

THOMAS P. DiNAPOLI  
STATE COMPTROLLER



110 STATE STREET  
ALBANY, NEW YORK 12236

STATE OF NEW YORK  
**OFFICE OF THE STATE COMPTROLLER**

July 17, 2007

Mr. Richard P. Mills  
Commissioner  
State Education Department  
State Education Building - Room 111  
89 Washington Avenue  
Albany, NY 12234

Mr. James Campbell  
Executive Director  
Leake and Watts Services, Inc.  
463 Hawthorne Avenue  
Yonkers, NY 10705

Re: Leake and Watts Services, Inc.  
Compliance with the Reimbursable  
Cost Manual  
For the Year Ended June 30, 2005  
Report 2006-S-123

Dear Mr. Mills and Mr. Campbell:

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 certain costs and revenues reported by Leake and Watts Services, Inc. (Leake and Watts) on the Consolidated Fiscal Report (CFR) submitted to the New York State Education Department (SED) for the year ended June 30, 2005 (or the 2004-05 fiscal year). The CFR data is used by SED to establish tuition reimbursement rates for several programs administered by Leake and Watts. Among these are the Biondi School Age Education Program (the Biondi Program or program code 9000); the Ames Early Education Center Preschool Integrated Special Program (the Ames Program or program code 9160); and the Katherine Dodge Brownell Preschool Integrated Education Program (the Brownell Program or program code 9165). We also audited the corresponding enrollment data reported by Leake and Watts for rate-setting purposes.

**A. Background**

Leake and Watts serves over 3,000 children with special educational, developmental, and behavioral needs through a range of educational, residential, foster care, and juvenile justice programs. These services are offered at a main campus located in Yonkers and at education centers and group homes in Westchester County and the Bronx. Educational programs are offered to children from preschool through high school ages.

For children placed with institutions such as Leake and Watts, SED develops annual tuition rates for counties and school districts to use to reimburse service providers (such as Leake and Watts) for the costs of their programs, as prescribed by the Education Law. The tuition rates are based on financial and enrollment data submitted by the providers to SED annually on a CFR. The CFR allows service providers to report costs and revenues associated with their educational programs through a standardized reporting mechanism. SED staff reviews the cost and revenue data reported on the CFR and then inputs that data to SED's rate setting system. Once calculated, tuition rates are subject to the review and approval of the Division of the Budget. To provide guidance on the eligibility of costs and allocation of non-direct care costs, SED issued the Reimbursable Cost Manual (Manual). SED sets reimbursement rates for seven educational programs at Leake and Watts. The three largest programs are:

- the Biondi Program (code 9000) for school-aged special education children. The Biondi Program has a facility in Yonkers for middle and high school students and another in the Bronx for elementary school students. For the fiscal year ended June 30, 2005, the Biondi Program's total costs were about \$19.4 million, with personal service costs totaling \$9.4 million;
- the Ames Program (code 9160) for preschool special education students which is operated at the Ames Early Education Center in Yonkers. For the fiscal year ended June 30, 2005, total costs for the Ames Program were about \$1.6 million; and
- the Brownell Program (code 9165) for preschool students which is located in the Bronx. For the fiscal year ended June 30, 2005, total costs for the Brownell Program were about \$618,000.

**B. Audit Scope, Objectives and Methodology**

We audited the costs and revenues reported by Leake and Watts on the CFR for the fiscal year ended June 30, 2005 for the Biondi, Ames and Brownell Programs (the three largest education programs administered by Leake and Watts). The objectives of our audit were to determine if the costs and revenues reported on the CFR were properly supported by Leake and Watts' books and records and were allowable per the Manual. We also reviewed the methods used to allocate Leake and Watts' non-direct care costs and the enrollment data reported for rate-setting purposes. Our audit did not include the other four Leake and Watts programs included on the CFR. The revenues and expenses of these programs were less than those of the programs we reviewed. Our audit also did not include costs associated with any residential programs operated by Leake and Watts.

To accomplish our objectives, we reviewed Leake and Watts' financial records for the fiscal year ended June 30, 2005 and other pertinent documentation related to data reported on the CFR, including audit documentation from Leake and Watts' independent certified public accountants. We also interviewed officials from Leake and Watts, officials from SED, and a consultant who helped Leake and Watts prepare the CFR. Where appropriate, we reviewed student records and observed certain operations. We concentrated our audit on the personal service costs for the Biondi program and on the bond refinancing costs. To complete our audit work, we selected a judgmental sample of costs reported by Leake and Watts for review. Our sample took into account the relative materiality and risk of the various costs reported by Leake and Watts. Also, we apportioned any audit disallowances we identified, as appropriate, to the three educational programs within the scope of our audit.

