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COMPTROLLER

OFFICE OF THE NEW YORK STATE COMPTROLLER

DIVISION OF STATE GOVERNMENT ACCOUNTABILITY

PYRAMIDS CHILD DEVELOPMENT CENTER

COMPLIANCE WITH THE REIMBURSABLE COST MANUAL FOR THE FISCAL YEAR ENDED JUNE 30, 2006

Report 2007-S-91

AUDIT OBJECTIVE

Our audit objective was to determine whether the cost, enrollment, and service data reported to the State Education Department (SED) by Pyramids Child Development Center (Pyramids) on the Consolidated Fiscal Report (CFR) for the fiscal year ended June 30, 2006 were properly supported and allowed by the Reimbursable Cost Manual (Manual).

AUDIT RESULTS - SUMMARY

We identified material deficiencies in the CFR submitted by Pyramids for the year ended June 30, 2006. As a result, we propose adjustments which reduce the total allowable costs by $239,889 (see Exhibit A) for the four educational programs we reviewed. These adjustments included certain personal service and other-than-personal-service-costs. Adjustments for personal services pertained to the Executive Director's compensation and accruals for staff bonuses. Other-than personal service adjustments included depreciation, amortization, accounting (bookkeeping) and legal fees, penalties, and other costs that were not allowable per the Manual. Based on our audit, we propose disallowances totaling $113,511 for the 9100 Program (see Exhibit B), $32,676 for the 9101 Program (see Exhibit C), $20,255 for the 9135 Program (see Exhibit D), and $73,447 for the 9160 Program (see Exhibit E). These disallowances will likely cause SED to re-compute the tuition rates for these programs. (See pp. 3-8, 12-19)

We further concluded that Pyramids' Board of Directors is not sufficiently independent. Four of the Board's five members had a direct relationship with the school. In fact, three of the four members in question were employees of Pyramids. Consequently, we concluded that Pyramids' Board did not have sufficient capability to provide adequate guidance and monitoring of Pyramids' financial affairs. (See pp. 9-10)

Our report contains eight recommendations, three of which are addressed to SED. SED officials agreed with the three recommendations and indicated certain actions they will take with respect to them. The remaining five recommendations were made to Pyramids to help improve controls over its CFR preparation and certain related financial and management practices. Pyramids officials did not specifically agree or disagree with most of the recommendations we made. In addition, Pyramids officials disagreed with most of the proposed disallowances detained in this report. However, officials indicated that they would seek to hire a qualified person to fill the position of Controller to help ensure that Pryamids' CFR complies with the Manual.

This report, dated May 15, 2008, is available on our website at:http://www.osc.state.ny.us. Add or update your mailing list address by contacting us at: (518) 474-3271 or
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BACKGROUND

Pyramids is a not-for-profit entity and is approved by the State to provide early intervention and pre-school special education services to children from birth through age five. Pyramids operates seven pre-school special education facilities which are located in Morrisonville, Elizabethtown, Keeseville, and Ticonderoga (in northeastern New York State). Pyramids staff also provides certain services at children's homes. Among the services provide by Pyramids are; speech therapy, physical therapy, and special education and counseling. Pyramids also

operates day care centers within Clinton and Essex counties.

The State Education Department (SED) develops tuition reimbursement rates for the four preschool special educational programs operated by Pyramids. The Preschool Special Class Full Day (code 9100) and the Pre-School Special Class Half-Day (code 9101) programs are classes approved by SED to operate more than 2.5 hours per day, and they include students with the same or differing disabilities who are grouped together because of similar needs. The Preschool Special Education Itinerant Teacher (SEIT or code 9135) program provides services to preschool students by a certified special education teacher at sites including an approved pre-kindergarten or head start program, the student's home, a hospital, a state facility or a child care location. The Preschool-Integrated Special Class (code 9160) program is approved to operate more than 2.5 hours per day and employs a special education teacher and at least one para-professional in a classroom consisting of disabled and non-disabled preschool students - or separate non-disabled and disabled classes housed in the same physical space.

The Executive Director of Pyramids is also the president and sole stockholder of Dorsett-Felicelli Incorporated (Dorsett-Felicelli). Dorsett-Felicelli is a privately-owned corporation, approved by the State Department of Health and SED, that provides early intervention evaluations (for infants through children age two) and preschool evaluations (for children age three to five) for speech, physical and occupational therapy, special education services, and developmental playgroups.

SED annually develops tuition rates to be used to reimburse providers for the costs of program services, as prescribed by the State Education Law. The tuition rates are based on financial data and the enrollments (or the number of sessions provided) reported to SED on the CFR. SED requires Pyramids and Dorsett-Felicelli to submit one aggregated CFR including all programs of both entities. Pyramids and Dorsett-Felicelli hired a CPA firm to prepare its financial statements and the aggregated CFR.

AUDIT FINDINGS AND RECOMMENDATIONS

For the 2005-06 year, Pyramids and Dorsett-Felicelli reported total costs of nearly $3.9 million for all of the programs operated by these entities. The costs for the four preschool special education programs that we reviewed totaled $2,130,601, including $1,720,664 in personal service costs (including fringe benefits) for direct care and $409,937 in other-than-personal-service costs and administrative costs. For the four programs we reviewed, we propose that SED disallow $239,889 (see Exhibit A), including $131,468 in direct care costs and $108,421 in non-direct care (or administrative) costs. Exhibits B through E detail the specific costs disallowed for each of the four programs reviewed.

Direct Care Costs

For the programs we reviewed, we propose disallowance of direct care costs totaling $131,468 (as noted previously). The disallowances for direct care included personal service costs (including salaries and fringe benefits) totaling $101,335 and other-than-personal-service costs totaling $30,133.

Personal Service Costs

Personal service costs must be reported as either direct care costs (such as teachers' salaries) or non-direct care costs (such as

administrators' salaries). Direct care costs should be charged to specific programs based on employees' work locations and functions.

For the 2005-06 year, Pyramids claimed about $1.7 million of direct care personal service costs for the four programs that we reviewed. We tested the allocations and supporting documentation for a judgmental sample of 15 of Pyramids direct care staff. Based on our review, we concluded that personal service costs for direct care were generally properly supported and reported accurately. However, we propose disallowances totaling $101,335 for other personal service costs that were not consistent with the Manual. The disallowances pertained to accruals for staff bonuses.

