



STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

December 13, 2012

Dr. John B. King, Jr.
Commissioner
New York State Education Department
89 Washington Avenue
Albany, NY 12234

Re: Report 2011-0021

Dear Dr. King:

Our Office examined¹ select expenses claimed for reimbursement by Baychester Youth Council, Inc. (Baychester) for the 21st Century Community Learning Centers (Community Learning Centers) program with the New York State Education Department (Department) under contract C400859 during the period July 1, 2010 through June 30, 2011. During this period, Baychester claimed expenses for reimbursement totaling \$545,000, of which the Department paid \$490,500. Based on our findings, we expanded our review on a limited basis to include expenses Baychester did not request reimbursement for but were relevant to our examination.

The objectives of our examination were to determine if: (i) Baychester expended funds in accordance with the contract; (ii) Baychester accounted for other revenue in accordance with the terms and conditions of the contract; and (iii) the Department's monitoring procedures relative to the Community Learning Centers program are effective in assessing and mitigating risk of paying grantees for inappropriate expenses.

A. Results of Examination

We found Baychester's Executive Director certified \$250,401 in claim reimbursements for expenses that were either inappropriate or could not be substantiated. The claims, which were certified as directly attributable to the Baychester program and made in accordance with the Department-approved budget and all applicable federal and State laws and regulations, include \$189,303 in expenses that cannot be substantiated as paid and \$61,098 in inappropriate expenses. Inappropriate expenses include \$3,519 in State grant funds that were used to purchase electronic

¹We performed our examination in accordance with the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution, as well as Article II, Section 8, and Article VII, Section 111 of the State Finance Law.

equipment that evidence supports was delivered to and installed in the Executive Director's home.

After identifying the unaccounted for grant funds, we expanded our review on a limited basis to include additional expenses that were relevant to our examination, including: inappropriate or unsubstantiated transactions the Executive Director authorized between 2007 and 2010 totaling \$159,334 that were classified into a loan receivable due from the Executive Director (during this period, Baychester held this as well as other State and New York City contracts); disbursements totaling \$4,990 that the Executive Director made to herself and admitted were for rent for her personal residence and a personal hotel stay; and disbursements totaling \$3,000 made to the Chair of Baychester's Board of Directors (Board Chair) for personal legal fees.

In addition to the inappropriate and unsubstantiated expenses noted above, Baychester failed to report \$18,419 in revenue to the Department. Accordingly, either the Department's grant obligation should be reduced, or Baychester should be required to provide more services.

We found these conditions at Baychester went undetected by the Department because the Department's monitoring procedures relative to this grant program are not designed to detect grantees making inappropriate or unsubstantiated disbursements or not reporting revenue. The Department had sufficient indicators available to recognize Baychester was financially stressed and was not complying with the terms and conditions of the contract. However, the Department failed to realize the risk associated with Baychester.

We shared a draft report with Department officials and considered their comments (Attachment A) in preparing this final report. Department officials agree with our recommendations and stated they have made progress in enhancing their monitoring procedures. In addition, the Department has cancelled its contract with Baychester and requested repayment of the inappropriate and unsubstantiated expenses claimed. The Department will conduct an audit of the expenses Baychester has claimed since the inception of its contract, and will try to determine the appropriate action to take related to additional revenue received by Baychester.

B. Background and Methodology

The Community Learning Centers program is a federally funded program administered by the Department that provides academic enrichment and youth development opportunities during non-school hours to children who attend high-poverty, low-performing schools.

Baychester was awarded contract C400859 for the period July 1, 2008 through June 30, 2013. This contract was preceded by two contracts Baychester held with the State from March 2005 through December 2009. Contract C400859 is valued at \$2.725 million or \$545,000 for each budget year of the contract term. For our examination period, the Department approved payments totaling \$545,000 in the following budget categories: professional salaries, support staff salaries, purchased services, supplies and materials, and employee benefits. However, Department officials requested our Office return one voucher totaling \$54,500 unpaid after we notified them of Baychester's failure to provide supporting documentation relative to our examination. Therefore, Baychester was paid \$490,500 during our examination period.

To perform our examination, we reviewed bank records, invoices, employee time cards, and other documentation relevant to the expenses Baychester claimed under the Community Learning Centers contract. Based on our findings, we expanded our review on a limited basis to include other expenses relevant to our examination. We also interviewed Department and Baychester officials, as well as Baychester's Certified Public Accountant (CPA).