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 Leake and Watts operations that are included within our audit scope. Further, these standards require that we understand Leake and Watts internal control structure and compliance with those laws, rules and regulations that are relevant to the operations 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. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

### **C. Results of Audit**

Our audit identified several errors in the CFR data submitted by Leake and Watts for the fiscal year we audited. These errors, which totaled \$646,066 for the three programs we reviewed, pertained primarily to bond refinancing costs and the salaries of certain Leake and Watts officials. Because of these errors, we propose disallowances totaling \$615,176 for the Biondi Program (see Exhibit A), \$29,153 for the Ames Program (see Exhibit B), and \$1,737 for the Brownell Program (see Exhibit C). These disallowances will likely cause SED to re-compute the tuition rates for these programs.

## 1. Bond Refinancing Costs

In December 2004, Leake and Watts re-financed capital project bonds which were originally issued in 1994. As part of the new bond issuance, Leake and Watts incurred re-financing costs of \$1,422,200. On the CFR, Leake and Watts officials expensed \$1,349,200 for the year ended June 30, 2005 and amortized \$73,000 over the 20-year remaining life of the bonds. These costs were allocated to several Leake and Watts' programs whose capital projects were funded by the bonds. Leake and Watts reported \$590,017 in re-financing costs for two of the programs we reviewed (\$563,808 for the Biondi Program and \$26,209 for the Ames Program). These costs included the following; underwriters' discounts, bond insurance premiums, NYS bond issuance charge, legal fees, printing costs, trustee fees, rating agency fees, and other miscellaneous costs associated with the issuance of the Series 2004 Bonds.

Officials from Leake and Watts sought and obtained approval from SED to refinance their bond obligations. However, officials did not receive approval from SED for the method used to report the re-financing costs on the CFR. According to the Manual, such costs should be amortized over the life of the bonds. Consequently, Leake and Watts should have reported bond re-financing costs of \$29,500 on its CFR (with \$28,190 allocated to the Biondi Program and \$1,310 allocated to the Ames Program). Because Leake and Watts did not comply with the Manual, the capital improvement interest expense on the CFR was overstated by \$560,517 ( $\$590,017 - \$29,500$ ) in total for the programs we reviewed.

## 2. Personal Service Costs

According to the Manual, reimbursement of employee compensation (including salary and fringe benefits) for certain job titles shall not exceed the median paid to comparable personnel in public schools for similar work in the region in which the reporting entity is located. For rate-setting purposes, SED limits the amount of compensation that an entity can claim for its executive management (including the executive director and assistant executive director) to the regional median compensation for comparable administrative job titles of public school districts. The median compensation amounts are determined annually by SED through information obtained from school districts through SED's Basic Educational Data System.

The compensation for the Executive Director and an Associate Executive Director exceeded the median salaries paid to comparable personnel in the Mid-Hudson Region (Region). The compensation package for the Executive Director totaled \$348,006. This was \$137,868 more than the median compensation level (\$210,138) in the Region for a comparable position (school district superintendent). The compensation package for the Associate Executive Director was \$211,418. This was \$31,539 more than the median compensation level (\$179,879) for a comparable position in the Region. For the three programs we reviewed, the disallowances allocated to the Executive Director's compensation and the Associate Executive Director's compensation totaled \$55,999. Leake and Watts' officials stated the two employees receive comparatively higher compensation because of their long tenures with the agency.

The Manual also requires that personal service costs that cannot be charged directly to a specific program be allocated across all programs benefited by those expenditures. The preferred methodology to allocate the salaries and fringe benefits for employees who work on multiple

programs includes formal analysis of the number of hours employees actually work for the various programs in question. Consequently, entities should maintain appropriate documentation to support the numbers of hours used to calculate the amounts of allocated costs. Acceptable documentation may include payroll records (such as time distribution reports) or time studies.

For the 2004-05 year, Leake and Watts claimed about \$700,000 of allocated personal service costs for the programs we reviewed. However, the allocated personal service costs were not supported by time distribution reports or other time studies. Instead, Leake and Watts officials used the ratios of classrooms designated for specific programs. We tested the allocations of personal services costs for a judgmental sample of 20 employees, and we concluded that the allocations were materially reasonable. Consequently, we did not disallow any of the allocated personal service costs charged to the programs we reviewed. Nevertheless, Leake and Watts should maintain the appropriate documentation to support allocated personal service costs in the future.

