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

Division of State Government Accountability

Compliance With the Reimbursable Cost Manual

State Education Department
Milestone School for Child Development

Report 2014-S-37

July 2015

Executive Summary

Purpose

To determine whether the costs reported by the Milestone School for Child Development (Milestone) on its Consolidated Fiscal Reports (CFRs) were properly documented, program-related, and allowable pursuant to the State Education Department's (SED) Reimbursable Cost Manual (Manual). The audit included all expenses claimed on Milestone's CFR for the fiscal year 2012-13, and certain expenses claimed on Milestone's CFRs for the two fiscal years ended June 30, 2012.

Background

The Milestone School for Child Development provides full-day preschool special education center-based and integrated programs to disabled children between the ages of three and five years. During the 2012-13 school year, Milestone serviced about 110 students. The New York City Department of Education (DoE) refers students to Milestone based on clinical evaluations and pays for its services using rates established by SED. The rates are based on the financial information that Milestone reports to SED on its annual CFRs. Reimbursable costs must be reasonable, program-appropriate, and properly documented. SED reimburses DoE for a portion of its payments to Milestone based on statutory rates. For the fiscal year ended June 30, 2013, Milestone reported approximately $3.8 million in reimbursable costs for its SED Programs. Our audit scope period focused primarily on fiscal year 2012-13. However, we expanded our review to include certain items claimed on the CFRs for fiscal years 2010-11 and 2011-12.

Key Findings

For the three fiscal years ended June 30, 2013, we identified $801,859 in reported costs that did not comply with Manual requirements and recommend such costs be disallowed. These ineligible costs included $285,455 in personal services costs and $516,404 in other than personal service (OTPS) costs. Among the disallowances we identified were:

- $196,160 in unsupported rent expenses;
- $188,447 in various other unsupported OTPS costs. The expenses in question lacked invoices, contracts, and/or other necessary documentation;
- $149,815 in unsupported fringe benefit costs;
- $105,632 in over-allocated compensation costs for three employees who also worked at Milestone affiliates; and
- $63,310 in OTPS charges that were not actually incurred.

Key Recommendations

To SED:

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

To Milestone:

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

Other Related Audits/Reports of Interest

Bilingual SEIT & Preschool, Inc.: Compliance with the Reimbursable Cost Manual (2011-S-13)
IncludED Educational Services, Inc.: Compliance with the Reimbursable Cost Manual (2010-S-59)

State of New York
Office of the State Comptroller

Division of State Government Accountability

July 17, 2015

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

Mr. Ken Rosenbaum
Executive Director
Milestone School for Child Development
15 Hanover Place
Brooklyn, NY 11201

Dear Ms. Elia and Mr. Rosenbaum:

The Office of the State Comptroller is committed to 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 of our audit of the expenses submitted by the Milestone School for Child Development to the State Education Department for the purposes of establishing the tuition reimbursement rates entitled *Compliance With the Reimbursable Cost Manual*. The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

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

Background

The Milestone School for Child Development (Milestone) is a for-profit organization that provides full-day preschool center-based (code 9100) and integrated (code 9160) special education programs to children ages three through five years. For the purposes of this report, these programs are collectively referred to as the State Education Department (SED) Programs. Based in Brooklyn, New York, Milestone provides these SED Programs to children throughout Brooklyn and neighboring boroughs. During the 2012-13 school year, Milestone served about 110 students.

The New York City Department of Education (DoE) refers students to Milestone based on clinical evaluations and pays for Milestone's services using rates established by SED. The rates are based on the financial information that Milestone reports to SED on its annual Consolidated Fiscal Reports (CFRs). To qualify for reimbursement, Milestone'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 relating to multiple programs. Reimbursable costs must be reasonable, program-appropriate, and properly documented. SED reimburses DoE for a portion of its payments to Milestone based on statutory rates.

Chapter 545 of the Laws of 2013 mandates the State Comptroller audit the expenses reported to SED by special education service providers for preschool children with disabilities. For the fiscal year ended June 30, 2013, Milestone reported approximately $3.8 million in reimbursable costs for its SED Programs. Our audit scope period focused on fiscal year 2012-13; however, we expanded our review to include certain items claimed on the CFRs for fiscal years 2010-11 and 2011-12.