In addition to the findings contained in this report, we identified matters we consider to be of lesser significance. We conveyed these matters to Department officials verbally during the closing conference and did not include them in this report.

C. Details of Findings

Actions of the Executive Director

Only those disbursements of funds that are reasonable and necessary to carry out the Community Learning Center program's purposes and objectives should be approved. Baychester must maintain supporting or source documents (i.e., purchase orders, delivery receipts, vendor invoices) for all disbursements. Any equipment, furniture, supplies or other property purchased with grant funds is the property of the State. Also, Article 7, Section 716 of New York State's Not-For-Profit Corporation Law (Not-For-Profit Law) precludes Baychester from making loans to its directors or officers, which would include Baychester's Executive Director and Board Chair. Any Baychester officer or director who authorizes or participates in a loan made in violation of the Not-For-Profit Law is also in violation of their duty to the corporation. In addition, Baychester is required to disclose any other revenue to the Department so that revenue can be used either to offset State funding or to increase program services.

Baychester's Executive Director is responsible for reviewing and approving all disbursements of Baychester funds, approving employee time sheets, and ensuring State funds are expended according to the terms and conditions of the contract. The Executive Director is the only Baychester employee who has the authority to approve fund disbursements. The Executive Director certified to the Department that all expenses claimed for the 2010-2011 budget year were directly attributable to the Baychester program and were made in accordance with the contract, the Department-approved budget, as well as all applicable federal and State laws and regulations.

During our examination, we found the Executive Director requested the Department reimburse Baychester for expenses claimed but not paid to employees or vendors doing business with Baychester. The Executive Director failed to maintain the required supporting documentation to account for disbursements of program funds or to substantiate those disbursements were actually made. In addition, we found evidence that the Executive Director approved Baychester funds, and potentially Community Learning Center funds, for personal use, including: checks payable to the Executive Director, to Baychester Youth Council, and to cash from Baychester's account without support to document the business purpose for those disbursements; an order for electronic equipment that evidence supports was delivered to and installed in her personal residence; and a loan to the Board Chair. In addition, the Executive Director failed to report to the Department other revenue Baychester received which should have been used to reduce the Department's grant obligation or to increase services.

Inappropriate and Unsubstantiated Reimbursements Claimed

Baychester sought reimbursement for \$545,000 in costs claimed to be related to the Community Learning Center program as part of the following Department-approved budget categories: professional salaries, support staff salaries, purchased services, supplies and materials, and employee benefits. Of this amount, we identified \$189,303 in expenses that cannot be substantiated as paid and \$61,098 in inappropriate expenses for a total of \$250,401. These include:

- \$65,301 in vendor expenses that could not be substantiated as paid because there were either no corresponding cancelled checks, or in one case, the check was returned by the bank due to insufficient funds. Based on our review of the bank records, Baychester did not provide the vendor with a replacement check during our examination period.

- \$3,519 in vendor expenses for electronic equipment that we could not locate on Baychester's premises. During our examination we sought to determine the purpose of this purchase from an appliance and electronic retailer that Baychester claimed for reimbursement from the Department. When the Executive Director could not provide an invoice to substantiate the transaction, we subpoenaed the retailer's records and found the disbursement was for electronic equipment, including two LCD televisions, a Blu Ray home theater, Wii software and a USB LAN adaptor. The Executive Director was unable to show us the items listed on the invoice and claimed that they may have been stolen. Not only did the Executive Director not report any alleged theft to the police, but the retailer's records demonstrate that the equipment was delivered and installed in the Executive Director's personal residence. Further corroborating that no theft occurred from Baychester and that the equipment was for the Executive Director's personal use, the Baychester employee responsible for ordering this type of equipment (also the Executive Director's son) confirmed that he had not ordered the equipment in question, nor had the equipment ever been present on Baychester's premises.
- \$20,700 for vendor expenses for which Baychester could not provide adequate documentation (e.g., invoices, dates of services) to support the expenses were program-related and/or incurred during the 2010-2011 budget year.
- \$11,175 in social security expenses claimed in excess of Baychester's required contribution. The actual use of the funds cannot be substantiated.
- \$112,827 in employee salaries that could not be substantiated as paid because there was either no corresponding cancelled check or the check Baychester gave the employee was returned by the bank due to insufficient funds. A portion of the unsubstantiated salary expenses may be attributed to the Executive Director's temporary practice of authorizing a single check to cover the bi-weekly payroll during a portion of our examination period. According to the Executive Director, after cashing the check, she would pay Baychester's employees with cash. Although Baychester did provide us with lists of employee signatures indicating which employees received cash, these lists did not indicate how much cash each employee received. Therefore, we cannot rely on this limited documentation to support employee payroll expenses.

