ALAN G. HEVESI
COMPTROLLER

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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

October 31, 2005

Mr. Richard P. Mills
Commissioner
State Education Department
State Education Building - Room 125
89 Washington Avenue
Albany, NY 12234

Mr. Michael Gordon
Executive Director
Manhattan Center for Early Learning
328 East 62nd Street
New York, NY 10021

Re: Compliance with Reimbursable Cost Manual for Year Ended June 30, 2002
Report 2004-S-14

Dear Mr. Mills and Mr. Gordon:

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, we have audited the costs reported by the Manhattan Center for Early Learning (MCEL) on the Consolidated Fiscal Report (CFR) submitted to the State Education Department (SED) for the establishment of tuition rates for the Pre-School Center Based (Full Day - 9100) and Pre-School Center Based (Half Day - 9115) programs. Our audit covers the CFR submitted by MCEL for the period July 1, 2001 through June 30, 2002. We also audited the enrollment data used by MCEL for billing the NYC Department of Education (DoE) for services provided in the Center Based programs.

A. Background

MCEL is a not for profit corporation that was formed in the mid 1990's, pursuant to Section 402 of the not-for-profit corporation laws of New York State. MCEL, located in Manhattan, New York City, provides a variety of client services, including pre-school and daycare services for children, evaluation and therapeutic services and family support services. MCEL serves about 68 students in its programs. Funds to support these programs are provided to MCEL by the DoE,

which, in turn, recaptures a percentage of their costs from SED. MCEL is paid a tuition rate established by SED, using the costs reported on the CFR, for each student enrolled in their programs.

SED reviews the costs and revenues reported on the CFR and compares the costs to a rate-setting mechanism that limits various operating and administrative cost amounts. The tuition rate established by SED is reviewed and approved by the Division of the Budget. To provide guidance on what types of costs are eligible or ineligible and how common costs should be allocated, SED has issued a Reimbursable Cost Manual (Manual). For the fiscal year ended June 30, 2002, MCEL reported total costs of $3,096,340 on its CFR submitted to SED to operate the 9100 and 9115 programs. SED used this information to establish a tuition rate for the year. An additional $178,926 in expenditures, related to MCEL's Preschool Evaluation Program (9190) was excluded from our review, because the costs relate to a fee-for-service program that is not subject to the rate-setting process.

B. Audit Scope, Objectives and Methodology

We audited the costs and enrollment data reported by MCEL on the CFR for the period July 1, 2001 to June 30, 2002. (Our audit did not include the CFR and enrollment data for the subsequent period because MCEL had not submitted a CFR for that year at the time of our audit.) The objectives of our audit were to determine if the costs reported on the CFR were:

- properly supported by MCEL's books and records,
- related to the 9100 and 9115 programs, and
- allowable, as provided for in the Manual.

We also reviewed the methods used to allocate MCEL's common administrative costs and the enrollment data reported for rate-setting purposes.

To accomplish our objectives, we reviewed MCEL's financial records and the audit documentation maintained by MCEL's firm of independent certified public accountants. We also interviewed MCEL officials and staff and officials of SED. Where appropriate, we reviewed student records and performed observations of MCEL operations. To complete our audit work, we selected a sample of costs claimed by MCEL. Our sample took into account the relative materiality and risk of the transactions.

We conducted our audit in accordance with generally accepted government auditing standards. Such standards require that we plan and perform our audit to adequately assess those MCEL operations that are included within our audit scope. Further, these standards require that we understand the MCEL's internal control structure and compliance with those laws, rules and regulations that are relevant to the operations, which are included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures, as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments, and decisions made by

management. We believe our audit provides a reasonable basis for our findings, conclusions and recommendations.

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, several of which are performed by the Division of State Services. 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.

C. Results of Audit

Our audit found errors in the CFR submitted by MCEL for the fiscal year we audited. The combined amount of the adjustments we propose total $617,109. The significant adjustments to the CFR amounts will likely cause SED to re-compute the tuition rates for MCEL's programs.

For the fiscal year ended June 30, 2002, for the 9100 program, $2,203,211 in expenses were submitted, for which $1,706,252 were allowed, after adjustments totaling $496,959. (See Exhibit A) For the 9115 program, $893,129 in expenses were submitted, for which $772,979 were allowed, after adjustments totaling $120,150. (See Exhibit B)

1. Personal Service Costs

Personal service costs must be reported on the CFR as either direct cost, such as for teachers' salaries, or indirect (administrative) costs, such as a portion of the agency's executive director's salary. Direct costs should be charged directly to a program based upon where the person works while indirect costs should be allocated amongst all the programs operated by an agency based upon some fair and reasonable method. According to the Manual, any expenditure that cannot be charged directly to a specific program must be allocated across all of the entity's programs that benefit from the expenditure. In addition, the entity's operating programs must use allocation methods that are fair and reasonable, as determined by SED. Such methods, as well as the statistical basis used when calculating allocation percentages, must be documented and retained for each fiscal year for review upon audit. Allocation percentages should be reviewed on an annual basis by the entity and adjusted as necessary.

