

THOMAS P. DINAPOLI
COMPTROLLER



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ALBANY, NEW YORK 12236

STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

December 29, 2015

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

Mr. Andrew McKenzie
Executive Director
Newmeadow, Inc.
100 Saratoga Village Blvd, Suite 35
Malta, NY 12020

Re: Compliance With the Reimbursable
Cost Manual
Report 2015-S-48

Dear Ms. Elia and Mr. McKenzie:

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, we conducted an audit of the expenses submitted by Newmeadow, Inc. (Newmeadow) to the State Education Department (SED) for purposes of establishing the preschool special education tuition reimbursement rates used to bill public funding sources that are supported by State aid payments.

Background

Newmeadow, a not-for-profit organization located in Malta, New York, is an SED-approved provider of preschool special education services. Newmeadow offers a range of services and programs to children with disabilities from three to five years of age that include Preschool Special Class, Preschool Integrated Special Class, Preschool Special Education Itinerant Teacher Services, Preschool Evaluations, Preschool Related Services, Special Education 1:1 Aides, and Early Intervention.

For the fiscal year ended June 30, 2014, Newmeadow offered three SED-funded rate-based programs: Preschool Special Class, Preschool Integrated Special Class, and Preschool Special

Education Itinerant Teacher Services (collectively referred to as the Programs). During the 2013-14 school year, Newmeadow provided these special education services to about 150 children with learning disabilities from 25 school districts located in eight counties in Upstate New York.

The counties that use Newmeadow's preschool special education services pay tuition to Newmeadow using reimbursement rates set by SED. The State reimburses the counties 59.5 percent of the special education tuition that counties pay. SED sets the special education tuition rates based on financial information, including costs, reported by Newmeadow on its annual Consolidated Fiscal Reports (CFRs) filed with SED. Costs reported on the CFR must comply fully with the guidelines in SED's Reimbursable Cost Manual (RCM) regarding the eligibility of costs and documentation requirements and meet the reporting requirements prescribed in the Consolidated Fiscal Reporting and Claiming Manual (CFR Manual). For the fiscal year ended June 30, 2014, Newmeadow reported a total of \$3.4 million in reimbursable costs on its CFR, of which \$2.9 million was for the Programs.

Results of Audit

According to SED guidelines, costs reported on the CFR should be reasonable, necessary, directly related to the special education program, and properly documented. For the fiscal year ended June 30, 2014, we identified \$12,059 in costs charged to the Programs that did not comply with SED's requirements for reimbursement. The non-reimbursable costs included \$3,897 in personal service costs and \$8,162 in other than personal service (OTPS) costs. We also found unreported less-than-arm's-length relationships that Newmeadow should have disclosed on its CFR and financial statements. We also determined that Newmeadow did not maintain sufficient inventory records or have a process for identifying board members' conflicts of interest on an ongoing basis.

Personal Service Costs

We reviewed the personal service costs reported on Newmeadow's 2013-14 CFR and identified non-reimbursable costs totaling \$3,897. The non-reimbursable costs included compensation for employees who performed work that was not related to the Programs, excessive compensation, and ineligible bonus payments, as follows.

Payments to Employees for Work at a Related Entity

According to the RCM, costs reported on the CFR for a particular special education program should be directly related to that program. However, Newmeadow inappropriately charged salary expenses to the Programs for employees who worked on behalf of a related entity, Educational Models Inc.

Newmeadow uses software offered by Educational Models Inc., a corporation owned and operated by the founder and former executive director of Newmeadow. This software is used by teachers to track and report student progress and development. According to an agreement between Newmeadow and Educational Models, Newmeadow may use software

offered by Educational Models free of monetary charge. In exchange, Newmeadow provides the environment, including staff time, program resources, and student data, for the development of various Educational Models products and services.

Newmeadow reported personal service expenses on its CFR for two employees for time spent working on behalf of Educational Models. This work included meetings regarding a patent for the software and meetings with an attorney. Therefore, we concluded that \$2,400, which included \$1,980 in salary expenses allocated to the Programs and \$420 in associated fringe benefits, was ineligible for reimbursement because these expenses were not Program-related.

