors' offer was made in good faith, and OSC was willing to allocate the appropriate resources to retrieve and review all personnel files and performance evaluations. However, NYL refused this offer. Consequently, we concluded that there was a high risk that NYL did not have the required evaluations to support claims for reimbursement of the lump sum payments.
37. NYL's claim that they could provide all evaluations if OSC agreed to give them the additional months it would take to do so is disingenuous. NYL officials should have been aware of the Manual's requirement pertaining to the reimbursement of lump sum payments, particularly since auditors specifically cited such criteria in a preliminary finding dated April 22, 2016. Therefore, NYL had more than enough time (from April 22, 2016 through December 12, 2016) to produce the evaluations. Also, under these circumstances, auditors were concerned that, at this late stage of the audit process, there was risk that additional time could be used to create records that would not be contemporaneous with the bonus payments in question.
38. NYL misses the point. The fact remains that the Manual requires bonus payments to be supported by performance evaluations, and NYL could not provide written evidence of such evaluations for the bonus payments in question during the lengthy audit engagement. Also, we disagree with NYL's tacit assertion that a bonus payment should be allowed if the recipient's personnel file could not be located, using an assumption that the evaluation was performed and documented but the personnel file was apparently misplaced or lost. This is contrary to the Manual and professional auditing standards. Also, by applying such standard, an agency could simply claim that required records were prepared, but were misplaced or lost, whenever there are instances of non-compliance with documentation requirements.
39. This recommended disallowance was based on documentation provided to OSC after a preliminary report was issued on April 22, 2016. Consistent with standard practice and process, we reviewed the documentation and included the \$58,030 recommended disallowance in our draft report. Further, OSC provided NYL with documentation detailing the \$58,030 recommended disallowance for staff awards on November 9, 2016.
40. We revised our report to reduce the recommended disallowance by \$1,924 for one of the two employees for whom NYL provided evaluations. The documentation for one of the employees, however, showed that the employee worked for MSA rather than NYL.
41. This statement is misleading. On June 16, 2015, we requested documentation to support the \$13.8 million Management Agreement fee paid to YAI by NYL. It was our expectation that NYL would provide this information in a timely manner. It was not. Therefore, on April

5, 2016, we recommended disallowance of the \$13.8 million Management Agreement fee, citing the lack of documentation to support the fee. On August 10, 2016, after the closing conference, we reiterated our request for documentation to support certain costs, including the contribution made to YAI's Supplemental Executive Retirement Plan (SERP) and bonus payments to agency administration staff. Some of the information was provided by YAI on October 26, 2016, and the remainder on November 7, 2016. We reviewed the documentation and determined that costs related to the SERP, YAI administrative bonuses, and overtime should also be recommended for disallowance. Given the timing, these recommended disallowances were not included in the November 8, 2016 draft report. Therefore, consistent with GAGAS, we sent written correspondence (including a detailed spreadsheet) on December 4, 2016 to NYL, informing officials of the additional recommended disallowances.

