



Report
and
Recommendations
of the
X STATE OF NEW JERSEY
COMMISSION OF INVESTIGATION
on the

MISUSE of PUBLIC FUNDS
in the OPERATION of NON-PUBLIC SCHOOLS
for HANDICAPPED CHILDREN

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ACQUISITIONS

REPORT AND RECOMMENDATIONS

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In The

OPERATION OF NON-PUBLIC SCHOOLS

For

HANDICAPPED CHILDREN

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STATE COMMISSION OF INVESTIGATION

of

New Jersey



State of New Jersey
COMMISSION OF INVESTIGATION

25 WEST STATE STREET
TRENTON, N.J. 08608
TELEPHONE (609) 292-8767

May, 1978

TO: *The Governor and the Members of the Legislature
of the State of New Jersey:*

The New Jersey State Commission of Investigation
herewith submits its Report and Recommendations on its
Investigation of the Misuse of Public Funds in the
Operation of Non-Public Schools for the Handicapped.
This transmittal is made under Section 10 of P.L.
1968, Chapter 266 (N.J.S.A. 52:9M-10), the Act
creating the Commission.

Respectfully Submitted,
Joseph H. Rodriguez, *Chairman*
Lewis B. Kaden, *Commissioner*
Arthur S. Lane, *Commissioner*

Investigation of the Misuse of Public Funds in
the Operation of Non-Public Schools for Handicapped Children

TABLE OF CONTENTS

	Page
BACKGROUND.....	I
THE S.C.I. INVESTIGATION.....	4
THE TESTIMONY -- January 18, 1978.....	9
Role of State and Local Districts.....	9
A Multitude of Duties.....	10
Insufficient Staff.....	13
Lack of Control by Local Districts.....	14
Audits Based Only on Suspicion.....	15
Calais School.....	17
At School Only Six Hours Weekly.....	19
Leitners' Egbert Hill "Offices".....	20
Son David on the Payroll.....	22
Going to School on \$12,600 a Year.....	25
Calais Salary Ranges.....	28
"Book Club" Purchases With School Funds.....	32
Paintings Charged to "Books/Supplies".....	36
Weed Killers, Insect Sprays, Gardeners.....	40
School Paid for Air Conditioning at the House.....	46
School-Funded Trip to the West.....	47
A Consultant Who Was Also A Brother-in-Law.....	47
Movable Chairs and Carpeting.....	54

	Page
What Was Considered "Office Area?".....	55
Questioned Checks Amounted to \$42,207.56.....	58
Further Personal Use of School Funds.....	59
Mr. Leitner Defends Payouts.....	60
Pollock: "Nothing Less Than Appalling".....	61
Leitners Not Often At School.....	62
Lincoln School.....	66
Vacations Were at School Expenses.....	68
Travel Charged to "Tires/Repairs".....	72
The Lincoln School Van.....	72
School Paid for House Work.....	75
Porch was for the Dogs, in Part.....	77
They Were "Entitled" to State-Paid Porch.....	78
\$40,000 Back for a \$20,000 Loan.....	83
School Paid for Personal Maid.....	85
Who Really Ran the School.....	89
The School's Van Was for Personal Use.....	93
THE TESTIMONY - January 19, 1978.....	96
Preface.....	96
Manor Woods Academy.....	97
Real Estate Pyramiding.....	104
State Paying the Farrell Leases.....	112
They Started With Nothing.....	114

	Page
Somerset Hills School.....	117
<i>Capital Improvement -- or Just a Repair?.....</i>	121
<i>The Holding Corporation.....</i>	128
<i>Mr. Steinbaum's Income.....</i>	130
<i>A Different Story.....</i>	136
<i>Those Checks to Mr. Steinbaum.....</i>	136
<i>Mr. Steinbaum's "Cash Flow".....</i>	138
<i>A Lucrative Rental Arrangement.....</i>	139
Abuses Led to ASAH.....	144
<i>Bigger Boards, More Meetings.....</i>	148
<i>Reserve Fund Eases School Board Delays.....</i>	151
<i>Tuition Reimbursements.....</i>	161
<i>ASAH and the State.....</i>	164
<i>Many Outstanding Schools.....</i>	166
Difficulties at the State Level.....	167
<i>150 Schools, One Overseer.....</i>	171
<i>Coping with Fiscal Abuses Difficult.....</i>	173
<i>Profiteering on the Handicapped.....</i>	177
The Concluding Statement.....	178
CONCLUSIONS AND RECOMMENDATIONS.....	183

INVESTIGATION OF THE MISUSE OF PUBLIC FUNDS
IN THE OPERATION OF NON-PUBLIC SCHOOLS FOR
HANDICAPPED CHILDREN

BACKGROUND

New Jersey's strong concern for the welfare of handicapped children is reflected in the history of state support for special education programs for these children.

Indeed, New Jersey became the first state -- in 1911 -- to require special education curricula for the deaf, blind and mentally retarded. Subsequent legislation, which substantially enlarged the state's share of all local school costs, also expanded the type and number of state-aided educational programs for both mentally and physically handicapped children. Thus, New Jersey's financial aid for special education rose from \$1.2 million in 1955-56 to \$18 million in 1967-68, or 41 per cent of the \$44 million then invested in this effort. By 1976-77, state support for special education for the handicapped had risen to \$107 million, or 60 per cent of a total outlay of about \$170 million.

Of this overall special education system, the New Jersey State Commission of Investigation concentrated its inquiry on the public funding of non-public schools for educating children who are so severely handicapped that local schools will not or can not accommodate them. Ever since the use of private facilities for special

education purposes was authorized, the number of these schools has proliferated. During the 1977-78 school year, according to testimony before the Commission, 250 non-public schools were accredited for special education purposes -- 100 outside the state and 150 within the state. Of the latter, 125 are day schools and the remainder are also residential facilities. The cost of these programs last year was \$26 million, shared almost equally by the state and the local districts. All but \$2 million of the total expenditure was on in-state programs. At the time of the Commission's inquiry, about 5,000 children were enrolled in private facilities in one or another of a dozen handicap categories for which appropriate courses are required. These categories are: Educable or trainable mentally retarded, perceptually impaired, orthopedically handicapped, neurologically impaired, visually handicapped, auditorially handicapped, communication handicapped, emotionally disturbed, chronically ill and multiply handicapped.

The local school district is at the core of the non-public school special education system. The placement of a pupil in a school is the responsibility of a local child study team, consisting of a social worker, a school psychologist, a learning disabilities teacher-consultant and a physician. There is at least one team in each of the 600-plus school districts -- a statutory requirement -- but there are about 800 teams throughout the

state because larger districts have more than one.

Mrs. Eleanor Engelbrecht, state coordinator of non-public school eligibility, testified that these child study teams "have a number of options in front of them in their search for the right placement" of a handicapped child. She said: "They first look, of course, into their own district where this child can be educated. If nothing quite fits or suits the child, they look next door to another county or another region, and they go on until, I think, about the sixth or seventh on the list is the option of the non-public school, either in-state or out-of-state."

The private schools to which child study teams refer seriously handicapped children are funded by a system that lacks basic checks and balances -- a deficiency that became evident at the outset of the Commission's inquiry. Under the statute, local school districts are required to pay private school tuition bills as submitted. These local district payments are partially reimbursed by the state Department of Education, which sets tuition rates for various handicap categories -- ranging from \$3,400 for the chronically ill to \$6,800 for the visually handicapped. These rates are predicated on costs, projected and actual, that are now submitted to the state Education Department by the private schools. Prior to the summer of 1977 no reports of actual costs were ever required by the state. Eventually, the combined flood of estimated and actual

cost statements into the Trenton bureau defied the most superficial monitoring effort.

Only in the past two years have even random and cursory audits been permitted. When at least the scattered audits began, they were undertaken at Mrs. Engelbrecht's request by the Education Department's Division of Administration and Finance, itself understaffed. Prior to the Commission's public hearings in January, 1978, only nine audits had been performed.

It was not until January, 1976, that any private schools for the handicapped were audited at all, according to Vincent D. Calabrese, assistant education commissioner for administration and finance. He told the S.C.I. the "random basis" audits that were initiated were limited by an opinion by the Attorney General's office to merely a determination of "the validity of the tuition charges." Calabrese also testified his office had a staff of "only six auditors for the entire state" who are responsible for monitoring 611 school districts, among other statutory duties, as well as the limited surveillance of 150 private schools for the handicapped.

THE S.C.I. INVESTIGATION

During 1977 the operations of certain non-public schools for handicapped children were subjected to mounting criticism -- by parents of pupils, by state and local education officials, by former employes and, most effectively, by newspapers whose investigative reporters uncovered

irregularities. The Commission itself received a number of complaints and undertook an evaluation. Exploratory interviews were conducted -- at the office of the Morris County Daily Record, which had run a series of articles in late March on alleged improprieties at two schools; with Dr. David Holmes, president of the Association of Schools and Agencies for the Handicapped (ASAH), and with Chief Auditor James Oszfolk of the state Education Department, among others. These discussions raised additional questions about the financial management and control of these facilities, many of which could not even meet ASAH standards for membership.

The evaluation quickly turned into an extensive probe. For the first time the target schools came under wide-ranging fiscal scrutiny as the Commission's staff of Special Agent-Accountants inspected and compared vouchers, bank records, purchase orders, budget estimates, cost reports and expense accounts.

The scope of the Commission's investigation was defined in the subpoenas issued for financial records and served on prospective executive session witnesses. These subpoenas stated:

Whether the laws of this State with respect to the education of handicapped children are being faithfully executed and effectively implemented, with particular reference to the manner in which Special Education programs are being provided for handicapped children by private education institutions.

Even despite the Attorney General's restrictive definition of what could be checked, the state audits of five schools at least revealed that three had been overpaid but that no attempt had been made to recover the excess payments. Nonetheless, analyses of these incomplete state audits by the Commission's staff led to the conclusion that more penetrating audits were necessary. Upon the Commission's orders, intensive financial inquiries were launched into the records of the Calais School in Convent Station in Morris County, the Lincoln School in Peapack in Somerset County, Manor Woods Academy in Estelle Manor in Atlantic County and Somerset Hills School in Warrenton in Somerset County. As these audits progressed, the Commission's Special Agents interviewed vendors and other principals to confirm the evidence of questionable procedures that the fiscal scrutiny was revealing.

The Commission's probe uncovered widespread misuse of public funds by certain school operators as well as many questionable practices that could not be condoned. The Commission decided that the seriousness of the abuses warranted a public demonstration of their adverse impact on the special education effort to improve the wellbeing of handicapped youngsters. The S.C.I. thus hoped to promote an expeditious correction of the system's faults. As S.C.I. Chairman Joseph H. Rodriguez stated on January 18, 1978, at the opening of the Commission's two days of

public hearings in the State House:

The primary concern of this Commission is to assure that no handicapped child who is enrolled in programs of Special Education is shortchanged, and to insure that taxpayer funds are properly used for educational purposes.

Our investigation has disclosed examples of exploitation of this program, including the misuse or misappropriation of public funds for personal gain and other non-educational activities, when these funds should have been utilized solely to improve the educational programs offered these helpless children.

I want to emphasize that these hearings should not be construed by anyone as an indictment of the entire system of Special Education for the handicapped. Many of the 150 private schools that are providing this necessary educational service no doubt have outstanding records. We are concentrating here on schools where our investigation has produced evidence of serious abuses. Our desire is to subject these irregularities to a public spotlight in order to spur corrective action. We intend after this hearing to issue a report including our recommendations for legislative and administrative reform. We will also, when and where appropriate, refer to the proper law enforcement agencies the full results of our investigation.

The Commission feels that vigorous and continuous public support for Special Education programs for handicapped children is essential. The abuses of a few of these schools should not be permitted to damage or destroy the reputation of the entire system or of the many dedicated people serving the handicapped children in our state.

The testimony you will hear today will confirm unwarranted abuses of a program for which \$26 million in public tax monies has been authorized for the educational betterment of children who are in dire need of such special facilities.

Because we felt that the improprieties our inquiry uncovered should be halted as quickly as possible, we decided they should be subjected to swift public exposure and swift correction -- even as our inquiry into this complex and vital system continues into other aspects.

We intend, as in past public hearings, to record testimony reflecting all facets of this Special Education program, all sides of an extremely intricate and sensitive endeavor to improve the minds and the lives of children who themselves are unable to call out to us for the help they need.

This report will review the record of the fore-said public hearing as a basis for the specific requests for legislation which are outlined in the recommendations section.

THE TESTIMONY - January 18, 1978

THE ROLE OF THE STATE AND LOCAL DISTRICTS

To establish a factual background for the Commission's public hearing expose of irregularities and questionable practices in the use of Special Education funds by certain non-public schools for the handicapped, the Commission first questioned Mrs. Eleanor Engelbrecht, state coordinator of non-public school programs.

She noted that of the \$160-175 million cost of financing Special Education for handicapped children, her job concerned the \$26 million paid to non-public schools. She also noted that these non-public schools provide educational programs for at least 11 mandated categories of handicaps for which varying tuition payments are required, ranging from a low of \$3,400 for "chronically ill" to \$6,800 for "visually handicapped".*

Mrs. Engelbrecht outlined the system by which a child is placed in a non-public school and the way the cost of educating such a child is financed.**

Initially, she testified, a child is identified as "in need of special education" primarily by the classroom teacher, although this determination also can come from parents, school officials and even the

