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Special education programs fulfill a great need across New York State, providing our youngest citizens with disabilities a quality learning experience that addresses their individual differences and needs. While many private special education providers use public funds conscientiously and in accordance with State rules, there are others that abuse the system and misuse the funding they receive from the State and local governments, resulting in taxpayers paying more than they should for these vital programs.

Over the last decade, my office has found a troubling pattern of mismanagement, waste and even fraud by numerous private providers of preschool special education services. Our audits have uncovered inaccurate and inappropriate self-reported program costs, as well as ineffective program monitoring and oversight. As a result, children needing special education services have been shortchanged by those private providers who have used public funds inappropriately.

The State Legislature responded to these reports of abuse by passing legislation requiring my office to audit the expenses submitted by every provider of preschool special education services to the State Education Department (SED) and to report annually on our findings to the Governor and the Legislature. This is the fourth such annual report.

To improve oversight and management of this essential public program, we’ve coordinated our audit efforts with SED, the New York City Department of Education, the New York State Association of Counties, and the individual counties themselves. We also provide training to county officials and private providers to explain the importance of this initiative and to discuss the steps in the OSC audit process, the findings of our audits, and the need for strong internal controls.

As we continue monitoring the costs for preschool special education services, my office will continue to emphasize the importance of critical internal controls and responsible external oversight.

Thomas P. DiNapoli
State Comptroller
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Executive Summary

The State Education Department (SED) oversees special education programs, which provide services to students with disabilities between the ages of 3 and 21 in New York State. While most school-age students with disabilities in New York receive their educational services from public school districts, preschool special education services are predominantly provided by private providers. SED reports that about 80,000 preschool students with disabilities receive services throughout the State annually from over 300 approved providers at an annual cost of about $1.4 billion to the State and its local governments.

Private special education providers can be for-profit or not-for-profit organizations. SED annually develops rates for preschool special education programs operated by approved providers based on actual costs reported to SED, which must be in compliance with comprehensive instructions and guidelines promulgated by SED.

Since 2004, the Office of the State Comptroller (OSC) has conducted over 100 audits of expenses submitted to SED by preschool special education providers, which focused on compliance with SED cost-reporting guidelines and the accuracy and appropriateness of provider-reported program costs. These audits have cumulatively identified $65 million in cost savings. In addition, they have resulted in 13 arrests and nine guilty pleas for illegal activities, as well as $17.85 million in court-ordered restitution. Audits found patterns of providers seeking reimbursement for unsupported expenditures, expenses claimed for other programs, personal expenses included with program expenses, no-show jobs, and increased costs associated with less-than-arm’s-length transactions.

In June 2012, Comptroller DiNapoli announced a special education audit initiative, which involved a broader, sector-wide perspective. He also proposed legislation to improve the oversight of public funding for preschool special education providers.

As a result, Chapter 545 of the Laws of 2013 was signed into law on December 18, 2013. The law requires the State Comptroller to audit the expenses reported to SED by every program provider of special education services for preschool children with disabilities, subject to the funding made available by the Legislature for such purpose. The law also requires the Comptroller to report annually to the Governor and the Legislature regarding the audits conducted during the preceding 12 months.

In 2017, OSC completed 23 audits of expenses submitted to SED by preschool special education providers. These audits identified over $12.5 million in recommended disallowances. An additional audit was engaged in 2017; however, the provider closed abruptly during the course of the audit. As such, OSC was unable to complete the normal audit process.
These audits indicate that there continue to be serious errors in cost reporting by the preschool special education providers to SED. Disallowed expenses range from claimed costs for services provided directly to children to administrative functions.

Section 200.18 of the Regulations of the Commissioner of Education was amended in 2016 to make clear that SED shall review final audit reports, which shall be used to establish tuition rates based on audit to the extent the Commissioner determines that the audit findings and recommended disallowances contained therein are warranted and consistent with applicable laws, regulations and guidelines.
Overview

Background

The State Education Department (SED) oversees special education programs, which provide services to students with disabilities between the ages of 3 and 21 in New York State. Based on the individual needs of students with disabilities, school districts arrange for student services, which can be provided by public entities or private special education providers. While most school age students with disabilities in New York receive their educational services from public school districts, preschool special education services are predominantly provided by private providers.

SED reports that about 80,000 preschool students with disabilities receive services throughout the State annually from over 300 approved providers. Eligible students may receive related services only, services of a Special Education Itinerant Teacher (SEIT), or be placed in a special class program for either a half day or a full day, including integrated programs for students without disabilities when appropriate. New York’s system allows for the provision of related and SEIT services within general education preschool and/or day care environments, as well as in the child’s home. Special Class Integrated Setting (SCIS) programs offer full or part-time special class services in an early childhood program setting with typically developing peers.

Private special education providers can be for-profit or not-for-profit organizations. These providers must be approved by SED to deliver special education services to children in New York. SED annually develops rates for preschool special education programs operated by approved providers based on actual costs reported to SED. These rates are used to reimburse providers for eligible costs, which must be in compliance with comprehensive instructions and guidelines set forth in SED’s Consolidated Fiscal Reporting and Claiming Manual (CFR Manual) and its Reimbursable Cost Manual (RCM).