In addition to the center-based and integrated special education programs subject to our audit, Milestone also administered an evaluation program, a 1:1 aide program, and a Federal Individuals with Disabilities in Education (IDEA) Grant. Several Milestone employees also performed services at two Milestone-affiliated entities (Wee Care Child Care and Hanover Place Child Care), which provide day care and a Universal Pre-Kindergarten (UPK) program.

Audit Findings and Recommendations

For the three fiscal years ended June 30, 2013, we identified $801,859 in reported costs that did not comply with the Manual's requirements for reimbursement. The ineligible costs included $285,455 in personal service costs and $516,404 in other than personal service (OTPS) costs (see Exhibit at the end of the report).

Personal Service Costs

According to the Manual, 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 provider's CFR as either direct care costs (e.g., teachers' salaries) or non-direct care costs (e.g., administrators' salaries). During fiscal year 2012-13, Milestone reported about $2.8 million in reimbursable personal service costs. We identified $285,455 in personal service costs that do not comply with the Manual's guidelines for reimbursement, as follows:

Excessive Allocation of Shared Employees' Compensation

According to the Manual, compensation paid to provider employees who do not work solely for the SED Programs must be allocated between all of the programs they work on based on their actual work effort or other allocation methods that are fair and reasonable. This is especially important when a provider operates multiple programs with different funding sources. The allocation methods used must be documented and retained for a minimum of seven years. However, Milestone did not maintain any time and attendance or other records to document the time spent by their shared employees at Milestone or any of its affiliates.

We identified three Milestone employees – the Executive Director (ED), Curriculum Coordinator (CC), and bookkeeper – whose salaries total $235,787 and were over-allocated to the SED Programs. These employees acknowledged that their work time was shared among Milestone and two affiliated entities. In fact, Milestone's ED and CC were listed on the website of Wee Care Child Care as the ED and Assistant Executive Director, respectively. Further, Milestone's ED and bookkeeper were listed as the ED and Financial Director, respectively, of Hanover Place Child Care. Nevertheless, their entire salaries were charged to Milestone's payroll.

Due to the lack of Milestone's own time and attendance records, we used the ratio value method (an allocation method approved by SED) to calculate a fair and reasonable allocation to Milestone for these three employees. This method distributes shared costs by the percentage of a program's operating costs to the total operating costs of the entire agency (or, in this case, the multiple entities these individuals served). As a result, we determined that only $130,155 of the $235,787 in compensation charged to Milestone should have been allocated to SED Programs. We recommend SED recover the $105,632 ($235,787 - $130,155) in over-allocated costs for the three officials.

Ineligible Salary Expenses for Aides

Special education 1:1 aides are funded separately from the preschool special education tuition reimbursement rate. As such, charges for 1:1 aides are ineligible for reimbursement through the SED Programs. The costs for 1:1 aides should be charged to a distinct Program code (9230). However, Milestone officials charged $19,546 for compensation paid to 21 aides on its CFR for the SED Programs. We recommend SED disallow the $19,546 that was improperly charged to the SED Programs.

Unsupported Salary Expenses

The Manual stipulates that reimbursable compensation costs must be based on approved and documented payrolls. Payrolls must be supported by employee time and attendance records, which must be signed by both the employee and his/her supervisor and completed at least monthly.

We identified $10,462 in unsupported compensation costs as follows:

- Milestone officials maintain class rosters of their students, as well as the teachers and aides assigned to the classes. However, for three employees (one teacher and two teacher assistants), Milestone officials did not provide any evidence, such as class rosters/assignments or work product, demonstrating that these three employees worked for the SED Programs during the audit period. Milestone charged $7,992 of their aggregate compensation to the SED Programs.
- For another teacher assistant, Milestone charged the program $9,240 in salary. However, the payroll records for this employee show that she was paid only $6,770. We recommend SED disallow the $2,470 ($9,240 - $6,770) of unsupported charges for this employee.