*See Exhibit, P. 9a

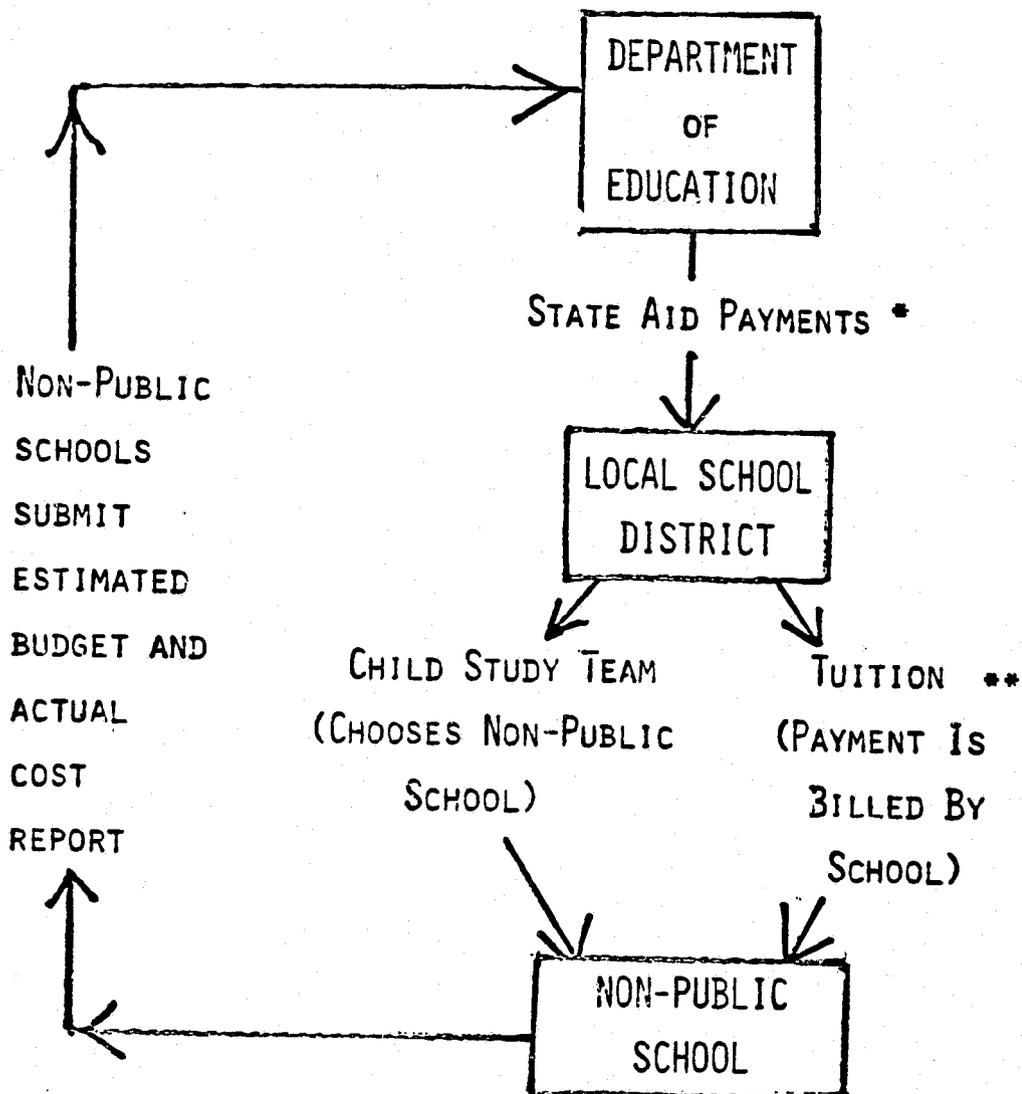
**See Exhibit, P. 9b

COMPARISON OF TUITION RATES

SCHOOL YEAR 1976-77 AND 1977-78

<u>CATEGORY</u>	<u>1976-77</u>	<u>STRUCK 1977-78</u>	<u>AMENDED 1977-78</u>
ORTHOPEDIC HANDICAP	\$6000	\$5700	\$6000
VISUAL HANDICAP	\$6800	\$5500	\$6800
AUDITORY HANDICAP	\$5500	\$4900	\$5500
CHRONICALLY ILL	\$2500	\$3400	\$3400
EDUCABLE	\$4000	\$4300	\$4300
TRAINABLE	\$4700	\$4800	\$4800
EMOTIONALLY DISTURBED	\$5300	\$5000	\$5300
NEUROLOGICALLY IMPAIRED	\$4300	\$4400	\$4400
SOCIALLY MALADJUSTED	\$4600	\$4200	\$4600
COMMUNICATION HANDICAP	\$5500	\$5000	\$5500
PERCEPTUALLY IMPAIRED	\$3100	\$3500	\$3500

SPECIAL EDUCATION NON-PUBLIC SCHOOLS



* CATEGORICAL AID ADJUSTED BY HANDICAP CLASSIFICATION AND ADDITIONAL COST FACTOR.

** TUITION RATE SET BY THE DEPARTMENT BASED ON ESTIMATED BUDGET.

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child. If the school superintendent decides this judgment should be evaluated, it is referred to a child-study team composed of four "professionals" -- the school's social worker, psychologist, learning-disabilities teacher/consultant and a physician. Each of the more than 600 school districts in the state has at least one child-study team but there are a total of some 800 teams because larger school districts have more than one. The child study team is responsible for the proper placement of the handicapped child -- and one of the alternatives is a non-public school.

A Multitude of Duties

At this juncture, the child-study team places its ward according to educational and personal needs in one of 250 approved non-public schools, 150 of which are in-state, 100 of which are out-of-state, and 10 percent of which, or 25, are in-state "residential" facilities serving the child on a 24-hour basis.

Mrs. Engelbrecht indicated any one could receive certification for a non-public school after meeting certain conditions, one of which criteria -- a sort of "certificate of need" determination such as is utilized in the Health Department for proposed hospital facilities -- had been in effect for only four months prior to the Commission's public hearing. Once a need was established and county school authorities approved the

proposed school's physical plant, the applicant school would file its application papers with the State Education Department.

Q. And what happens to them next?

A. They are -- they come back into the office, or into our office, and we go over them with a fine tooth comb because they contain all of the basic evidence that we need to comply with the rules and regulations.

Q. All right. Do they also submit, pursuant to that application process, financial information?

A. Yes, sir. Part of that includes the proposed budget for their school for the current school year.

Q. And with regard to the review of that financial situation, what does the fine tooth comb entail?

A. We would check each item in the budget carefully.

Q. Against what?

A. Our forms are closely related to the financial procedures for the public schools. We consider administrative costs, costs for materials, costs for instructional staff and so forth down the list.

Q. In other words, you yourself would have an idea of what each cost component should be running in a ball-park figure for each of these schools; is that correct?

A. Yes, sir, and if we don't know, we call the applicant and ask him.

Q. All right. And if you didn't get a sufficient explanation from the applicant --

A. We have been -- since I have been in this office, which is only a year-and-a-half, I have been asking for audits to help me from the Department of Administration and Finance.

Q. Is it essentially the same process on a renewal for a non-public school?

A. Yes.

Q. In other words, each year they go through this process?

A. Each year the whole process has to be repeated, including the visit by the county superintendent to the physical plant.

Q. And do you check their report of expenses to see if their report matched their anticipated budget which is submitted in the beginning of the school year?

A. I have only had one round with budgets, but I did ask for a revised budget from everybody last year, and we then were able to compare the original projected budget with the revised budget that came in during the summer months.

Q. In other words, at the beginning of the school year from each non-public school you received a proposed budget and set rates based on that?

A. Yes, sir.

Q. And after you got into your office you asked for a report of expenses to see if they matched up?

A. The exact expense to see what happened.

Q. Had any of your predecessors done that?

A. No, sir.

Q. Now, the monies received by non-public schools are all public monies; is that correct?

A. Yes, sir.

Insufficient Staff

One of the problems the Commission hoped to highlight for swift corrective action was a need for more adequate staffing to regulate and monitor such a complex and sensitive program. Mrs. Engelbrecht's testimony left little question about the seriousness of the staffing deficiency:

Q. Who is your direct supervisor?

A. My direct supervisor is Mr. James Richardson.

Q. And his position with --

A. Director of the Bureau of Special Education and Pupil Personnel Services.

Q. How many people do you, in turn, supervise?

A. I have nobody to supervise, sir.

Q. You are the only person doing exactly what you're doing; is that correct?

A. Yes.

Q. Do you have responsibility for receiving and checking budgets?

A. Yes, and --

Q. Do you also have responsibility of checking expenses of non-public schools?

A. Yes, I do.

Q. Teaching handicapped children, that is.

A. Yes, I do.

Q. You also have some responsibility for input on setting of rates with regard to that particular aspect?

A. Yes, I do.

Lack of Control by Local Districts

Commissioner Stewart G. Pollock questioned the process by which the non-public schools are paid by local school districts (state aid representing about half of such payouts) but are not checked by the districts.

Q. The part that troubles me is this: That the money seems to be coming, a check, from the local school board, and yet to the extent that there is supervision of expenditures and budgets which really determine the rates, that seems to be done by another entity, the State of New Jersey. Is that a fair statement?

A. Yes, but I don't think that would affect the programming for the child.

Q. The part that concerns me is that the entity that's sending the check does not have direct control over the setting of the rates and the expenditures.

A. They do not at this time.

Q. All right. Thank you.

A. I don't feel it would be necessary, but I don't think that in any way has bothered anybody up and down the system, however. Really, you have something in mind that I don't quite understand.

Q. The part that troubles me, I mean, is wherever you have public funds expended and there is no direct control by the public entity spending those funds over the expenses that lead to the disbursement of public funds, there's an opportunity for someone to capitalize on that to the disadvantage of those for whom the funds are sought or intended to be spent.

Conceded Mrs. Engelbrecht: "You have a point."

Audits Based Only on Suspicion

Chairman Rodriguez also questioned a trouble-spot -- the auditing limitations. He noted that Mrs. Engelbrecht's office "has no auditing capabilities" although, as she pointed out, it can draw on the services of the State Division of Administration and

Finance, which it does. The Chairman:

Q. And when you call upon them, is it essentially because of the feeling that one of the line items or one of the components of the budget seems to be out of line?

A. Yes, sir, this is true.

Q. If they appear to be in line, is there anything that would trigger an audit of a particular school where that budget seems to be in line with your desk review?

A. Not at this time. I would say, though, as you know, we, I think, have had ten different audits. Five were done the year before I came into this office, and these were selected at random. Some were selected from North Jersey; some from South Jersey; some large and some small. I repeated that process this year with four other non-public schools, and again we selected these at random because we saw something wrong in their line items.

Q. So, then, the way that it has been handled up to the present time, it would be possible for some schools to have existed for quite some time without any audit at all if their line items didn't appear to trigger the concern?

A. Yes, sir.

THE CALAIS SCHOOL

The first of the non-public schools whose financial mismanagement became a target of S.C.I. scrutiny -- particularly by the agency's team of special agent-accountants -- is located on St. Elizabeth's campus in Convent Station in Morris Township, Morris County, occupying a rental premises of a little over four floors or some 17,000 square feet. It was incorporated as a non-profit school in 1970. Its enrollment at the time of the public hearing consisted of 125 students, 70 per cent of whom were emotionally disturbed and 30 per cent neurologically impaired. Besides the tuition payments the Calais School received \$5,000 for each emotionally disturbed child and \$4,400 for each neurologically impaired child. The school's Executive Director, Lionel Leitner, testified that contributions to the school over the past eight years totaled "in the neighborhood of \$25,000 to \$30,000."

Mr. Leitner, who lives on Egbert Hill, Morristown, testified that he also is president and treasurer of the Calais day school, that he had done consulting work for "maybe a dozen hours a year," all since 1970. During most of this period he was employed full time at Pica-tinny Arsenal. He retired on a pension from the arsenal in January, 1977.

Mr. Leitner's wife, Charlotte, he testified further, is a psychologist and is vice president, secretary and

"director of services" of the Calais School. She has an "office" -- as he said he also does -- at their Egbert Hill home.

Both Mr. and Mrs. Leitner are incorporators of the Calais School, along with Dr. Lawrence Kesner. The incorporators are the school's trustees.

Mr. Leitner testified that his salary from the Calais School is \$33,600 and his wife's \$30,000. He conceded that from 1970 through January of 1977, when he was employed both as executive director of the school and fulltime at Picatinny, his salary at the arsenal ranged to \$37,000-plus.

After noting that his post at the Calais School was "akin perhaps to the superintendent of schools" and "business director," with only superficial or indirect responsibilities for educational programming, Mr. Leitner was questioned by Counsel Siavage on the amount of time he devoted to his duties, particularly when he also worked fulltime at Picatinny:

Q. When did you attend to the work of the school during that period of time?

A. I took care of that evenings and weekends and time off that I was on leave.

Q. And how many hours a week would you say that you devoted to the school work?

A. Well, it varied. In the early period it would have been less when we only had a student population of about 23 the first year. The last couple of years it's been about 30 hours a week.

At School Only Six Hours Weekly

Mr. Leitner said his wife handled for Calais School "all of the senior policy responsibilities relative to all professional aspects of the school," as well as serving as school psychologist.

Q. How much time does she spend at the school?

Mr. Einhorn: (Mr. Leitner's counsel) Excuse me. when you say "at the school," are you referring to the --

Mr. Siavage: I'm referring to the school in Convent Station as opposed to Mr. Leitner's home, yes.

A. I'd say approximately six hours a week.

Q. About six hours a week.

A. Yes.

Q. And the rest of the time which she spends on school-related functions she spends at Egbert Hill?

A. That's correct.

Q. And where does she spend that time at Egbert Hill when she works on school-related functions?

A. Well, it would be all over, really. It's wherever it's convenient for her to do what she's doing.

Q. She didn't --

A. We use the entire facility in that respect. If it's something like reading a report or meeting, or what-have-you, she might do that any place in the -- at the residence.

The Leitners' Egbert Hill "Offices"

Because the Commission had indicated it was interested in ascertaining precisely what kind of Calais School "work" was actually conducted at the Leitners' Egbert Hill house, Counsel Siavage introduced into the record photographs of the couple's "offices" at their home, including furnishings, ornamental and otherwise. The photographs were taken by the Daily Record of Morris County in mid-1976, when the Leitners made their residence available as the "Home of the Week" for a picture series by the newspaper. The prints were provided to the S.C.I. at the request of the Commission.

Counsel wanted to know more details about the "business use" -- supposedly for Calais School work -- that was made of the Egbert Hill home:

BY MR. SIAVAGE:

Q. Now, I think you testified before that your wife Charlotte conducts her private practice also in your Egbert Hill residence; is that correct?

A. Yes.

Q. And she does that in the office which is exhibited by C-6? (Photograph of her office)

A. Partly.

Q. Where does she do the rest of her private practice?

A. Well, she doesn't necessarily confine herself to that office.

Q. Where does she see private patients, elsewhere in the home on Egbert Hill?

A. Well, she may go on the porch; she may go outside; may go in the conference room; she may go in the kitchen; she may go anywhere.

Q. Does she go to the pool?

A. She may.

Q. How many hours a week does Mrs. Leitner spend on her private practice?

A. I'd say --

Mr. Einhorn: Excuse me. Are we talking as of now, sir?

Mr. Siavage: As of now.

A. I'd say between 15 and 20 hours.

Q. How long has she spent between 15 and 20 hours on her private practice?

A. Well, I'd guess since about 1974. Prior to that, I'd say she was much more limited; very little practice.

Q. Okay. So she spent, did you say, 15 or 20 hours?

A. 15 to 20 hours.

Q. A week on her private practice in '74, '75, '76 and '77?

A. Approximately.

Q. All right. And what does she spend the rest of her work week upon?

A. Calais School.

Q. Calais. Does she also see patients anywhere else other than the Egbert Hill site?

A. No.

Son David on the Payroll

The Leitners have two sons, David, who was 25, and Steven, who was 29. Both figured in Mr. Leitner's testimony about the manner in which the day school's funds were spent, particularly David as an employee of the school.

The Commission questioned Mr. Leitner about David:

Q. What is his annual salary?

A. Well, --

Mr. Einhorn: As of now, sir?

Mr. Siavage: As of now.

A. As of today?

Q. Yes.

A. Well, now he's drawing \$275 twice a month.

Q. How long has he been drawing \$275 twice a month?

A. Since January 1st.

Q. Of what year?

A. This year.

Q. Two weeks ago?

A. Right.

X X X X

Q. What was he drawing prior to two weeks ago?

A. \$525.

Q. Twice a month?

A. Right.

Mr. Einhorn: May I have a moment, Counsel?