The cost of these services is substantial. SED reports that about $1.4 billion is spent annually by the State and its local governments on services for preschool special education. Since 2004, the Office of the State Comptroller (OSC) has conducted over 100 audits of expenses submitted to SED by preschool special education providers, which focused on compliance with SED cost-reporting guidelines and the accuracy and appropriateness of provider-reported program costs. These audits have cumulatively identified $65 million in cost savings. In addition, they have resulted in 13 arrests and nine guilty pleas for illegal activities, as well as $17.85 million in court-ordered restitution. Audits found patterns of providers seeking reimbursement for unsupported expenditures, expenses claimed for other programs, personal expenses included with program expenses, no-show jobs, and increased costs associated with less-than-arm’s-length transactions. OSC concluded that stopping fraudulent, wasteful and abusive practices by these providers required a more comprehensive approach.
In June 2012, Comptroller DiNapoli announced a special education audit initiative, which involved a broader, sector-wide perspective as well as multiple concurrent individual audits, better coordination with SED and the New York City Department of Education (DOE), input from various interested parties, use of data analysis and risk analysis, and use of fraud and forensic auditing techniques. Comptroller DiNapoli also proposed legislation to improve the oversight of public funding for preschool special education providers.

**Chapter 545 Legislation**

Chapter 545 of the Laws of 2013 was signed into law on December 18, 2013. Under the law, the State Comptroller is required to audit the expenses reported to SED by every program provider of special education services for preschool children with disabilities, “within such funds as are made available for such purpose.” The statute requires the State Comptroller to “inform and advise the Governor and the Legislature in December of each year regarding its audits of expenses reported to the department by program providers of special education services for preschool children with disabilities conducted during the preceding twelve months and regarding any other pertinent information the comptroller deems appropriate.” This report fulfills the statutory reporting requirement under Chapter 545 for 2017.

Chapter 545 also directed SED to conduct a comprehensive study of alternative systems of reimbursement methodologies and monitoring protocols for the tuition and maintenance components of preschool special education services. SED submitted its study on December 18, 2014.

Based on the study’s recommendations, Chapter 56 of the Laws of 2015 amended Section 4410 of the Education Law by adding a new provision as follows: “Notwithstanding any other provision of law, rule or regulation to the contrary, on or before the two thousand sixteen – two thousand seventeen school year and thereafter, to be phased-in over no more than four years from such starting year, the commissioner, subject to the approval of the director of the budget, shall establish regional tuition rates for special education itinerant services based on average actual costs in accordance with a methodology established pursuant to subdivision four of section forty-four hundred five of this article.”

SED has also enacted amendments to the Regulations of the Commissioner of Education that strengthened other aspects of the preschool special education program. These are discussed later in this report.
OSC Initiative Activities

As required by Section 4410-c of the Education Law, OSC developed a risk assessment process to prioritize the preschool special education audits to be undertaken in accordance with the initiative. The process includes performing ongoing analysis of the data reported to SED by providers on their annual Consolidated Fiscal Reports (CFRs) to identify high-risk indicators. These indicators are used to assist auditors with the identification of high-risk expenses and the development of a comprehensive audit plan for the initiative.

OSC established an internal workgroup that performs ongoing analysis to continually assess risk of the data and expenses reported to SED and the other agencies that require providers to file an annual CFR. The workgroup has identified a number of risk factors and applied them to multiple data sources. The workgroup assesses its methods against prior and current work to validate the model's effectiveness.

OSC developed standard audit protocols and a detailed audit template to ensure consistency in the preschool special education audits. OSC also established procedures to refer any findings of fraud, abuse or other conduct constituting a crime identified during an audit to its own internal investigations unit as well as to external agencies with appropriate legal jurisdiction. OSC incorporated these procedures into specialized training provided to all staff involved in the audit initiative.

OSC has continued to provide training for preschool special education providers. As part of this training, providers have been given information on the steps in the OSC audit process, beginning with the issuance of an engagement letter through the release of a final report. The training also addresses the State’s expectations with respect to documentation of reimbursable costs. During 2017, OSC received one request to present at a training session (sponsored by the Alliance for Children) for 150 individuals from the preschool special education community.

OSC has collaborated with SED, the New York City DOE, the counties, the New York State Association of Counties and other external groups to provide regular updates on OSC implementation activities. To facilitate this collaboration, OSC has established a dedicated electronic mailbox to communicate with and provide guidance and information to external stakeholders. The mailbox is also used as a platform to coordinate efforts in auditing preschool special education services and programs.
SED has supported measures to remove disincentives for municipalities to audit preschool special education programs by increasing the share of overpayments that may be recovered by a municipality conducting a fiscal audit of such services or programs for which it bears fiscal responsibility and proportionally reducing the State’s share of such disallowed funds. Chapter 57 of the Laws of 2013 included provisions which authorize a municipality to retain 100 percent of any recoveries identified by its audits.