In total, we found $497,877 in personal service costs that did not meet the Manual's requirements and represent audit adjustments for the 2002 fiscal year. We found that the allocation methodology used by MCEL to spread out the costs for certain staff was in error. We found that too much of the salary costs for some staff were allocated to the two programs. We also found that employees who worked for an Early Intervention program funded by the New York State Department of Health were incorrectly charged to the 9100 and 9115 programs. The following table summarizes

personal service costs that were charged to the MCEL's preschool special education programs, but should have been charged to other programs administered by the MCEL or to the agency's administrative costs:

Summary of Adjusted Personal Service Costs			
Category of Personal Service Cost	Program 9100	Program 9115	Total Amount Adjusted
Direct / Early Intervention	$360,292	$62,777	$423,069
Indirect - Administrative Expenses	---	---	74,808
Total	---	---	$ 497,877

In addition, we found that some administrative staff such as office managers, secretaries, and administrative assistants were charged to the 9100 and 9115 program as teacher assistants, a direct cost, while their salaries should have been correctly reported as an indirect or administrative cost. Of the $423,069 in adjustments we made to direct personal service costs, $74,808 of these costs should have been reported in the indirect (or administrative) category of expenses. We have placed these adjusted costs into the indirect costs section.

(In response to our draft report, MCEL officials disagreed with some of our observations, citing different methodologies that they used in allocating teachers' and administrators' time to the various programs. MCEL officials determined the amounts that should be reimbursed based on a variety of computations.)

2. <u>Other Than Personal Service Costs</u>

The Manual provides guidance as to what costs are eligible for reimbursement and what documentation is required to properly support the costs reported on the CFR. Expenses should be reasonable, necessary or program-related and properly documented. According to the Manual, adequate documentation for consultant work includes the consultant's resume, a written contract that describes the nature of the service to be provided, the charge per day, and the dates the service was delivered. Costs to the entity that were the result of a violation or failure to comply with laws and regulations, such as fines and penalties, are not reimbursable. In addition, vehicle use must be documented by notations in individual vehicle logs that include the date and time of travel, the destination to and from, the mileage traveled, the purpose of the trip, and the name of the traveler. Out-of-state travel, with the exception of certain conferences, is not allowable.

The Manual states that all personal expenses - travel expenses, beverage charges, parties for staff, holiday parties, rental expenses for personal apartments, etc. - are not reimbursable. Nor are employees reimbursed for costs incurred in entertaining officers or other employees, or for activities either related or not related to the program such as meals, lodging, rentals, transportation, and gratuities. The costs of food provided to staff are not reimbursable. Additionally, phone calls must be properly documented as being related to the contract.

In total, $119,232 of other than personal service costs were adjusted. This amount includes over $32,000 paid for personal apartment rental expenses, over $27,000 for staff travel that was deemed to be unrelated to the programs under review and over $13,000 of advertising expenditures not related to the contract. In addition, nearly $22,000 of clinician expenditures for teaching, occupational and speech therapy services were found to be insufficiently documented. The remaining adjusted amount was dispersed amongst various small dollar items.

(In response to our draft report, MCEL officials disagreed with some of our recommended adjustments. MCEL officials stated that, in their opinion, sufficient documentation existed for the remaining expenditures. Based on MCEL's formal response, including the addendum and related exhibits to the draft audit report and other documentation provided by MCEL officials, we reduced the recommended total adjustment by $105,748 [from $722,857 in the draft report to $617,109 in this final report]. We continue to disagree with MCEL regarding the remaining adjustments.)

Please refer to the tables shown on the following pages for more information regarding submitted expenses, allowed amounts, adjustments and reasons for adjustments (Notes). The details of our adjustments were provided to MCEL and to SED for their review.