### 3. Other-Than-Personal-Service Costs

The Manual provides guidance on costs that are reimbursable and the related record keeping requirements. Costs will be considered for reimbursement provided such costs are reasonable, necessary, and directly related to the education program - and are sufficiently documented. Reimbursable costs are included in the calculation of tuition rates up to limits approved by SED. In addition, the Manual states costs will not be considered to be reimbursable, upon field audit, without appropriate written documentation of such costs.

The Manual also specifies that certain costs are not reimbursable. Non-reimbursable costs can include expenses normally assumed by parents attending public schools, such as the cost of clothing or uniforms, breakfast or dinner expenses for students on overnight trips or for after-school sporting events. Other non-reimbursable costs include: food or other expenses related to staff parties or meetings; parking violations; damages occurring to employee vehicles at the school; and transactions without proper documentation. For the 2004-05 year, we identified \$29,550 of other-than-personal costs reported on the CFR which were not allowed per the Manual. These costs included: \$14,046 of expenses normally assumed by parents of students attending public schools; \$13,657 of ineligible expenses for staff; and \$1,847 of expenses that were not sufficiently documented.

Refer to Exhibits A through C for more detailed information regarding the costs reported by Leake and Watts on the CFR, the amounts allowed, the disallowances and the reasons for the disallowances. We provided the details of our disallowances to officials of Leake and Watts and to SED for their review during our audit fieldwork.

### 4. Student Enrollment

SED uses the full-time equivalent (FTE) enrollment of an entity's program to calculate that programs' tuition reimbursement rate. Accordingly, the Manual requires schools, such as Leake and Watts, to calculate its programs' FTE enrollments through a prescribed methodology which includes the starting and ending dates of each student's enrollment. We verified that Leake and Watts reported the appropriate number of FTE students on the CFR for the Biondi, Ames and Brownell

programs. Specifically, we traced a judgmental sample of students from the monthly summary of student enrollment to class rosters and daily attendance records. Based on our review, we determined that all students in our sample were enrolled and attending their respective programs. We also determined that the starting and ending dates of students' enrollments were correct. Consequently, we concluded that FTE enrollment reporting by Leake and Watts was accurate.

### **Recommendations**

#### **To SED:**

1. *Review the disallowances resulting from our audit and make the appropriate adjustments to the costs reported on the CFR. Recalculate the tuition rates based on the CFR for 2004-05 year.*

(SED officials agreed with the recommendation and stated that they will recalculate Leake and Watts tuition rates using the 2004-05 CFR and any appropriate audit adjustments.)

#### **To Leake and Watts:**

2. *Comply with the Manual's eligibility and documentation requirements for program costs reported on the CFR.*
3. *When appropriate, obtain formal guidance from SED rate-setting officials for reporting costs pertaining to unique financial transactions, such as the bond re-financing, on the CFR.*
4. *Comply with the Manual's requirements for allocating costs (for shared staff and any other function) among multiple programs. Ensure the rationale for and calculations of allocated costs are adequately documented.*

(Leake and Watts officials did not specifically agree or disagree with our recommendations. However, officials concurred with SED's determination that bond refinancing costs could be amortized for CFR reporting purposes, and officials will amortize such costs in the future. Officials also stated that the compensation packages of the Executive Director and Associated Executive Director were reasonable based on their lengths of service with Leake and Watts and the salaries of senior officials at similar agencies in the New York City metropolitan area.)

We provided draft copies of this report to officials of SED and Leake and Watts for their review and formal comment. We considered SED's and Leake and Watts' comments in preparing this report and have included them as Appendices A and B, respectively.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Commissioner of Education shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons why.

Major contributors to this report were Bill Clynes, Kathleen Hotaling, David Pleeter, and Nicole Van Hoesen.

We wish to express our appreciation to the management and staff of Leake and Watts and SED for the courtesies and cooperation extended to our auditors during this audit.