Mr. Siavage: Yes.

(Discussion held between the witness and his counsel.)

A. (Continuing) May I explain this, please?

Q. Yes.

A. David Leitner, my son, is one of ten people selected throughout the whole United States for a National Science Foundation grant, and this is in the field of environmental education, and it's connected with the Passaic River Coalition, and his duties on this grant commenced two weeks ago.

Q. I see.

A. And as he reduced his work as a result of that, we reduced his salary accordingly.

Q. I understand. On an annual basis, then, last year he was making approximately \$12,600?

A. That's correct.

Q. Okay. And what was his function at the school?

A. Well, he's an environmental science studies specialist. He's basically a resource person for

the teachers on the staff in trying to implement a very difficult area for special ed schools that's weak, I would say, throughout the whole educational process, and in that he tries to help these teachers set up some kind of instructional relationship that would relate to these children who have difficulty handling normal programs in an area of interest and meaningfulness to them so that they could learn a great many things connected with science, environment, and so on, and he works with the teachers, gets children sent to him by the teachers to work in this area, and has stimulated considerable interest and improvement in quite a few of the children in this connection.

Q. He does not teach directly, in other words.

A. Well, he's not a teacher. He's a resource person, but he does -- I can't say that he doesn't teach. He's not counted as a teacher, but he does, in essence, as part of this assistance program, do teaching, but he's primarily a resource person.

X X X X

Q. Does he have a certificate to teach handicapped children?

A. No, and we don't count him as a teacher.

Q. Okay. Does he have a bachelor of science degree obtained when, if he does?

A. Yes, in December of 1975.

Q. How much time did he spend at the school prior to the reduction of his duties, prior to the time of the federal grant?

A. It's part-time.

Q. A 40-hour week?

A. No. We don't have a 40-hour week. The average time is about 30 hours.

Q. 30 hours. And he spent 30 hours a week at the school during the time he was employed?

A. No. That's he would spend four days at school and one day preparing materials elsewhere.

Going to School on \$12,600 a Year

Mr. Leitner testified that his son David was on the Calais School payroll during a period where he was a fulltime college student -- and was paid \$12,600 even while he was attending graduate school. Mr. Leitner explained the situation thus:

Q. How much time did he spend at the school then?

A. He didn't spend -- in his undergraduate period?

Q. Yes.

A. He didn't spend time at school then.

Q. Was he ever employed at the school while he was in graduate studies?

A. So I understand, when you say "school," you mean the Convent Station?

Q. Right.

A. Okay. Graduate school you're talking about, now?

Q. Has he ever gone to graduate school?

A. He's in graduate school -- he was in graduate school this past term.

Q. He started in September?

A. Yes.

Q. All right. And he was being paid by the school \$12,600 a year at that time?

A. That's correct.

The Chairman: Where was the graduate school located?

The Witness: Kean College

Commissioner Lane: Where was the undergraduate school located?

The Witness: Ramapo, Ramapo State College.

Commissioner Lane: How far removed is that from --

The Witness: Ramapo State College?

Commissioner Lane: -- The Calais School.

The Witness: Oh, about an hour's time.

Q. Did he live at undergraduate school or live at your --

A. Yes, he lived at undergraduate school.

Q. And he's a full-time student there?

A. Yes, sir.

Q. And he was on the payroll of your school as well?

A. Yes, sir.

Q. He didn't spend any time at the Calais School; is that correct?

I thought you said he spent no time at Calais School --

A. That's correct.

Q. -- while he was an undergraduate. What was his contribution during those years?

A. His responsibilities then had to do with doing curriculum research, develop surveying -- he was given a position with a target to survey the environmental studies field in particular, with the goal of developing pilot programs that he would then begin to engage upon graduation at the school, and to -- try them out and develop an area in which the school was rather weak in. That school happens to be one of the foremost locations for environmental studies in the country in this particular area, and many of the professors who he was acquainted with are considered resource people by the state Department of Education in this particular field, and this is a field that's been singled out for emphasis and special programs set up at the Montclair State Teachers College in this connection also. So it's an area that had a lot of public interest.

Q. Do you have some idea during the four years of his undergraduate, four undergraduate years, how much time he spent in his duties at Calais School?

A. He was only employed approximately one year by the Calais School during that period.

Q. Senior year?

A. Senior year.

Q. How much time did he spend on Calais School work during that year?

A. I guess it probably would be in the neighborhood of 20 hours a week.

Q. And what do you see -- how do you compute that, you yourself?

A. Oh, well, I'm guessing, really. I don't have a definitive knowledge of the precise number of hours.

Calais Salary Ranges Erratic

Mr. Leitner, who said he visited the Calais School "perhaps 30 times" in a year, explained how the salaries for school officials and employes were set -- and how they varied.

He was asked about who determined salaries at the school.

A. Staff salaries are determined primarily by myself and reviewed by the board of trustees.

Q. Which includes yourself?

A. In particular, relative to the senior executives. In the lower levels, it's primarily a determination by myself in connection with consultation with Dr. Goralsky who's the headmaster.

Q. How much does Mr. Goralsky make as headmaster?

A. He gets \$33,600 a year right now.

Q. Would you consider Goralsky, yourself, your wife, the administration of the school?

A. Well, we're the senior administration, yes, sir.

Q. All right. And the board of directors, if it gets involved in setting salaries, includes yourself, your wife and Dr. Kesner?

A. That's correct.

Q. How much time does Mr. Goralsky spend at the school?

A. Full-time. Actually, more than full-time, probably, in a sense.

Q. What would you say his work week consisted of in number of hours, if you know?

A. At least 40.

Q. At least 40. I show you what's been marked Exhibit C-5 for the purposes of identification, and ask you if you recognize it as the expense budget summary of the Calais School submitted to the New Jersey Department of Education for the school year

1976-77?

A. Yes.

Q. Thank you.

A. That's covering when?

Q. The school year listed on it is 1976-77.

A. Right. This covers the actual expenditures for that year.

Q. Does that document, which you have just identified, specify the salaries of the teachers and the support staff?

A. Yes, sir.

Q. What is the range of salaries for the teachers on this staff, and I ask you to look at this document, with respect to this document, and I ask you if it's a range between eighty-two-hundred, and ninety-four-hundred dollars?

A. No, it goes up to thirteen-thousand.

Q. Okay. Who is making thirteen-thousand?

A. Our industrial arts teacher.

Q. Is anyone else making in excess of \$10,000?

A. Yes, our program coordinator was getting fifteen-five then.

Q. Is that the assistant principal?

A. Yes.

Q. Okay.

A. The vice-principal and program coordinator, yes.

Q. In that same document, David Leitner is making \$12,600 a year?

A. Yes.

Q. Is there anybody else on staff making more than him other than the ones you have mentioned?

A. Presently or at that time?

Q. According to that document.

A. No, sir.

Q. Okay. Do those -- does that staff include peoples -- people with master's degrees?

A. That's correct.

Q. And does it include people with master's of education and master's in speech therapy?

A. Correct.

Q. Was David considered a more important member of the staff than people with master's in reading and speech therapy?

A. Yes. We have people with master degrees on the staff who were working as aides at a much more nominal salary, and we had teachers with bachelor's degrees who were getting double and more than their salaries. So it had to do with the contribution and the importance of it more than anything else.*

*However, these and other comments in this portion of Mr. Leitner's testimony are put in a different light by witness John Ermanis, who taught at the Calais School more than four years. A college graduate and a certified teacher of the handicapped, his salary ranged from \$6,000 to \$8,400. He testified that the Leitners appeared at the school infrequently. See "Leitners Not Often At School", Pp. 62-66.

"Book Club" Purchases With School Funds

After confirming that he and his wife are responsible for signing Calais School checks, except that the headmaster, Dr. Goralsky, could sign disbursements from a petty cash account, Mr. Leitner began a litany of purchases that seemed to have little or no application to instructing handicapped children.

His book club and magazine purchases were examples:

Q. Okay. Thank you. Mr. Leitner, I'm showing you a series of checks drawn on The Calais School account and signed by Lionel Leitner, which we'll refer to as Exhibit C-9 in this proceeding. They are check Nos. 7889, 7744, 7558, 7297, 7080, 6775, and ask you if you can recognize your signature on those checks and could you tell the Commission who the payee on those checks is?

A. The payee is the Book of the Month Club, and it's my signature.

Q. I show you another series of checks from the same exhibit, check Nos. 7954, 7883, 7585, 6854, 1724, and I ask you who the payee on those checks is and whether you signed them.

A. Yes. It's the Jewish Book Club.

Q. And to where were those books delivered that respond to those checks?

A. My residence.

Q. Some of the titles of the books involved, according to the invoices, are The Rockefellers, Moscow Farewell, Moshe Dyan, Blind Ambition, Face of Battle.

Are those books used for the business of The Calais School?

A. The practice relative to purchase of books by myself is to turn books over, after I have finished with them, to the school for the use of the school, the staff, and any students that would want to use it. I also regard myself as a member of the staff.

Q. They are used for the educational background of the staff shall we say?

A. Some -- they may.

Q. And how long does it take you to turn those books over to the school?

A. Varies considerably. I have turned over many, many books and periodicals that are acquired in this fashion and others that I have acquired personally over the years. There's no particular pattern to it.

Q. I show you, again, what's a portion of Exhibit 9, check No. 7662 and I ask you whether you signed that check, the amount of the check, and who the payee is.

A. Tennis. It's my signature and it's \$23.

Q. Is that a Calais School check?

A. Yes.

Q. Is Tennis magazine turned over to the school?

A. Yes.

Q. Is it read by the students?

A. I wouldn't know.

Q. Is it read by the instructors?

A. I wouldn't know.

X X X X

Check Payouts Followed "Global Pattern"

Another Calais School check introduced into the hearing record -- signed by Mr. Leitner for payment of \$261.66 to Jabberwock---caused the witness to discuss his pattern of allocating "school" and "personal" costs. Counsel showed the check to Mr. Leitner:

Q. I ask you if you recognize that check.

A. Yes.

Q. And can you tell the Commission what it was for?

A. Covers -- it's a fireplace enclosure that prevents draft from the fireplace in my wife's office.

Q. In your home?

A. Yes.

COMMISSIONER POLLOCK: Doesn't the fireplace have a flue you can close?

THE WITNESS: It's not adequate. It's still

drafty. As a matter of fact, I have added a heating unit as well just outside the fireplace.

Q. Did the board of trustees at Calais make that decision or did you make that decision?

A. I made that decision.

COMMISSIONER LANE: This two-sixty-one-sixty-six, was that the entire cost of the unit.

THE WITNESS: Yes.

COMMISSIONER LANE: The cost wasn't allocated between the school and the work done in that office for the school, in accordance with your testimony, and other work done by your wife individually as a doctor?

THE WITNESS: No, it was not, sir. The allocation of expenses are not necessarily item-by-item and expense-by-expense, but we follow a more global pattern.

COMMISSIONER LANE: I take it that that there are times you individually pay for things that go to the school?

THE WITNESS: No. I'm trying to say that at the Egbert Hills site we make a great many expenditures, the predominance of which we pay for personally and an amount we consider reasonable we have paid by the school.

Paintings Charged to "Books/Supplies"

The witness was shown separate Calais School checks he signed, one for \$845 and one for \$955, payable to artist Joseph L.C. Santoro. These and similar public hearing exhibits led to a long discourse by Mr. Leitner on how public funds paid to the school were "invested" in paintings and other cultural objects. Mr. Leitner was asked if he recognized the Santoro checks and what they were for:

A. Yes, I recognize them. These are two paintings that the Calais School invested in.

Q. Okay. Where are they located?

A. They are located in my office.

Q. And check No. 6965, in the amount of thirteen-hundred-and-three dollars, dated 9/21/76, payable to A. Konrad, signed by Lionel Leitner. Do you recognize that check and what was that for?

A. It's the same reason. It's a painting by Adolph Konrad who agreed to -- both artists agreed to sell for a non-profit institution at a discount for investment purposes.

Q. Now, you said the school made the decision to invest in these paintings. Did you mean that the school was using that as a means of investment?

A. I don't understand your significance of what you're saying.

Q. Did the board of trustees decide to invest in art work as opposed to putting some money in the school, in a bank account, or is that in addition to a bank account, if you could explain it?

A. Well, the school developed a certain amount of surplus funds, the predominance of which are needed for cash-flow problems. A modest amount of the funds which were excessive to that requirement, it was felt, should be invested in something, in a highly inflationary environment that we exist in, in something that would be more likely to hold value.

Q. Does your wife also have objects of art in her office in your home?

A. She has a bronze bust in her office, and she has a clock, an antique clock.

Q. All right. Does Dr. Kesner have any art objects?

A. He has no objects that would have been procured by The Calais School.

Q. It was decided that the objects that were used as a means of investment would be placed in the offices in Egbert Hill?

A. Yes.

Q. Okay. Do you know how those paintings, by the way, were charged to your expense report to the Department of Education?

A. Well, I believe they were charged on the supplies account. We have no particular account for such a thing -- not -- because we have not engaged in such a practice before.

Q. Books and supplies they were charged to?

A. The account -- yes, it's called books and supplies.

Q. On that expense report, is there any line for other?

A. Yes, there is.

Q. In other words, if you wanted to break it out, you could have?

A. Of course, that's possible. We don't follow our accounts from that. We -- I'd annotate a stub as to what I purchased. The accountant, bookkeeper, would spread it into an account that she deemed appropriate and it would go into an account there. Now, I don't think the set of accounts set up included something called other.

COMMISSIONER POLLOCK: Mr. Leitner, excuse me. Your funds for The Calais School come from the State of New Jersey and the sending school districts, do they not?

THE WITNESS: Yes, sir, they all come from the sending school districts, and the ones that come from the -- from public institutions all come from the local school districts.

COMMISSIONER POLLOCK: These are all monies sent, tax monies, that are sent to you through the needs of the sending districts?

THE WITNESS: These are all in payment of tuition for services rendered by Calais School.

COMMISSIONER POLLOCK: Which are raised by taxes?

THE WITNESS: Yes.

COMMISSIONER POLLOCK: And you took some of these monies and purchased paintings and bronze statues and antique clocks; is that a true statement?

THE WITNESS: That's a true statement.

COMMISSIONER LANE: We might as well, while we're on the subject, find out who made the decision to buy these paintings and other objects of art.

THE WITNESS: These particular ones, I did.

COMMISSIONER: All right.

THE CHAIRMAN: Well, did any of the other members of the school know that you had made that decision?

THE WITNESS: Well, subsequently my wife and Dr. Kesner.

THE CHAIRMAN: Prior to the decision, did they know that you were going to invest, take monies from The Calais School --

THE WITNESS: The general concept of investment.

THE CHAIRMAN: But it was not known by them?

THE WITNESS: The general concept of investment was known. Specifically these particular items were not known.

THE CHAIRMAN: Were any of the teachers advised at the school that these art works existed in your home for the education of the children?

THE WITNESS: These objects were not procured for the education of the children.

Weedkillers, Insect Sprays, Gardeners...