During the course of our review, we identified an additional reportable matter that Newmeadow should correct in order to be in compliance with SED guidelines. We determined that Newmeadow did not disclose the relationship with Educational Models on its financial statements or the CFR, as required by the RCM. According to the RCM, 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 one of the parties is (or may be) prevented from pursuing its own separate interests. We found that the owner of Educational Models returned to serve as interim executive director of Newmeadow on two separate occasions after his initial retirement in 2007 and served as a consultant to the existing executive director during 2013. In this capacity, he had the opportunity to influence Newmeadow's management and operations and, therefore, the relationship between Newmeadow and Educational Models should have been disclosed.

Bonus Payments

The RCM restricts merit awards (or bonuses) to employees in direct care titles. However, we found that Newmeadow reported \$1,497 in expenses for a bonus and related fringe benefits on its CFR for an employee in a non-direct care position. These expenses, therefore, were not reimbursable.

Other Than Personal Service Costs

We reviewed Newmeadow's OTPS costs reported on its 2013-14 CFR and identified non-reimbursable costs totaling \$8,162. Specifically, we found the following:

- According to the RCM, costs resulting from food for staff, and gifts of any kind are non-reimbursable. We identified \$2,020 in non-reimbursable costs for staff food and gifts that Newmeadow reported on its CFR.
- According to the RCM, costs associated with non-audit services provided by an accounting firm within 365 days of required audit work are not reimbursable. We identified \$6,142 in non-reimbursable expenses that Newmeadow reported on its CFR for non-audit services that were performed by the same CPA firm Newmeadow contracted with for its annual audit. The non-audit services included a review of interim projections and an appeal of an SED rate.

Other Matters

During our audit, we identified procedural and control deficiencies that Newmeadow officials should address to help ensure compliance with the RCM and other SED-prescribed guidance. The deficiencies pertained to inventory record-keeping requirements and conflict of interest disclosures by the board of directors.

Insufficient Inventory Records

The RCM describes specific record-keeping requirements for maintaining adequate inventory records. These records should list: the invoice number; description of the item; make; model; serial number of the item; cost; date of purchase; date retired; the program(s) using the asset; the location; and whether the item was donated.

We determined that Newmeadow's inventory records only accounted for electronic equipment and did not include items such as desks and desk chairs. We further found that the inventory records we reviewed did not contain certain information required by the RCM such as invoice number, cost, date of purchase, or date retired (if applicable). The records also did not consistently contain the make and model or the program using the asset. Additionally, we determined that, for eight of eleven invoices we reviewed, some serial numbers on each of the eight invoices for equipment like notebook computers and monitors were not accounted for on Newmeadow's inventory list.

During our audit testing, we did locate and verify the items in our sample. However, we noted that some items were not in the location indicated on the inventory list. Without maintenance of adequate inventory records, there is a risk that Newmeadow may not be able to sufficiently manage and oversee its assets.

Lack of Conflict of Interest Disclosures by Board of Directors

The RCM states a board of directors should have a written conflict of interest policy. Additionally, the RCM calls for the policy to require each board member to provide full, ongoing disclosure to the institution of any interest the board member and/or his or her family has in any entity with which the board transacts business. The policy must also include a process for identifying and fully disclosing all LTAL relationships and transactions on an ongoing basis.

We determined Newmeadow does have a conflict of interest policy; however, the policy does not include a process for identifying board members' conflicts of interest on an ongoing basis. Consequently, no conflicts of interest were disclosed during our audit scope. We found that, for a portion of our audit scope, a co-founder of Newmeadow served on Newmeadow's board of directors. However, as previously stated in this report, we determined that another co-founder (her husband) was also the owner of a related entity, Educational Models Inc., which had business dealings with Newmeadow. If Newmeadow had a process for identifying board members' conflicts of interest on an ongoing basis, this relationship would have been disclosed.

Recommendations

To SED:

1. Review the disallowances identified by our audit and, if warranted, make the necessary adjustments to Newmeadow's reimbursement rates.
2. Remind Newmeadow officials of the pertinent SED guidelines that relate to the deficiencies we identified.