Unsupported/Ineligible Fringe Benefit Expenses

According to the Manual, costs will be considered for reimbursement if they are reasonable, necessary, directly related to the education program, and sufficiently documented. We identified $149,815 in unsupported or inappropriate fringe benefit costs as follows:

- $78,307 in certain fringe benefit expenses that were already included in gross compensation charges (i.e., the fringe benefit charges were double-counted);
- $40,282 in unsupported fringe benefit costs, including $12,050 in overstated payroll taxes (e.g., FICA) and $16,132 in health insurance premiums without supported billings;
- $24,770 in fringe benefit costs corresponding to our disallowance of the overstated salaries reported above; and
- $6,456 in expenses applicable to prior reporting periods (fiscal years 2006-07 through 2010-11).

Other Than Personal Service Costs

According to the Manual, OTPS costs must be reasonable, necessary, program-related, and supported by sufficient and appropriate documentation. During fiscal year 2012-13, Milestone charged $955,546 in OTPS expenses to the SED Programs. We identified $516,404 of these expenses that did not comply with SED reimbursement requirements.

Overstated Rent Expense

The Manual states that rental agreements, including those for renewals, must be in writing, dated, and signed by both the lessee and the lessor. Rental charges claimed on the CFR must be based on actual rent expenses supported by the lease and payment documentation. Rent security deposits are not reimbursable. Further, according to the Manual, when programs share the same geographic location, property and related costs (e.g., utilities, repairs and maintenance, leases) must be allocated between all of the programs utilizing the common space and resources. The Consolidated Fiscal Reporting and Claiming Manual (CFR Manual) recommends that providers use the "square footage" methodology for the allocation of these costs.

For the three years ended June 30, 2013, Milestone reported $1,335,574 in rent expenses applicable to the SED Programs. However, based on Milestone's lease agreements and subsequent amendments, and by applying the square footage methodology, we determined that Milestone should have paid only $1,139,414 during the period. This includes $912,713 in lease payments and $226,701 for its proportional share (59.7 percent) of real estate taxes. Thus, we recommend SED recover the $196,160 ($1,335,574 - $1,139,414) in excessive lease costs charged to the SED Programs.

Unsupported Expenses

According to the Manual, reimbursable OTPS expenses must be supported by sufficient and appropriate documentation, such as purchase orders, invoices, and receiving documents. We identified $188,447 in unsupported expenses, as follows:

- $104,809 in unsupported charges, including $26,422 in telephone expenses paid to Verizon Wireless, IT Builder, Time Warner Cable, and others. No vendor invoices or contracts were provided to support these payments;
- $51,712 in depreciation expenses for leasehold improvements without any supporting documentation regarding the related projects, when made, where, or at what cost; and
- $31,926 in American Express charges with no documentation (i.e., invoices) to support the vendor billing statements. Thus, we could not determine whether these charges (including payments for AOL on-line services, purchases from Home Depot and Amazon, and Sirius satellite service) were program-related, as otherwise required.

Duplicate Payments and Voided Checks

We identified $63,310 in expenses that Milestone reported on its CFR, but did not actually incur. Specifically, these ineligible charges included:

- $32,142 in voided checks that were not corrected on Milestone's general ledger, and thus, the check amounts were included on the CFR. Among the voided checks were $15,211 for general insurance and $12,864 for utilities; and
- $31,168 for certain other expenses, including $23,483 in duplicate payments for utilities and $4,892 offset by grants for staff development.

Other Ineligible Expenses

We identified expenses totaling $68,487 that are specifically ineligible for reimbursement based on the Manual. The ineligible costs included:

- $27,018 in charges relating to prior periods, including payments to a pension consultant, a wall climbing training session, and repairs and maintenance;
- $12,991 in charges for expenses unrelated to the SED Programs;
- $10,508 in charges for entertainment, food, and gifts;
- $10,105 in unsupported vehicle expenses, which included $8,608 for auto insurance. Milestone officials did not maintain the required vehicle logs or any other documentation to support the program-related use of these vehicles. In addition, they informed us that the vehicles were in fact used for commuting; and
- $7,865 for interest and penalties paid on a Milestone line of credit with no SED Program-related need, and miscellaneous ineligible expenses.