The New York City DOE and the counties of Monroe, Onondaga and Suffolk conduct their own fiscal audits of local preschool special education programs delivering services within their jurisdictions and have completed approximately 33 audits to date cumulatively.

**Collaboration with Other State Agencies**

During 2017, OSC continued to partner successfully with various outside law enforcement agencies to investigate and prosecute the theft of public funds intended for special needs students. This year marked the culmination of a four-year investigation with the Queens County District Attorney’s Office into four individuals associated with the now-defunct Island Child Development Center for diverting more than $12 million in special education funding to relatives, their for-profit businesses and personal expenses, including jewelry, a wedding and home renovation. OSC commenced an examination of Island Child in 2012, which revealed highly suspect expenditures and the apparent misuse of public funds. OSC partnered with the Queens District Attorney to investigate the fraud jointly. The investigation found that the four individuals had stolen millions in State funds. All four have pleaded guilty this year to various felony charges, including grand larceny in the first degree and identity theft. Three of the four were sentenced to jail time and all four were ordered to pay back almost $8.5 million.
In 2017, OSC completed 23 audits of expenses submitted to SED by preschool special education providers. These audits have cumulatively identified over $12.5 million in recommended disallowances, or about 3 percent of the total claimed expenses of $454 million for the audit period. There are currently approximately 15 audits in progress. An additional audit was engaged in 2017; however, the provider closed abruptly during the course of the audit. As such, OSC was unable to complete the normal audit process.

Disallowed expenses range from claimed costs for services provided directly to children to administrative functions. In the past, OSC’s audits of expenses submitted to SED by certain special education providers identified widespread mismanagement and blatant misuse of public funds intended for the education of children with disabilities, as well as outright fraud.

The audits completed in 2017 indicate that there continue to be serious errors in cost reporting by the preschool special education providers to SED. The number of findings in certain categories continues to be of concern, in particular errors related to the allocation and/or the inappropriate claiming of personal service expenses and other-than-personal-services (OTPS) expenses claimed from other programs.

The 2017 audit findings can be summarized as follows:

**Expenses Claimed from Other Programs** – Private special education providers can offer more than preschool special educational services to their students. For instance, providers may also offer evaluation services, day care services or early intervention services. However, payments for services under these types of programs are based on fixed fees for services, as opposed to reported costs on the CFR.

Revenues, expenses (including personal services and OTPS), staffing, enrollment and shared costs are all self-reported within the CFR schedules in the aggregate and allocated to each program administered by the provider. CFRs can become further complicated when shared costs are allocated to programs reimbursed by different State agencies. The CFR Manual and RCM explain in detail how these allocations are to be made and reported on the CFR.

OSC audits completed and issued in 2017 identified over $5.3 million (or 42.4 percent of total disallowances) in expenses from other programs charged to the preschool programs. The costs claimed from other programs include both payroll-related expenses and OTPS expenses:

- **Allocation of Payroll Expenses** – The RCM requires salaries of employees who perform tasks for more than one program to be allocated among all programs for which they work. Furthermore, entities must maintain appropriate documentation reflecting the hours used in this allocation.
Fifteen of the 23 audits identified over $4.2 million in payroll costs from other programs charged to the preschool programs, which is significantly higher than amounts reported in prior years.

- **OTPS Expenses** – SED guidelines require that any expenditure that cannot be charged directly to a specific program be allocated across all programs and/or entities that benefit from the expenditure (e.g., general maintenance and overhead expenses). The RCM requires providers to maintain documentation of the methodologies used to allocate costs to the various programs which they operate. Over half of the audits completed and issued in 2017 (15 out of 23) identified problems related to the allocation of OTPS costs and/or the inappropriate claiming of expenses from other programs. The dollar amount of these findings totaled about $1.1 million, a substantial increase from prior years.

**Personal Service-Related Findings** – In addition to the allocation of payroll expenses from other programs previously noted, OSC audits completed and issued in 2017 identified about $4.2 million of unsupported or ineligible payroll-related expenses:

- **Unsupported or ineligible payroll expenses** – SED requires providers to base employee compensation on approved and documented payrolls, which are supported by time and attendance records for all employees. Also, Section 200.9 of the Regulations of the Commissioner of Education (Regulations) states that providers shall maintain adequate records to document direct and/or indirect service hours provided, as well as time spent on all other activities related to each student served. Nine out of 23 audits found issues with the maintenance of payroll and time distribution documentation as required by the RCM. Although the number of payroll-related problems reported in 2017 is slightly lower than those reported in 2016, the dollar amount increased from $1.9 million to over $2.8 million.

- **Unsupported bonuses** – SED requires that salary bonuses be based on merit and supported by performance evaluations to be eligible for reimbursement. Nine of the 23 audits found evidence of claimed bonuses that were not in compliance with the RCM. Similar to the payroll expense problems noted above, the number of bonus-related problems reported in 2017 is slightly lower than those reported in 2016, but the dollar amount of the findings increased from about $600,000 to almost $1.1 million.
Other Than Personal Services (OTPS)-Related Findings – 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 properly documented. In addition, expenses of a personal nature are not reimbursable. OSC audits completed and issued in 2017 identified almost $3 million in unsupported or ineligible OTPS-related expenses:

- **Unsupported/Ineligible Costs** – In nearly all of the audited programs (19 out of 23), there were findings of ineligible expenses, which were either not program-related or not supported by adequate documentation. The findings increased in dollar value from about $1.1 million in 2016 to over $1.6 million reported this year. This includes $347,000 for claimed costs related to staff food and entertainment, which was an increase in such claimed costs from two prior periods ($165,600 in 2015 and $138,000 in 2016).

