



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
North Country Kids, Inc.**



Report 2016-S-53

April 2017

Executive Summary

Purpose

To determine whether the costs reported by North County Kids, Inc. (North Country) on its Consolidated Fiscal Reports (CFRs) were properly calculated, adequately documented, and allowable under the State Education Department's (SED) guidelines, including the Reimbursable Cost Manual (RCM). The audit covered expenses reported on North Country's CFR for the fiscal year ended June 30, 2014, and certain expenses reported on North Country's CFR for the fiscal year ended June 30, 2013.

Background

North Country is an SED-approved, for-profit special education provider located in Clinton County, New York. North Country provides preschool special education services to children with disabilities who are between three and five years of age. North Country is reimbursed for preschool special education services through rates set by SED. The reimbursement rates are based on financial information, including costs, that North Country reports to SED on its annual CFR. To be eligible for reimbursement, reported costs must comply with the RCM requirements. For the two fiscal years ended June 30, 2014, North Country reported \$2.6 million in reimbursable costs on its CFRs for the rate-based preschool special education programs (Programs) it operated.

Key Findings

For the two years ended June 30, 2014, we identified \$79,084 in ineligible costs that North Country reported on its CFRs for the Programs. The ineligible costs included:

- \$69,272 in other than personal service costs, which consisted of \$54,694 in less-than-arm's-length lease expenses, \$5,791 in non-reimbursable interest expense, \$5,580 in ineligible life insurance expenses, and \$3,207 in other non-reimbursable expenses that included food, gifts, charitable donations, and expenses that lacked sufficient documentation; and
- \$9,812 in personal service costs, which consisted of \$8,579 in ineligible bonuses and \$1,233 in incorrectly allocated salary and fringe benefit costs.

Key Recommendations

To SED:

- Review the disallowances identified by our audit and, if warranted, make the necessary adjustments to the costs reported on North Country's CFRs and to North Country's tuition reimbursement rates.
- Remind North Country officials of the pertinent SED requirements that relate to the deficiencies we identified.

To North Country:

- Ensure that costs reported on annual CFRs fully comply with SED's requirements, and communicate with SED to obtain clarification as needed.

Other Related Audits/Reports of Interest

[HTA of New York, Inc.: Compliance With the Reimbursable Cost Manual \(2016-S-36\)](#)

[Jowonio, Inc.: Compliance With the Reimbursable Cost Manual \(2016-S-48\)](#)

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

Division of State Government Accountability

April 13, 2017

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

Ms. Stephanie Girard
Executive Director
North Country Kids, Inc.
22 New York Road
Plattsburgh, NY 12903

Dear Ms. Elia and Ms. Girard:

The Office of the State Comptroller is committed to helping State agencies, public authorities, and local government agencies manage government resources efficiently and effectively and, by so doing, providing accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of State agencies, public authorities, and local government agencies, as well as their compliance with relevant statutes and their observance of good business practices. 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 costs submitted by North Country Kids, Inc. to the State Education Department for the purpose of establishing the preschool special education tuition reimbursement rates used to bill public funding sources that are supported by State aid payments, 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; 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 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

North Country Kids, Inc. (North Country) is a for-profit organization that provides various educational services in Clinton, Essex, and Franklin counties in northern New York. North Country is authorized by the State Education Department (SED) to provide, among other programs, preschool special education services to children with disabilities who are between three and five years of age. During the audit period, North Country provided the following rate-based preschool special education programs to 152 students: Preschool Special Class – over 2.5 hours per day; Preschool Integrated Special Class – over 2.5 hours per day; and Preschool Special Education Itinerant Teacher (SEIT) services (collectively referred to as the Programs).

The counties that use North Country's preschool special education services pay tuition to North Country using reimbursement rates set by SED. The State, in turn, reimburses the counties 59.5 percent of the tuition that counties pay. SED sets the special education tuition rates based on financial information, including costs, reported by North Country on the annual Consolidated Fiscal Reports (CFRs) that it submits to 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 must meet the reporting requirements prescribed in the Consolidated Fiscal Reporting and Claiming Manual (CFR Manual). For the two fiscal years ended June 30, 2014, North Country reported about \$2.6 million in reimbursable costs for the Programs on its CFRs.

Audit Findings and Recommendations

According to the RCM, costs reported on the CFR are considered for reimbursement if they are reasonable, necessary, directly related to the special education program, and adequately documented. For the two fiscal years ended June 30, 2014, we identified \$79,084 in costs that North Country reported on its CFRs that did not comply with the RCM's requirements for reimbursement. The ineligible costs included \$69,272 in other than personal service (OTPS) costs and \$9,812 in personal service costs. In certain instances, some of the ineligible costs were previously identified by SED, which we noted in the report.