Recommendations

To SED:

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

2. Work with Milestone officials to help ensure their compliance with Manual provisions.

To Milestone:

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

Audit Scope and Methodology

We audited the costs reported on Milestone's CFRs to determine whether they were properly documented, program-related, and allowable pursuant to SED's Manual. The audit included all claimed expenses for fiscal year 2012-13, and certain expenses claimed on Milestone's CFRs for the two fiscal years ended June 30, 2012.

To accomplish our objectives, we reviewed the Manual and the CFR Manual, Milestone's CFRs, and relevant financial records for the audit period. We also interviewed Milestone officials, staff, and independent auditors to obtain an understanding of their financial and business practices. In addition, we assessed a sample of reported costs to determine whether they were supported, program-appropriate, and reimbursable. Our review of Milestone's internal controls focused on the controls over Milestone's CFR preparation process.

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

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

Authority

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

Reporting Requirements

We provided draft copies of this report to SED and Milestone officials for their review and formal comment. Their comments were considered in preparing this final report and are attached to the end of the report. In their response, SED officials agreed with our recommendations and indicated that they would take certain actions to address them.

Milestone officials, however, disagreed with our report's findings, and our rejoinders to certain

Milestone comments are included in the report's State Comptroller's Comments. Milestone officials also included a lengthy set of attachments with their response. Those attachments are not included in this report. However, they have been retained on file at the Office of the State Comptroller.

Within 90 days 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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Vision

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

Exhibit

Milestone School for Child Development
Summary of Reported, Disallowed, and Allowed Costs
for the 2010-2011, 2011-2012, and 2012-2013 Fiscal Years

Program Costs	Amount Per CFR	Amount Disallowed	Amount Allowed	Notes To Exhibit
Personal Services				
Direct	$8,150,277	$187,441	$7,962,836	
Agency Admin	$833,245	$98,014	$735,231	
Total - Personal Services	**$8,983,522**	**$285,455**	**$8,698,067**	A,F,H
Other Than Personal Services				
Direct	$1,368,672	$335,588	$1,033,084	
Agency Admin	$727,081	$180,816	$546,265	
Total - Other Than Personal Services	**$2,095,753**	**$516,404**	**$1,579,349**	A,B,C,D,E,G
Total Program Costs	**$11,079,275**	**$801,859**	**$10,277,416**	

Notes to Exhibit

The following Notes refer to specific sections of SED's Reimbursable Cost Manual 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 Milestone officials during the course of our audit.

A. Section II - Costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the education program, and are sufficiently documented.
B. Section II.20.B - All personal expenses, such as gift certificates to staff and vendors, flowers or parties for staff are not reimbursable unless specified otherwise in this Manual.
C. Section II.22.C - Costs of food provided to any staff including lunchroom monitors are not reimbursable.
D. Section II.41.A - Rental agreements, including renewals, must be in writing, dated, and signed by the lessee and the lessor.
E. Section II.41.B.2 - Occupancy costs must be based on actual documented rental charges and supported by bills, vouchers, etc.
F. Section III.1.A - Compensation costs must be based on approved and documented payrolls.
G. 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.
H. 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.

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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June 1, 2015

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

Dear Mr. Patone:

The following is the New York State Education Department's (SED) response to the draft audit report, 2014-S-37, of the State Education Department: Milestone School for Child Development (Milestone).

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; however, it should be noted that on March 26, 2015 Milestone notified SED of its planned voluntary closure.

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

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

Recommendation 2: Work with Milestone officials to help ensure their compliance with Manual provisions.

We agree with this recommendation. SED will continue to provide technical assistance if requested, and will encourage Milestone officials to seek our counsel regarding Reimbursable Cost Manual standards for the remaining cost reports it submits to SED.

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

Sincerely,

S. Cates-Williams

Sharon Cates-Williams

c: James P. DeLorenzo
Suzanne Bolling

Agency Comments - Milestone School

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June 5, 2015

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

Frank Patone, Audit Director
State of New York Office of the State Comptroller
123 William Street, 21st Floor
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Re: Milestone School for Child Development, Inc.
Your Draft Audit Report # 2014-S-37

Dear Mr. Patone:

This letter is in response to your draft audit report with respect to your audit of Milestone School for Child Development, Inc. ("Milestone").