Very truly yours,

Brian E. Mason  
Audit Manager

cc: Ms. Theresa Savo, SED  
Mr. James Conway, SED  
Mr. Thomas Hamel, SED  
Ms. Lisa Ng, DOB  
Mr. Michael Mazzocco, Leake and Watts

<b>Leake and Watts Services, Inc.</b>				
<b>Schedule of Submitted and Allowed Program Costs</b>				
<b>Biondi Special Education School Age Program (9000)</b>				
<b>For the Fiscal Year Ended June 30, 2005</b>				
	Costs Reported Per CFR	Proposed Disallowance	Amount Allowed	Notes to Exhibit
Personal Service	\$9,418,738	-	\$ 9,418,738	
Vacation Accruals	\$8,548	-	\$8,548	
Total Fringe Benefits	<u>\$2,643,245</u>	-	<u>\$ 2,643,245</u>	
Total Personal Service	\$12,070,531	-	\$12,070,531	
Other-Than-Personal-Service	\$2,405,862	\$29,550	\$2,376,312	A, B, C, F, G ,H, I
Equipment	\$453,119	-	\$453,119	
Property	<u>\$2,577,497</u>	<u>\$535,618</u>	<u>\$2,041,879</u>	E
Total Operating Cost	\$17,507,009	\$565,168	\$16,941,841	
Agency Administration Allocation	<u>\$1,901,499</u>	<u>\$50,008</u>	<u>\$ 1,851,491</u>	D
Total Program Cost	\$19,408,508	\$615,176	\$18,793,332	

<b>Leake and Watts Services, Inc.</b>				
<b>Schedules of Submitted and Allowed Program Costs</b>				
<b>Ames Special Education Preschool Integrated Program (9160)</b>				
<b>For the Fiscal Year Ended June 30, 2005</b>				
	Costs Reported Per CFR	Proposed Disallowance	Amount Allowed	Notes to Exhibit
Personal Service	\$762,463	-	\$762,463	
Vacation Accruals	(\$1,466)	-	(\$1,466)	
Total Fringe Benefits	<u>\$199,458</u>	-	<u>\$199,458</u>	
Total Personal Service	\$960,455	-	\$960,455	
Other-Than-Personal-Service	\$271,110	-	\$271,110	
Equipment	\$22,093	-	\$22,093	
Property	<u>\$142,154</u>	<u>\$24,899</u>	<u>\$117,255</u>	E
Total Operating Cost	\$1,395,812	\$24,899	\$1,370,913	
Agency Administration Allocation	<u>\$161,769</u>	<u>\$ 4,254</u>	<u>\$157,515</u>	D
Total Program Cost	\$1,557,581	\$29,153	\$1,528,428	

<b>Leake and Watts Services, Inc.</b>				
<b>Schedules of Submitted and Allowed Program Costs</b>				
<b>Brownell Special Education Preschool Integrated Program (9165)</b>				
<b>For the Fiscal Year Ended June 30, 2005</b>				
	Costs Reported Per CFR	Proposed Disallowance	Amount Allowed	Notes to Exhibit
Personal Service	\$292,752	-	\$292,752	
Vacation Accruals	-	-	-	
Total Fringe Benefits	<u>\$82,101</u>	-	<u>\$82,101</u>	
Total Personal Service	\$374,853	-	\$374,853	
Other-Than-Personal-Service	\$127,952	-	\$127,952	
Equipment	\$5,419	-	\$5,419	
Property	<u>\$43,643</u>	-	<u>\$43,643</u>	
Total Operating Cost	\$551,867	-	\$551,867	
Agency Administration Allocation	<u>\$66,044</u>	<u>\$1,737</u>	<u>\$64,307</u>	D
Total Program Cost	\$617,911	\$1,737	\$616,174	

## **Notes to Exhibits**

The notes shown below refer to specific sections of the Cost Reimbursement Manual upon which we have based our adjustments. We have summarized the applicable section to explain the rationale for our disallowance. Details of the transactions in question were provided to officials of Leake and Watts and to SED during the audit.

- A. Section 1 - Costs must be reasonable, necessary, directly related to the education program and sufficiently documented. We determined some costs were not sufficiently documented.
- B. Section 1.11 B - Costs for ordinary living expenses such as the cost of overnight class trips or other expenses that are normally assumed by parents of students attending public schools are not reimbursable.
- C. Section 1.12 - Costs for ordinary living expenses such as the cost of clothing and uniforms that are normally assumed by parents or legal guardians of students attending day care centers or public schools, are not reimbursable. Clothing expenses for staff such as uniforms for custodians or bus drivers, even if required by school policy, are not reimbursable. Such costs are considered personal expenses.
- D. Section 1.14 B 4a - Compensation for the entity's executive director, assistant executive director and chief financial officer is limited to the regional median compensation for comparable administration job titles of public school districts, as determined and published annually by SED's Basic Educational Data System. Reimbursement of employee compensation for these job titles shall not exceed the median paid to comparable personnel in public schools for similar work in the region in which the entity is located.
- E. Section 1.18 B (2) - Expenses related to purchasing or constructing a facility such as attorney's fees; recording costs; transfer taxes; and service charges such as finder's fees, should be amortized over the term of the mortgage.
- F. Section 1.21 - Costs incurred for entertaining 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.
- G. Section 1.22 - Costs resulting from violation of, or failure by, the entity to comply with Federal, State and/or local laws and regulations, are not reimbursable.
- H. Section 1.23 C - Costs of food provided to any staff are not reimbursable.
- I. Section 1.30(3) - Costs for food, beverages, entertainment and other related costs for meetings including Board Meetings are not reimbursable.