The Manual has specific criteria for reporting compensation for personal services, including bonus compensation. On its CFR, Pyramids reported $86,000 in accrued wages for 14 employees and administrative staff. This included an accrual of $10,000 for the Executive Director (in addition to the Executive Director's regular compensation as detailed subsequently in this report). To determine if the $86,000 represented actual wage accruals or employee bonuses, we compared employees' wage statements to the payroll registers for the employees who had wages accrued. All 14 employees received the full amounts of their standard wages each pay period, and consequently, no wages were owed to these employees at the end of the fiscal year. Because no wages were owed, there was no basis to accrue additional wage costs for the 14 employees. Consequently, we contacted Pyramids' CPA firm to obtain documentation for the justifications and the amounts of the accruals. The CPA firm provided us with documentation from a consultant, hired by Pyramids, to maximize the reporting of expenses on the CFR (and thereby help increase Pyramids' tuition rates). That documentation explicitly identified the accrued wages as bonuses for the 14 employees.

The Manual requires that bonuses be based on documented performance evaluations to justify the amounts of the payments. However, we reviewed each of the 14 employees' personnel files and found no employee performance evaluations. Further, Pyramids' Controller told us that formal performance evaluations are not prepared for staff. Subsequent to our initial review of this matter, Pyramids' Executive Director stated the payments were not bonuses (based on performance evaluations). Rather, the extra payments were purportedly based on increases in the numbers of children served and units of services delivered. However, there was no documentation to demonstrate that bonus recipients actually served larger numbers of children and/or provided additional units of service. Consequently, we propose a disallowance totaling $101,335 in direct care personal service costs for the four programs we reviewed. This includes the $86,000 in accrued wages (bonuses) that did not meet the requirements of the Manual and the related fringe benefit costs of $15,335.

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. All purchases must be supported with invoices listing the items purchased and the date of purchase. Reported costs (payments) must also be supported by cancelled checks. However, Pyramids sometimes did not comply with the Manual, and consequently, we propose disallowing $30,133 in other-than-personal-service costs

reported for the four programs we audited. The disallowances pertained to depreciation, amortization, penalties, and other costs that were not allowable per the Manual.

a.) Depreciation and Amortization Costs

Depreciation is generally allowable for tuition rate setting purposes. The Manual requires that documentation relating to the purchase of fixed assets, equipment, land or building improvements be retained to support the calculations of depreciation. In addition, documentation of any related financing (such as mortgages, loans, or bonds) and grants must be retained as long as the facility is used by any education program the provider operates. However, the portion of building construction, acquisition, or renovation and/or equipment funded by a government grant (or other public funding) cannot be funded again (or reimbursed) through depreciation claimed on the CFR. The asset cost basis must be reduced by the amount of the grant(s), and any remaining balance should be depreciated according to the Manual.

Pyramids claimed $30,184 for building depreciation for all of its programs. We reviewed a depreciation schedule provided by Pyramids' CPA firm, and found that the firm did not deduct grant amounts (of $849,412) that Pyramids used to purchase and renovate its main campus facilities. After adjusting for the grant funds, we determined the eligible building depreciation to be only $8,815. This resulted in a disallowance of $13,604 in building depreciation for the programs we reviewed.

Pyramids reported $22,755 for equipment depreciation and amortization. This included $13,430 for equipment depreciation and $9,325 for the amortization of organizational costs. Most of the depreciation pertained to equipment and furniture purchased in 2005 and 2006. Pyramids did not maintain equipment inventory control records that could be used to determine depreciation, and consequently, we reviewed a depreciation schedule prepared by Pyramids' CPA firm. There were, however, errors in this schedule. The CPA firm calculated depreciation for equipment purchased in 2006 over 12 months instead of the actual number of months the equipment was in service. In addition, Pyramids could not provide us with the supporting documentation for several furniture and equipment purchases. Consequently, we disallowed equipment depreciation costs totaling $6,277.

Pyramids amortized organizational costs (of $9,325 annually) over a period of ten years, instead of the five-year period allowed by the Manual. As a result, amortized organization costs were under-reported by $9,325. We offset the allowable amortization costs against the disallowance of $6,277 for equipment depreciation. Consequently, we allowed an additional $1,941 in allocations for equipment depreciation and amortization costs for the four programs we audited.

b.) Other Operating Expenses

The Manual specifies that certain costs are not reimbursable. Non-reimbursable costs include costs of food provided to any staff; costs incurred for the entertainment of officers or employees or for activities not related to the program; payments for Federal, State and local taxes or any related penalties and interest; and penalties and interest on late payments or nonpayment of payroll withholding taxes.

On its CFR, Pyramids allocated a total of $32,881 for Miscellaneous Operating Expenses for all of its programs. We tested 26 transactions totaling $24,464 from categories including Meals and

Entertainment, Penalties, and Dues and Memberships. We determined that some portion of all 26 transactions tested were not supported by adequate documentation and/or were not allowable per the Manual. Included in the disallowed amount were seven transactions totaling $17,132 for tax penalties and interest. Also, $6,488 for staff meals were not adequately supported with receipts, agendas or attendance records. Based on our review, we determined that the allocations of Pyramids' Miscellaneous Operating costs should be reduced by $14,389 for the programs we reviewed.

We further determined that Therapy Supplies and Food costs should be reduced by $4,081 for the programs we reviewed. Several Therapy Supplies transactions totaling $2,160 were unsupported. This included an unexplained general journal entry and a credit card payment on behalf of Pyramids' Executive Director. Also, Pyramids officials could not provide adequate supporting documentation for food purchases for its education programs totaling $1,921.

Non-Direct Care (Administrative) Costs

According to the Manual, any expenditure that cannot be charged directly to a specific program must be allocated across all of an entity's programs that benefit from the expenditure, including non-direct care costs (such as administration). Non-direct care costs are allocated to the education programs using the ratios of individual program's direct care costs to the total direct care costs for all programs. Allocation methods for non-direct care costs, including the statistical basis used to calculate allocation rates, must be documented and retained for review upon audit. Pyramids reported total non-direct care costs of $438,093. We disallowed non-direct care costs of $108,421 (including $93,113 in personal service and $15,308 in other-than-personal-service costs) for the four programs we audited. Exhibits B through E detail the specific non-direct care (administrative) costs disallowed for each of the programs we reviewed.

Administrative Salary Costs

The administrative payroll cost reported by Pyramids and Dorsett-Felicelli was $205,157 (excluding fringe benefits) for all of its programs. According to the Manual, employee compensation costs must be based on payrolls that are approved and documented. Further, Payrolls must be supported by employee time and attendance records prepared contemporaneously with the time periods for which the employee was paid. Time sheets must be signed by the employee and a supervisor, and must be completed at least monthly.