Other Than Personal Service Costs

For the two years ended June 30, 2014, we identified \$69,272 in OTPS costs that were not eligible for reimbursement. The ineligible costs included \$54,694 in less-than-arm's-length (LTAL) building lease expenses that exceeded the owner's actual costs; \$5,791 in non-reimbursable interest expense related to late CFR submissions; \$5,580 in ineligible life insurance expenses; and \$3,207 for other non-reimbursable expenses that included food, gifts, charitable donations, and expenses that lacked sufficient supporting documentation.

Lease Costs

According to the RCM, costs for real property LTAL transactions are reimbursed based on the owner's actual cost or fair market value, whichever is less. For the two years ended June 30, 2014, North Country reported property costs that included \$54,694 in LTAL transactions that exceeded the owner's actual costs. Therefore, the \$54,694 in reported costs were not reimbursable.

North Country leased property from Come Learn with Me (CLWM), a related party. On its 2013-2014 CFR, North Country reported lease costs paid to CLWM in the amount of \$59,314. However, we determined the owner's actual costs totaled \$42,623, resulting in reported costs that exceeded the owner's actual costs by \$16,691. On its 2012-2013 CFR, North Country reported lease costs paid to CLWM in the amount of \$86,367. However, we determined the owner's actual costs totaled \$48,364, resulting in reported costs that exceeded the owner's actual costs by \$38,003. Together, the non-reimbursable expenses totaled \$54,694 (\$16,691 + \$38,003). SED previously identified a portion of these costs as ineligible for reimbursement.

Working Capital Interest

The CFR Manual requires providers to submit CFRs no later than 120 days after the end of the reporting period, or no later than 150 days after the end of the reporting period with a pre-approved 30-day extension request. For July–June filers, such as North Country, the due date is November 1 and the extended due date is December 1. According to the RCM, interest expense on working capital loans is not reimbursable if the CFR is not submitted within 90 days after the appropriate due date.

North Country submitted its 2013-2014 CFR on April 10, 2015, which was 160 days after the November 1 due date. For the 2012-2013 program year, North Country requested and received a 30-day extension until December 1. However, North Country submitted the CFR on May 7, 2014, 157 days after the extended due date. In both cases, the CFR was submitted more than 90 days after the appropriate due date. Consequently, we determined \$5,791 in working capital interest was ineligible for reimbursement for the two years ended June 30, 2014. SED previously identified a portion of these costs as ineligible for reimbursement.

Ineligible Life Insurance Costs

According to the RCM, the cost of insurance on the lives of owners, officers, or employees is not reimbursable if the school is identified as a beneficiary on the policy. For the two years ended June 30, 2014, North Country reported \$5,580 in life insurance costs that were ineligible for reimbursement because North Country was listed as the beneficiary.

Other Ineligible Costs

According to the RCM, costs for gifts, charitable donations, and food are not reimbursable. Also, costs reported on the CFR are considered for reimbursement if they are adequately documented. We identified \$3,207 in costs that were ineligible for reimbursement because they were not in compliance with these RCM requirements. SED previously identified a portion of these costs as ineligible for reimbursement. The ineligible costs included:

- \$1,171 for gifts;
- \$812 for charitable donations;
- \$696 for food; and
- \$528 for maintenance services that did not have sufficient supporting documentation.

Personal Service Costs

For the two years ended June 30, 2014, we identified \$9,812 in personal service costs that were not eligible for reimbursement. The ineligible costs included \$8,579 in bonuses and \$1,233 in salary and fringe benefits that were directly charged to the SEIT program instead of being allocated among all programs, as required.

Bonuses

According to the RCM, bonus compensation is restricted to direct care employees and may not exceed three-and-one-half percent of the employee's base salary. North Country reported \$8,579 in non-reimbursable bonuses on its CFRs, as follows: \$8,436 in bonuses (\$7,700 in bonuses and \$736 in associated fringe benefits) for ineligible non-direct care staff and \$143 in bonuses (\$130 in bonuses and \$13 in associated fringe benefits) that exceeded three-and-one-half percent of the base salary of the direct care employees who received them.

Allocation of Housekeeping and Maintenance Salaries

According to the CFR Manual, costs should be directly charged to the programs they relate to. If costs cannot be directly charged, then providers must use allocation methods that are fair and reasonable. North Country allocated housekeeping and maintenance salary costs directly to each of its programs using a fair and reasonable allocation method, based on the actual space (square footage) used by each program, and assuming the assignments of square footage to programs were appropriate and accurate. However, North Country erroneously assigned square footage to its SEIT program under the methodology, even though that particular program did not have any program-specific space dedicated to it. As a result, North Country reported \$1,233 in excess housekeeping and maintenance salary costs (\$1,024 in salary and \$209 in associated fringe benefits) on its CFR.