Recommendations

To SED:

1. *Recover $617,109 from MCEL for adjusted program costs.*

To MCEL:

2. *Review the work activities for all employees and establish an allocation methodology for distributing salary costs amongst MCEL's programs that distributes salary costs in proportion to the time spent on the various programs.*

3. *Ensure that all costs are reported correctly on the CFR as either direct care or indirect care costs. Do not report indirect personal service care costs as direct personal service care costs.*

4. *Ensure that all other-than-personal-service costs reported on the CFR are eligible pursuant to the Manual and are adequately documented.*

We provided draft copies of this report to SED and MCEL officials for their review and formal comment. We considered SED's and MCEL's comments in preparing this report and have included them as Appendices A and B, respectively. MCEL's response included an addendum and a series of exhibits that we did not append to this report due to their length. However, we have retained these documents on file for inspection at the Office of the State Comptroller. Also, our comments and rejoinders to SED's and MCEL's response to our audit report are presented in Appendix C, State Comptroller's Notes.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Commissioner of SED shall report to the Governor, the State Comptroller, and the leaders

of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons why.

Major contributors to this report were Brian Mason, Tom Trypuc, Marc S. Geller, Irina Kovaneva, Hugh Zhang, Ken Haque and Joe Giaimo.

We wish to express our appreciation to the management and staff of the Manhattan Center for Early Learning and SED for the courtesies and cooperation extended to our auditors during this audit.

Very truly yours,

Steven E. Sossei
Audit Director

cc: Ms. Theresa Savo, SED
Mr. Michael Abbott, SED
Mr. John Delaney, SED
Mr. Robert Barnes, DOB

Schedules of Submitted and Allowed Program Costs

Pre-School Center Based – Full Day
Program 9100
Expenses for Fiscal Year 2002

	Submitted Pre-School Center Based	Adjustments	Allowed	Notes to Exhibit
Personal Service	$1,124,516	$264,921	$859,595	M
Mandated Fringe Benefits	$169,525	$39,738	$129,787	M
Non-Mandated Fringe Benefits	237,353	55,633	181,720	M
Total Fringe Benefits	$406,878	$95,371	$311,507	
Food	$12,973	$1,140	$11,833	B,C,E,F,I
Repair & Maintenance	4,997	360	4,637	M
Staff Travel	23,513	22,800	713	D,H,I,K
Contracted Direct Care and Clinical Personal Services (from CFR-4A)	44,285	13,684	30,601	L
Supplies & Material (non-Household)	38,285	1,515	36,770	A,B,C,D,E,F,I,J,M
Other (Detail Attached) / Program Enrichment	4,234	0	4,234	
TOTAL OTPS	$128,287	$39,499	$88,788	
Lease Rental Equipment	$468	$0	$468	
Depreciation - Equipment	4,862	0	4,862	
TOTAL EQUIPMENT	$5,330	$0	$5,330	
Agency Admin. Allocated - PS	$300,052	$53,862	$246,190	A,B,C,F,G,I,J,M
- OTPS	238,148	43,306	194,842	
	$538,200	$ 97,168	$441,032	
Total Program Costs	$2,203,211	$496,959	$1,706,252	

EXHIBIT A

Schedules of Submitted and Allowed Program Costs

Pre-School Center Based – Half Day
Program 9115
Expenses for Fiscal Year 2002

	Submitted Pre-School Center Based	Adjustments	Allowed	Notes to Exhibit
Personal Service	$437,907	$46,159	$391,748	M
Mandated Fringe Benefits	$66,017	$6,924	$59,093	M
Non-Mandated Fringe Benefits	92,430	9,694	82,736	M
Total Fringe Benefits	$158,447	$16,618	$141,829	
Food	$9,716	$859	$8,857	B,C,E,F,I
Repair & Maintenance	3,742	268	3,474	M
Staff Travel	8,804	8,433	371	D,H,I,K
Contracted Direct Care and Clinical Personal Services (from CFR-4A)	22,090	8,272	13,818	L
Supplies & Material (non-household)	28,672	1,143	27,529	A,B,C,D,E,F,I,J
Other (Detail Attached) - Program Enrichment	1,586	0	1,586	
TOTAL OTPS	$74,610	$18,975	$55,635	
Lease Rental Equipment	$350	$0	$350	
Depreciation - Equipment	3,642	0	3,642	
TOTAL EQUIPMENT	$3,992	$0	$3,992	
Agency Admin. Allocated - PS	$121,634	$20,946	$100,688	A,B,C,F,G,I,J,M
- OTPS	96,539	17,452	79,087	
	$218,173	$38,398	$179,775	
Total Program Costs	$893,129	$120,150	$772,979	

EXHIBIT B

Notes to Exhibits

The Notes shown below refer to specific sections of the Cost Reimbursement Manual upon which we have based our adjustment. We have summarized the applicable section to explain the rational for our disallowance. Details of the transactions in question were provided to SED and MCEL officials during the course of the audit.

A. Section 1 - Costs must be reasonable, necessary and program related. We determined that some costs were not related to the program.

B. Section 1.21.A - Costs incurred for entertainment of officers or employees, or for activities not related to the program, or any related items such as meals, lodging, rentals, transportation, and gratuities, are not reimbursable.