Pyramids administrative staff did not maintain traditional time and attendance records of their hours worked and absences. Instead, most administrative staff used the same computerized entry/exit system used by teachers, therapists, and other Pyramids employees to generate some form of timekeeping records. The system records entry to and exit from most Pyramids locations. Pyramids officials also noted that the system can be manually overridden, with entry and exit times adjusted and/or recorded after the date in question. Consequently, Pyramids did not have appropriate time and attendance records to support administrative employees' compensation and leave accrual balances. During our field work, we observed that most administrative staff (with the exception of the Executive Director) generally maintained regular work schedules. Therefore, we propose no disallowance with respect to these employees. However, we concluded that Pyramids needs to develop and implement a formal time and attendance

recording system that supports payroll costs and conforms with the Manual.

The primary residence of Pyramids' Executive Director is in North Carolina. Based on our observations and information provided by Pyramids staff, we concluded that the Executive Director was rarely on-site at any of Pyramids' facilities. Further, Pyramids computerized entry/exit system did not record the Executive Director's entry to and/or exit from Pyramids' facilities. Nor did the Executive Director maintain any records of the time she spent fulfilling her responsibilities to the school. According to SED officials, time and attendance records for the Executive Director should be available for audit. Such records should also be made available to the Board of Directors to help ensure that costs for executive management are justified. The total compensation for the Executive Director was $171,168 (including salary of $143,792 and fringe benefits of $27,376). This exceeded the median compensation level for the region (as allowed by the Manual) by $4,388 ($171,168 minus the regional median compensation of $166,780.)

Further, we examined other documentation provided by Pyramids officials in lieu of the required time and attendance records. Specifically, we reviewed a list of dates when the Executive Director was purportedly in the vicinity of Pyramids' facilities during the 2005-06 school year and copies of credit card statements for the same period. We also reviewed a computer network transaction log which, according to Pyramids officials, provided evidence of the Executive Director's Pyramids-related work activity. However, the records provided to us did not constitute sufficient evidence of the Executive Director's presence at Pyramids or her Pyramids-related work activities. Because there was little evidence that the Executive Director was present at Pyramids and because the Executive Director did not prepare and maintain any time and attendance records, we propose a disallowance of the total compensation ($171,168) claimed on the CFR. The total amount of this disallowance allocable to the four programs we reviewed was $93,113.

Other-Than-Personal-Service Administrative Costs

The Manual states that costs associated with retainers for legal, accounting or consulting services are not reimbursable unless the fees represent payments for actual services rendered. In addition, lobbying fees are not allowed. Pyramids and Dorsett-Felicelli reported $40,767 for accounting costs. We disallowed accounting expenses totaling $16,201. The disallowance included five transactions totaling $11,165 from periods prior to the 2005-06 year and $600 in charges for the preparation of the Executive Director's personal Federal and State income tax returns. This disallowance also includes $4,436 in bookkeeping fees that were not sufficiently documented. Pyramids and Dorsett-Felicelli hired an accounting firm to perform certain bookkeeping services, including the preparation of payrolls and monthly trial balances. Further, Pyramids' Controller is related to a partner in the accounting firm, and therefore, this arrangement was less-than-arms-length. Fees paid to the accounting firm totaled $21,316, and the firm provided sufficient documentation (including detailed staff time records) for most of its fees. However, the charges (for $4,436) for the relative of Pyramids' Comptroller were not adequately supported.

Pyramids reported $17,641 for legal fees on the CFR. We disallowed expenses totaling $8,000 because the expenses claimed did not meet several of the Manual's requirements.

Specifically, we disallowed $5,000 for a retainer to initiate a lawsuit, $2,500 in prior period legal fees that were not documented, and $500 for lobbying services. We also disallowed $3,939 in miscellaneous administrative costs, including building depreciation.

In total, the disallowances for the other-than-personal-service administrative costs were $28,140 for all of Pyramids programs. The allocations of these disallowances to the programs we reviewed totaled $15,308.

Recommendations

To SED:

1. Review the personal service and other-than-personal-services adjustments in this report and make appropriate adjustments to the costs reported on Pyramids' CFR. Recompute the tuition rates and advise the localities to take appropriate actions to recover any overpayments.

2. Assess the ability of Pyramids officials and its CPA firm to prepare the CFR properly and provide training and/or additional guidance to Pyramids and its CPA firm, as appropriate.

To Pyramids:

3. Comply with the Manual's requirements for documenting and maintaining time keeping records and staff evaluations.

4. Ensure all other-than-personal-service costs reported on the CFR are eligible pursuant to the Manual and that they are adequately documented. Supporting documentation should include equipment inventory controls records (to help calculate depreciation costs) and invoices (and/or other related documents) to support purchases.

Enrollment and SEIT Session Reporting

SED uses the full-time equivalent (FTE) student enrollment of an entity's program to calculate that programs' tuition reimbursement rate. Accordingly, the Manual requires schools, such as Pyramids, to calculate its programs' FTE student enrollment through a prescribed methodology which includes the starting and ending dates of each student's enrollment. We verified that Pyramids reported the appropriate number of FTE students of the CFR for its four educational programs. Specifically, we traced a judgmental sample of 64 of Pyramids nearly 300 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 enrollments reported by Pyramids were materially accurate.

SED requires SEIT sessions reported on the CFR to be based on the sessions authorized in the students' Individualized Education Programs (IEPs). For the year ended June 30, 2006, Pyramids reported 8,440 SEIT sessions on the CFR. We compared the clinical records for 21 students receiving sessions from Pyramids to documentation used to prepare data for the CFR. We also reviewed documentation provided by Clinton and Essex County officials. Based on our review, we concluded that Pyramids correctly reported IEP-authorized SEIT sessions to SED.

Board Governance and Controls

Internal controls are the process and procedures set by an entity's board of directors and management to reasonably assure the efficiency of operations, the reliability of financial reporting, and compliance with applicable laws and regulations. We found Pyramids' Board of Directors (Board) and management had not established the necessary policies and procedures to ensure the school's financial operations complied with the Manual.

The Manual provides information to assist board members in the performance of their responsibilities to the institution and their duties to the community it serves. The Manual requires the board of directors of a not-for-profit entity (like Pyramids) to be independent of its management; meet at least twice a year; keep accurate minutes of all meetings; avoid any conflict of interests (or even the appearance of a conflict) and maintain a conflict of interest policy for board members and employees; and require each member to file an annual written disclosure of any business involvement with the institution or related parties. The board should also address concerns raised by independent certified public accountants hired to review the entity's financial operations and financial statements.

Pyramids' Board of Directors was not independent. Four of the Board's five members had a direct relationship with the school. Specifically, Pyramids' Executive Director also served as President of the Board. Pyramids' Controller was the Board's Treasurer. In addition, the school's billing clerk served as the Board's Secretary and was also related to the Executive Director. A fourth Board member is the sister of Pyramids' Comptroller and Board Treasurer. We concluded that such relationships diminished the independence of Pyramids' Board of Directors and, therefore, its effectiveness.