Recommendations

To SED:

1. Review the disallowances identified by our audit and, if warranted, make the necessary adjustments to the costs reported on North Country's CFRs and to North Country's tuition reimbursement rates.
2. Remind North Country officials of the pertinent SED requirements that relate to the deficiencies we identified.

To North Country:

3. Ensure that costs reported on annual CFRs fully comply with SED's requirements, and communicate with SED to obtain clarification as needed.

Audit Scope, Objective, and Methodology

We audited the costs that North Country reported on its CFR for the year ended June 30, 2014, and certain costs reported on its CFR for the fiscal year ended June 30, 2013. The objective of our audit was to determine whether the reported costs were allowable, properly calculated, and adequately documented in accordance with applicable SED requirements.

To accomplish our objective and assess internal controls related to our objective, we reviewed the RCM that applied to the years we examined, as well as the CFR Manual and its related appendices. We became familiar with North Country's internal controls as they related to costs it reported on the CFR. We also interviewed personnel to obtain an understanding of the practices for reporting costs on the CFR. We reviewed North Country's CFR for the fiscal year ended June 30, 2014 and relevant financial records for the audit period. We obtained accounting records and supporting information to assess whether certain costs claimed by North Country on the CFR that were considered high risk and reimbursable in limited circumstances, such as LTAL transactions and

bonuses, were allowable, properly calculated, and adequately documented. Based on exceptions found in our initial review, we expanded our review to include certain costs reported for the fiscal year ended June 30, 2013.

We conducted our performance audit in accordance with generally accepted government auditing standards. Those 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 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 functions do not affect our ability to conduct independent audits of program performance.

Authority

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

Reporting Requirements

We provided a draft copy of this report to SED and North Country officials for their review and formal comment. We considered their comments in preparing this report and attached them in their entirety to it. In their responses, SED and North Country officials agreed with the audit recommendations and indicated the actions they will take to address them. Our rejoinder to certain North Country comments that pertain to SED adjustments to LTAL lease transactions is included in the report's State Comptroller's Comment.

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.

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

**North Country Kids, Inc.
Schedule of Submitted and Disallowed Program Costs
for the Two Years Ended June 30, 2014**

Program Costs	Amount per CFR	Amount Disallowed	Amount Remaining	Notes to Exhibit
Personal Services	\$2,257,486	\$9,812	\$2,247,674	A-C
Other Than Personal Services	370,027	69,272	300,755	D-J
Total Program Costs	\$2,627,513	\$79,084	\$2,548,429	

Notes to Exhibit

The following Notes refer to specific sections of the RCM and CFR Manual that we used as a basis for 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 North Country officials during the course of the audit.

- A. RCM Section II.13.A.(10): A merit award may be reimbursed if it is based on merit, as measured and supported by employee performance evaluations and does not exceed three and a half percent of the base salary of the direct care employee who is receiving the merit award. In addition, merit awards are restricted to direct care titles/employees as defined by the Reimbursable Cost Manual's Appendix A-1 and those in the 100 job code series as defined by the Consolidated Fiscal Report's Appendix R.
- B. RCM Section III.1.M.(1)(i): Any expenditures that cannot be charged directly to a specific program must be allocated across all programs and/or entities benefited by the expenditure. For example, salaries of employees who perform tasks for more than one program and/or entity must be allocated among all programs and/or entities for which they work.
- C. CFR Manual Appendix J: Expenses such as food, transportation, supplies and material, staff travel and training, etc. which cannot be directly charged to a specific program or State Agency must be allocated across all such entities deriving benefits.
- D. RCM 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.
- E. RCM Section II.28.D.(3): Working capital interest will be reimbursed on a prorated basis if submitted within 90 days of the respective CFR due date. Otherwise, it is non-reimbursable.
- F. RCM Section II.27.C: Costs of insurance on the lives of owners, officers or employees when the entity is identified as the beneficiary are not reimbursable. Costs to insure against the loss of key personnel are not reimbursable.
- G. RCM Section II.22.C: Costs of food provided to any staff, including lunchroom monitors, are not reimbursable.
- H. RCM Section II.24: Gifts of any kind are non-reimbursable.
- I. RCM Section II.16: Political and charitable contributions and donations made by the program are not reimbursable.
- J. RCM Section II: Costs are considered for reimbursement if they are reasonable, necessary, directly related to the special education program, and adequately documented.

Agency Comments - State Education Department



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

DEPUTY COMMISSIONER
Office of Performance Improvement and Management Services
O: 518.473-4706
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March 31, 2017

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, 2016-S-53, Compliance with the Reimbursable Cost Manual: North Country Kids, Inc. (North Country).

Recommendation 1: Review the disallowances identified by our audit and, if warranted, make the necessary adjustments to the costs reported on North Country's CFRs and to North Country's tuition reimbursement rates.

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

Recommendation 2: Remind North Country officials of the pertinent SED requirements that relate to the deficiencies we identified.