- \$28,348 for employee salaries claimed where there was no corresponding time sheet documenting the employee worked the hours, or the time sheet Baychester provided did not support the hours paid to employees.
- \$1,426 for field trips that included participants from age levels outside the contract-approved population.
- \$1,290 for two invoices with the same vendor where Baychester provided no support for \$1,000 of the total and questionable documentation for the balance. Baychester's vendor provided a handwritten invoice for \$290, with a description of the service, the number of labor hours, and Baychester's payment information. However, Baychester provided us with an invoice for the same service with different information in a different handwriting than the invoice we received from the vendor.
- \$5,815 for indirect costs in excess of what Baychester was entitled to. Baychester requested reimbursement for indirect costs totaling \$13,000 by applying the Department-approved indirect cost rate (2.50 percent) to the modified direct costs claimed for reimbursement. We adjusted Baychester's modified direct cost base to account for our findings and recalculated the indirect cost reimbursement.

Improper Payments to the Executive Director

As noted previously in this report, Baychester requested reimbursement for various expenses that could not be substantiated as paid to vendors doing business with Baychester or employees. In an effort to determine what the Executive Director used Community Learning Center program funds for, we expanded our review to include Baychester's bank records and audited financial statements. Our review of Baychester's bank records identified several transactions that could be personal in nature.

We discussed specific transactions with the Executive Director, who admitted to using Baychester funds for personal expenses and expenses unrelated to Baychester's program. These include an estimated \$4,000 to pay rent for her personal residence and a \$990 hotel stay the Executive Director admitted was personal in nature. In addition, the Executive Director stated that she authorized a \$3,000 loan to pay personal legal fees for Baychester's Board Chair and was unaware that she could not use Baychester's funds for this purpose. The \$3,000 was wired from Baychester's account to the Board Chair's account. In accordance with the Not-For-Profit

Law, any officers or directors that authorize or participate in loans to officers or directors are in violation of the Not-For-Profit Law and are also in violation of their duties to the corporation.

In addition to our review of Baychester's bank records, we found that Baychester's audited financial statements contain a loan receivable due from its Executive Director that has grown from \$17,229 as of December 31, 2007 to \$159,334 as of December 31, 2010 (during which time Baychester held this contract, as well as other State and New York City contracts). According to Baychester's CPA, this loan receivable encompasses various transactions that the CPA determined are either inappropriate or unsubstantiated as related to Baychester's program.

The transactions that encompass the loan receivable include checks written to the Executive Director and to cash, among others. We reviewed the loan receivable transactions during the first six months of our examination period (July 1 through December 31, 2010) totaling \$34,113 along with Baychester's bank records and identified the following:

- A check for \$3,907 payable to the Executive Director for a lost payroll check for the payroll period September 21, 2010 through October 4, 2010. However, we found another cancelled check, also totaling \$3,907, payable to the Executive Director noting the same payroll period. Both checks were endorsed by the Executive Director and cashed on the same day.
- A check from Baychester's operating account totaling \$2,000 was made payable to and endorsed by the Executive Director. The check was later deposited in the personal account the Executive Director shares with her son.
- A transfer from Baychester's operating account totaling \$2,000 was made to the Executive Director's personal bank account that the Executive Director shares with her son.
- The CPA classified three transactions totaling \$12,000 into the loan receivable because the Executive Director was unable to provide documentation to support what the funds were used for, or determined the funds were used inappropriately. Although we were also unable to determine what these funds were used for, we found that the three transactions were made up of checks from Baychester's operating account made payable to cash, to Baychester itself, and to the Executive Director. Baychester's Executive Director signed and endorsed these checks.

- The CPA classified the remaining transactions totaling \$14,206 into the loan receivable because Baychester was not able to provide documentation to substantiate what the funds were used for, or determined the funds were used inappropriately. Due to the state of Baychester's records, along with our own review of available documentation, we were unable to substantiate what these funds were used for.