C. Section 1.21.B - All personal expenses, such as personal travel expenses, laundry charges, beverage charges, gift certificates to staff and vendors, flowers or parties for staff, holiday parties, repairs on a personal vehicle, rental expenses for personal apartments, etc., are not reimbursable unless specified otherwise.

D. Section 1.22 - Costs resulting from violations of, or failure by, the entity to comply with Federal, State, and/or local laws and regulations, are not reimbursable.

E. Section 1.23.C - Costs of food provided to any staff, including lunchroom monitors, are not reimbursable.

F. Section 1.30 (3) - Costs for food, beverages, entertainment and other related costs for meetings, including Board meetings, are not reimbursable.

G. Section 1.55.A - Costs incurred for telephone service, local and long distance telephone calls, electronic facsimiles (FAX) and charges for cellular telephones, etc., are reimbursable provided that they pertain to the special education program. We determined that some costs were not related to the program.

H. Section 1.57.B - Out-of-state travel costs, except for certain conferences, are not reimbursable. We determined that out-of-state travel costs were not related to conferences.

I. Section II.A - Costs will not be reimbursable without appropriate written documentation. We found some costs were not documented.

J. Section II.A.4 - All purchases must be supported with invoices listing items purchased and indicating date of purchase and date of payment, as well as canceled checks. We found some costs were not documented.

K. Section II.A.5 - Logs must be kept for each employee indicating dates of travel, destination, purpose, mileage, and related costs such as tolls, parking and gasoline.

L. Section II.A.3 - Adequate documentation includes, but is not limited to, the consultant's resume, a written contract which includes the nature of the services to be provided, the charge per day and service dates. In addition, the documentation should include the number of days actually worked and the students' names for each service date and number of hours worked if direct care services were provided. We determined that some consulting costs were not supported in this manner.

M. Section II.A.13 - Entities operating programs must use allocation methods that are fair and reasonable, as determined by SED. Such allocation methods, as well as the statistical basis used to calculate allocation percentages, must be documented and retained for each fiscal year for review upon audit. Allocation percentages should be reviewed on an annual basis and adjusted as necessary. We determined that MCEL did not follow this guidance when allocating administrative costs.

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

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June 7, 2005

Mr. Steven E. Sossei
Audit Director
Office of the State Comptroller
Bureau of State Audit
110 State Street – 11th Floor
Albany, NY 12236

Dear Mr. Sossei:

I am responding to your letter of May 6, 2005 to Commissioner Mills regarding the Office of the State Comptroller's Draft Audit Report (2004-S-14) for the Manhattan Center for Early Learning (MCEL) - Compliance with the Reimbursable Cost Manual for the year ended June 30, 2002. Our comments to the draft audit findings and your recommendation to the Department are provided below.

The draft audit report identifies several reporting errors and deficiencies in internal controls related to over reporting of personal services and other-than-personal-service costs. As recommended in the Department's response to the preliminary audit findings, we urge you to include additional recommendations to MCEL to address more of the cost reporting weaknesses described in the draft audit report.

* Note 1

Recommendation 1

Recover $722,857 from MCEL for adjusted program costs.

* Note 2

The Department agrees with this recommendation.

We will make the appropriate adjustments to MCEL's allowable costs when determining the 2001-02 final audit tuition rate.

If you have any questions, please contact John Delaney, Coordinator of the Rate Setting Unit at (518) 486-2774.

Sincerely,

Theresa E. Savo

Theresa E. Savo

c: John Delaney
Linda Rhodes

* See State Comptroller's Notes, p. 17

Appendix A

MANHATTAN CENTER
FOR EARLY LEARNING

328 EAST 62 ND STREET, NEW YORK, NY 10021 / PHONE:(212) 752-7575 / FAX (212) 752-7564

BY E-MAIL AND FEDERAL EXPRESS

July 27, 2005

Steve Sossei
Audit Program Director
Office of the New York State Comptroller
State Audit Bureau
110 State Street-11th Floor
Albany, NY 12236-0001

Re: Response to Draft Audit Report

Dear Steve:

First, let me thank you once again for your patience in giving us adequate time to respond fully to the draft audit report.

While we appreciate the fact that your report sharply reduced the proposed disallowances contained in your preliminary findings, we believe this report nevertheless contains many factual and analytical errors and adopts a methodology which is unreasonable and improper for reasons set out below. While we now recognize that our implementation of our allocation methodology in the CFR we submitted also contained errors which require certain corrections, we believe that the disallowances proposed by your report are in substantial measure unjustifiable. We attach an Addendum setting out in detail areas in which we believe your draft report contains factual or analytical errors or is otherwise inconsistent with the requirements of the Reimbursement Cost Manual in the areas of Payroll, Clinician Review, and OTPS. We also believe your draft report erred in adopting a new allocation methodology rather than auditing our compliance with our established allocation methodology which we believe is in compliance with the Reimbursement Cost Manual.