Pyramids' officials were unable to provide us with a copy of Pyramids By-Laws. Further, the Board does not meet on a regular basis, and it has done little to address matters included in the management letters (from Pyramids' CPA firm) that accompany the general purpose financial statements. There were nine issues in the 2006 letter that were previously addressed in the 2005 letter, but were not corrected at the time of our audit fieldwork (which began in August 2007). This included the need to create an independent Board. In addition, the Manual requires schools, such as Pyramids, to submit management letters, along with audited financial statements to SED. However, Pyramids officials did not submit the management letters to SED when they submitted their audited statements.

Pyramids' officials could only provide us with the minutes of one board meeting, held on November 9, 2005. Minutes for prior or subsequent meetings, if any, were not available. Moreover, the Board has not established a written conflict of interest policy, and members do not file written disclosures of any business involvement with related parties. Pyramids conducted a number of related party transactions, against the formal advice of its CPA firm (from management letters that accompanied the financial statements for 2005 and 2006). As noted earlier in this report, a partner in bookkeeping firm used by Pyramids is also the brother of Pyramids' Controller/Board Treasurer. Also, Pyramids purchased office supplies (totaling $13,510) from a company owned and operated by relatives of both the Board President/Executive Director and the Board's Secretary. There was no documentation that a competitive

procurement process was followed to obtain the office supplies. Pyramids' CPA firm recommended that action be taken to eliminate perceived conflicts of interest. However, because the Executive Director believes that there have been no conflicts of interest, the CPAs' guidance was not followed, nor presented to the overall Board for consideration.

We further concluded that Pyramids' Board and management lacked sufficient understanding of CFR preparation requirements, including pertinent provisions of the Manual. Pyramids officials and officials from the accounting firm that provided monthly bookkeeping services to the school acknowledged that they were not familiar with the Manual's guidance on allowable costs. Rather, they relied on the CPA firm to prepare both organizations' general purpose financial statements and the CFR. Officials of the CPA firm that prepared the CFR for Pyramids stated that the errors we identified occurred because staff at Pyramids and the bookkeeping firm were unfamiliar with the Manual. In addition, Pyramids' officials have not developed written policies and procedures to guide business office staff in the performance of their job duties.

Recommendations

To SED:

5. Require Pyramids to establish an independent board of directors. Ensure the newly formed board of directors consists of a minimum of five independent voting members, who avoid any conflicts of interest and annually file written disclosure of any business involvement with the institution or related parties. Instruct Pyramids to have its board of directors meet at least twice a year and keep accurate minutes of all meetings.

To Pyramids:

6. Establish a Board of Directors that is independent from Pyramids executive management.

7. In accordance with the Manual, require the Board of Directors to:

- Meet at least twice year, and more often as needed or required by statue;
- Keep accurate minutes of all meetings;
- Develop and comply with a conflict of interest policy for board members and Pyramids employees;
- Require each Board member to file an annual written disclosure statement; and
- Review and document the process for selecting new Board members.

8. Develop and implement formal internal controls (policies and procedures) to reasonably assure the reliability of financial reporting and compliance with applicable laws and regulations, including the provisions of the Manual.

AUDIT SCOPE AND METHODOLOGY

We audited the costs and required program data reported by Pyramids on the CFR for the period July 1, 2005 through June 30, 2006. We conducted our audit in accordance with generally accepted government auditing standards. To accomplish our objective, we reviewed Pyramids' financial records, including audit documentation maintained by Pyramids' independent CPAs and accounting (bookkeeping) firm. We interviewed

Pyramids officials and staff to obtain an understanding of Pyramids' financial practices. In addition, we interviewed SED officials to obtain an understanding of the CFR and its impact of the calculation of tuition payments and session payment rates. We tested the supporting documentation for certain costs reported on the CFR for the 2005-06 year in relation to the Manual. Further, we reviewed the method used by Pyramids to allocate personal service costs between its various programs and verified sessions reported on the CFR to the IEPs of students receiving services from Pyramids. We also interviewed officials from Clinton and Essex Counties to understand Pyramids billing practices and officials of the CPA firm that certified Pyramids' CFR to determine the procedures they used to verify the information reported.

Our audit was limited to the four preschool special education programs (codes 9100, 9101, 9135, and 9160) at Pyramids, as detailed previously in this report. Our audit did not include the Early Intervention Program, daycare programs, or any other programs operated and administered by Pyramids and/or Dorsett-Felicelli.

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

AUTHORITY

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

REPORTING REQUIREMENTS

We provided draft copies of this report to SED and Pyramids officials for their review and formal comment. We considered their comments in preparing this report. Complete copies of SED's and Pyramids' responses are included as Appendixes A and B, respectively. Our rejoinders to Pyramids' response are presented in Appendix C, State Comptroller's Comments.

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

CONTRIBUTORS TO THE REPORT

Major contributors to this report include Steven Sossei, Brian Mason, William Clynes, Mary T. Roylance, Anthony J. Calabrese and David L. Pleeter.

Exhibit A

Pyramids Child Development Center Summary of Disallowances by Program For the Fiscal Year July 1, 2005 through June 30, 2006				
Program Code No.	**Direct Care Salary and Fringe Benefits**	**Direct Care Other-Than-Personal Services**	**Non-Direct Care (Administration)**	**Total Disallowance**
9100	$ 74,865	$ 7,186	$ 31,460	$113,511
9101	$0	$ 7,669	$ 25,007	$ 32,676
9135	$0	$ 4,641	$ 15,614	$ 20,255
9160	$ 26,470	$10,637	$ 36,340	$ 73,447
Total	$101,335	$30,133	$108,421	$239,889

Exhibit B

Pyramids Child Development Center Schedule of Submitted and Allowed Program Costs Preschool Special Class Full Day (9100) Program For the Fiscal Year July 1, 2005 through June 30, 2006				
	Amount Per CFR	**Disallowance (Increase)**	**Amount Allowed Per Audit**	**Notes to Exhibits**
Personal Service	$391,484	$63,700	$327,784	C,T
Fringe Benefits				
Mandated Fringe Benefits	$ 32,106	$ 5,224	$26,882	C
Non-Mandated Fringe Benefits	$ 36,509	$ 5,941	$30,568	C
Total Fringe Benefits	$ 68,615	$ 11,165	$57,450	
Food	$ 8,933	$ 551	$ 8,382	O, R
Miscellaneous	$ 4,530	$ 3,319	$ 1,211	A,E,F,H,I,J,K,L,M,N,O,R
Supply Therapy	$ 6,485	$ 518	$ 5,967	A,H,J,M,T
All other OTPS	$ 28,237	$0	$ 28,237	
Equipment	$ 3,041	($466)	$ 3,507	O, R, S, W
Building	$ 4,611	$ 3,264	$ 1,347	G
Total OTPS	$ 55,837	$ 7,186	$ 48,651	
Total Operating Costs	$515,936	$ 82,051	$433,885	
Agency Administration Allocation	$ 66,798	$ 31,460	$ 35,338	A, B, D, E, G
Total Program/Site Costs	$582,734	$113,511	$469,223	