To Newmeadow:

3. Ensure that costs reported on annual CFRs fully comply with SED's guidelines and requirements.
4. Improve compliance with the RCM by: requiring that all LTAL business relationships be properly reported on the CFR and financial statements; maintaining required inventory records; and developing a process for identifying board members' conflicts of interest on an ongoing basis.

Audit Scope, Objective, and Methodology

We audited the expenses submitted by Newmeadow on its CFR for the fiscal year ended June 30, 2014. The objective of our audit was to determine whether the costs submitted by Newmeadow on its CFR were properly calculated, adequately documented, and allowable under SED's guidelines, including the RCM.

To accomplish our objective and assess internal controls related to our objective, we reviewed Newmeadow's 2013-14 CFR and financial statements. We interviewed Newmeadow officials and staff to obtain an understanding of their financial practices relating to the expenses reported on Newmeadow's CFR. We also interviewed SED officials and obtained an understanding of the CFR, as well as the policies and procedures contained in the RCM and CFR Manual. We reviewed a judgmental sample of Program costs. The sample included selected items only reimbursable under limited circumstances, such as employee bonuses, food, and gifts. To complete our audit work, we reviewed supporting documentation for costs submitted by Newmeadow on its CFR and made a determination of whether the costs complied with and were allowable by the RCM and CFR Manual.

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

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints

members (some of whom have minority voting rights) to certain boards, commissions, and public authorities. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

Reporting Requirements

We provided a draft copy of this report to SED and Newmeadow officials for their review and formal comment. We considered their comments in preparing this report and have included them in their entirety at the end of it. In their responses, officials agreed with our audit recommendations and indicated the actions they will take to address them.

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 where recommendations were not implemented, the reasons why.

Major contributors to this report were Warren Fitzgerald, Brian Krawiecki, Rebecca Tuczynski, Joseph Paduano, and Innocentia Freeman.

We would like to thank SED and Newmeadow management and staff for the courtesies and cooperation extended to our auditors during this review.

Sincerely,

Andrea Inman
Audit Director

cc: Thalia Melendez, Director - Office of Audit Services, SED
Suzanne Bolling, Director of Special Education Fiscal Services, SED

Agency Comments - State Education Department



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

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December 10, 2015

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

Dear Ms. Inman:

The following is the New York State Education Department's (Department) response to the draft audit report, 2015-S-48, Compliance with the Reimbursable Cost Manual: Newmeadow Inc.

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

Recommendation 1: Review the disallowances identified by our audit and, if warranted, make the necessary adjustments to Newmeadow's reimbursement rates.

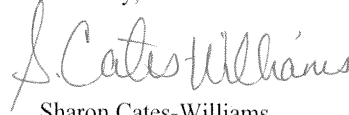
We agree with this recommendation. The Department will review the recommended disallowances as noted in the report and make adjustments to the reported costs to recover any overpayments, as appropriate, by recalculating tuition rates.

Recommendation 2: Remind Newmeadow officials of the pertinent SED guidelines that relate to the deficiencies we identified.

We agree with this recommendation. The Department will continue to provide technical assistance whenever requested and will strongly recommend that Newmeadow 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,

A handwritten signature in cursive script that reads "S. Cates-Williams".

Sharon Cates-Williams

c: James P. DeLorenzo
Suzanne Bolling

Agency Comments - Newmeadow, Inc.



December 1, 2015

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

Dear Ms. Inman:

This letter is written in response to Compliance Audit Report 2015-S-48 conducted by your office. Let me begin by stating that the audit team assigned conducted themselves with utmost professionalism and courtesy throughout the process. They were particularly sensitive to our operations avoiding any hindrance to our ability to serve the children and families who attend our programs.

With regard to audit findings, I offer the following response:

Newmeadow will continue to strive with increasing effort to meet the standards of the Reimbursable Cost Manual. All findings will be evaluated and addressed in that spirit. We will continue to work with the Rate Setting Unit of SED and seek their response to questions and clarifications that may arise throughout the year.

Finally, please note that the reconciliation rates issued for the 2013-14 audit period resulted in costs exceeding adjusted cost screens in one of our programs. Therefore, it is our understanding that the noted disallowance findings allocated to that program will first be netted against the screen.

Thank you for the opportunity to respond.

Sincerely,



Andrew F. McKenzie
Executive Director

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