- **Consultant Services** – The RCM provides extensive guidance on the use of consultants, the proper claiming of costs for their services, and related supporting documentation requirements. The RCM requires that the selection of consultant services must be done at a minimum of every five years through a competitive bid process. In addition, the consultant services cannot be used for services that could have been performed by a properly certified school officer or an employee who possesses the necessary technical skills. Over half of the audits (12 out of 23) noted recommended disallowances for consultant services. The 2017 audits found an increase in the number of problems reported in 2016, as well as an increase in the dollar amount of the findings from about $695,000 to about $757,000 in 2017.

- **Vehicle-Related Expenses** – SED allows for the reimbursement of vehicle costs as long as vehicle usage is program-related and documented in logs, which include dates, times, purposes, destinations, mileage and names of persons using the vehicles. Six out of 23 of the audits identified recommended disallowances of vehicle-related expenses, which were inadequately documented or otherwise ineligible for reimbursement—a slight decrease from the number of problems reported in 2016.

- **Penalties, Interest, Fines and Late Fees** – The RCM expressly states that fines, penalties, late fees, and certain forms of interest are not reimbursable. The RCM further states that costs resulting from violations of, or from failures to comply with federal, State, and/or local laws and regulations are not reimbursable. In 2017, 10 of the 23 audits noted recommended disallowances for non-reimbursable penalties, interest, fines and late fees—a slight decrease from the number of problems reported in 2016.
Incorrect Allocation of Costs – SED also requires providers to classify correctly costs as either direct care costs (those associated with the provision of instruction and related services to students) and non-direct care costs (those attributable to the general administration of a program and/or the operation and maintenance of a program’s facilities). Six of the 23 audits identified issues related to allocation of costs between direct and non-direct care, about the same number of problems noted in 2016. However, the dollar amount of the findings increased in 2017.

Errors in Account Methodologies Used for Depreciation, Amortization and Accruals – SED guidelines permit reimbursement of the depreciation of capital assets and the amortization of financing costs over the useful life of the assets. Four out of 23 audits found inappropriate expensing of such costs—a decrease in the number of problems reported in 2016. The dollar amount of the audit findings also decreased.

Undisclosed Less-Than-Arm’s-Length (LTAL) Transactions – SED requires special education providers to disclose all less-than-arm’s-length (LTAL) transactions in their CFRs and in the notes to their audited financial statements. In brief, a LTAL relationship exists when there are related parties and one party can control or significantly influence the business decisions of another party due to the nature of their personal relationships (e.g., spouses who conduct business with each other). Disclosure of such relationships is necessary to help ensure the propriety of costs for reimbursement purposes. Similar to last year, three out of 26 audits identified LTAL transactions, which were not disclosed as required. Additionally, two audits identified significant problems with reported costs related to LTAL business transactions, even though the relationships were disclosed on the CFRs.

In 17 of the 23 audits conducted in 2017, the providers were overseen by boards of directors. OSC audits reported that two providers did not disclose related-party transactions with vendors who served on their respective boards of directors on the CFRs as required.

Lack of Due Diligence by Certified Public Accountants – As part of the CFR submission process, each provider is required to have an independent certified public accountant (CPA) express an opinion on its financial statements and certify that its CFR is prepared in accordance with SED guidelines. The purpose of the certification is to ensure that the CFR data is reported consistently and can be relied upon for the rate-setting process. OSC audits completed in 2017 continue to find numerous errors in costs reported in CFRs that can be attributed to a lack of due diligence by CPAs hired by special education providers. Examples include: instances of claimed expenses for other programs included with preschool special education costs reported on CFRs; LTAL transactions; errors in allocation methodologies; and errors in accounting methodologies used for depreciation, amortization, and accruals.
The following graph presents some of the more common findings and their corresponding rates of occurrence, as identified in our reports in 2017.

Patterns of Inappropriate Claimed Expenses for Special Education Services in New York State

- Errors in Accounting Methodologies: 17%
- Incorrect Allocation of Costs: 26%
- Unsupported/Ineligible Vehicle Expenses: 26%
- Unsupported Bonuses: 39%
- Unsupported/Ineligible Payroll Expenses: 39%
- Penalties, Interest, Fines, Fees: 43%
- OTPS Expenses - Other Programs: 52%
- Unsupported/Ineligible Consultant Services: 52%
- Payroll Expenses - Other Programs: 65%
- Unsupported/Ineligible Costs: 83%
Special Education Program Audits Completed and Issued in 2017

ACDS, Inc., (ACDS) (2016-S-76) is a not-for-profit organization located in Plainview, New York, that provides a range of educational services, including preschool special education services to children with disabilities from birth to five years of age. For the fiscal year ended June 30, 2014, ACDS reported $4,752,257 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $30,104 in OTPS costs that did not comply with SED’s requirements for reimbursement, including:

- $13,845 for costs from other ACDS programs that were either improperly allocated or not eligible for reimbursement;
- $8,919 in insufficiently documented vehicle costs; and
- $6,139 in improperly allocated and ineligible administration costs.