Exhibit C

Pyramids Child Development Center Schedule of Submitted and Allowed Program Costs Preschool Special Class Half Day (9101) Program For the Fiscal Year July 1, 2005 through June 30, 2006				
	Amount Per CFR	**Disallowance (Increase)**	**Amount Allowed Per Audit**	**Notes to Exhibits**
Personal Service	$341,367	$0	$341,367	C,T
Fringe Benefits				
Mandated Fringe Benefits	$ 26,969	$0	$ 26,969	
Non-Mandated Fringe Benefits	$ 38,022	$0	$ 38,022	
Total Fringe	$ 64,991	$0	$ 64,991	
Food	$ 9,303	$ 574	$ 8,729	O, R
Miscellaneous	$ 4,967	$ 3,640	$ 1,327	A,E,F,H,I,J,K,L,M,N, O,R
Supply Therapy	$ 6,754	$ 540	$ 6,214	A,H,J,M,T
All other OTPS	$ 2,236	$0	$ 2,236	
Equipment	$ 3,167	($485)	$ 3,652	O, R, S, W
Building	$ 4,803	$ 3,400	$ 1,403	G
Total OTPS	$ 31,230	$ 7,669	$ 23,561	
Total Operating Costs	$437,588	$ 7,669	$429,919	
Agency Administration Allocation	$ 60,022	$25,007	$ 35,015	A, B, D, E, G
Total Program/Site Costs	$497,610	$32,676	$464,934	

Exhibit D

Pyramids Child Development Center Schedule of Submitted and Allowed Program Costs Preschool Special Education Itinerant Teacher (SEIT) (9135) Program For the Fiscal Year July 1, 2005 through June 30, 2006				
	Amount Per CFR	**Disallowance (Increase)**	**Amount Allowed Per Audit**	**Notes to Exhibits**
Personal Service	$223,244	$0	$223,244	
Fringe Benefits				
Mandated Fringe Benefits	$ 17,637	$0	$ 17,637	
Non-Mandated Fringe Benefits	$ 24,865	$0	$ 24,865	
Total Fringe	$ 42,502	$0	$ 42,502	
Food	$0	$0	$0	
Miscellaneous	$ 3,249	$ 2,381	$ 868	L,M,N,O,R
Supply Therapy	$ 4,417	$ 353	$ 4,064	A,H,J,M,T
All other OTPS	$ 1,463	$0	$ 1,463	
Equipment	$ 2,071	($ 317)	$ 2,388	O, R, S, W
Building	$ 3,141	$ 2,224	$ 917	G
Total OTPS	$ 14,341	$ 4,641	$ 9,700	
Total Operating Costs	$280,087	$ 4,641	$275,446	
Agency Administration Allocation	$38,048	$15,614	$ 22,434	A, B, D, E, G
Total Program/Site Costs	$318,135	$20,255	$297,880	

Exhibit E

Pyramids Child Development Center Schedule of Submitted and Allowed Program Costs Preschool-Integrated Special Class (9160) Program For the Fiscal Year July 1, 2005 through June 30, 2006				
	Amount Per CFR	**Disallowance (Increase)**	**Amount Allowed Per Audit**	**Notes to Exhibits**
Personal Service	$495,757	$22,300	$473,457	C,T
Fringe Benefits				
Mandated Fringe Benefits	$ 39,970	$ 1,798	$ 38,172	C
Non-Mandated Fringe Benefits	$ 52,734	$ 2,372	$ 50,362	C
Total Fringe Benefits	$ 92,704	$ 4,170	$ 88,534	
Food	$ 12,903	$ 796	$ 12,107	A,E,F,H,I,J,K,L
Miscellaneous	$ 6,890	$ 5,049	$ 1,841	M,N,O,R
Supply Therapy	$ 9,367	$ 749	$ 8,618	A,H,J,M,T
All other OTPS	$ 17,502	$0	$ 17,502	
Equipment	$ 4,393	($ 673)	$ 5,066	O, R, S, W
Building	$ 6,661	$ 4,716	$ 1,945	G
Total OTPS	$ 57,716	$10,637	$ 47,079	
Total Operating Costs	$646,177	$37,107	$609,070	
Agency Administration Allocation	$ 85,946	$36,340	$ 49,606	A, B, D, E, G
Total Program/Site Costs	$732,123	$73,447	$658,676	

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 sections to explain the rationale for our disallowance. Details of the transactions in question were provided to SED and Pyramids officials during the course of the audit.

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

B. Section I.14.A(4)(a) - Compensation (i.e., salaries plus fringe benefits) for the entity's executive director, assistant executive director and chief financial officer will be directly compared 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 Systems. Reimbursement of employee compensation for these job titles shall not exceed the median paid to comparable personnel in public schools for similar work and hours of employment in the region in which the entity is located.

C. Section I.14.A(11) - Bonus compensation shall mean a non-recurring and non-accumulating (i.e., not included in base salary of subsequent years) lump sum payment(s) in excess of regularly scheduled salary which is not directly related to hours worked. Bonus compensation may be reimbursed if based on merit as measured and supported by employee performance evaluations.

D. Section I.15 A(1)(2)(5) - Costs of consultants' services, including independent accountants, are reimbursable provided that: Fees do not exceed the prevailing rate for such services. The school will maintain documentation to support the regional prevailing rate at the time such costs are incurred. The services could not have been performed by an appropriately certified school officer or employee who possesses the necessary technical skills or by the SED Rate Setting Unit staff. Fees and transactions meet criteria for less-than arm's length transactions when applicable.

E. Section I.15 B - Costs associated with retainers for legal, accounting or consulting services are not reimbursable unless the fee represents payment for actual documented reimbursable services rendered provided the services are not for lobbying efforts.

F. Section I.17 - Political and charitable contributions and donations made by the program are not reimbursable.

G. Section I.18.A.6 - The portion of the cost of building construction, acquisition, renovation or equipment cost funded by a government grant or other public funding cannot be reimbursed again through depreciation of these costs. The asset cost must be reduced by the amount of the grant(s) and the balance depreciated in accordance with the Manual.

H. Section I.21.A and B - Costs incurred for entertainment of officers or employees, or for activities not related to the program, or any related items such as meals, lodging, gift

certificates to staff, flowers or parties for staff, holiday parties, and gratuities, are not reimbursable.