At the outset, we wish to raise several preliminary points regarding your draft report. First, Milestone does not agree that your office has authority to conduct the audit at issue under the New York State Constitution, as interpreted by the New York Court of Appeals in *Blue Cross & Blue Shield of Cent. N.Y. v McCall*, 89 N.Y.2d 160 (1996), *New York Charter Schools v. DiNapoli*, 13 N.Y.3d 120 (2009) and *Handler v. DiNapoli*, 23 N.Y.3d 239 (2014). Milestone's cooperation with your audit, its prior responses to your preliminary reports and this response do not waive any of its rights to challenge your office's authority to conduct this audit or any decision to act upon it, and Milestone expressly reserves all rights to do so.

* Comment 1

Second, Milestone objects to your listing of Reports 2011-S-13 and 2010-S-59 as "Other Related Audits/Report of Interest" in the Executive Summary of your report. Those two reports involved highly publicized findings of fraud by your office. Your draft report has not made any findings of fraud or other wrongdoing on Milestone's part. Your proposed disallowances all result from differences in interpretation as to what the Reimbursable Cost Manual ("RCM") promulgated by the New York State Education Department ("SED") requires. There is nothing

* Comment 2

*See State Comptroller's Comments, page 22.

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

"related" or similar between your draft findings with respect to Milestone and your findings in those two reports. Accordingly, your references to those two other reports as "Other Related Audits/Reports of Interest" should be deleted from your report, as they create a false and prejudicial impression that similar findings have been made with respect to Milestone. There are many other reports you could have referred to which, unlike those two reports, are similar to this one, as they involve disagreements over what the RCM requires, not fraud by the audited provider.

Third, your report is both legally and factually inaccurate. In several areas throughout your report you make conclusory statements about what the governing SED Manuals purportedly require or preclude without any citation to any specific provision. You also state your allegations as purported "fact", without addressing Milestone's positions and evidence presented in response to your prior preliminary reports.

* Comment 3

Fourth, we also object to use of derogatory language like "excessive" allocation of compensation, "overstated" rent expenses and "unsupported" expenses. This language is unnecessary and inaccurate and creates a misleading impression. The rent was not overstated, no excessive allocation of compensation was made, and no expenses were unsupported.

* Comment 4

We now will address certain of the specific cost disallowances proposed in your draft report.

Allocation of Shared Employees' Compensation

Milestone disagrees with your proposed disallowances of "excessive" shared employees' compensation and requests that they be deleted from your final report. The allocations of such compensation to Milestone not only were not "excessive"; they were very conservative.

Your draft report states that these three owner employees' "entire salaries were charged to Milestone's payroll." That is inaccurate. The CFR incorrectly reported these three employees as 1.0 FTE. However, as was shown to your auditors, they in fact were paid as 0.77 FTE for the Executive Director, 0.57 FTE for the Curriculum Coordinator and 0.34 FTE for the Bookkeeper/Administrator. In other words, Milestone paid the Executive Director 77%, or $143,000, of an Executive Director's allowable salary of $186,293; it paid the Curriculum Coordinator 57%, or $74,570.16, of a Curriculum Coordinator's allowable salary of $132,000; and it paid the Bookkeeper/Administrator 34%, or $51,007.92, of a Bookkeeper/Administrator's total allowable salary of $150,000.

* Comment 5

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ATTORNEYS-AT-LAW

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This allocation was based upon each of these owner-employee's knowledge of how his or her time was spent. It was supported by ample documentation reflecting the work that each of these persons did. The reason that Milestone work required more of their time than work for the other entities was that Milestone had more operational issues, involving more space, more equipment and more coordination among different types of direct care workers, which required more executive attention. Also, Wee Care Child Care and Hannover Place Child Care, unlike Milestone, had non-owner directors managing their day-to-day operations, so that these three owner-employees did not need to be involved in day-to-day operational issues.

* Comment 6

The reasons that no payment of salary from other entities was reflected in the ledgers for 2012-13 was that, on advice of their accountant, that year their compensation from Hannover Place Child Care was paid to them in the form of an owner's distribution, rather than as salary. These owner-employees were paid salary by Hannover Place Child Care in other years. The form of the compensation they received from Hannover Place Child Care makes no difference to the validity of the allocation to Milestone. They received no compensation from Wee Care Child Care because they did not spend substantial time on work for it.