* Notes 2 and 3

A central thrust of your report challenges the methodology we used to allocate expenses between MCEL (CPSE) and MCEI (EI) programs. That methodology is set out in writing in a document which was provided to your staff entitled "Procedure for Allocation of Expenses Between Manhattan Center for Early Learning and Manhattan Center for Early Intervention, Inc." (Allocation Procedure) We also provided your staff with spreadsheets implementing this methodology.

* Note 4

The Reimbursable Cost Manual discusses the requirements for inter-program allocations:

> "Entities operating programs must use allocation methods that are fair and reasonable as determined by the Commissioner's fiscal representatives. Such allocation methods, as well as the statistical basis used to calculate allocation percentages, must be documented and retained for each fiscal year for review upon audit. Allocation percentages should be reviewed on an annual basis and adjusted if necessary." Section II, Paragraph A13(b)
>
> "For CFR filers…, agency administration costs shall be allocated to all programs operating by the entity based on the Ratio Value Method of Allocation. Agency administration costs allocated to grant cost centers shall be the lower of actual cost allowable based on the Ratio Value

* See State Comptroller's Notes, p. 17

Method or the maximum amount that can be charged based on grantor requirements." Section II, Paragraph A13(c)

Our allocation methodology as described in the Allocation Procedure complies with the standard set out in the Reimbursement Cost Manual. It is a fair and reasonable procedure as determined by the Commissioners fiscal representatives on several occasions. The Allocation Procedure relies on the ratio of direct costs to allocate shared direct and indirect costs and conforms to the Ratio Value Method which is required by the Reimbursement Cost Manual for the allocation of agency administration costs. It is a similar methodology to that used in the CFR allocation of costs among programs.

* Note 4

The MCEL methodology has been fully examined and approved by SED and by an SED auditor on several occasions, and MCEL has relied on these approvals over many years in making program decisions. In response to the requests of the Program Services Reimbursement Unit of SED, we submitted the Allocation Procedure to them together with an expense allocation worksheet and illustrative spreadsheet data, on or about November 11, 1997[1], and again on or about June 24, 1998[2], in order for them to review and approve the allocation methodology. We were subsequently advised by the Program Services Reimbursement Unit in both cases that the Allocation Procedure as submitted was acceptable. The Allocation Procedure was also submitted to Israeloff, Trattner & Co., P.C., which carefully evaluated and accepted our allocation methodology in the course of an audit of fiscal year 1998 conducted on behalf of SED.[3]

* Notes 4 and 5

We have continued to employ the Allocation Procedure which was submitted to and approved by SED. We have relied on the allocations to prepare and evaluate the income and expenses of different program units. In particular, based upon these allocations, we determined that a center based early intervention program was financially feasible although marginal and produced small gains and losses in various years.

* Note 5

Notwithstanding the important clinical benefits of the early intervention program and its financial benefits to the CPSE program, our early intervention program could only be justified if it was financially viable and our evaluation of its financial position depended completely upon our understanding that the allocation methodology was proper and accurate. But if the Comptroller draft audit report was implemented, the centerbased EI program for fiscal year 2002 would have devastating losses exceeding $500,000-600,000 on revenue of approximately $1,060,000. This is apart from those costs like out of state travel disallowed for reasons other than allocation issues but which are real expenses of conducting both the CPSE and EI programs and will have to be borne by the early intervention program. Had SED advised in 1997 or 1998 that instead of the allocation method which we submitted, we would be compelled to us the methodology proposed in the Comptroller audit, we simply would terminated all service to early intervention children in our center. The CPSE program would have been financially far worse off for reasons we have describe below.[4]

* Note 6

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[1] Exhibit 1

[2] Exhibit 2

[3] Israeloff, Trattner & Co., P.C. found an error in the implementation of the allocation procedure for that fiscal year which was acknowledged by MCEL in its response to the findings in a letter dated March 24, 2003. The Allocation Procedure requires the allocation of all fringe benefit costs of staff based upon the allocation of salaries. The procedure was followed for administrative staff but the benefit costs were inadvertently omitted for instructional staff.

[4] In fact, as a result of the uncertainty created by the Comptroller audit, we have sharply reduced the EI program and have recently announced the termination effective August 31, 2005, of all EI developmental classes which have comprised most of our EI services. We will be left with EI ABA classes which receive no therapies, have separately funded supervision, and separately funded intake. It is our intention to move these ABA classes to separate locations in the near future since we believe the allocation method proposed in the draft audit report would result in EI subsidizing CPSE.