I. Section I.22 Fines and Penalties - Costs resulting from violation of, or failure by, the entity to comply with Federal, State and/or local laws and regulations, are not reimbursable.

J. Section I.23 C - Costs of food provided to any staff are not reimbursable.

K. Section I.30 Meetings and Conferences - For reimbursement purposes, conferences are generally defined to include meetings, conventions, symposiums, seminars, Department sponsored sessions or other such assemblies whose primary purpose is the dissemination of technical information. Conferences must be directly related to the education program or to the administration of the program. Programs shall be required upon audit to provide brochures, agenda or other literature that verify attendance and document the purpose of the conference or meeting. We found that costs for staff meetings and conferences were not supported by agendas or other literature and attendance records.

L. Section I.30.3 - Costs for food beverages, entertainment and other related costs for meetings, including Board meetings, are not reimbursable.

M. Section I.30.6 - Documentation to support the cost of meetings and conferences must include the names and job titles of staff that attended and the program(s) served by each staff person.

N. Section I.54.B Taxes - Payments for Federal, State and local taxes or any related penalties and interest are not reimbursable. Penalties and interest on late payments or nonpayment of payroll withholding taxes are not reimbursable.

O. Section II.A - Record Keeping Section 200.9 (d) of the Commissioner's Regulations requires entities operating approved programs retain pertinent accounting, allocation and enrollment attendance records supporting reported data directly or indirectly related to the establishment of the tuition rate for seven years following the end of each reporting year. Information relating to the acquisition of fixed assets, equipment, land or building improvements and any related financing arrangements and grants must be retained as long as the facility is used by any education program the provider operates if the period exceeds seven years. Costs will not be reimbursable on field audit without appropriate written documentation of costs.

P. Section II.A.1 Payroll - Compensation costs must be based on payrolls that are approved and documented. Payroll must be supported by employee time records prepared during, not after, the time period for which the employee was paid. Employee time sheets must be signed by the employee and a supervisor, and must be completed at least monthly.

Q. Section II.A.3 - Adequate documentation of consultant services 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.

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

S. Section II.A.9 - Equipment and Furniture - Inventory records, including the invoice, must be kept for all items purchased by the entity or donated to the entity for the benefit of approved programs. These records should list: the invoice number; a description of the item; the make; mode; or serial number of the item; cost; date of purchase; date retired; if applicable the program(s) using the asset; and the location. Pyramids did not maintain equipment inventory control records.

T. Section II.B.1 - Entities operating programs must maintain accounts in accordance with generally accepted accounting principles and section 200.9 (d) of the Commissioner's Regulations.

U. Section II.B.2 - The accrual basis of accounting is required for all programs receiving Article 81 and Article 89 funds. We found some costs from prior periods were not accrued.

V. Section II.B.5 - Entities operating programs must establish adequate systems of internal controls and to conduct risk assessments in accordance with guidelines of the Committee of Sponsoring Organizations (COSO).

W. For the programs we reviewed, we calculated equipment disallowances totaling $6,277. However, Pyramids amortized organizational costs, over a period of ten years instead of the five-year period allowed by the Manual. Therefore understating this allowable cost $9,325. As a result of these two errors, we calculated the additional eligible amortization offset by the equipment deprecation disallowance, totaled $1,941 in additional allowable expenses for the four programs under audit.

APPENDIX A - AUDITEE RESPONSE

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

March 12, 2008

Mr. Brian E. Mason
Audit Manager
New York State
Office of the State Comptroller
110 State Street, 11th Floor
Albany, New York 12236

Dear Mr. Mason:

I am responding to your letter of February 1, 2008 addressed to Commissioner Mills transmitting the Office of the State Comptroller's (OSC) draft audit report (2007-S-91) entitled "Pyramids Child Development Center." The following is the New York State Education Department's response to the OSC recommendations. We are only responding to the three recommendations in the report that are directed to the Department.

Recommendation 1: Review the personal service and other-than-personal services adjustments in this report and make appropriate adjustments to the costs reported on Pyramids' CFR. Re-compute the tuition rates and advise the localities to take appropriate action to recover any overpayments.

We agree with the recommendation. Upon the release of the final audit report, the Department will amend the rates as appropriate and notify municipalities of those adjusted tuition rates.

Recommendation 2: Assess the ability of Pyramids officials and its CPA firm to prepare the CFR properly and provide training and/or additional guidance to Pyramids and its CPA firm, as appropriate.

We agree with the recommendation.

Recommendation 5: Require Pyramids to establish an independent board of directors. Ensure the newly formed board of directors consists of a minimum of five independent voting members, who avoid any conflicts of interest and annually file written disclosure of any business involvement with the institution or related parties. Instruct Pyramids to have its board of directors meet at least twice a year and keep accurate minutes of all meetings.

We agree with the recommendation and will provide such direction to the school as soon as this report becomes final.

Should you have any questions regarding this letter, please contact Mr. Thomas Hamel, Chief of the Rate Setting Bureau, at (518) 486-2991.

Sincerely,

Theresa E. Savo

Theresa E. Savo

c: James Conway
Thomas Hamel

APPENDIX B - AUDITEE RESPONSE

PYRAMIDS
CHILD DEVELOPMENT CENTER
2155 State Route 22B
Morrisonville, NY 12962-3417
518-562-3847

February 19, 2008

Brain E. Manson
Office of the State Government Accountability
110 State St., 11th Floor
Albany, NY 11236

Dear Mr. Manson:

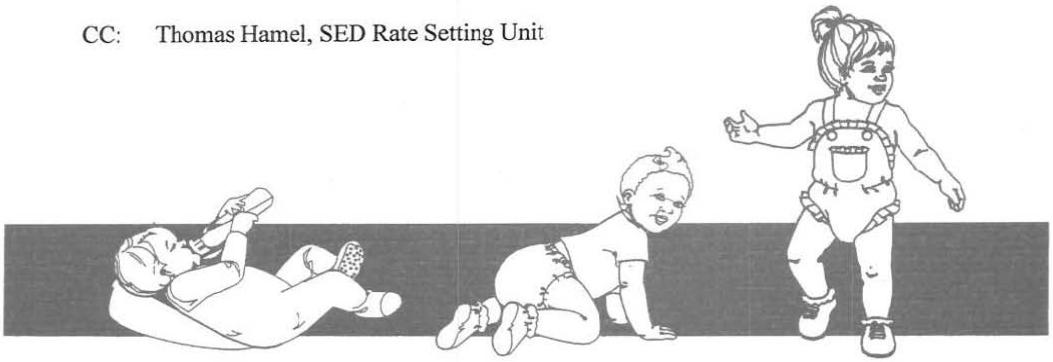
Enclosed you will find the final responses to the fiscal audit year ending June 30, 2006.