Adirondack Helping Hands, Inc. (Adirondack) (2016-S-88) is a for-profit organization located in Plattsburgh, New York, that provides a range of educational services, including preschool special education services to children with disabilities who are between the ages of three and five years. For the fiscal year ended June 30, 2014, Adirondack reported $1,103,535 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $37,643 in costs that did not comply with SED’s requirements for reimbursement, including:

- $22,215 in OTPS costs that were not eligible for reimbursement; and
- $15,428 in excess salary expenses for the two owners of Adirondack who also worked at a related entity.

The OSC audit determined Adirondack did not disclose payments made to two employees who were family members of the owners as LTAL transactions on its CFR, as required.

Advanced Therapeutic Concepts, Inc. (ATC) (2016-S-42) is a for-profit organization located in Spring Valley, New York, that provides a range of educational services, including preschool special education services to children with disabilities who are between the ages of three and five years. For the three fiscal years ended June 30, 2015, ATC reported $5,513,912 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $181,938 in costs that did not comply with SED’s requirements for reimbursement, including:

- $70,992 for computer software costs not supported by sufficient documentation, such as original invoices or canceled checks;
$53,569 in health insurance reimbursements for which there was no support that employees actually incurred such costs;

$31,535 for compensation costs paid to nine teachers at a higher per-session rate than stated in their contracts; and

$25,842 for various OTPS costs that were ineligible and/or insufficiently documented.

**Birch Family Services, Inc. (Birch) (2016-S-74)** is a not-for-profit organization located in New York City that provides a range of educational services, including preschool special education services to children with disabilities who are between the ages of three and five years. For the two fiscal years ended June 30, 2013, Birch reported $52,067,664 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $1,376,319 in costs that did not comply with SED’s requirements for reimbursement, including:

- $833,498 for compensation costs paid to employees who worked for other Birch programs including a training institute, a job coaching program and a related fundraising entity;
- $310,778 for incorrectly allocated OTPS costs including property-related costs; and
- $88,266 in insufficiently documented costs, including rent expenses, staff reimbursements and legal expenses.

**Books and Rattles, Inc. (Books and Rattles) (2016-S-25)** is a for-profit organization located in New York City that provides a range of educational services, including preschool special education services to children with disabilities who are between the ages of three and five years. For the two fiscal years ended June 30, 2013, Books and Rattles reported $9,666,952 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $242,357 in costs that did not comply with SED’s requirements for reimbursement, including:

- $60,690 for unsupported employee compensation expenses;
- $57,097 for unsupported vehicle expenses;
- $39,226 in unsupported expenses such as supplies, maintenance, and services;
- $39,027 in over-allocated compensation costs for 10 shared employees who work for a related private day care company; and
- $28,076 in expenses that were ineligible for reimbursement including fines and late fees, personal phone services for family members, and food and gifts for staff.
**Brookville Center for Children’s Services, Inc. (Brookville) (2016-S-75)** is a not-for-profit organization based in Nassau County that provides a range of educational services, including preschool special education to children with disabilities who are between the ages of three and five years. For the three fiscal years ended June 30, 2014, Brookville reported $72,221,558 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $1,089,215 in costs that did not comply with SED’s requirements for reimbursement, including:

- $305,207 in administrative costs that were allocated to the cost-based programs for eight Brookville employees. The services performed by these employees should have been provided by AHRC under the terms of the Management Agreement (see further explanation below);
- $273,100 in ineligible management fees reported as OTPS costs;
- $240,673 in lease expenses including costs attributable to excessive space allocations; and
- $234,291 in ineligible and/or insufficiently documented fringe benefit expenses.

On June 21, 2010, Brookville entered into a Management Agreement with NYSARC, Inc. – Nassau County Chapter (AHRC). The Management Agreement required AHRC to provide Brookville with certain administrative and executive management services. AHRC was also responsible for providing financial services connected with Brookville’s operations. For the three-year period ended June 30, 2014, Brookville claimed $4.5 million in costs related to the Management Agreement. Additionally, Brookville reported the Management Agreement with AHRC as a related-party transaction on its CFR for the fiscal year ended June 30, 2014.