The next public hearing episode involving expenditures by the Leitners out of the public funds of the Calais School began with Leitner's identification of a Calais School check in the amount of \$41, payable to Agway Supplies.

Mr. Leitner said it was "entirely possible" that the checks were in payment for -- as Commission counsel explained the invoice -- plants, garden tools, trays, poison ivy spray, weedkiller spray, hornet killer spray. The question of who utilized these items led to another revelation -- the employment by the Leitners of part-time gardeners at school expense. As Commission Counsel explained, these purchases required a visual depiction of the Leitners' Egbert Hills estate:

Q. Mr. Leitner, since it may become relevant to talk about where the weedkiller was applied or for other matters, I'm going to ask that a chart* of your residence be placed up. It is not perfectly in detail, nor in scale, and was prepared essentially by a former employee of yours for the Commission.

If it does not depict your house and grounds in any particular respect, perhaps you could change it now, but if it does, just for the purpose of checking, then we can leave it as it is. Maybe you can answer the question.

A. In general. The scale may be different.

Q. Okay.

COMMISSIONER POLLOCK: How many acres are we talking about?

Q. 6.97?

A. That's correct, approximately.

Q. Do you know where the weedkiller was applied on those grounds?

A. No.

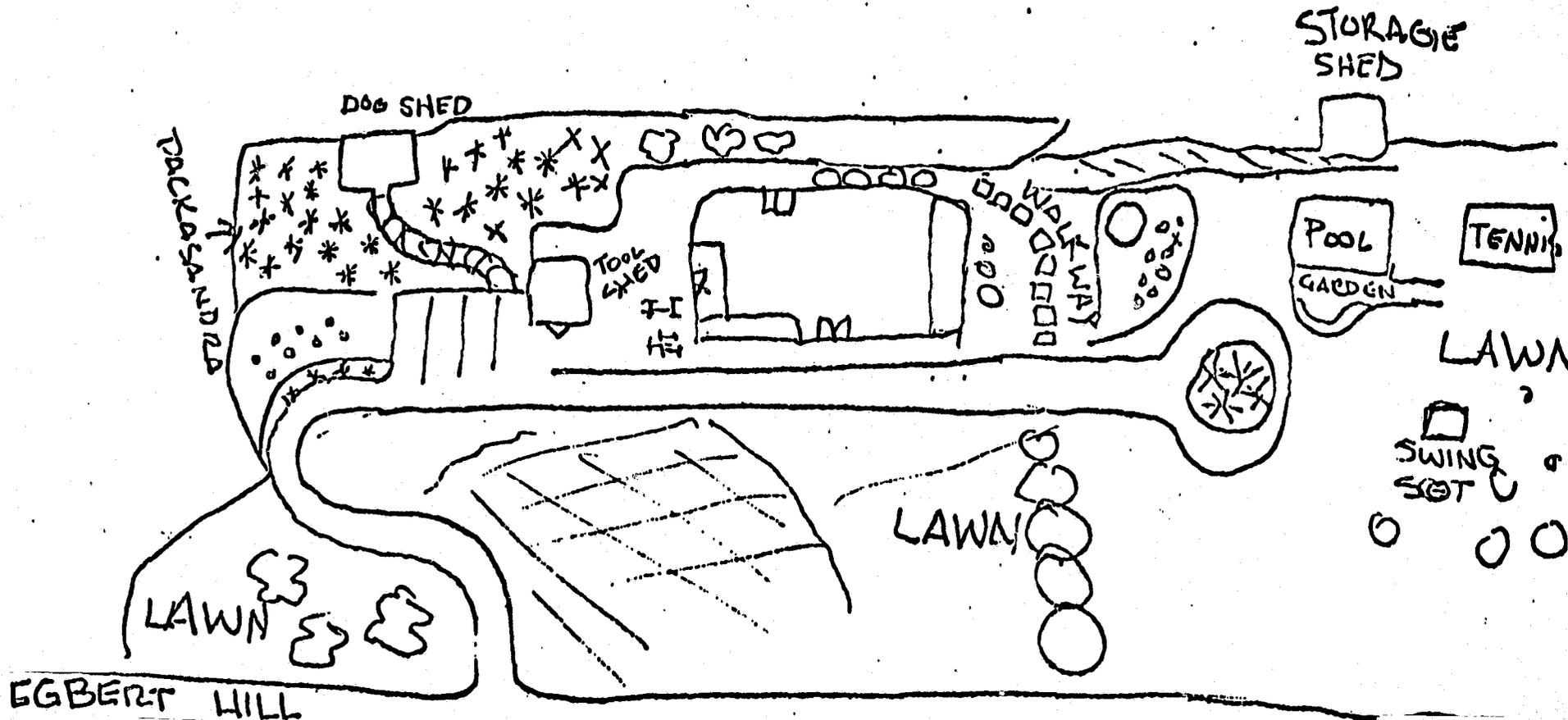
Q. Did you apply it.

A. No.

Q. Who applied it.

A. I really don't know.

*See Exhibit, P, 41a



LEITNER HOUSE AND GROUNDS.....

Q. Showing you a series of checks which are another part of Exhibit C-9 for the purposes of identification, the first two checks, 6885, dated August 29th, 1976, and 6967, dated September 20, 1976, are payable to Dan Allen, A-L-L-E-N, and the second two checks, 6825 and 6743, dated August 8th, 1976 and July 8th, 1976, respectively, in the amounts of \$248.75 and \$200 even, respectively, payable to Diane Gorman.

I ask you if you recognize that series of four checks.

A. Yes.

Q. What were those checks for?

A. For cutting the lawn.

Q. Those are Calais checks?

A. Yes, sir.

Q. Where was the lawn cut?

A. Wherever lawn was cut.

Q. All of the lawn at the Egbert Hills site?

A. Whatever portion of the lawn was cut was cut.

Q. Well, did they skip any, usually?

A. They usually didn't cut the whole thing at once, so they would usually skip some one time and do some another time.

Q. They did a satisfactory job during the summer cutting the lawn. You had no complaints, did you?

A. Reasonably.

Q. Okay. What else did Dan Allen and Diane Gorman do?

(Discussion held between the witness and his counsel.)

A. I think primarily, it is my recollection, that they worked on the grounds.

Q. Would that --

A. They may have done some weeding or --

Q. Did they put in -- did Dan Allen put in a slate walkway?

A. Oh, he may have.

Q. Referring to Exhibit C-4.

A. Yes.

Q. They both got \$2.50 an hour, if you recall?

A. Sounds appropriate.

Q. Those checks total \$654.25 and represent a portion of the summer, would you agree with that?

A. Yes.

THE CHAIRMAN: Again, Mr. Leitner, the sole purpose would be the fact that your office is located in the house?

THE WITNESS: This is the administrative center of the school and we felt it appropriate to bear some overall portion of the cost there.

Q. Showing you another series of checks which are a portion of Exhibit C-9, and they are check

numbers as follows: 6798, 7116, 5655, 7346, 5799, 6364. They are dated in a period of time from April of 1976 through November, 1976, and they are all payable to Lawn King. All of them are in amount of \$267.75 with the exception of one check, No. 7346, which is in the amount \$297.65. They are all Calais School checks signed by Lionel Leitner.

I would ask you, first, if you recognize them, and then ask you to tell the Commission what they were for. There is a -- the total amount is sixteen-hundred-and-thirty-six dollars and forty cents.

A. I recognize them and they are for treating and restoring the central lawn area, approximately one acre.

Q. Referring to this bottom portion of Exhibit C-4?

A. The proportions are grossly distorted.

Q. Okay.

A. But in that general configuration.

Q. I ask you if you recognize, again, a portion of Exhibit C-9, which are check Nos. 6711, dated 6/30/1976, in the amount of \$2,137, and check No. 7217, dated November 8th, 1976, in the amount of \$130, both payable to Somerville Equipment Company,

Can you tell the Commissioners what those checks were for?

A. One was for a hand mower and one was for a Gravely tractor mower.

Q. And where were the -- was the Gravely tractor mower, that's a ride-on mower?

A. It's a sulky-type mower.

Q. Pardon?

A. It has a sulky.

Q. A sulky?

A. Yes. It can be ridden on or walked alongside of.

Q. I see. Were they used to cut the grass at the Egbert Hills site?

A. Yes, sir.

Q. Did you use those to cut the grass?

A. Yes, sir.

Q. Did --

COMMISSIONER LANE: Were they used to cut grass at any other site?

THE WITNESS: No, sir.

Q. Did Dan Allen, the employee who cut the grass, also use those?

A. I don't recall whether he was using that or not. We had a previous mower -- time frame wise I can't say whether he used it or not. He may have, if it was the time that he was cutting grass when we had that.

Q. You wouldn't disagree with his sworn statement that he did use --

A. Oh, no, no. I just --

MR. STAVAGE: Since I have referred to it, Mr. Chairman, I will add Mr. Allen's sworn statement on that fact and others to the record and have it marked.

THE CHAIRMAN: All right. I think those statements should be included.

MR. EINHORN: Can I get a copy of that?

MR. STAVAGE: Yes.

(A transcript of a tape recorded statement of Daniel Allen, dated January 13, 1978, is received and marked C-11.)

School Paid for Air Conditioning at the House

Counsel next referred to four checks amounting to a total of \$2,630, payable to Braun Air Conditioning & Heating, for what Mr. Leitner admitted was an air conditioning system for "my office area" at the Egbert Hills residence.

Mr. Leither was asked whether the installation involved duct work into two adjoining bedrooms:

A. Yes. Both of these were rooms that were also partially used in connection with school business.

Q. The bedrooms?

A. Yes, sir.

School-Funded Trip to the West

Shown a Calais School check amounting to \$1,220, which he signed payable to Empress Travel, in September, 1976, Mr. Leitner explained that it "represents payment for travel to a conference in Los Angeles by my wife and myself, the National Conference for Physical Training of Handicapped Children. Also includes hotel accommodations at -- for one night in Los Angeles, and I believe three or four nights in Las Vegas, and a tour, an air tour, to the Grand Canyon from Las Vegas."

Mr. Leitner estimated the trip took about 10 days, approximately five days in Los Angeles and four or five days in Las Vegas.

A Consultant Who Was Also a Brother-In-Law

But the interrogation brought out other facts about the publicly-funded trip, including an additional payment to Mr. Leitner's brother-in-law. Mr. Leitner was pressed for details:

Q. *And the school paid for the entire trip?*

A. Yes, sir.

Q. *Where was the conference located?*

A. It -- excuse me. It paid for the trip; didn't pay for our -- when we were at Vegas for entertainment or food or things like that.

Q. *Okay.*

A. Excuse me.

Q. The last question was, where was the conference located? Was that L.A. or Vegas?

A. It was in L.A.

Q. Was there any conference for the four or five days that you were there?

A. No.

COMMISSIONER LANE: How long was the conference?

Q. How long was the conference in L.A., about five days also?

A. No. It was two days and a night.

Q. Two days and a night?

A. Yes.

Q. Do you remember where it was held?

A. I think it was the Marriott Hotel, but I'm not positive.

Q. Did you attend the lectures?

A. Yes, sir.

Q. All of them?

A. No.

Q. Where did you stay in Las Vegas?

A. Ceasars Palace.

Q. Check No. 7076, another part of Exhibit C-9, payable to Marten Rich, in the amount of \$750 relates to the same trip

What was the check for, if you accept my representation?

A. Yes. It was payment for several things. One was accommodations for about four days and nights, transportation, setting up some meeting with a teacher of the handicapped, and primarily, over and above that, for an extensive debriefing session on his familial problems in regard to problems of a handicapped family.

Q. Who is Marten Rich?

A. Marten Rich is my brother-in-law.

Q. He's married to your sister?

A. Yes.

Q. He provided service to you in Los Angeles of chauffeuring; is that fair?

A. Yes.

Q. And introducing you to a teacher of the handicapped, I think?

A. Arranging and participating in meetings with us.

Q. And then allowing you to share his thoughts on being a member of a handicapped family?

A. Well, it was a rather intensive involvement as to his therapy, his problems, familial problems, connected with it; type of emotional impacts, type of health impacts that result, cross-playing problems.

Q. Are you saying, essentially, that a portion of the \$750 was a consulting fee?

A. Well, you might label it that. I don't have a convenient label for it.

Q. Did Marten Rich understand what he was being paid for, do you think?

A. Did he understand what he was paying for?

Q. What he was being paid for.

A. Well, he didn't bill me, and if I gave him nothing, he probably wouldn't have thought it inappropriate. But the services he rendered I considered were of value, of considerable value, to us and our relationship to a school dealing with the handicapped and I volunteered the payment to him for that.

Q. Did you consider it more akin to a gift than a payment?

A. No, sir, it was payment for services rendered.

Q. Which he did not expect?

A. Which he may not have expected.

COMMISSIONER LANE: Does the school district from which tax monies come to your school, does anybody in that district know about this payment --

THE WITNESS: No, sir.

COMMISSIONER LANE: -- for service? Does anybody in the State of New Jersey know about it.

THE WITNESS: Well, I know about it.

COMMISSIONER LANE: Any official or anybody employed by any department of the State of New Jersey know about it other than yourself?

THE WITNESS: Apart from these proceedings, no.

(Discussion held between the witness and his counsel.)

CHAIRMAN RODRIGUEZ: Did you convey any of the information you received during that consultation service with any members of your staff at The Calais School?

THE WITNESS: Well, my wife participated in these, and I'm sure the absorption of the information influences her professional judgements relative to the school problems and appreciation of the family-therapy problems that we're always engaged in. We have extensive familial therapy sessions at the school, and I'm sure it influences the professional advice and counsel that she renders without it being explicitly tied in.

School Funds to Fix Tennis Court

A Calais School check for \$1,500, signed by Mr. Leitner and payable to Steven Westervelt, was described by the witness as payment for "repainting and restriping and putting a new net on the tennis court" at Egbert Hill. Details were sought on how this could be regarded as a school expenditure:

Q. And that would have been one of the administrative facilities, I would assume, that would be available in an emergency situation?

A. No. We intended, we had planned to use that in an adjunct capability, to bring children there

as well as to entertain people who have helped the school and people who are in the field of special ed for --

COMMISSIONER LANE: *Whom is it used for, the school?*

THE WITNESS: Apart from entertainment aspects, we have not, because when we had the series of vandalism incidents we were very reluctant, thought it imprudent to bring the children there at that time, but --

COMMISSIONER LANE: *Excuse me --*

MR. EINHORN: *Finish.*

COMMISSIONER LANE: *Finish up. What entertainment? You referred to --*

THE WITNESS: Well, we had people who helped found the school come there quite often to play tennis, including Dr. Kesner and friends of his, and we have had several people involved in special education working at other school systems who have come there, who have -- who have benefited from this tennis court.

COMMISSIONER LANE: *Have you used the tennis court for purely social reasons?*

THE WITNESS: Yes, we have. We have also used it in connection with some fund raising functions for the Morris County Mental Health Association.

THE CHAIRMAN: *Have you ever used it, or have the children ever gained the benefit of this expenditure?*

THE WITNESS: No, sir.