Please advise if there is any additional information necessary required.

Sincerely,

Melissa Dorsett-Felicelli
Pyramids Child Development
Executive Director
518-562-3847, ext. 119
mdefelicelli@pyramidspreschool.org

CC: Thomas Hamel, SED Rate Setting Unit



Final Report
2/19/08

Re: Response NY State to Audit for Pyramids Child Development Center

Address: 2155 Rt. 22 B Morrisonville, NY 12962

Program Description: 4410 Preschool Special Education and OCFS Child Care

Executive Director: Melissa Dorsett-Felicelli

Date: February 19, 2008

Audit Year: 2005-2006

Section A – Other than Personal Services

On behalf of Pyramids Child Development Center, under depreciation and amortization costs, we are agreeing to the net disallowance of 11663.

Section B – Other than Personal Services

On behalf of Pyramids Child Development Center, we are not agreeing to the disallowance of 17132, other operating expenses, based on the forgoing conclusions.

Tax penalties and interest, in the amount of 17132, are the result of delayed 4410 revenue. The first 4410 installment for the 05-06 school year was received January 2006. Interest from cash notes and delayed tax payments were the result of freeing up cash in order to meet 9 payrolls prior to receiving county payments for mandated classroom programming.

* Comment 1

On behalf of Pyramids Child Development Center, we are not agreeing to the disallowance of 4389, therapy supplies, and 3958, staff meals/workshops based on the forgoing conclusions.

Pyramids has made improvements with the collection of receipts and purchase orders with more controls and cross referencing in place as current practice. This disallowance will have a negative impact on the total revenues for the 4410 programming. These expenses would have been allowed had we been able to locate the receipts requested at the time of the audit.

* Comment 2

Wage Accruals – Personal Service Costs

On behalf of Pyramids Child Development Center, Inc, we are not agreeing with the disallowance of $101,335 direct care personal services, based on the forgoing conclusions.

Wage accruals were the result of increasing the amount of wages during 05-06 school year based on the amount of service and units provided for these providers for the 12:1:1 classroom model. This is the largest group of children serviced in a single special education classroom with the most amounts of units of therapy. Therefore the wage adjustments were given for this group of therapists and teachers to be consistent across the board with how wages are determined based on the amount of children serviced and units delivered. These were not bonuses based on

* See State Comptroller's Comments, page 27

evaluation of work. The administration percentage of these wages was to be consistent with spreading out the administration wages for each class code. The two other class models, did not see a wage increase, 6:1:1 and 8:1:2 (fewer children, fewer services). Therefore, the "bonus" requirements as described in the CFR Manual were not to be applied as these wage increases were not evaluation driven or bonus intended.

*
Comment
3

Therefore disallowance of $101,335 is clearly disputable based on the fact that these wage increases were not the results of bonuses but rather wage increases.
With regards to the superintendent adjustment, this bring the total 4410 wage, as per the Pyramids payroll, for the course of the 05-60 year to $78,000.00 The other adjustments ranged between $3500-7500 for an additional 14 employees responsible for servicing the 12:1:1 classrooms.

*
Comments
3 and 4

Finally, the wage increase in 05-06 have been carried over each year since 05-06 for these same employees and positions. A bonus does not continue year to year as part of the annual wage. Salary documentation for the following years was neither requested nor considered in this discussion. Salary documentation can be provided for 06-07 and 07-08 per request.

Superintendent Wages, Personal Service Costs

On behalf of Pyramids Child Development Center, Inc., we are not agreeing with the disallowance of $93,113 based on the forgoing conclusion.

There are two problematic areas of concern over the disallowance of the superintendent wages.

First, the recommendation to disallow combined wages from both companies is without justifiable merit. The early intervention company is entirely separate from the Pyramids 4410, state monitored revenue. With separate payroll, bookkeeping and a separate fiscal audit and annual financial report, exclusive to early intervention revenue attempts to disallow it is a gross over-generalization. This deducts revenue, of $76000, from the current 4410 program funding that was never a part of the 4410 funding and consequently penalizes the 4410 fiscal viability.

*
Comment
5

Secondly, the state audit claims there was not enough "evidence" to validate the superintendent's physical presence at the facility. The state audit report fails to cite or reference what this amount of time must be in numbers or requirement. In fact, there is nothing cited or made reference to in the Manual stating how often the Superintendent must be physically present nor does the Manual require documentation of such activity. Moreover, as would be the case with most superintendent positions, this role requires supervision of a multitude of locations, as is the case with Pyramids, and thus it would not seem prudent to dictate how often the superintendent must be "physically" present at any one location. In fact, offices of the superintendent of most schools are often housed at different locations of the classrooms resulting in work that is remotely completed via computer technology.

*
Comment
6

In addition, the state audit report fails to apply the information provided with the Outlook Web Access Logs; a complete caption of the Executive Director's Work/Superintendent. As desired evidence of work, the logs not only identify location, on site and off-site, but also frequency as per log, in and log out times, shared drive access and frequency of email correspondence. As per consultation with an independent computer technology company, Kroll Ontrack, OWA logs can not be manipulated or adjusted in any way. This is concrete information that is valid, succinct and factual and the state audit team has negated to include this as valid information with regards to their claim of no "evidence." These OWA Logs show a consistent pattern of on and off site work, completed by the superintendent, during the 05-06 school year.

*
Comment
7

* See State Comptroller's Comments, pages 27 and 28

Discussion of Administration Staff Maintaining Attendance Records

The report indicates there will not be a disallowance for administrative salary costs as the auditors agreed to use the data from the current attendance monitoring system in place to monitor and track administration attendance. The report claims our computer scanning system, in place since 2001, is not intended to monitor attendance but is instead is a tracking system for who is present in the facility. This is incorrect. The Pyramids' payroll staff relies on this system to generate and cross reference all payroll for both hourly and salaried employees. It is a logging system with multiple applications and attendance reporting logs can be printed and reviewed for all employees upon request.

As per the audit report and recommendations, Pyramids administration is now maintaining additional manual attendance records to provide a routine description of on and off site duties.

*
Comment
8

Other-Than-Personal-Service Administrative Costs

On behalf of Pyramids Child Development Services, Inc., we are not agreeing with the disallowance of 6466, accounting fees, based on forgoing conclusion.

The sibling relationship between the accounting firm/ payroll office and the Pyramids' internal bookkeeper, as required by the Reimbursable Cost Manual, has been consistently disclosed during annual financial audits. Full disclosure is the requirement and this requirement has been met. Therefore there is no justifiable reason to disallow this proposed amount of 16210.

Moreover, the amount paid for this service, primarily payroll preparation, is not inflated. This was validated by the auditors during the audit when they called a number of regional firms for a cost comparison assessment.