* See State Comptroller's Notes, p. 17

Whatever the merits of one allocation methodology or another, it would be fundamentally unfair to impose a new methodology retrospectively many years after an agency has reasonably relied to its detriment on an approach which has been submitted for approval and approved on two separate occasions by SED and approved by an auditor for SED on another. Under these circumstances, if SED wishes to change its guidance, we believe it must do so prospectively after giving the agency sufficient time to adjust to any changes in allocation procedure.

* Note 7

As we have indicated, the Allocation Procedure and Excel spreadsheets implementing that procedure for fiscal year 2002 were submitted to your staff. However, your preliminary findings and your draft audit report ignore our procedure and create a different methodology from the approved methodology we relied on. It utilizes enrollment head count as the basis for allocation of shared direct costs and indirect costs. In the attached Addendum, we comment on the merits of this allocation approach which we believe is not a fair and reasonable approach. Moreover, we believe it is clearly in violation of the Reimbursable Cost Manual requirement that the Ratio Value Method of allocation be used to allocate agency administrative costs to all programs operated by an entity. Section II, Paragraph A13(c).

* Notes 6 and 8

Apart from the merits of the allocation methodology created by your office as a possible allocation methodology, there is no authority which establishes it as a required approach. In view of the submission of the MCEL Allocation Procedure to SED in 1997 and 1998 and its approval as a basis for allocation in the audit by Israeloff, Trattner & Co., P.C. and the reliance on this allocation methodology by MCEL for many years, MCEL was entitled to use and rely on this methodology for allocation of expenses as a fair and reasonable allocation method which had been approved by the Commissioner's fiscal representatives particularly in the absence of prospective guidance to the contrary from SED. Therefore, we believe the establishment of a new allocation methodology by your office was improper and believe the appropriate auditing role given the history of our Allocation Procedure is to audit our compliance with our established methodology.

* Notes 7 and 8

At the same time we recognize the Comptroller's Office has correctly identified errors in the implementation of the methodology which should be corrected. For example, in charging direct costs for teachers and teacher assistants, we relied on our teacher supervisor to designate from recollection the CPSE and EI assignments for the Summer and Fall terms. The Comptroller's Office utilized the class assignment rosters prepared on a regular basis during the year which permits a more precise analysis. We believe their approach is correct. A careful analysis of the rosters showed we had made some errors in allocations of teachers and teacher assistants salaries to CPSE and some errors in allocations we made to EI[5].

We are submitting herewith a revised EL/EI expense allocation worksheet for fiscal year 2002 which recalculates the inter-program expense allocations[6] and a supporting salary allocation worksheet[7]. We have revised our expense allocations for fiscal year 2002 based on our Allocation Procedure but modified to reflect errors identified by your audit in the direct service payroll, in clinician review, and in OTPS other than those with which we take issue in the Addendum.[8] We have incorporated many of the disallowances in your report. We have expanded the category of Shared Direct staff who must be allocated among programs to correspond to your audit findings. However, we have recognized that EI consists of two distinct programs, EI-ABA (which serves exclusively children on the autistic spectrum using a behavioral approach) and EI-Developmental (which serves more characteristic speech and cognitively delayed children utilizing a play based developmental approach), with different

[5] Although we brought these errors to the attention of your staff, the Draft Audit Report ignored clear errowhere CPSE teacher and teacher assistant expenses were erroneously charged to EI. Clearly any errors identified should be corrected notwithstanding the beneficiary of the correction.
[6] Exhibit 3. This document will also be sent electronically.
[7] This document will be sent electronically
[8] Pages 16-18 of the Addendum contains a more detailed discussion of the revisions made in our allocation worksheet to reflect disallowances and changes in your draft audit report.

* See State Comptroller's Notes, p. 17-18

characteristics in terms of Shared Direct Staff. Many of the Shared Direct Staff support the Developmental program but do not supervise or support the ABA program in any way. At the same time, the allocation methodology for the therapy staff on our payroll and for the shared direct and administrative staff follows the MCEL Allocation Procedure which we believe complies with the Reimbursement Cost Manual.