MR. EINHORN: May I have a moment, please?

(Discussion held between the witness and his counsel).

THE WITNESS: Excuse me. May I reconsider that question?

THE CHAIRMAN: *If you will.*

THE WITNESS: You said have the children ever gained any benefit from it.

THE CHAIRMAN: *Any direct benefit.*

THE WITNESS: Well, they got indirect benefit from it.

THE CHAIRMAN: *My question then would be to define indirect.*

THE WITNESS: They never played on it.

THE CHAIRMAN: *They never played on it.*

THE WITNESS: Right.

COMMISSIONER LANE: *What's the direct?*

THE WITNESS: The value of dealing with people who have helped the school in getting feedback in terms of that helps us do a better job with the school. They benefit from that.

"Movable" Chairs and Carpeting

Mr. Leitner identified another Calais School check, in the amount of \$431.60 to Casual Living, as payment for eight chairs for Mrs. Leitner's "office area." Mrs. Leitner signed this check. Counsel Siavage wanted to know what she did with the chairs on non-office occasions.

Q. And they are all in her office?

A. They're in her office area. I think one is in another room that is occasionally used in connection with work, but it's not the primary office.

Q. Does she move the chairs out when she does her private-practice business in her office?

A. The chairs are moved in and out from time-to-time. They're not heavy.

Q. So when she sees private patients, she takes them out?

A. Excuse me?

Q. The question was, that you just responded to was, does she move the chairs out of her office when she conducts her private practice there?

A. Oh, I misunderstood you. She -- what I was trying to say was, that the chairs are moved in and out, but not because someone comes in for a private-practice reason.

Q. Okay.

A. They may be moved onto a porch if they are to be used at that moment, but this is their normal position.

School funds also paid for carpeting. Counsel asked Mr. Leitner to explain a Calais School check for \$1,812.32 payable to Ward S. Sands. Did Mr. Leitner recall that?

A. Yes. This is for carpeting covering the stairs and foyer area leading to my office.

Q. All right. Was it also installed in the hallway?

A. That's what I'm saying, the foyer area.

Q. Does it measure approximately 12 by 14 feet?

MR. EINHORN: If you know.

A. Sounds right.

Q. Does the check also represent payments for undercarpeting, padding, in all -- in several portions of the house; that is, in five different portions of the house?

A. I'm not aware of that. Possibly.

What Was Considered "Office Area?"

In quick order, Commission counsel had Mr. Leitner identify a series of checks related to alterations at Egbert Hill, all at the Calais School's expense. One was for \$200 for "possibly" repairing a window and a ceiling in the first floor hallway of the house.

Another check was for \$1,500 for making a parking space and pathway to the "entrance to the office area." Still other checks amounting to \$3,100 were paid out of school funds for carpentry, including stuccoed ceilings.

Commissioner Lane sought to pinpoint the areas of such activities:

COMMISSIONER LANE: *And those were in your office?*

THE WITNESS: No. That was in the -- my wife's office area, the hallway and stairway leading up towards my office, and it was the ceiling of the adjoining room to my office.

COMMISSIONER LANE: *I'm sorry.*

THE WITNESS: That was about it.

COMMISSIONER LANE: *Are you finished?*

THE WITNESS: Yeah.

COMMISSIONER LANE: *You're not distinguishing, are you, between your wife's and your office area as opposed to your office, are you?*

Do you consider the office area any larger space than the office?

THE WITNESS: Well, there's the foyer outside my office being the office -- being an office area. My wife's office primarily is the office itself there, and there's a small connecting passage between the rooms that would be part of it.

COMMISSIONER LANE: *Do you consider that all, very definitely, school related?*

THE WITNESS: Yes, sir.

School funds financed lavatory work, also -- according to a \$240 Calais School check that Mr. Leitner identified as signed by him. It was paid to a Henry Moorehouse.

Q. Do you recall what that was for?

A. Yes. This is part of the cost that -- Mr. Moorehouse did, I guess, did some tile work in a couple of the bathrooms.

Q. Tile work in the bathrooms?

THE CHAIRMAN: The bathrooms are located where?

THE WITNESS: Well, one is in my office -- near my office, and the other I -- I don't recall which other one he worked in, frankly.

COMMISSIONER LANE: They are, that's part of the benefit to the school, part of the premises?

THE WITNESS: Well, you work in a building. You need a bathroom.

COMMISSIONER LANE: I suppose if you live in the building you need one, too.

THE WITNESS: Yes. We paid part --

MR. EINHORN: Okay.

EXAMINATION BY COMMISSINER LANE:

Q. This series of rooms and anterooms and so forth and stairways to rooms and doors to rooms, have you ever explained to anybody in the school district your concept of this related office space related to the school?

A. No, sir.

Q. Have you ever described all that to anybody in the state?

A. No, sir.

Questioned Checks Amounted to \$42,207.56

Mr. Leitner's testimony was climaxed by Chairman Rodriguez, who had kept score on the Calais School checks signed by the Leitners for various activities that the Commissioners found hard to accept as truly education-oriented.

EXAMINATION BY THE CHAIRMAN:

Q. Mr. Leitner, just keeping some running totals here of these checks that have been questioned and substantially involve your net worth property, total some \$42,207.56. Are you indicating to us that there are people located in the school and are representative or in a responsible position with respect to making decisions that are aware of that total going into your home?

A. Are there people aware of that?

Q. Yes.

A. You mean officially?

Q. Officially in the school.

A. In the Calais --

Q. The Calais School.

A. Yes. I'm aware of it. My wife is. Dr. Kesner's aware of it.

COMMISSIONER LANE: *Anybody else?*

THE WITNESS: *I'm not sure.*

EXAMINATION BY MR. SIAVAGE:

Q. *You and your wife have a majority vote on the board of directors, don't you?*

A. *Yes.*

Further Personal Use of School Funds

The range of the diversion of Calais School funds to the personal use of the Leitners was wide. Mr. Leitner conceded he made personal telephone calls that were paid for by the school, that he purchased scientific supplies for son David and a stereo for son Steven that were used by them at home before eventually being brought to the school, and that he bought "note cards" from the Metropolitan Museum of Art on the school account. The purchase and installation of a security and alarm system at Mr. Leitner's Egbert Hill home also was largely paid out of public funds from the school account, according to his testimony.

After Mr. Leitner explained how he and his wife established school-financed life insurance and retirement plans for themselves, Commissioner Lane asked if the Leitners didn't think that was an "out of line" use of tax money. "No sir," answered Mr. Leitner, "not in the global sense."

Mr. Leitner Defends Payouts

When Commission Counsel questioned the witness about a Calais School check for \$850 for carpentry work by John T. O'Donnell at the Egbert Hill home, Mr. Leitner said he could not specify what the particular payment was for because of work done generally at the house, "some in office areas, some not in office areas," some paid for personally and some paid for out of school funds. As for O'Donnell, Mr. Leitner said, "He did some work, I believe, on our porch."

Counsel Siavage was about to go on to other Calais School checks signed by Mr. Leitner when Mr. Leitner conferred with his lawyer and then stated:

THE WITNESS: If I can elaborate a little bit.

Ever since the school has started, we have operated on the basis of having the office site at our residence, and initially, the first couple of years, the classroom facilities were located at a hotel, and that would operate during holidays and in the summer period was inappropriate to have any office space there.

When we first moved into the new site where we're presently located, no space was available for headquarters office space apart from the fact that I considered it undesirable to co-locate. Subsequent to that we went on a year-to-year lease at the insistence of the landlord, the Sisters of Charity of St. Elizabeth's, and even though space

opened up, that could be leased by a result of a moving of one of the tenants.

We considered it undesirable for several reasons, the primary one that we felt it's inappropriate to co-locate, but, secondly, apart from that, that we had a year-to-year basis and would be a tenuous situation with the possibility of problems.

Just recently, as a matter of fact, we have been notified -- we had planned, with these things in mind, to have at this adjunct facility of the school, capabilities for emergencies and so on in connection with the school, particularly in the administrative area, and since all of this has taken place, it -- recently we have been notified that our lease is not going to be renewed because they are going to demolish the building.

So the next school building, we are again going to have to be in a position to shift, and we have the advantage of at least having made whatever expenditures that we do in the administrative area to provide some continuity and a site that might help us in the transition.

Pollock: "Nothing Less Than Appalling"

Commissioner Pollock asked Mr. Leitner if he was suggesting that he planned to transfer the children to his home at Egbert Hill. When Mr. Leitner reiterated

a need to make Egbert Hill capable of handling administrative problems in any transition of Calais School to another site, his overall defense drew a blast of criticism:

COMMISSIONER POLLOCK: I don't know if you can appreciate the impact of hearing testimony of paintings, statues, swimming pool equipment, tennis equipment, lawn care, pensions, gifts to family members, trips, upon someone who is sitting here, trying to sit here, in an impartial way and to assess what the appropriate way to regulate a program, a very noble, high-minded program such as this is, that the cumulative effect of this is, to me, is nothing less than appalling, and to hear you try to defend this, I'll have to tell you in all candor, is also appalling.

Leitners Not Often At School

John Ermanis, a college graduate and a certified teacher of handicapped children, taught at the Calais School from January 8, 1973, through June, 1977. He joined the staff as a \$65-a-week aide but within a year became the school's "crisis intervention" teacher. His salary as a teacher ranged from \$6,000 to \$8,400.

According to his testimony, he didn't see much of the Leitners during his four years and six months of

service at the school.

Q. Were you there during a period of time that David Leitner was on the staff of the school?

A. I can't say whether he was on the staff, but he was present in the school at times, yes.

Q. How often did you see him during the time of your presence at the school?

A. Well, initially, I believe he came -- he started in the spring of '76, although I can't be certain, and he came in maybe twice a week. But I feel, in all fairness, I should qualify my answer by saying that I was in an isolated part of the school. I wasn't on the academic floors.

Q. As far as you know, he came in twice a week?

A. Roughly, yes.

Q. Okay. Do you know of his duties while he was there?

A. From my understanding, he had a nature and environment type class with the younger children in the school.

X X X X

Q. How many times during a school year would you see Mr. Leitner and Mrs. Leitner on the premises?

A. Together or separately?

Q. Let's start with separately.

A. Separately. I seen Mr. Leitner approximately maybe three times a year.

Q. Three times a year.

COMMISSIONER POLLOCK: Three what?

THE WITNESS: Three times a year.

COMMISSIONER POLLOCK: A year?

THE WITNESS: Yes.

Q. And Mrs. Leitner?

A. Oh, it's difficult to say, but I'd say three, four, maybe five times a year.

Q. Again, three or four, five times a year?

A. Yes, But, as I said, I'm away from the main offices. I'm in, you know, a removed part of the school and it could have been more for all I know.

Q. That's how many times you saw them and you were a full-time employee?

A. That's as many times as I did see.

Q. Did they tour the school when they came in on these occasions?

A. Yes. Mr. Leitner would walk around the school and I couldn't say whether it was every occasion, but he did.

Q. He usually found you in the remote part of the building when he came in?

A. I had a student check who was walking around the building, yes, and Mrs. Leitner, she -- I really can't say. She did tour the school with some -- some potential sending school districts, the people.

Q. Your wife is a former teacher there, too, isn't she, at The Calais School?

A. Yes.

Q. How long did she work there?

A. She worked there six years.

Q. From what period to what period?

A. She ended '77 and she began -- I really don't know when she began, but it was a total of six years.

Q. If you know, did she see the Leitners on the grounds more than you did?

A. To my knowledge, no, she didn't. She's expressed that she hasn't.

X X X X

COMMISSIONER LANE: Who ran the school while you were there?

THE WITNESS: Jack Goralsky, Dr. Goralsky.

COMMISSIONER LANE: Did you attend faculty meetings under him?

THE WITNESS: Yes, I did, every day.

COMMISSIONER LANE: Did Mr. and Mrs. Leitner ever appear at faculty meetings?

THE WITNESS: Mr. Leitner, to my recollection, appeared once when he explained a hospitalization policy with the school, institute, I think in September of '76, and Mrs. Leitner, on occasions, she would.

And I can remember one specific occasion when, not at the daily meeting, but at -- once a year the sending school district would send a team to see, evaluate, how their student was coming along in school and what they would be doing next year and if the school was an appropriate setting or what the child's future should be, and she attended that.

LINCOLN SCHOOL

The Lincoln School of Adaptive Education, Inc., of Peapack, was the next target of the Commission's public hearing disclosures. The first witness to testify on irregularities at this day school for handicapped children was Miss Ruth E. MacGrandle, the business manager and a founder of the non-profit, private school in 1971.

In outlining the development of the school, she testified that the board of directors consisted of herself and Miss Christine H. Compton, her friend of 20 years, who was the executive director and education director of the school; Andrew Compton, Mrs. Compton's nephew and a stockbroker; Herbert MacGrandle, Miss MacGrandle's brother, who is retired, and Arthur Harris, a businessman and husband of the school's learning disabilities teacher.

The school's enrollment, Miss MacGrandle testified, was at 54 for 1977-78, about 85 in 1976-77, and has been as high as 100 -- broken into only two categories of pupils,

neurologically impaired and emotionally disturbed.

She said the board of directors usually meet only twice a year "unless we call special meetings." In fact, the board of directors recently held three special meetings -- because of the S.C.I., investigation and in March, 1977, because a critical newspaper article was published about the school that month.

Miss MacGrandle testified that she and Miss Compton each received \$30,000 "plus summers" as salary in 1976-77 but that their salaries now were \$25,000 for herself and \$22,000 for Miss Compton, "plus summers." The summer compensation was based on the monthly salary rate, for 1976-78 at \$2,500 a month for Miss MacGrandle and \$2,200 a month for Miss Compton and in the previous year \$3,000 per month for each in July and August.

Miss MacGrandle also testified that she and Miss Compton took extended vacations to Florida each year, usually right after Christmas to the middle of February or longer. In 1977, they stayed until March. One year, she recalled, they followed up their Florida vacation with a two-week cruise in March. Miss MacGrandle whose journeys with Miss Compton were to become a major public hearing topic, contended they were "working vacations:"

A. While I am in Florida all bills are sent to me and I sign all the checks. I take the school checkbook with me and all --

Q. Right.

A. -- are checked and verified down there, and then the money is sent from Florida. Also I handle all the tuition billings and mail them back to the school ready to be going -- to be mailed.