* Comment 7

The allocations made by Milestone are allowed by the RCM. Section III, Subsection IB, Time Distribution, which states that "if hours of service cannot be calculated on a time study cannot be performed, then alternative methods that are equitable have not and conform to generally accepted accounting principles may be utilized" to allocate salary and fringe benefits for staff who work in multiple programs. In this case, the owner-executives at issue, like most owner-executives, did not keep time records of exactly how much time they spent on work for each respective company at various times throughout each day, as it would have been burdensome to do so and was not required. Accordingly, hours of service cannot be calculated, and time studies cannot be completed. However, they were aware of how their time was spent proportionally, and the allocations were made based on that knowledge. The allocations made are equitable; they were made by owner-employees with direct knowledge of what they did, with an intent to understate, if anything, the proportionate time spent on Milestone work in order to be conservative. Moreover, they are supported by substantial documentation reflecting much of the work done. The allocation also conforms to generally accepted accounting principles. Your draft report does not and cannot suggest otherwise. For these reasons, these proposed disallowances should be deleted from your final report.

* Comment 8

* Comment 9

The Rent Expense

Milestone disagrees without your proposed disallowances of the "overstated" rent expense and requests that you delete them from your final report. The rent expense is based on accurate, well-documented allocations of the total rent based on the "square footage" methodology recommended (although not required) by the RCM and is not "overstated" at all.

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

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While the draft report does not explain your calculation of the rent and why it is different from Milestone's, it is our understanding that the reason that your calculation is different is that you have not included the third floor of 15 Hannover Place, which was used exclusively by Milestone. There is no factual basis to exclude that space from the calculation. As was explained to you, this space was added by a separate amendment document, dated June 20, 2002, but which did not commence until July 1, 2004, after the then-tenant's lease of the third floor expired. A copy of that lease amendment was provided to your auditors, and another copy is submitted with this letter as Attachment 1.

* Comment 10

While your draft report does not mention the amendment, we are advised that during the audit you questioned the *bona fides* of the amendment. Both Milestone and the landlord confirmed to your auditors during the audit that this lease amendment was considered to be effective by all parties and was fully performed after the commencement date on July 1, 2004. Payment records confirm that the rent for the third floor of 15 Hannover Place required by the amendment document in fact was paid after that date.

Milestone also provided you with a calculation of the allocation of rent, based upon a room by room analysis of which company used which space in both 15 Hannover Place and 283 Livingston Street. That analysis reflected that 59.7% of the overall space was used by Milestone. Accordingly, 59.7% of the rent and taxes were allocated to Milestone, which was appropriate. A copy of that calculation is attached to this letter as Attachment 2. A copy of floor plans, Department of Health permit approvals and letters documenting measurements taken by Milestone supporting the numbers used in the calculation, which also were given to the auditors, are attached to this letter as Attachment 3. This documentation fully supports Milestone's allocation.

* Comment 11

Your preliminary report does not identify anything that you contend is wrong with Milestone's calculation, much less provide any explanation of why you think anything in that calculation is wrong. Milestone's calculation is correct and fully in accordance with the RCM, and you have stated no facts, and there are no facts, supporting your apparent position to the contrary.

* Comment 12

We are advised that during the audit, your auditors took the position that the leases should have been modified every time the use of space by Milestone and Hannover Place Child Care changed to reflect such change. If that is what your position is based on, with all due respect your position is incorrect. The RCM does not require that, and there is no reason why a lease of space from a landlord by one entity for use by itself and an affiliated entity should address which entity will use which space at all. Simply stated, there is no reason why the landlord would care about that or would require, or even allow, terms in the lease about that. All the landlord cares is that the party contracting with the landlord be responsible to the landlord for

* Comments 12, 13

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payment of the rent for the whole space and that any restrictions on the overall allowed use of the space be observed. The landlord does not care how other parties using the space in permitted ways allocate use of the space or rent responsibility among themselves. Milestone has provided documentation and other evidence demonstrating which entity in fact used which space during the audited years. Your report does not cite any evidence contradicting that, and there is no such evidence. Accordingly, your proposed disallowances should be deleted.