*** Notes 2 and 9**

Apart from the requirements of the Reimbursement Cost Manual which we believe allow flexibility in designing a fair and reasonable methodology but require an allocation methodology very much along the lines of our Allocation Procedure, there are other important financial factors which should be taken into account in reviewing inter-program allocations between CPSE and EI programs. The early intervention program offered two substantial and concrete financial benefits to our CPSE centerbased program which were major factors in the decision to operate and grow the centerbased EI program. One of the financial inefficiencies of the CPSE program resulted from seasonal fluctuations. This is a result of the aging out of CPSE children on June 30 of a fiscal year, the reduction in enrollment in the summer because many children are mandated for 10 months rather than 12 months, and the ramp up of enrollment beginning in September of each year and the filling of enrollment in the late fall and early winter. Since we have preferred that most staff be full time salaried staff since we believe it offers the highest quality staff, most opportunity for supervision, and most reliable staffing to meet children's mandates, the CPSE program tended toward staff/enrollment imbalance with case loads light in the summer and fall and heavy in the winter and spring. Since we had more classroom capacity than CPSE enrollment capacity under our business plan and since most EI children aged out at the end of August, we found we could limit overstaffing for CPSE staff in the summer and fall by adding EI classrooms and children in the Spring and Summer. These EI children could fill empty or light CPSE classrooms and caseloads in the summer and many would be prospective CPSE students in September after they aged out from EI thereby significantly reducing the cost of overstaffing in the fall resulting from the ramp up of CPSE students. This strategy operated to the significant financial benefit of the CPSE program. The audit fails to observe or measure this financial benefit to CPSE as a result of the EI program.

*** Note 10**

A second financial benefit to the CPSE program is the ability to reduce the CPSE costs by allocating to EI a portion of shared costs. Because the building we rent had more classroom space than we were able to utilize for CPSE under our business plan, the EI services we provided enabled us to reduce the CPSE cost per student of many shared resources partly allocated to the EI program. Thus, our CPSE program alone would require a Nurse, Speech Supervisor, Educational Director, Controller and the like. By adding an EI program which can also be supported by the same shared staff, shared facility costs and other shared resources, the CPSE Program will bear less cost per student. The audit also fails to observe or measure this financial benefit to CPSE as a result of the EI program.[9]

*** Notes 10 and 11**

We believe there are also important issues of public policy which motivated the creation and operation of an early intervention program in coordination with a CPSE program which we submit are relevant considerations in the review of inter-program allocations. Even though our early intervention center based program was financially marginal, we believed it was important to continue it. Assuming we

[9] In the implementation of its Allocation Procedure, MCEL has allocated many shared direct costs. The Comptroller has identified other staff whom it has treated as shared direct staff and has required an allocation of these costs between the CPSE and EI programs. MCEL practice in defining shared direct staff has been consistent, and no objection had been raised in the Israeloff, Trattner audit or other reviews of our methodology. While we believe there is merit in the Comptrollers contention that such cost should be shared, we would argue that this issue too should be raised prospectively. The additional shared direct staff are all staff who would be required if the early intervention program did not exist. In our revised EL/EI expense allocation worksheet, we include the shared direct staff suggested by the Comptroller but request reconsideration of this issue by the Comptroller and by SED in view of the approval of these practices in the past, the substantial financial benefits to our CPSE program from the operation of the EI program, the fact that the staff identified would all be required if CPSE operated alone and the very harsh outcome to MCEL if the staff designated as shared direct must all be allocated retroactively in the 2002 fiscal year.

* See State Comptroller's Notes, pp. 17-18

could at least break even, we were committed to serve the zero to three population because of the importance of providing services to children with special needs during this critical early phase of their life. We continue to be very active in the organizations focused on the needs of the zero to three year old population. Our Educational Director is, for example an officer, a board member, and a member of the Executive Committee of the New York City Zero to Three organization. A center based early intervention program while extremely important to the development of special needs children is financially marginal. In fact, many such center based programs in New York City have closed in the last few years for financial reasons. We believed that the sharing of overhead on the basis reflected in our CFR could not only reduce CPSE costs but also make workable a program which would otherwise be financially unworkable. As we indicate above, as a result of the uncertainty created by the preliminary work of the Comptrollers office we have now closed most of our early intervention program and the rest will be moved or closed by December of this year.

*** Notes 3 and 12**

We have also focused on the analysis and factual validity of your audit approach. Based on our review, we believe that there are significant factual and analytical errors in your analysis and that your disallowances are greatly overstated. In the attached Addendum we set out an outline addressing these differences in the areas of Payroll, Clinician Review, and OTPS.

*** Note 2**

Let me thank you again for your flexibility in the timing of our response and your kindness with respect to my mother's health crisis which delayed our response beyond our initial agreement. Please thank your auditing staff as well for their courtesies and professionalism in their dealings with us.