Q. You handle writing the checks and the tuition billings while you're in Florida?

A. Right, and anything else. We're in contact at least every other day.

Q. You're in contact with the school at least every other day?

A. Yes, right.

The Vacations Were At School Expense

It turned out that the Misses MacGrandle and Compton also went to Florida in the Fall of 1976. The witness also confirmed that all such trips were paid out of the Lincoln School's public funds and that they used the school's van for vacation travel. Counsel Siavage introduced copies of three Lincoln School checks payable to the Gulf Oil Corp. -- for \$75.09 on Nov. 10, 1976; \$107.70 on Dec. 23, 1977, and \$84.47 on Jan. 28, 1977 -- and asked Miss MacGrandle if she recognized them:

A. Yes, I do.

Q. Okay. They obviously are payments to Gulf Oil Corporation. Can you tell the Commissioners for what?

A. Gas and oil charges and possibly others. I don't know. Gas and oil charges.

Q. Gas and oil charges for what vehicle?

A. The Dodge van.

Q. And what year is that Dodge van?

A. '75? '76. I don't know.

Q. Is it owned by the school?

A. Yes, it is.

Q. Purchased by the school?

A. Yes.

Q. Do you take that van to Florida?

A. Yes, we do.

Q. And do you pay the gas charges into that van when it's going to Florida with school funds?

A. Yes.

X X X X

Q. There is a trip that begins in October. On October 12th is the first gas purchase going down, apparently going down to Florida because the last purchase is in Florida, and then there are invoices coming back from Florida appearing to arrive in New Jersey on November the 6th. That would be a four-week period in October and November in 1976. Do you recall that trip?

A. Yes.

Q. Okay. And that was different from the trip that you took in December and January --

A. Yes.

Q. -- and February? What was the purpose of that trip? Was that another vacation?

A. I presume that was the time Miss Compton's niece was killed. I'm not sure.

Q. Her lease where --

A. Her niece.

Q. Her niece was killed?

A. Right.

Q. You went --

A. In an automobile accident.

Q. You went down to Florida for a month?

A. Um-hum.

Q. Was it common for you to go in the fall during other school years?

A. Not usually.

Q. Did the school also pay for a plane ride back from Florida on one occasion for Miss Compton?

A. Yes.

Counsel next showed Miss MacGrandle a series of Diners Club checks, written against the school account in December, 1976, and February, 1977, in the amounts of \$302.89, \$84.63 and \$62.51.

Q. I wonder if you recall what they were for?

A. The same as the Gulf.

Q. Was one for --

A. Travel expenses.

Q. All right.

A. and --

Q. Was check No. 3016 for Miss Compton's airline ticket?

A. I don't know. Is that on that, on the stub of that bill?

Q. Yes, it is.

A. Then that was the time that she was needed at school.

Q. Okay.

A. And she flew back

A. (Continuing) She was needed immediately, so there was no time to drive back.

Q. The cruise, was that in the 1976-77 school year, the past one did you say?

A. I don't think so.

Q. It was the year before?

A. I believe so.

Q. How many weeks are in the school calendar for Lincoln School?

A. I believe it's 44 weeks in the school year.

Q. And you spent approximately at least, in that year, about a fourth of that time in Florida?

A. Is that what six weeks would be?

Q. Well, it's ten, six and four. There were two vacations in that year.

A. I don't know. That's about right.

Travel Charged to "Tires/Repairs"

Counsel asked if Miss MacGrandle recalled how the Diners Club check for Miss Compton's airplane ticket was "expensed in your report to the state," that is, what account was it listed under:

A. The same account as the Diners and Gulf. It was included in charges.

Q. If I told you it was charged to tires and repairs, would you disagree with me?

A. No, I would not.

Q. Are you the one that charged it to tires and repairs?

A. I would think so.

Q. Is there any particular reason --

A. I didn't know I had an account that was entitled tires and repairs. I thought it was all gas charges.

The Lincoln School Van

Counsel introduced into the hearing record a bill -- excluding state sales taxes because the non-profit school was in a tax exempt classification -- for the purchase of a van from Morristown Dodge, Inc., in March, 1976. Miss MacGrandle confirmed the invoice of \$4,463 for the vehicle.

Q. Do you recall, did you have any part to play in the purchasing of this van, Miss MacGrandle?

A. Yes, I did.

Q. And what was the purpose of the purchase of the van?

A. Well, we needed something to carry materials because we do a lot of shopping in the Shop-Rite and they do not deliver. We have lugged furniture and machinery and equipment of all kinds. We try to avoid as many expenses as we can, and that's what it was used for. It carried children's chairs and desks we purchased from Morristown.

Q. *It wasn't for the purpose of transporting children?*

A. Oh, that too, but basically it was used for transporting materials.

Q. *What kind of materials did you want to transport in the van? I think you said furniture.*

A. We transported desks and chairs from Morristown. We also transported materials that we purchased at the Shop-Rite. We picked up furniture and equipment that we bought at a -- at an auction sale, made five or six trips one summer, but it's used continuously for that purpose. Also during the school day it is available for children.

Q. *Was the four-speaker AM-FM stereo tape deck put in it for the children or for the transporting purposes or what was it --*

A. I don't know.

Q. *Okay. Did you become aware that there were certain seat configurations that would be placed in the van when you purchased it?*

A. Different than the ones that were already in it?

Q. Yes. Let me explain it to you. Attached to Exhibit C-13 is the brochure for the van.

A. Um-hum.

Q. And at Page 7 there are four different kind of seat configurations ranging from a five-passenger configuration up to fourteen-passenger configuration in about the same vehicle.

A. We have this one (indicating.)

Q. The five-passenger?

A. Right. We kept one seat available for passengers.

Q. Okay.

A. And the back we wanted empty for transportation of materials.

Q. You weren't thinking too much about transporting the children, then, with the five-seat configuration?

A. No, no.

COMMISSIONER POLLOCK: Did you ever use it for personal use?

THE WITNESS: Yes, we have.

COMMISSIONER POLLOCK: Ever taken it out of the state?

THE WITNESS: Yes, we have.

Q. You take it with you every time you go to Florida, don't you?

A. Yes.

THE CHAIRMAN: And, in fact, you spent some two-and-a-half months in Florida and that van would be down there that period of time?

THE WITNESS: We were never there two-and-a-half months.

THE CHAIRMAN: Over the period of time you would be travelling down, you would stay with the van?

THE WITNESS: Yes, it would be -- it stayed with us.

School Paid for House Work

Miss MacGrandle testified next about Lincoln School checks she signed in payment to a contractor, Frederick Schaan & Son Inc., for construction work on her home:

Q. Have you ever paid Mr. Schaan personally for any kind of work?

A. No.

Q. You have always paid him with school funds no matter what he's done for you?

A. Yes.

Q. Has he ever done any work on your personal residence?

A. Yes, he has.

Q. Where do you live?

A. I live at 50 Clover Hill Road, Millington.

Q. In Millington. And do you live alone?

A. No. I live with Miss Compton.

Q. Okay. What has Mr. Schaan done for you at the residence at the Clover Hill Road?

A. He built a porch for us.

Q. He built a porch?

A. Um-hum.

Q. In front of the home?

A. No, in the back.

Q. In the back. Is it an enclosed porch?

A. Yes, it is.

COMMISSIONER POLLOCK: Heated? Is it heated?

THE WITNESS: It has electric heat in the base.

Q. Okay. And that was paid for with school funds?

A. Yes, it was.

Q. Okay. When was that addition put on?

A. 1974, I believe. '73?

Q. Yes. I'll refresh your recollection. The dates of the checks are March 11th, 1974, April 22nd, 1974 and June 11th, 1974. Does that comport with your recollection?

A. Right.

Q. And the total amount is, the amount of the invoice No. 157, which is part of a larger exhibit in this proceeding marked C-12, is in the amount \$7,657.

A. Um-hum.

Q. Okay.

A. Except I do not understand this partition and closet.

Q. Okay.

A. Whether that is part of this. I assume it to be part of this whole bill.

Q. Okay. Did you write those checks --

A. Yes, I did.

Porch Was for the Dogs, in Part

It turned out that the new porch constructed at the MacGrandle-Compton home out of school funds was to be used, partly, by their dogs. That came out when Miss MacGrandle testified that the porch contained storage -- two chairs and a television set -- and some "dog crates."

Q. You are in the dog raising business; is that correct?

A. No.

Q. Okay. Do you show dogs?

A. I have one dog that I have owned for about ten years. It's ten years old. I have raised a litter, two litters of puppies. This one dog has been shown and brought to a championship. She had two litters and one of her puppies in the first litter became a champion and one from the second litter has become a champion, but I would not say I raised dogs. I do not have a kennel.

Q. You own any dogs now?

A. Yes, I do.

Q. Okay. How many do you own?

A. Four, five.

Q. And does Miss Compton own any?

A. Well, we share them.

Q. You share them?

A. I don't know who they're registered in. Sometimes they're registered in my name; sometimes her name.

Q. Where are the dogs located, on Clover Hill?

A. Yes.

Q. In a kennel or inside the house?

A. Inside the house on the porch.

Q. Do you have anyone attend them while you're away working?

A. Not really.

Q. What do you mean "not really"? Do you have someone attend them or not?

A. No, I do not.

They Were "Entitled" To a State-Paid Porch

Miss MacGrandle's counsel, Barry Osmun of Morristown, asked that the interrogation be interrupted so she could explain why she and Miss Compton felt they were "entitled" to a \$7,000-plus addition on their house paid for out of Lincoln School funds.

COMMISSIONER POLLOCK: I think we should hear that.

COMMISSIONER LANE: We want the facts.

MR. OSMUN: Would you explain, Miss MacGrandle.

THE WITNESS: We felt that when we bought the porch, or when we paid for it with the school check, we had given, loaned money to the school many times and had worked for two years when we first started the school without pay and at a nominal pay to start, and we had purchased a great deal of materials and equipment before we opened the school, and we felt that at the time we had the porch done, we were, maybe I should say, we didn't -- we weren't too flushed, so we figured that at that time Miss Compton was going into the hospital and we would have to live all on one floor, and we have a split-level, as you see, and she was going to the hospital for a major operation, and we felt that she would not be able to go up and down stairs, and, therefore, we would have to live on one level and have a bedroom there, and that's why we did it that way. We didn't want to make a bedroom out in back, so we made it a porch and we felt that the school basically owed us that money.

BY MR. SIAVAGE:

Q. *You felt you were entitled to it?*

A. Yes.

MR. OSMUN: Were there any notes for those loans?

THE WITNESS: No, there were not.

A. (Continuing) We bought a number of things when we opened the school. The school was opened in September of '70, but prior to that you cannot open a school with no equipment or supplies, and we never charged for these things that we had acquired that is necessary to run the school, and even though we only had one child, we had to have equipment, desks and chairs and things like that, and we had never billed for that.

We had no records for it because it was bought one here, one there where we could and when we could, and so we sort of felt that, well, that would be a repayment of that money that we had paid into the school.

However, Miss MacGrandle never told anybody -- neither the state nor the school districts from which Lincoln School received tuition funds -- that, as Commissioner Pollock put it, "you felt you had this money coming to you."

COMMISSIONER POLLOCK: *And was there -- what I'm curious to know is, how was this expenditure, \$7,657, reflected in your report to the state? What did you classify it under?*

MR. OSMUN: There was no report required at that time.

THE WITNESS: Oh, there was no report required at that time. There was -- I think we only started with budgets and reports to the state

the following year, I think.

COMMISSIONER POLLOCK: *So that really --*

THE WITNESS: We did not need any budgets or requirements or get any directives or any guidelines from the state until -- until when? Until --

MR. OSMUN: 1975.

THE WITNESS: Until 1975. Until 1975.

COMMISSIONER POLLOCK: *When, to your knowledge, was the first time that any public official either from the State of New Jersey or from a sending district learned of this expenditure, \$7,657 for an addition to your home?*

THE WITNESS: I do not know, unless it was at the time of the audit by the State Department of Education, but nothing was ever said to us at that time.

COMMISSIONER POLLOCK: *Did you participate in that audit?*

THE WITNESS: Oh, absolutely not.

COMMISSIONER POLLOCK: *Did you communicate or speak with any of the people from the state?*

THE WITNESS: No.

COMMISSIONER POLLOCK: *Who on behalf of the school did speak with the representatives from the state?*

THE WITNESS: I do not know.

X X X X

Q. Okay. And you are the business manager and you did not prepare the cost report, the expense report?

A. No. I gave them the figures that I had in my ledger and I am not familiar with making out budgets, so, therefore, I just sat by and listened.

Q. I see. You gave them the figures out of the ones that you had in your books and records?

A. Right.

Q. They put them in the right columns?

A. Yes, they put them in the columns.

Q. They put them in the columns. I mean, you're still not sure whether they are the right columns?

A. I don't know whether they are the right columns or not.

Q. There is an item on Line 850 called other fixed charges in the amount of \$20,533.32 and you have been asked about that prior in executive session, have you not?

A. Right.

Q. What does that represent?

\$40,000 Back for \$20,000 Loan

A. That represents a loan of \$20,000 plus interest of five-hundred-and-thirty-three-thirty-two.

Q. Which was made by you?

A. Which was -- yes.

Q. To the school?

A. I loaned the money.

Q. To the school in the early part of the term of that year?

A. Right.

Q. To help with the cash flow problem?

A. Right.

Q. And sometime during the year you expensed it and the school paid you back out of state funds?

A. Right.

Q. And then you reported that as an expenditure to the state, correct?

A. Right.

Q. And the school incurred salaries. Was it to cover salaries during that year?

A. Yes. Every year we loaned or borrowed money in order to have the cash flow and payroll because of the lack of receipt of tuition payments before at least mid-October, early November.

Q. Do you understand that as a result of this accounting procedure the school essentially got \$40,000 during that period now?

A. How can they get forty? It's twenty.

CONTINUED

1 OF 3

Q. You loaned them twenty in the beginning of the school year.

A. Yeah.

Q. And then --

A. I --

Q. Then the state gave them twenty, but it was a little bit later on.

A. I don't understand that. The state gave them twenty? The money was returned at the end of the year.

Q. The money to cover your budget which you submit in September comes from the state, correct?

A. Yes.

Q. And it is in response to a budget request that you make of the state, correct?

A. Yes.

Q. And it includes all your expenses for that year?

A. Yes.

Q. All right. In this particular year you gave the school \$20,000 before the state gave you any money.

A. Yes.

Q. And then the state paid all of the expenses of the school that year, correct?

A. Yes.

Q. And in addition gave you the \$20,000 back?

A. Yes.

Q. Okay. In essence, you overstated your expenses by \$20,000 as a result of this accounting procedure?

A. I guess.

School Paid For Personal Maid

Miss Christine Compton, the next witness, disclosed that the Lincoln School was paying out of public funds for a personal nursemaid for her mother.

Q. Would the papers -- strike that, the books and records of the Lincoln School disclose salary paid to one Ruth Burnet? Are you familiar with that?

A. Yes.

Q. Do you recall what period of time Ruth Burnet was being paid by the school?

A. I have that. I hope I haven't lost it. Yes. Yes, I have it here.

She started being paid by the school, not on the payroll, but by the school, on October 15th of 1973. She was placed on the payroll on April 1st of '74.

Q. All right. Wait a minute. Now, Miss Compton, let me stop you right there. The first time she was on the payroll of the Lincoln School was April 1st, 1974?

A. 1974, yes.

Q. All right. And she started in what capacity prior to that? I didn't get that.

A. She was on -- she was just paid, just paid -- not as a payroll. She was not on payroll.

Q. She was not on the payroll, but she was paid by the school?

A. Yes.

Q. Did she get any different amounts of money during the period October 15th, 1973 to April 1st, 1974 than she did subsequent to April, '74 when she actually joined the payroll?