**Building Blocks Developmental Preschool, Inc. (Building Blocks) (2017-S-1)** is a not-for-profit organization located in Commack, New York, that provides a range of educational services, including preschool special education services to children with disabilities who are between the ages of three and five years. For the three fiscal years ended June 30, 2015, Building Blocks reported $16,274,363 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $56,966 in OTPS costs that did not comply with SED’s requirements for reimbursement, including:

- $43,916 in lease costs for an unapproved program site; and
- $9,157 in improperly allocated administrative lease costs.
East River Child Development Center (East River) (2016-S-3) is a not-for-profit organization located in New York City that provides a range of educational services, including preschool special education services to children with disabilities who are between the ages of three and five years. For the fiscal year ended June 30, 2014, ERCDC reported $4,885,165 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $350,246 in costs that did not comply with SED’s requirements for reimbursement, including:

- $116,508 in retirement plan payments for certain employees that were not proportionally similar to benefits for general East River staff;
- $89,940 in excessive compensation costs for East River’s comptroller;
- $52,266 for unsupported employee compensation expenses; and
- $43,025 in compensation costs charged for employees of another East River program.

Elmcrest Children’s Center, Inc. (Elmcrest) (2016-S-62) is a not-for-profit organization located in Syracuse, New York, that provides a range of educational services, including preschool special education services to children with disabilities who are between the ages of three and five years. For the fiscal year ended June 30, 2014, Elmcrest reported $1,985,672 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $54,250 in costs that did not comply with SED’s requirements for reimbursement, including:

- $16,578 in understated revenues that should have been offset against the program costs;
- $16,468 for staff bonuses and fringe benefits that were not based on merit; and
- $12,911 in improperly allocated personal service and OTPS costs.

The OSC audit also determined Elmcrest did not disclose on its CFR, as required, related-party transactions with two vendors who served on its Board of Directors.

Ganrormic, Inc. (Ganrormic) (2016-S-58) is a for-profit organization located in Orchard Park, New York, that provides a range of special education programs, including preschool special education services to children with disabilities who are between the ages of three and five years. For the fiscal year ended June 30, 2014, Ganrormic reported $1,261,290 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $4,854 in OTPS costs that did not comply with SED’s requirements for reimbursement, including $2,773 for professional services over-allocated from other programs.
The OSC audit also questioned the appropriateness of $14,431 Ganrormic charged to the preschool special education programs for professional services not obtained through the competitive procurement process.

**Hagedorn Little Village School (Hagedorn) (2017-S-4)** is a not-for-profit organization located in Seaford, New York, that provides special education services to children with disabilities from birth to five years of age. For the fiscal year ended June 30, 2015, Hagedorn reported $6,285,225 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $10,040 in OTPS costs that did not comply with SED’s requirements for reimbursement, including $5,627 in costs related to other Hagedorn programs and $3,071 in fundraising-related costs.

**Hawthorne Foundation, Inc. (Hawthorne) (2017-S-3)** is a not-for-profit organization located in Hawthorne, New York, that provides a range of services for individuals with developmental disabilities, including preschool special education services to children with disabilities who are between the ages of three and five years. For the fiscal year ended June 30, 2015, Hawthorne reported $2,809,691 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $75,189 in costs that did not comply with SED’s requirements for reimbursement, including:

- $56,619 in personal service costs for insufficiently documented staff time;
- $11,419 in expensed equipment that was not properly capitalized and depreciated; and
- $4,483 in OTPS costs from other programs that were incorrectly allocated to the preschool program.

The OSC audit also determined Hawthorne did not disclose on its CFR, as required, related-party transactions with three individuals. The three individuals included: the former Hawthorne chief executive officer who provided consulting services; the Secretary of the Board of Directors, whose law firm was paid for legal services; and Hawthorne’s chief financial officer, who also served as treasurer of Hawthorne’s Board.

**HeartShare Human Services, Inc. (HeartShare) (2016-S-45)** is a not-for-profit organization located in New York City that provides a range of services for individuals with developmental disabilities, including preschool special education services to children with disabilities who are between the ages of three and five years. For the three fiscal years ended June 30, 2014, HeartShare reported $37,986,229 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $1,529,789 in costs that did not comply with SED’s requirements for reimbursement, including:
$891,018 in personal service costs for compensation paid to 71 individuals who worked for other HeartShare programs, including residential and family support services programs, and evaluation programs;

$204,855 in ineligible bonuses, including bonuses paid to non-direct care staff, including the Executive Director, Assistant Executive Director, and Chief Financial Officer; and

$140,899 in OTPS costs that were over-allocated to the preschool cost-based programs.

Kennedy Child Study Center (Kennedy) (2017-S-7) is a not-for-profit organization located in New York City that provides a range of educational programs and services, including preschool special education services to children with disabilities who are between the ages of three and five years. For the three fiscal years ended June 30, 2014, Kennedy reported $41,743,538 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $612,781 in costs that did not comply with SED’s requirements for reimbursement, including:

$583,400 in excessive compensation costs for six psychologists over-allocated to the preschool cost-based programs; and

$32,134 in ineligible OTPS expenses, including $13,116 for charitable donations and $9,741 for parking garage costs for the Executive Director’s privately owned vehicle.