The Other Proposed Disallowances

The other proposed disallowances in your draft report were fully addressed in Milestone's prior responses to your prior preliminary reports. Milestone continues to believe that most of your proposed disallowances are incorrect and requests that they too be deleted from your final report. Milestone refers you to its prior responses to your preliminary reports for the reasons why those proposed disallowances are incorrect.

* Comment 14

Conclusion

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

Very truly yours,

Frederick J. Berman

Frederick J. Berman

FJB:jp
Enclosures

State Comptroller's Comments

1. The State Comptroller's legal authority to audit the State Education Department is expressly cited on page 10 of the report.
2. Our report neither asserts nor implies that the findings derived through our audit of the costs submitted by Milestone were the same as the findings detailed in the Other Related Audits/Reports of Interest (or vice versa).
3. We maintain that our report is both factually and legally correct. As prescribed by the Reimbursable Cost Manual (Manual), the regulatory references for our findings are detailed in the report's Notes to Exhibit. Further, we did not ignore any evidence or information provided by Milestone. As such, we maintain that evidence obtained during the audit provides a reasonable basis for our findings and conclusions.
4. We use the terms "excessive" and "overstated" to mean more than the proper amount. It does not indicate explicitly or implicitly whether or not any discrepancy was deliberate. We use the term "unsupported" to mean that documentation to support charges to the audited programs was not available or provided to us.
5. The only salaries received by the Executive Director, Curriculum Coordinator, and Bookkeeper/Administrator were reported on Milestone's CFR. Milestone did not provide any supporting documentation, including documentation of the methodology that was purportedly used to determine the FTEs.
6. The owner-employee's "knowledge of how his or her time was spent" does not meet the Manual's documentation requirements, nor does it constitute a fair and reasonable salary allocation method consistent with the provisions of the Manual. In fact, as noted in our report, Milestone lacked a formal detailed allocation methodology. Moreover, as also noted in our report, we used the ratio value method (as prescribed by the Manual when actual time records are not available) to properly allocate the personal service costs in question and determine any amounts that should be disallowed.
7. As noted in the report, the Executive Director and Bookkeeper/Administrator and Curriculum Coordinator shared their work time between Milestone and two other related entities. However, Milestone had no documentation of their time spent working for each of the related entities and no documented allocation methodology. Thus, we used the ratio value method recommended by the Manual to allocate the salaries when no other documentation was provided.
8. The Milestone School and its legal representative misquote the Manual.
9. We used the ratio value method to allocate the compensation of the individuals in question because Milestone was unable to document the amounts of time the employees worked for the various programs to which they were assigned. As previously noted, the ratio value method is the method prescribed by the Manual under such circumstances, which existed at Milestone. Milestone's allocations, in fact, were not "supported by substantial documentation." Also see comment #7.
10. Milestone's "understanding" is wrong. In fact, we included the third floor of 15 Hanover Place in our calculations of allocable rent. Our rent calculations were provided to Milestone officials.
11. We allowed the rent expenses supported by the Milestone Lease Agreements and

Amendments provided to us. We also allowed 59.7 percent of the associated real estate taxes for the building. Furthermore, the copies of floor plans, permit approvals, and letters with floor measurements do not demonstrate that Milestone correctly calculated the allocations of rent expenses and real estate taxes claimed on its CFRs.

12. We computed the rent disallowances using the Milestone Lease Agreements and their amendments. The disallowances represented the amounts claimed in excess of the amounts otherwise allowable per the information provided by these documents.
13. The assertion is wrong. In fact, we did not take the position that leases should have been modified every time the use of space by Milestone and Hanover Place Child Care changed.
14. We maintain that the other proposed disallowances are correct. The Manual requires that costs reported for reimbursement be reasonable, necessary, directly related to the program, and sufficiently documented. Further, we discussed all of our audit disallowances with the provider during several meetings, including a formal closing conference, and provided Milestone with ample opportunity to submit adequate documentation to enable us to determine whether the costs in question were reimbursable. As detailed in the report, the costs in question were ineligible for reimbursement.