*
Comment
9

On behalf of Pyramids Child Development Services, Inc., we are not agreeing with the disallowance of 2395, accounting fees, based on forgoing conclusion.

Documentation of accounting payroll expenses as measured in units of time was not available for review however the pattern of work, payroll completion and the fact this firm is well within regional rates for their service as confirmed by the NYS Audit time during the fiscal audit. This is an allowable expense.

*
Comment
9

On behalf of Pyramids Child Development Services, Inc., we are not agreeing with the disallowance of 3939, legal fees, based on forgoing conclusion.

The amount cited,3000, is not a lobby fee. We pay annual professional dues in the amount of 500 and a receipt is available for review. The total amount of legal fees is well within the scope of an allowable expense. Invoices defining the exact purpose of the legal fee were provided at a later date but were not accepted for a final review.

*
Comment
10

* See State Comptroller's Comments, page 28

Summary

Pyramids Agrees to the disallowance of:
11663 – Depreciation and Amortization costs

Pyramids does not Agree to:

17132 Tax Penalties and Interest Due to Payroll Needs

6466 Family Relationship Disclosed

2395 Accounting Fees measured in work completed consistent with regional rates

101,335 Wage Increases not Bonuses

93113 Superintendent Wages – Physical presence not cited, defined or upheld in the Mannual

3939 Incorrect posting description - Professional annual fees in the amount of 500 are paid but not as lobby fees. The amount cited is within the scope of legal fees and receipts were provided at a later date.

Total disputed disallowances $224,380.00

Final Recommendations:

Comply with the Manual's requirements for the documenting and maintenance of the time keeping records and staff evaluations.

Pyramids will seek to hire and employ a qualified candidate to act as our Controller for the improvement of CFR compliance and CFR preparation and to ensure all costs allocations are consistent with the Manual. This measure is also intended to aide in ongoing preparation of the CFR to prevent annual 4410 funding gaps as has been the case since 2003.

Pyramids will establish an independent board absent of employees once it is determined that the employee(s) are no longer responsible for debt accumulated since 2004 due to insufficient 4410 funding. This will come as a result of rate revisions and/or refinancing with lending companies that do not require a personal guarantee.

APPENDIX C - STATE COMPTROLLER COMMENTS ON AUDITEE RESPONSE

1. The Reimbursable Cost Manual does not allow reimbursement for tax penalties and related interest charges. We encourage Pyramids to ensure that it bills the counties timely and to work with county officials to ensure that county payments are made timely.

2. The Reimbursable Cost Manual requires providers to have appropriate documentation available for audit to support claimed expenses. Pyramids officials acknowledge that they were unable to provide such documentation for the transactions in question. Further, our audit process provided Pyramids with ample opportunity to provide supporting documentation for those transactions. In addition, we are pleased that Pyramids officials have taken steps to improve their procedures to collect supporting documentation.

3. This statement is inconsistent with the evidence we examined during the course of our audit. As noted in our report, Pyramids CPA firm explicitly identified the accrued wages as bonuses (for the preparation of Pyramids CFR) for the 14 employees in question. Moreover, Pyramids officials were unable to support the claim that the additional personal service payments corresponded to increases in services provided by employees. In fact, employee workloads (in terms of student enrollments) at Pyramids have been declining in recent years.

4. Our audit included the fiscal year ended June 30, 2006. However, we determined that the base salaries of the employees in question were not increased at the outset of the following fiscal year (beginning July 1, 2006). We believe this provides evidence that the payments in question were, in fact, bonuses for the 2005-06 year (because they did not increase employees' base salaries). Further, although our audit was limited to the 2005-06 fiscal year, we did review pertinent financial documentation for periods after June 30, 2006. That documentation confirmed that the payments in question were bonuses.

5. We acknowledge that Pyramids and its related company (Dorsett-Felicelli, Inc.) are separate legal entities for which separate general purpose financial statements are prepared. However, for administrative efficiency, SED directed Pyramids and Dorsett-Felicelli, Inc. to combine and report all eligible program costs on one CFR for the various programs they operate. Further, non-direct care costs (including administrative charges such as the personal service costs of the Executive Director) are allocated to the programs included on the CFR using a ratio value method, as prescribed by SED. As detailed in the report, we used this method to allocate the disallowance (amounting to $93,113) of the Executive Director's salary to the four programs we audited.

6. Pyramids' statement is not accurate. Our report states that: "the records provided to us did not constitute sufficient evidence of the Executive Director's presence at Pyramids or her Pyramids-related work activities." Also, we acknowledge that the Manual does not reference how often the superintendent (Executive Director) must be physically present at the facility. However, SED does require payrolls to be supported by employee time and attendance records that are prepared contemporaneously for the periods for

which employees are paid. As our report notes, the Executive Director did not prepare and maintain any time and attendance records. Because of the absence of time and attendance records and the lack of sufficient evidence of the Executive Director's Pyramids-related activities, we disallowed the costs for the Executive Director charged to the programs we reviewed.

7. Pyramids' statement is not accurate. In fact, we did examine the web access logs provided to us as evidence of the Executive Director's Pyramids-related work. However, these logs contained numerous entries of assorted lengthy and complex alphanumeric codes for which Pyramids did not provide definitions or explanations. Consequently, the logs did not constitute sufficient evidence of the Executive Director's attendance and/or Pyramids-related work activities. Further, the act of accessing an internet web site does not provide sufficient evidence that substantive work was actually performed or accomplished.

8. We acknowledge that Pyramids computerized entry/exit system can be used for multiple purposes, including some form of time and attendance recording. Our report has been modified to note this more accurately. Moreover, we are pleased that Pyramids is taking steps to develop and implement a time and attendance record system that conforms to the requirements of the Manual.

9. In fact, the less-than-arms-length relationship with the accounting firm was not properly disclosed as required by SED on Schedule CFR-5, Transactions with Related Organizations/Individuals. Moreover, we did not disallow the amounts in question because they resulted from less-than-arms-length transactions. Rather, as noted in our report, we disallowed certain amounts because they: corresponded to periods prior to the 2005-06 year; were for the preparation of the Executive Director's personal income taxes; or were not adequately documented. We also acknowledge that accounting and payroll processing services are allowable expenses and that the hourly rates Pyramids paid for such services were reasonable. As such, we allowed a majority of the accounting and payroll processing costs claimed by Pyramids.

10. A portion of the amount in question ($500) was for lobbying fees, which are not allowed by the Manual. We also disallowed $2,500 that pertained to a prior period adjusting entry that was not adequately documented. Moreover, Pyramids did not provide us with invoices at a later date that detailed the purpose of the fees. We reviewed and considered all documentation provided to us by Pyramids. We also modified our report to detail the disallowance more accurately.

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