Lifeline Center for Child Development, Inc. (Lifeline) (2016-S-95) is a not-for-profit organization located in Queens Village, New York, that provides a range of educational programs and services, including preschool special education services to children with disabilities who are between the ages of three and five years. For the three fiscal years ended June 30, 2015, Lifeline reported $9,826,821 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $304,192 in costs that did not comply with SED’s requirements for reimbursement, including:

$80,506 for staff bonuses including payments to employees who were not eligible to receive bonuses, payments that exceeded the 3.5 percent limit set by SED, and payments that were not supported by performance evaluations;

$75,569 for property-related expenses incorrectly allocated to the preschool cost-based program;

$53,742 in staffing costs that exceeded the SED-approved staff-to-student ratio;

$31,313 for ineligible expenses, including taxi fares to transport parents and children to Lifeline for evaluation services and food and gifts for staff; and

$24,337 in compensation costs paid to Lifeline’s plant manager incorrectly allocated to the preschool cost-based program.
Lois Bronz Children’s Center, Inc. (Bronz) (2016-S-86) is a not-for-profit organization located in White Plains, New York, that provides a range of educational programs and services, including preschool special education services to children with disabilities who are between the ages of three and five years. For the two fiscal years ended June 30, 2014, Bronz reported $2,522,822 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $177,786 in costs that did not comply with SED’s requirements for reimbursement, including:

- $164,502 of offsetting revenue that was not include in the calculation of the tuition rate of the integrated program;
- $7,958 for staff bonuses not based on merit; and
- $5,326 in OTPS costs not eligible for reimbursement, including food for staff.

New York League for Early Learning, Inc. (NYL) 2015-S-43 is a not-for-profit organization located in New York City that provides a range of educational programs and services, including preschool special education services to children with disabilities who are between the ages of three and five years. For the three fiscal years ended June 30, 2014, NYL reported $138,242,983 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $5,771,008 in costs that did not comply with SED’s requirements for reimbursement, including:

- $1,728,270 in duplicate administrative compensation costs for the Executive Director, Assistant Executive Director and seven agency administrative staff that were also covered under a management agreement (see further explanation below);
- $1,209,263 for compensation paid to 347 employees who worked in other programs;
- $801,660 in unsupported/ineligible costs including contracted services, staff food, vehicle expenses, bonuses, and executive retirement plans that were claimed as part of a management fee;
- $738,901 for employee bonuses that were not based on merit or supported by employee performance evaluations;
- $331,235 in contracted services and food for students that were recorded as adjusting entries on the general ledger, but for which no other supporting documentation was provided; and
- $270,879 for property costs allocated from other programs.
During the three fiscal years ended June 30, 2014, NYL was an associate of the eight-member Young Adult Institute Network (Network), which also included the Young Adult Institute (YAI). The relationships among Network members were intertwined. During the same period, NYL was a signatory to a management agreement with YAI, wherein YAI agreed to provide management services to NYL for a total of about $13.8 million in fees, which were included on the corresponding CFRs. In November 2015, after the start of audit fieldwork, the agreement with YAI was terminated.

North Country Kids, Inc. (North Country) 2016-S-53 is a for-profit organization located in Plattsburgh, New York, that provides a range of educational programs and services, including preschool special education services to children with disabilities who are between the ages of three and five years. For the fiscal year ended June 30, 2014, North Country reported $2,627,513 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $79,084 in costs that did not comply with SED’s requirements for reimbursement, including:

- $54,694 in LTAL lease transactions that exceed the owner’s actual costs;
- $8,579 in bonuses to ineligible non-direct care staff; and
- $5,791 in work capital interest that was ineligible for reimbursement because North Country submitted two consecutive CFRs more than 90 days after the appropriate due dates.

Spotted Zebra Learning Center, Inc. (Spotted Zebra) (2016-S-81) is a for-profit organization located in Albany, New York, that provides special education services to children with disabilities from birth to five years of age. For the three fiscal years ended June 30, 2014, Spotted Zebra reported $2,541,981 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $13,058 in OTPS costs that did not comply with SED’s requirements for reimbursement, including $7,779 in working capital interest that was not eligible for reimbursement, and $4,683 for staff food and gifts.

The Child Study Center of New York (CSC) (2017-S-13) is a not-for-profit organization located in Jericho, New York, that provides a range of educational programs and services, including preschool special education services to children with disabilities who are between the ages of three and five years. For the fiscal year ended June 30, 2014, CSC reported $5,947,563 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $127,101 in costs that did not comply with SED’s requirements for reimbursement, including:

- $121,255 in employee fringe benefit costs incorrectly allocated to the rate-based preschool programs; and
- $5,846 in OTPS costs including food, personal travel and gifts.
The New Interdisciplinary School (NIS) (2017-S-20) is a not-for-profit organization located in Yaphank, New York, that provides a range of educational programs and services, including preschool special education services to children with disabilities who are between the ages of three and five years. For the two fiscal years ended June 30, 2015, NIS reported $11,563,647 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $119,752 in costs that did not comply with SED’s requirements for reimbursement, including:

- $83,192 in personal service costs, including $76,277 in salaries and fringe benefit costs that were incorrectly allocated to the rate-based preschool programs; and
- $36,560 in OTPS costs including unsupported consulting costs and ineligible auditing fees.