We agree with this recommendation. SED will continue to provide technical assistance whenever requested and will strongly recommend the North Country officials take advantage of our availability to help them better understand the standards for reimbursement as presented in Regulation and the Reimbursable Cost Manual (RCM). Furthermore, Consolidated Fiscal Report (CFR) training is available online on SED's webpage. SED recommends that all individuals signing the CFR certification statements, namely Executive Directors and Certified Public Accountants, complete this training. At the direction of the Board of Regents, the Department intends to require that this training be mandatory and will require individuals to verify that they have completed the training.

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 - North Country Kids, Inc.

North Country Kids, Inc.
22 New York Road
Plattsburgh NY, 12903
518-561-3803

March 29, 2017

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

Re: North Country Kids, Inc. Audit 2016-S-53

Dear Ms. Inman:

Please accept this as the response from North Country Kids, Inc. in reference to the draft audit report of our Consolidated Fiscal Reports (“CFR”) for the two years ended June 30, 2014. We would like to take the opportunity thank the NYS Office of the State Comptroller (“OSC”) for the professionalism extended to our agency through the audit.

In each of the findings we have indicated a response which explains our position.

Other than Personal Service Costs

Lease Costs

OSC Finding: The OSC non-reimbursable costs included in the audit report totaled \$54,694 for lease payments related to less-than-arm’s-length (LTAL) transactions for the two years ended June 30, 2014.

Agency Response: The building was first purchased in 2012. We inquired with a local realtor, at that time, to evaluate the property and provide fair market rental prices in order to prepare a fair and equitable lease to North Country Kids. The lease agreement was submitted to the New York State Education Department for approval. During our approval process and the review of these leases, it was not brought to our attention that the rent could not exceed our expenses. North Country Kids now understands that costs incurred in LTAL lease of real property transactions shall be reimbursed based on owner’s actual cost or fair market value, whichever is less. The

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OSC noted in the report that this cost was previously adjusted in our tuition rate reconciliations by the State Education Department (SED) for the above years and therefore there is no further adjustment required. This has been corrected in future reporting years.

* Comment 1

Working Capital Interest

OSC Finding: OSC determined that \$5,791 in working capital interest for the two years ended June 30, 2014 were ineligible.

Agency Response: North Country Kids understands that interest expense on working capital loans is non-reimbursable if the CFR was not submitted within 90 days after the appropriate due date. There were uncontrollable circumstances which contributed to the lateness of our CFR reports. Due to our geographic location, it remains difficult to find qualified independent CPA firms to audit our financial statements and CFR reports in the CFR timeline. This is primarily due to School District deadlines which are given priority. Our payroll recording in the general ledger is on a one month lag delaying the closing of our books. In addition, the determination of our tuition rates to be promulgated by SED has been delayed in previous years. This impacts our ability to close our financial statements.

Ineligible Life Insurance Costs

OSC Finding: OSC determined that \$5,580 in life insurance costs for the two years ended June 30, 2014 were ineligible.

Agency Response: North Country Kids understands that the reported cost of \$5,580 insurance on the lives of owners/officer or employees when the entity, if identified as the beneficiary, are not reimbursable. North Country Kids is in agreement that this item is ineligible for reimbursement.

*See State Comptroller's Comment, page 17.

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Other Ineligible Costs

OSC Finding: OSC determined that \$3,207 of costs deemed ineligible for reimbursement.

Agency Response: North Country Kids reported \$1,171 which was given as a Christmas bonus for purposes of improving staff retention, \$812 was for charitable donations and \$696 for food purchases. The \$528 was in payment of a maintenance contract which did not have a detailed invoice. OSC indicated that SED previously identified a portion of the costs as ineligible for reimbursement. North Country Kids is in agreement that these items are ineligible for reimbursement.

Personal Service Costs

Bonuses

OSC Finding: The OSC determined that bonuses of \$8,579 were ineligible for reimbursement. The ineligible costs included \$143 in direct care employee bonuses exceeding 3.5% and \$8,436 in non-direct care staff bonuses.

Agency Response: North Country Kids is in agreement that these costs are ineligible for reimbursement.

Allocation of Housekeeping and Maintenance Salaries

OSC Finding: The OSC determined that \$1,233 in excess expenses were reported on the CFR.

Agency Response: North Country Kids is in agreement that \$1,233 for housekeeping and maintenance salary and fringe benefits would have been more appropriately reported as administrative costs on CFR-3

Thank you for the consideration in review of our response. Please contact us directly with any further questions.

Sincerely,

Stephanie Girard
School Administrator, North Country Kids, Inc.

State Comptroller's Comment

1. We modified page 6 of our report to note that SED identified "a portion of" the costs in question as ineligible for reimbursement. Also, we maintain that SED should review the disallowances identified and, if warranted, make the necessary adjustments to the costs reported on the corresponding CFR and to North Country's tuition rates.