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

DEPUTY COMMISSIONER FOR OPERATIONS  
AND MANAGEMENT SERVICES  
Tel. (518) 474-2547  
Fax (518) 473-2827  
E-mail: tsavo@mail.nysed.gov

July 5, 2007

Mr. Brian E. Mason  
Audit Manager  
Office of the State Comptroller  
Division of State Government Accountability  
110 State Street – 11<sup>th</sup> Floor  
Albany, NY 12230

Dear Mr. Mason:

The following is the New York State Education Department's (SED) response to the draft audit report (2006-S-123) addressing the fiscal and enrollment data reported by Leake and Watts Services, Inc. on the Consolidated Fiscal Report (CFR) submitted to the Department for the year ended June 30, 2005. We will only be addressing those recommendations addressed to the Department.

**Recommendation 1:**

**Review the disallowances resulting from our audit and make the appropriate adjustments to the costs reported on the CFR. Recalculate the tuition rates based on the CFR for the 2004-05 year.**

We agree with the recommendation and will recalculate the tuition rates using the 2004-05 CFR plus any appropriate audit adjustments.

If you have any questions regarding this response, please contact Thomas Hamel, Chief of the Rate Setting Unit, at (518) 486-2991.

Sincerely,

Theresa E. Savo

c: Thomas Hamel



175th Anniversary

June 21, 2007

Leake and Watts Services, Inc.  
463 Hawthorne Avenue  
Yonkers, New York 10705  
914 375 8700  
914 375 8800 fax  
www.leakeandwatts.org

1529-35 Williamsbridge Road  
Bronx, NY 10461  
718 794 8200  
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Brian E. Mason  
Audit Manager  
Office of the State Comptroller  
Division of State Government Accountability  
110 State Street, 11<sup>th</sup> Floor  
Albany, NY 12236

Dear Mr. Mason:

This letter is the response to comments in the draft audit report (2006-S-123) addressing the fiscal and enrollment data reported by Leake and Watts Services, Inc. on the Consolidated Fiscal Report submitted to the State Education Department for the year ended June 30, 2005. I understand that this response will be included as an appendix to your final report.

The first comment relates to the refinancing of the agency's Dormitory Authority bonds. Leake and Watts operated under the belief that bond refunding costs had to be reported on the CFR consistent with Generally Accepted Accounting Principles. According to GAAP, most of the expenses of the refunding could not be amortized on our audited financial statements. This treatment was confirmed by two CPA firms (Deloitte and Touche and Loeb and Troper). Costs were reported on the CFR consistent with their treatment on the audited financial statements. When reviewed by the State Education Department's Rate Setting Unit at the time of rate reconciliation, Leake and Watts was not told that these expenses could be amortized. However, subsequent to the Comptroller's audit, the SED Rate Setting Unit determined that they could be amortized over the remaining life of the bonds for CFR reporting and rate setting purposes. Leake and Watts concurs with this treatment, and will report the amortized costs on future CFRs.

The second comment relates to personal service costs. It should be noted that SED only allows up to the median of compensation for Superintendents and Assistant Superintendents in the public schools. The median means that 50% of the Superintendents and Assistant Superintendents in the region make more than the allowable amount. Based on length of service and salary surveys of other nonprofit agencies in the NYC Metropolitan Area, Leake and Watts believes that the compensation paid to the Executive Director and the Associate Executive Director is reasonable.

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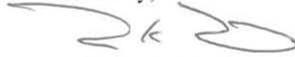
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*Assistant Executive Directors*

We thank the auditors for their most thorough review and recommendations.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael K. Mazzocco". The signature is fluid and cursive, with a large initial "M" and a long horizontal stroke extending to the left.

Michael K. Mazzocco  
Chief Financial Officer

Cc: J. Campbell  
D. Castro  
M. Ames