Therapy and Learning Center, Inc. (TLC) (2016-S-44) is a not-for-profit organization located in Brooklyn, New York, that provides preschool special education services to children with disabilities who are between the ages of three and five years. For the three fiscal years ended June 30, 2014, TLC reported $12,936,983 in reimbursable costs for its special education programs. The OSC audit recommended disallowances of $276,453 that did not comply with SED’s requirements for reimbursement, including:

- $87,178 in consultant costs that were either not itemized, or did not detail the dates and hours of services provided;
- $51,733 in overstated fringe benefit expenses;
- $51,707 in personal services costs charged from a fixed-fee program; and
- $36,525 in OTPS expenses allocated from TLC’s former Early Intervention program.

Variety Child Learning Center (Variety) (2016-S-77) is a not-for-profit organization located in Syosset, New York, that provides a range of special education services and programs to children with disabilities from birth to eight years of age. For the fiscal year ended June 30, 2014, Variety reported $9,356,352 in reimbursable costs for its preschool special education programs. The OSC audit recommended disallowances of $6,719 in OTPS costs that did not comply with SED’s requirements for reimbursement, including $6,313 in non-reimbursable advertising costs.
State Education Department

SED has reviewed OSC’s recommended disallowances, made adjustments to reimbursable costs, recalculated tuition rates as appropriate and recovered any overpayments resulting from such recalculations. SED continues to take actions to strengthen the fiscal oversight and accountability of preschool special education providers, including the following:

Special Education Financial Advisory Workgroup – The New York State Board of Regents created a Special Education Financial Advisory Workgroup to allow all interested stakeholders to provide input on the current tuition rate-setting structure for special education services and programs, and to discuss recommendations to maximize the efficient and effective use of State and local resources. SED reports that in September, October and November of 2017, a subcommittee of this workgroup met to discuss changes to the Special Class Integrated Setting (SCIS) rate-setting methodology, which is an alternative methodology required pursuant to Chapter 59 of the Laws of 2017. SED officials state that their objectives for developing a new SCIS methodology are to:

- Expand and preserve opportunities for preschool students with disabilities to be enrolled in early childhood programs with their typically developing peers;
- Promote early childhood program inclusion principles – bring the support services to the child rather than moving the child to the services;
- Remove incentives to over-enroll preschool students with disabilities in order to remain fiscally viable;
- Maintain program quality standards among all providers; and
- Provide transparency and predictability in funding at levels adequate to achieve desired program objectives.

Required CFR Training – Beginning with the submission of CFRs for the 2012-13 school year, SED encouraged all individuals signing the CFR certification statements (namely Executive Directors and CPAs) to complete training in CFR reporting requirements. This training is required of preschool providers upon approval and reapproval, and SED is tracking and verifying the individuals who have completed the required training. According to information provided by SED, for the 2017-year web-based training, 28 unique users participated in the training (watching a total of 172 videos).
Revised SED Regulations – In 2016, SED amended the Regulations of the Commissioner relating to preschool providers to clarify, consistent with State law, the locations where SCIS may be provided and to ensure preschool students enrolled in special classes receive the related services in their Individualized Education Program (a written statement of the educational program designed to meet a child’s individual needs) in conjunction with their special class programs. In addition, the regulations enhanced program standards for the instruction of preschool students with disabilities relating to: instruction toward the Prekindergarten Foundation for the Common Core; literacy instruction; progress monitoring; engagement of parents; make up of missed services; and use of positive behavioral supports.

Section 200.18 of the Regulations of the Commissioner was amended to make clear that SED shall review final audit reports, which shall be used to establish tuition rates based on audit to the extent the Commissioner determines that the audit findings and recommended disallowances contained therein are warranted and consistent with applicable laws, regulations and guidelines. Further, after consideration of the final audit by the Commissioner, tuition rates based on audit shall then be established by the Commissioner and become final after certification by the Director of the Budget.
As New York continues to find ways to strengthen its oversight of preschool special education programs, State policy makers must continue to encourage all stakeholders to commit long-term to making this important sector of the State’s education system work more efficiently and effectively. Accordingly, this Office will continue to take a leadership role in emphasizing the importance of responsible external oversight.
## Appendix A
### 2017 OSC Special Education Program Audits

<table>
<thead>
<tr>
<th>Provider/Audit Name</th>
<th>County</th>
<th>Audited Program Costs Reported on CFR</th>
<th>Number of Years in Scope</th>
<th>Total Disallowance</th>
</tr>
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<tbody>
<tr>
<td>ACDS, Inc.</td>
<td>Nassau</td>
<td>$4,752,257</td>
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<td>$30,104</td>
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<tr>
<td>Adirondack Helping Hands, Inc.</td>
<td>Clinton</td>
<td>$1,103,535</td>
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<td>Advanced Therapeutic Concepts, Inc.</td>
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<td>$9,666,952</td>
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<td>Brookville Center for Children's Services, Inc.</td>
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<td>$72,221,558</td>
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<td>Building Blocks Developmental Preschool, Inc.</td>
<td>Suffolk</td>
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<tr>
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<td>HeartShare Human Services, Inc.</td>
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<td>$9,356,352</td>
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<tr>
<td><strong>Total</strong></td>
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<td><strong>$12,526,844</strong></td>
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