42. NYL's assertion is untrue. In fact, OSC provided sufficient detail to enable NYL to respond meaningfully. Specifically, OSC provided a detailed response on December 9, 2016 that identified the specific items within the contracted services account, including ineligible costs related to staff recognition, gifts, holiday parties, and food for staff.
43. Neither NYL nor YAI provided auditors with sufficient financial records to determine YAI's actual cost to provide services under the Management Agreement. Moreover, because NYL and YAI were related parties (see pages 7-9 of the audit report and Exhibit B), the costs YAI charged to NYL (and NYL paid) under the Management Agreement were subject to specific Manual documentation requirements for eligibility. However, the records provided to auditors were not sufficient to support all of the costs NYL claimed.
44. NYL's assertion is incorrect. Our report does not state that YAI was a "parent" of NYL. Moreover, we maintain that YAI and NYL were related parties during the three fiscal years ended June 30, 2014 (see pages 7-9 of the audit report and Exhibit B). In fact, for the audit period, the CFRs for NYL and YAI listed the other entity as a related party. We also maintain that YAI had significant influence over NYL, as detailed on pages 7-9 of the audit report.
45. NYL's statement is misleading and confusing. First, NYL's response apparently confuses NYL and YAI in stating that: "NYL never was reported as a related entity on NYL's Form 990 or vice versa." In fact, a review of Form 990 for both YAI and NYL indicated that YAI's CFO was listed as the custodian for the books and records of both YAI and NYL for the entire audit period (the three fiscal years ended June 30, 2014). In addition, YAI's and NYL's CFRs, for the same period, listed the other entity as a related party.
46. We could not determine the authorized signatories for NYL's bank accounts before September 10, 2012. However, according to NYL's Board minutes dated December 3, 2012, the new signatories for NYL bank accounts effective September 10, 2012 were NYL's Board chairman and two senior YAI executives. Further, YAI's CFR for fiscal year ending June 30, 2012 lists NYL's Board chairman as a "key person" who has a financial interest in YAI. Also, there was no indication that NYL's Executive Director was a signatory to any of NYL's bank accounts.
47. NYL's assertion is misleading. In fact, the Board minutes list NYL as a guarantor, rather than a "standby" guarantor. Moreover, the minutes also stated that MSA did not have a sufficient financial history to obtain a construction loan on its own.
48. It is unclear how acting as an unconditional guarantor of YAI's multi-million dollar settlement with New York State was in NYL's best interest. Moreover, we question the assumption

that YAI's potential collapse would negatively impact NYL, if the two organizations were genuinely separate, independent, and unrelated. Further, the assertion that the guaranty would provide for the continuation of the Management Agreement appears to be rather flawed. In fact, NYL advised auditors that the Management Agreement was dissolved in November 2015. Finally, if YAI defaulted on its settlement agreement, NYL would have assumed considerable financial risk, which could have compromised its ability to remain a going concern.

49. NYL's assertion is misleading. We acknowledge that organizations sometimes enter into management agreements with other entities. However, NYL's and YAI's relationship went beyond a basic management agreement, as previously detailed in the report and other State Comptroller's Comments. Further, the fact that NYL entrusted YAI with "*all*" of NYL's "*business, management, fiscal, personnel, fundraising, planning, and program*" [emphasis added] functions and services (refer to Comment No. 13) illustrates that YAI had a material degree of control over several prominent NYL activities.
50. We revised our report to state that YAI's CFO was listed as the contact person for the CFR that NYL filed with SED for the fiscal year ended June 30, 2014 and that the Assistant Director of NYL Revenue Management (a YAI employee) was the contact person for the two fiscal years ended June 30, 2012 and June 30, 2013. Also, we noted that YAI's CFO was listed as the custodian for the books and records of both YAI and NYL for the three fiscal years ended June 30, 2014.
51. Based on the information provided to auditors, we can neither confirm nor dispute the assertion that "the only reason [the Assistant Director of Revenue Management] was not made an NYL employee altogether was to preserve her vested pension rights" at YAI. Further, this person told us that she was never an NYL employee, and she was not listed on NYL's payroll registers for the two fiscal years ended June 30, 2013.
52. We question the assertion that NYL reported the Management Agreement with YAI as a related party on the CFR solely "out of an abundance of caution." Moreover, based upon the abundance of aforementioned evidence, we concluded that NYL reported the Management Agreement as a related-party relationship on the CFRs correctly – because it was, in fact, a related-party relationship.
53. We disagree. At our December 12, 2016 meeting with the former Assistant Director of Revenue Management, the auditors requested documentation to show that she worked exclusively for NYL. Specifically, auditors requested documentation of her work product, copies of evaluations she prepared for NYL employees, and any other reports/information illustrating that she worked exclusively for NYL. In addition to previously provided documentation, NYL provided an affidavit, a copy of her letter of understanding, a list of NYL's employees who purportedly reported to her, and sign-in sheets/agendas for principal meetings. We reviewed the documentation and determined that it was insufficient to support that she worked for NYL.