Sincerely yours,

Michael Gordon
Executive Director

* See State Comptroller's Notes, pp. 17-18

State Comptroller's Notes

1. Based on SED's comments, we added recommendations 3 and 4 to the audit report.

2. Based on MCEL's formal response (including an addendum and related exhibits) to the draft audit report and our review of other documentation provided by MCEL officials, we reduced the recommended total disallowance from $722,857 to $617,109.

3. Our allocation methodology was consistent with the Ratio Value Method of allocating costs among multiple programs as prescribed by the Reimbursable Cost Manual. Specifically, we based allocations of direct salary and fringe benefit costs on the actual work (program) assignments of MCEL staff. MCEL's allocation practices did not fairly allocate costs between MCEL and the early intervention program. MCEL's methodologies were misapplied in actual practice. MCEL assigned all costs of direct care staff, when they were not servicing students, to the preschool special education programs we audited. All such costs should have been allocated between the early learning program and the early intervention program as well (based on the proportions of FTE enrollments of the various programs operated at the site). We used the ratio of 74 percent for the preschool programs and 26 percent for the early intervention program (as stipulated by MCEL in the addendum to its response to the draft audit report), and reduced the corresponding disallowance accordingly.

4. In our report, we do not take specific issue with the Procedure for Allocation of Expenses Between Manhattan Center for Early Learning and Manhattan Center for Early Intervention, Inc. (or Procedure for Allocation of Expenses) which was originally prepared in 1997 and revised in 1998. Moreover, irrespective of the Procedure for Allocation of Expense, we identified specific problems with MCEL's actual allocation of programs' costs for the 2001-02 year, as detailed previously in State Comptroller's Note 3.

5. According to SED officials, SED did not formally approve or disapprove the Procedure for Allocation of Expense. However, officials have maintained it on file and would accept it to the extent that MCEL's actual cost allocations and reporting were consistent with the Reimbursable Cost Manual. Moreover, we identified specific problems with MCEL's actual allocation of programs' costs for the 2001-02 year, as detailed previously in State Comptroller's Note No. 3. In addition, MCEL's application of the Procedure for Allocation of Expenses should not be predicated on the financial viability of the early intervention program (versus the preschool programs and the corresponding requirements of the Reimbursable Cost Manual).

6. No matter what the Procedure for Allocation of Expenses stated, MCEL's actual allocations of expenses (as reported on the CFR) to the preschool programs should have been fully consistent with the provisions of the Reimbursable Cost Manual. However, as our audit concluded, they were not. Moreover, the financial viability of the respective programs should not be a principal factor in the allocation of program costs for financial reporting (and related rate-setting) purposes.

7. Our audit did not retroactively impose a new allocation methodology on MCEL. Rather, our audit followed the Ratio Value Method of cost allocation as the Reimbursable Cost Manual has prescribed for many years (prior to 1997). Moreover, irrespective of the Procedure for Allocation of Expenses, Isrealoff, Trattner, and Co. was required to conduct its audit pursuant to the Reimbursable Cost Manual as well.

8. The use of FTE enrollment amounts to allocate costs among programs is consistent with the Ratio Value Method of cost allocation. (This is one reason why SED requires entities to report program enrollments on their CFRs.) Moreover, the Reimbursable Cost Manual requires certain shared costs to be allocated among all of an entity's discrete programs unless the entity can adequately document why such costs should not be allocated among those programs. MCEL could not adequately document why certain disallowed costs should have been allocated to the preschool programs instead of the early intervention program.

9. Prior to responding to our draft audit report, MCEL officials had not previously advised us of any bifurcation in the early intervention program for cost allocation and financial reporting purposes. Furthermore, we question whether such a bifurcation is consistent with the Reimbursable Cost Manual. Nonetheless, we reviewed MCEL's revised cost allocation worksheet and reduced the corresponding disallowance, as appropriate. Specifically, we applied the ratios determined by MCEL that allocated 74 percent of shared direct care and administrative costs to the preschool programs and 26 percent of such costs to the early intervention program. (Also, see State Comptroller's Note 2).

10. The scope of our audit was limited to MCEL's compliance with the Reimbursable Cost Manual for the 2001-02 fiscal year. Our audit was not intended to assess the relative financial benefits of the preschool and early intervention programs to each other.

11. We acknowledge that the preschool and early intervention programs can mutually benefit each other to the extent that certain costs can be shared. Moreover, the early intervention program's costs for a nurse, speech supervisor, education director and controller would likewise be greater if they were not shared with the preschool programs. The key issue remains whether or not such costs were shared (allocated) among the programs properly. Furthermore, in assessing the cost allocation issue prospectively, MCEL can petition SED to allow a greater proportion of shared costs to be charged to the preschool programs by providing SED with sufficient justification, including detailed documentary evidence.

12. Our audit did not address or question the programmatic benefit of the early intervention program.