A. I don't have that information. I'm sorry.

Q. Okay. What was the reason for not putting her --

A. I do have the total she received from October 15th to April. Would that help?

Q. Okay. What was the total? Yes.

A. Total was \$2,593.

Q. What was the reason for not having her on the payroll?

A. She was not working for the school.

Q. But she was being paid by the school?

A. Yes.

Q. What was she doing to --

A. She was taking care of my mother in a nursing home.

Q. Did she continue to take care of your mother subsequent to the time when she went, actually went, on the payroll of the school after 1/23/74?

A. No, she did not.

Q. She ceased completely?

A. No. Actually, I would say that she was about one month because I had thought I was going into the hospital in April, and I didn't go until May because I had to lose weight. They told me I had to lose weight before they would do the operation.

Q. So she did take care of your mother for a while?

A. Yes, for --

Q. After she went into the school pay?

A. For additional payroll, yes.

Q. How long did she remain on the school payroll?

A. Until March of 1977.

Q. Just this past March?

A. Yes, yes.

Q. Why was she taken off the payroll?

A. I felt that her duties were no longer necessary to the school.

Q. And was it also because of the fact that her presence on the payroll had been exposed in some manner?

A. Partially, yes, that too, and didn't want to subject her to the embarrassment.

Q. She actually went on the payroll of the school in April of 1974, and you said worked, still worked, as a nurse for your mother for about a period of a month.

A. One month, yes.

Q. I would suggest to you, by the way, that it's two months and that it lasted up until May 23rd, 19--

A. No, that's wrong. I have the hospital record. I went under anesthetic on the 15th and she was there when I came out because I remember I was very sick.

Q. Her entries in the nursing home, which your mother was in, by Miss Burnet to visit your mother in 1974, progress notes on the date May 1, 3, 4, 6, 7, 8, 9, 10, 13, 14, 18, 21 and 22.

A. She couldn't have been. She was with me, really, seriously. She was in the hospital with me from the time I went in for my operation, and she came home and took care of me at home and answered the phone and carried records back and forth for me, helped me interview people that wanted jobs and things of that sort.

Q. Okay.

A. I guarantee it.

Q. What were her duties at the school after May of 19--

A. She didn't really work at the school. She worked at home, took things back and forth for us, helped me.

A. (Continuing) Helped me personally in taking care of things at the school. I was rather incapacitated for quite a period of time, about six months.

Q. Would you describe her -- I don't mean to be unfair. Would you describe her essentially as a female valet for you?

A. I would say that was partially it, yes. Yes. She helped me to keep the school going.

Q. What was her monthly wage between October, November, 1974, and March of 1977, if you know?

A. I don't really remember. I could maybe look it up, but I don't remember. I don't have that record with me. They have never changed. The wages have never changed since she was on the payroll. She never got an increase in salary. She always stayed with the same salary.

Q. Would approximately \$7,000 in 1976-77 be --

A. Seven something.

Q. -- a fair estimate?

A. Seven something, yes.

Who Really Ran the School?

The next witness, Miss Betty Ingemanson of Succasunna, recalled her employment by the Lincoln School from April, 1973, until she was dismissed at the end of April, 1975. She was employed as the administrator prior to being succeeded by Dr. Charles H. Lusto. Her testimony raised questions about the contention by Miss MacGrandle that considerable school work was done in Florida during the MacGrandle-Compton vacations there.

COUNSEL SIAVAGE:

Q. And what were your duties?

A. They were multifaceted. I was in charge of the school when Miss Compton and Miss MacGrandle were not there. I also served as the nurse. I also served as the social worker, and I also served as a counsellor.

Q. Now, did you have any financial responsibility while you were at the school during that period of time?

A. My financial involvement was limited. However, when they were on vacation, I was -- I routinely took attendance and sent the reports to the district with the bills, and I was delegated by Miss MacGrandle that when the checks came back from the districts, that I was to see that they were deposited, and I was also left with signed checks by Miss MacGrandle to pay the monthly bills, such as the oil or electricity, whatever, but they were already signed by her and made out to the company. I just filled in the amount.

Q. For how long a period of time, in your experience, during the calendar school year September to June were Miss MacGrandle and Miss Compton in Florida?

A. I'd say they were away a minimum of three times during the school year, totalling an overall period of two to two-and-one-half months.

Q. How much interface did you have with Miss Compton and MacGrandle while they were in Florida. Did you talk to them on the phone while you were running the

school?

A. Yes. I called them, and one of the occasions Miss MacGrandle -- Miss Compton flew back, and I don't recall any emergency at the school. I think it was for personal reasons. I could -- I'm not sure of that, and I took her back to the airport about four days later.

Q. And what did Miss MacGrandle's financial responsibilities consist of while she was in Florida?

A. Well, when I was there, I really don't know what she did in Florida as far as the billing was concerned. I just, as I said -- say, handled the monthly bills when she left me the checks, and she left me the payroll also. I paid the teachers.

Q. You did basically everything of a financial nature?

A. Well, I handed out the checks that she had left for me, yes. That was my involvement.

Q. Did she still sign the checks and send them to you from Florida?

A. Well, usually payroll was the routine thing, and she made them out before she left and said, you know, when payday comes, please distribute them.

Q. Did you also handle Miss Compton's duties?

A. Oh, yes.

Q. What were Miss Compton's duties.

A. Well, Miss Compton was involved in hiring the teams. She was involved really in running the program aspects of the school. We often consulted because I was interested in programs and doing the best we could for a youngster, and so we were involved in that area, interviewing children.

Q. Essentially, were you doing Miss Compton's job, Miss MacGrandle's job and Dr. Lusto's job during the period of time when they were in Florida and when you were there at the school?

A. Of course when I was there Mr. Lusto was not because he replaced me. When Miss MacGrandle and Miss Compton were in Florida, yes, I was basically doing it.

Q. How much were you being paid?

A. I started at fourteen-thousand, and the second year they increased it a thousand to fifteen-thousand.

School Paid for Pupil Transport, but Not in the Van

Counsel showed checks totalling \$355, paid at various times between December, 1976, and May, 1977. Miss MacGrandle was asked about these Lincoln School payouts:

A. I cannot remember what each one is for, but I know we call Massocchi many times to have children sent back, taken home from school, because they are uncontrollable. We did not use the van at that time because we couldn't

spare two people plus a driver to go and handle children.

Q. Your answer to the question is those checks are for transporting children?

A. And we also use them when we have a large class going on field trips. We could not transport ten children.

Q. And I would assume they would have to use Massocchi when you had the school van in Florida also?

A. Yes, but we don't -- when were the checks dated?

Q. The checks, again, were December of '76, March 1st of '77, March 15th of '77.

A. We would not go on field trips at that time because of weather conditions. Most of our field trips are taken in the early fall and in the spring of the year.

Q. Why were you paying Massocchi in March?

A. To transport children that were going -- being sent home, uncontrollable children, and we have done this many times.

Q. Do you drive the van to and from school from your residence?

A. Yes, I do.

The School's Van Was for Personal Use

Lee Dodd of Randolph, the general manager of Morristown Dodge, a 10-year veteran in the automobile sales business,

the next witness, testified that the Dodge van was purchased for personal use because of its luxury equipment and its lack of safety features required for school transportation purposes. Dodd said he was familiar with the invoice that depicted the sale of the new Dodge van to the Lincoln School in 1976:

Q. Would you explain to the Commissioners how you're familiar with it?

A. I was the one that wrote the order, originally, back in March of 1976.

Q. Based on the equipage of this particular van in question, and based on your experience, do you have an opinion as to whether this van was purchased for school use or personal use?

A. Yes.

Q. What is that opinion?

A. Personal.

Q. Unequivocally?

A. Absolutely.

EXAMINATION BY COMMISSIONER POLLOCK:

Q. What do you base that on?

A. The particular equipment involved is not required in any manner for transportation of school children. The unit is a five-passenger Sportsman Van with a I'd say, a deluxe interior. It has a raised or extended roof on it, and the normal requirement would be a 15-passenger configuration, and it usually

conforms with both federal and state regulations and the requirements of the Board of Education, Transportation Division.

There is no safety equipment involved in this unit in reference to banded glass, first-aid kit or any other requirement.

Q. I have C-13 in front of me and I see some other items on here and I'm going to have to ask the question because I don't know the answer, but I note there's air-conditioning. Is that a normal piece of equipment in a school bus or vehicle used to transport children?

A. I think that air there would be a little broad because of the fact that depending on what the school is, if you're talking about particular children that do require, perhaps, a controlled environment there, air would be required, or if anything should be needed as far as equipment is concerned. It's not normally added.

Q. How about the AM-FM stereo tape, four-speaker?

A. That's not a normal piece of equipment, no.

Q. Tinted glass?

A. It is required on the 15-passenger vehicle, but not on this vehicle.

Q. What about an extended roof by Travel Trailer Center with carpet trim; is that a normal piece of equipment?

A. No, sir, it's not.

THE TESTIMONY - JANUARY 19, 1978

Preface

The Commission turned its attention from non-public day schools for handicapped children to private facilities where the handicapped children are educated in residential surroundings and remain in the jurisdiction of the facilities on a 24-hour basis. However, that change of focus was not the primary reason for S.C.I. Charman Rodriguez's statement at the beginning of the second day of public hearings on Special Education:

THE CHAIRMAN: Usually during its public hearings the Commission proceeds from one day's session to the next without pause for an intervening statement. However, this morning I want to make a brief observation before we resume public inquiry into dubious practices and procedures by some private schools and of the inadequacies of governmental controls over the disbursement and expenditure of public funds for such schools.

For the sake of clarity and equity, I want to indicate at this midway point that there now may develop a distinction between the evidence that was put into yesterday's public hearing record and what will be recorded today. For more than five hours on Wednesday certain non-public school operators testified -- "confessed" might be more apropos -- that they callously diverted public funds appropriated for the benefit of handicapped children to their own personal advantage. Thus, yesterday's hearing concentrated on examples of obvious abuses of the system. Today there will be a different emphasis: On the need for more adequate administrative direction and control of the system. Testimony will be forthcoming about non-public school practices involving funds which may or may not be legitimate but which provoke the same nagging questions as arose yesterday about the integrity and credibility of the non-public school reimbursement program. We expect to illustrate how certain non-public school

practices superficially conform with statutory and administrative requirements, yet nonetheless fall short of the straightforward, aboveboard standards the taxpaying public has every right to expect. No potentially defective yet technically correct operation should prevail if it even threatens to produce unsatisfactory results, particularly in such a sensitive field as the educational betterment of more than 5,000 handicapped children. No system of allocating and expending public funds should continue unchanged that allows less than arms-length transactions and potential, if not actual, conflicts of interest because of conditions which, in certain areas, invite rather than repel misconduct.

Today's review will cover a more complicated facet that will balance our overall critique and broaden the scope of the Commission's subsequent recommendations for both legislative and regulatory reforms.

MANOR WOODS ACADEMY

The Commission called as a witness Mrs. Annmarie Farrell, the administrator and part owner of Manor Woods Academy in Estell Manor in Mays Landing, Atlantic County. Mrs. Farrell's operation of this facility was a classic example of questions raised in Chairman Rodriguez's statement at the start of the Commission's second hearing day.

To set the stage, the background of the Farrell family and their extensive real estate and commercial holdings -- only 20 miles from Atlantic City -- mostly acquired while running their school for the handicapped, was put into the record. Mrs. Farrell said that she was the fifth person to be put in charge of the school, although she had "some" responsibility for school operation before she took full charge just two weeks prior to the Commission's public hearing.

Mrs. Farrell testified that she and her husband own and operate a campground, "The Olde Stagecoach Trail," a

"recreational-vehicle facility for families" in Mays Landing. They recently purchased a liquor store adjacent to the Manor Woods Academy and a seafood restaurant in Weymouth Township, a community which adjoins Mays Landing.

Q. Do you have any other business or occupation?

A. Not that I can remember at the moment.

Q. All right. Do you own shares in any corporations which are incorporated in the State of New Jersey?

A. Yes. Mr. Farrell and I share 50 per cent each in the Ecological Improvement Corporation.

Q. All right. When was that corporation incorporated?

A. I think it was in 1975.

Q. And does that own certain land and buildings in municipalities of Weymouth and Estell Manor?

A. Just in Estell Manor, yes.

Q. Are some of those buildings involved with the school?

A. Yes.

Q. And the land, also?

A. Yes.

Mrs. Farrell also testified that her husband "assists" at the campground but is employed by Manor Woods Academy as supervisor of maintenance. A mechanic, he also works in that role "just on the vehicles of the school."

Asked to define Manor Woods Academy, Mrs. Farrell testified that "we say that it's a private residential treatment and guidance center and we do provide special education to handicapped children." She stated that 42 students resided at the Academy, all males, ranging in age from 14 to 18 but mostly 16 to 18, and that there were no day students at the school. All of the children are classified as emotionally disturbed.

Mrs. Farrell said the Academy receives \$5,300 per student from the Education Department and local school boards for tuition, that sum being the maximum per capita rate for the handicap category of her entire enrollment. The Academy, she said, also receives \$750 per month, or \$9,000 a year, per student for residential care from the Division of Youth and Family Services (DYFS) in the State Department of Human Services. As Mrs. Farrell pointed out, the yearly receipts for each child thus works out to \$14,300.

Mrs. Farrell related that five of her students actually were educated at the Buena Regional High School in Estell Manor at a cost to the school of several thousand less than what the state was paying her on the assumption the Academy was educating these same children. The following testimony related to this issue:

Q. Let me see if I understand that. Of your forty-two students in residence, five receive their educational experience in a local public high school. Is that correct?

A. Yes. May I explain that?

Q. If you will let me finish the questions. If you would like to add to them.

Do you receive reimbursement from the State Department of Education for those five students who are educated in the local public schools in the amount of \$5300 per year?

A. Yes.

Q. Do you pay to the local public schools the approximate amount of \$3000 per year for their education?

A. \$311 some-odd cents per month.

Q. Okay. Now, there is a difference there between the amount that you receive from the state and the amount you pay to the local school district of \$2200. Is that correct?

A. If that's your figure.

Q. All right. Do you provide any service to those students in addition to the service being provided by the local public school district to justify that \$2200?

A. We feel that it was approved on that basis that we would provide the supportive services plus the transportation.

Q. All right. You say you feel it was approved on that basis. Who approved that pro-ration?

A. I, I feel that it was an application made to the State Department of Education in Trenton, to Dr. James Richardson; that he approved it through our county superintendent and the child study supervisor who helped us to arrange it.

Q. You say that you feel that. Do you have documentary evidence of that fact?

A. Yes.

Q. Okay. Would you be willing to provide that to the Commission at a later date?

A. I hope I can find it.

COMMISSIONER POLLOCK: Mrs. Farrell, assuming that, just for the sake of this conversation, that it was submitted and it was approved, there remains, nonetheless, a differential of \$2200 between the sum you receive and the sum you pay out for education. Can you explain to me, just as fully as you wish, what it is that provided for the differential?