The CPA told us that the Executive Director is responsible for paying back Baychester for transactions included in the loan receivable. When we discussed the loan receivable with the Executive Director, she claimed that she intended to repay it but was waiting for the CPA to create a repayment plan. This contradicts the CPA, who told us the Executive Director was supposed to create a repayment plan and have it approved by Baychester's Board. As of February 2012, there was no repayment plan in place, and we were not provided any evidence that any of the money had been repaid. Moreover, New York State's Not-For-Profit Corporation Law prohibits Baychester from making loans to its directors or officers.

Revenue Not Reported to the Department

In accordance with Section 11 of the Department's *Guide to Grants Administration and Implementation Resources*, Baychester is required to disclose any other funding sources to the Department. If additional funding covers the same type of services provided under its contract, the Department can reduce its grant obligation accordingly, or the grantee can increase the scope of services provided. Baychester can collect revenue without decreasing the amount of grant funds it receives from the Department if it submits a written request to, and receives approval from, the Department.

We reviewed bank records and found that Baychester collected \$18,419 in revenue from parents and other organizations during our examination period. However, Baychester did not disclose the receipt of these funds to the Department. Therefore, the Department should determine if Baychester increased the scope of the services provided or if it can reduce its grant payments to Baychester by this amount.

Department's Failure to Monitor

The Department uses a risk-based approach to prioritize grantees for monitoring. Depending on the determined risk, the Department will either conduct an on-site review or telephone interview for each grantee at least one time per contract period. At the commencement of our examination, Department officials stated they did not deem Baychester particularly risky and had not yet

scheduled it for an on-site review or telephone interview, even though it was already into the third year of the five year contract.

We found the Department's procedures for monitoring this grant program are ineffective in assessing and mitigating risk, thereby limiting its ability to prevent or detect inappropriate disbursements. The Department had sufficient indicators available to recognize Baychester was financially stressed and was not complying with the terms and conditions of the contract. However, the Department failed to realize the risk associated with Baychester, and therefore, did not engage in an on-site review of Baychester. These indicators include:

- The New York State Vendor Responsibility Questionnaire, which Baychester provided to the Department at the inception of this contract, indicated Baychester failed to pay federal withholding taxes for 2004, 2005 and 2006 timely. It also indicated Baychester failed to pay State withholding taxes for the 2005 and 2006 calendar years until 2007, and had State withholding tax payments outstanding for the 2007 calendar year. Baychester also disclosed its failure to pay 2006 and 2007 unemployment insurance returns timely.
- The Annual Performance Report that Baychester submitted to the Department for the budget period July 1, 2009 through June 30, 2010 indicated that of the 159 students served, 90 students (or 57 percent) were in age groups not allowed by the contract.
- Baychester did not submit its Annual Filing for Charitable Organizations for years ended 2007, 2008, and 2009 to the New York State Office of the Attorney General until 2011.
- Baychester failed to attend Department-required training related to managing contract funds.

In addition, in January 2006 the New York City Department of Youth and Community Development (DYCD) placed Baychester on a Corrective Action Plan to address the deficiencies it noted related to its contracts with Baychester, and did so again in November 2006 when it found many of the deficiencies continued to exist.

In April 2007 DYCD requested information detailing Baychester's delinquent payroll, unemployment and workers' compensation taxes and also required Baychester to reimburse it \$30,416 for payments made to the Executive Director's relatives. Finally, in May 2009 DYCD terminated its contracts with Baychester due to "a history of documented and reported Fiscal and

Programmatic issues over multiple years including non-compliance with DYCD's Fiscal Manual as well as Generally Accepted Accounting Principles.”

The Department's *Fiscal Guidelines for Federal and State Grants* requires Baychester to maintain supporting or source documents, including time and effort records, delivery receipts, vendor invoices, and payment documents, for all grant-related transactions. Despite the risk indicators mentioned above, the Department did not request documentation to support expenses Baychester claimed during our examination period. Had the Department done so, it would have determined Baychester was not expending funds in accordance with the contract. Instead, the Department approved payments to Baychester totaling \$545,000 for services performed during our examination period without reasonable assurance those funds were expended in accordance with the contract.

Baychester's Board of Directors

During our examination, we asked the Executive Director for the names of individuals that comprised Baychester's Board of Directors. We compared the names with Board members listed on another contract we had on file and found discrepancies. When we asked the Executive Director for clarification the following day, we received yet a third variation of individuals that she claimed comprised Baychester's Board.

Therefore, we have reservations that the Board provides appropriate oversight. However, if it does, we question the ability of the Board Chair to provide objective oversight when, as the Chair, she accepted Baychester funds from the Executive Director for personal use.

Conclusion

We conclude the Department's lack of effective oversight, combined with the Executive Director's blatant disregard for the terms and conditions of the contract and a lack of appropriate oversight by Baychester's Board, allowed these conditions to exist until detected by our auditors and investigators. Indeed, during our interview, the Executive Director expressed her view that once the State has remitted money to the program, she may make whatever use of it she sees fit.

On August 17, 2012, the Department terminated its contract with Baychester, effective September 21, 2012. Although Baychester no longer contracts with the State, we are referring our findings to the Bronx County District Attorney's Office for its review.

Recommendations

- 1) *Assess monitoring procedures relative to the Community Learning Centers program and establish controls that increase the detection of fraud, waste, and impropriety among grantees.*
- 2) *To resolve the inappropriate and unsubstantiated expenses found totaling \$250,401, withhold the final \$54,500 payment to Baychester for the year ended June 30, 2010 and recover the remaining balance of \$195,901.*
- 3) *Determine if the other revenue Baychester received supported services already covered under the contract, and reduce the Department's grant obligation accordingly.*
- 4) *Review expenses claimed by Baychester since the inception of the contract and recover inappropriate and unsubstantiated reimbursements accordingly.*

We thank the management and staff of the State Education Department for the courtesies and cooperation extended to our auditors. Since your response to the draft report is in agreement with this report, there is no need for further response unless you feel otherwise. If you choose to provide a response, we would appreciate it by January 14, 2013.

Sincerely,

Bernard J. McHugh
Director of State Expenditures

Enclosure: Attachment A

cc: James Conway, Director of Audit Services, State Education Department
Nelson Sheingold, Counsel for Investigations, Office of the State Comptroller



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

DEPUTY COMMISSIONER
Office of Performance Improvement and Management Services
O: 518.473-4706
F: 518.474-5392

November 14, 2012

Mr. Bernard J. McHugh
Director of State Expenditures
Office of the State Comptroller
110 State Street
Albany, NY 12236

Dear Mr. McHugh:

The following is the New York State Education Department's (Department) response to the draft audit report of contract (C400859) with Baychester Youth Council for operation of a 21st Century Community Learning Center (CCLC) program. The Department has taken actions to enhance monitoring prior to this audit and have also taken specific actions to respond to the audit.

During the past year, the Department has enhanced its oversight and monitoring of 21st CCLC grants and grant contracts. The activities that we have implemented include contracting with two 21st CLCC technical assistance centers to conduct monitoring visits, conducting monitoring telephone interviews of sites based on a risk assessment methodology, and reviewing selected final expenditure reports at the end of each year prior to payment. In addition, programs which begin operation on or after July 1, 2013 will be subject to an enhanced and standardized independent assessment. The Department has developed a manual, the NYSED Local Program Evaluation Framework, which clarifies the measurement and reporting requirements of the Department and the United States Education Department and outlines a focused evaluation strategy.

Recommendation #1: Assess monitoring procedures relative to the Community Learning Centers program and establish controls that increase the detection of fraud, waste, and impropriety among grantees.

As described above, the Department has already enhanced monitoring and will assess its protocols on an ongoing basis.

Recommendation #2: To resolve the inappropriate and unsubstantiated expenses found totaling \$250,401, withhold the final \$54,500 payment to Baychester for the year ended June 30, 2010 and recover the remaining balance of \$195,901.

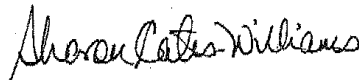
The Department has issued a letter to Baychester directing the repayment of the \$195,901 identified through the audit as inappropriate and unsubstantiated. The contract has been terminated and no further payments will be made.

Recommendation #3: Determine if the other revenue Baychester received supported services already covered under the contract, and reduce the Department's grant obligation accordingly.

Recommendation #4: Review expenses claimed by Baychester since the inception of the contract and recover inappropriate and unsubstantiated reimbursements accordingly.

In response to recommendations 3 and 4, the Department's Office of Audit Services will conduct an audit of Baychester's claimed expenses since the inception of the contract and attempt to determine the appropriate treatment of additional revenue received.

Sincerely,



Sharon Cates-Williams

c: Margaret Zollo
Betsy Kenney
John Delaney
James Conway