THE WITNESS: Yes. This would go under the social services, psychologicals; that we have a psychologist, that we have a psychologist, we have a psychiatrist, we have a medical director.

I'm trying to think of some of the items. I might ask some of the staff that I brought with me, if you could ask--excuse me just a minute?

COMMISSIONER POLLOCK: *Why don't you? Fine.*

*(Whereupon the witness confers with Mr. Edwards)**

THE WITNESS: *Mr. Edwards explains that it's involved also with residential, during the residential program, but it is tutoring. We provide tutoring for the children who are in the public school, and it's for transportation. He did say that.*

I'm trying to think of the other reasons. I just don't have them on the top of my head.

COMMISSIONER POLLOCK: *I understand. The point I'm trying to get at is: Have you, or has anyone, any governmental authority, ever asked you to determine whether or not that differential of \$2200 is cost related to these additional services that you have just described?*

THE WITNESS: *I don't feel that it was ever really broken down and that that difference has been assigned to any particular needs.*

COMMISSIONER POLLOCK: *I don't want to put words in your mouth, and, please, I want you to give me a fair and accurate response.*

Have you ever made an attempt to ascertain whether or not the \$2200 can be justified on a cost basis to these additional items you have mentioned, such as transportation and the additional services?

*James Edwards, Manor Woods Academy child care director.

THE WITNESS: We've been asked this question quite often, and we did make a breakdown and we feel very justified in the expenses. However, I can't keep it on top of my head what they are today. I could provide that for you.

COMMISSIONER POLLOCK: But you don't have it here today?

THE WITNESS: No. I'm sorry.

COMMISSIONER POLLOCK: Do you have any idea, on the items you enumerated, what portion of the 22--

THE WITNESS: Transportation is our biggest cost. We are in a very rural district and the school is approximately twenty miles away.

COMMISSIONER POLLOCK: How much of that \$2200 is allocable to transportation?

THE WITNESS: I'm sorry. I don't know.

COMMISSIONER POLLOCK: Does the school own busses?

THE WITNESS: We own some vans and we lease some. We don't have any busses.

COMMISSIONER POLLOCK: And those vans and-- vans rather are used not only for these five students in the public schools but for your other students as well?

THE WITNESS: Yes.

COMMISSIONER POLLOCK: They are also used for other purposes, aren't they?

THE WITNESS: Yes.

COMMISSIONER POLLOCK: Thank you.

MR. SIAVAGE: For the--

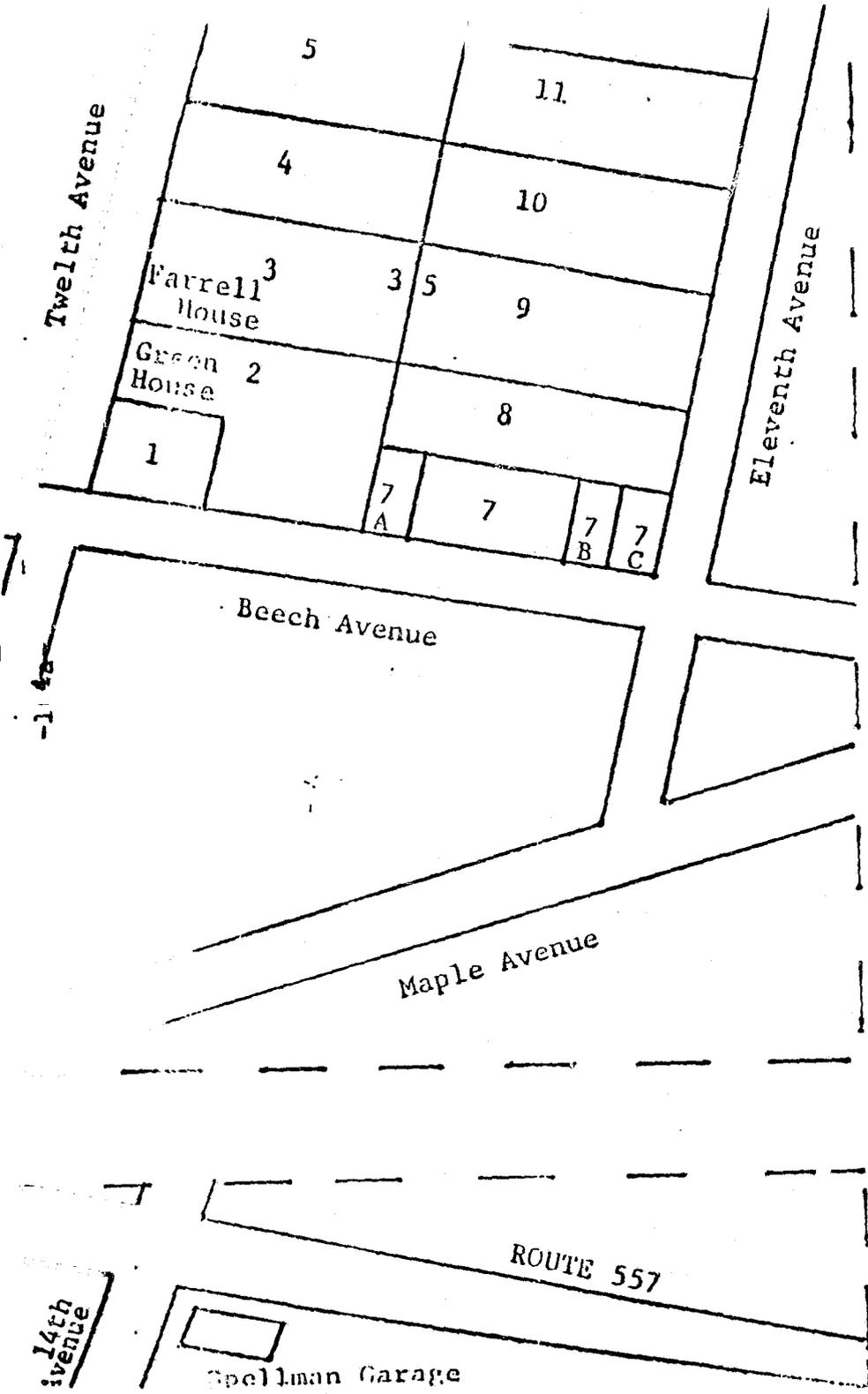
THE WITNESS: They're used for both residential and educational, the same vehicles.

Real Estate Pyramiding

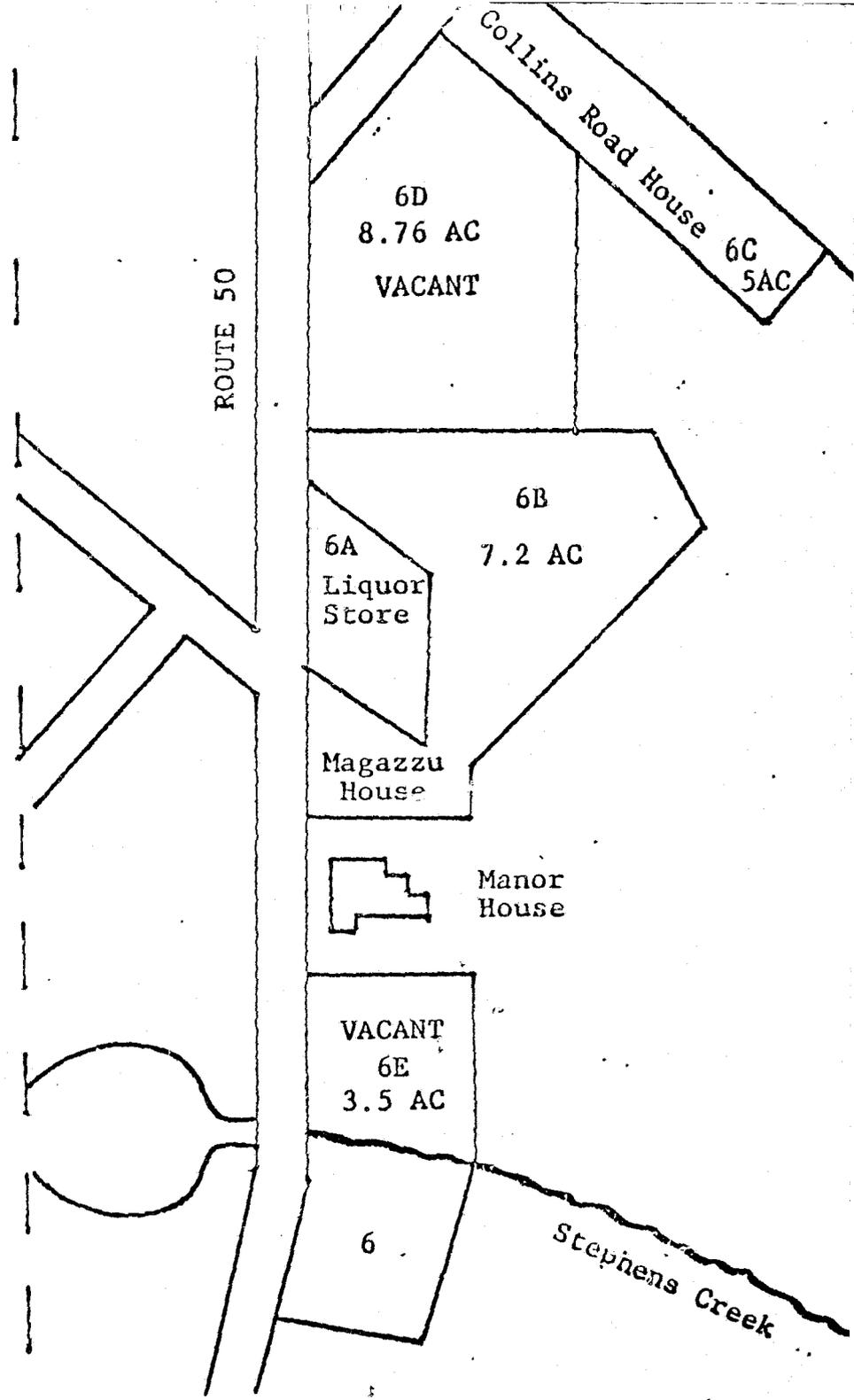
Because of the extent and variety of the properties and commercial enterprises involved in the Farrells' real estate-and-school transactions, the Commission put on exhibit a map* that charted the properties about which Mrs. Farrell would testify. These land-holdings included the administrative offices of the Manor Woods Academy located in the Manor House on Rt. 50. Next to it was a "residential facility" known as the Magazzu House, then the liquor store property, the back of which was used by the Academy for "educational and residential" purposes. Moving over to 12th Avenue, the chart also showed the Farrells' personal residence, which adjoins the "Olde Stagecoach Trail" campground.

Mrs. Farrell said Manor Woods Academy began in 1972 but that the Manor House property was not purchased until 1974. The Farrells purchased the property through Mainland Bank from Sidney Simon for \$85,000 -- a 100 percent-financed transaction between Simon and the Ecological Improvement Corp.

* See Exhibit, P. 104a



FOUR MILE INTERVAL



ROUTE 50

VACANT
6E
3.5 AC

6D
8.76 AC
VACANT

6A
Liquor
Store

6B
7.2 AC

Magazzu
House

Manor
House

6

Stephens Creek

6C
5AC

14th
avenue

Spellman Garage

ROUTE 557

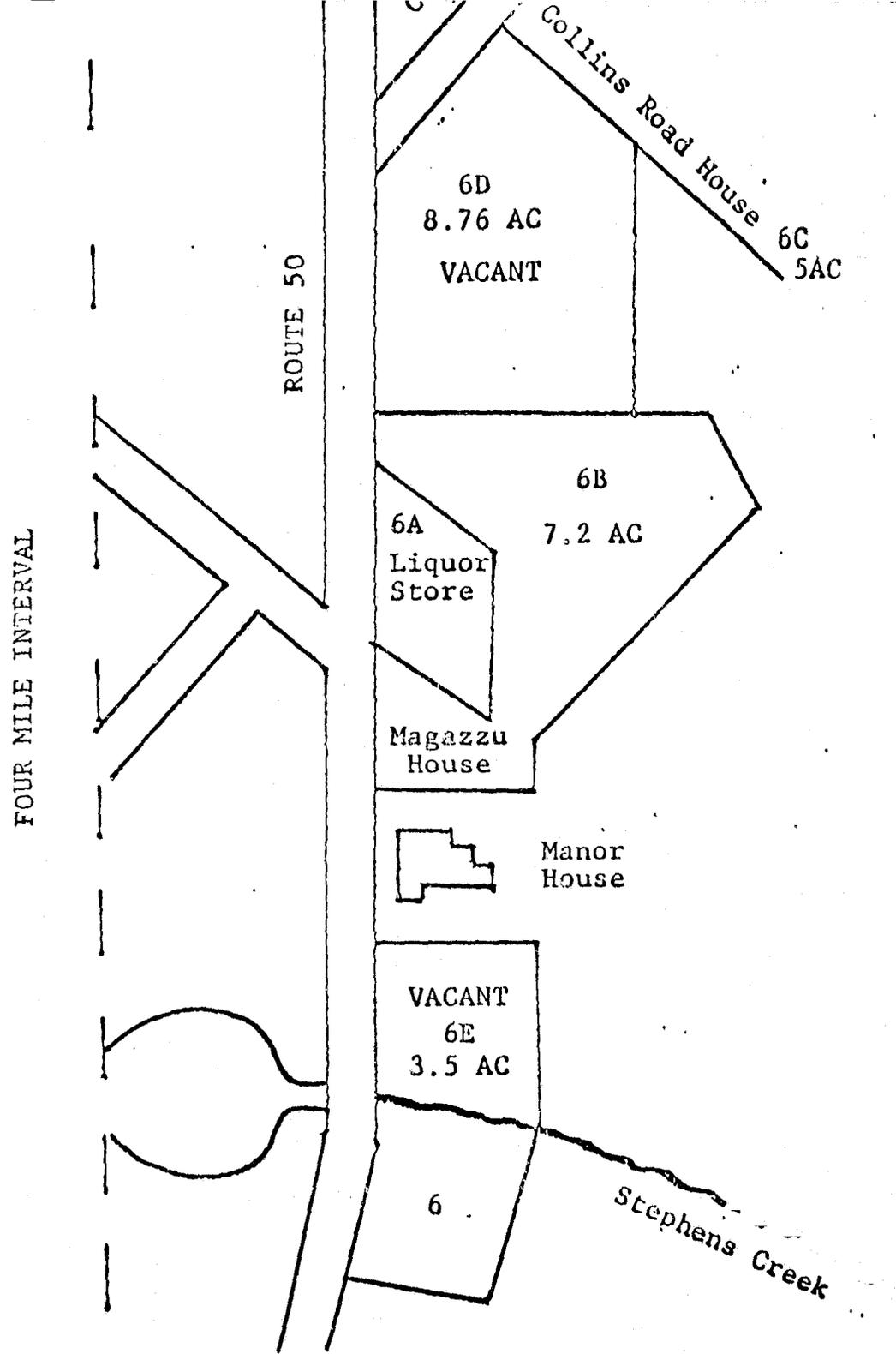
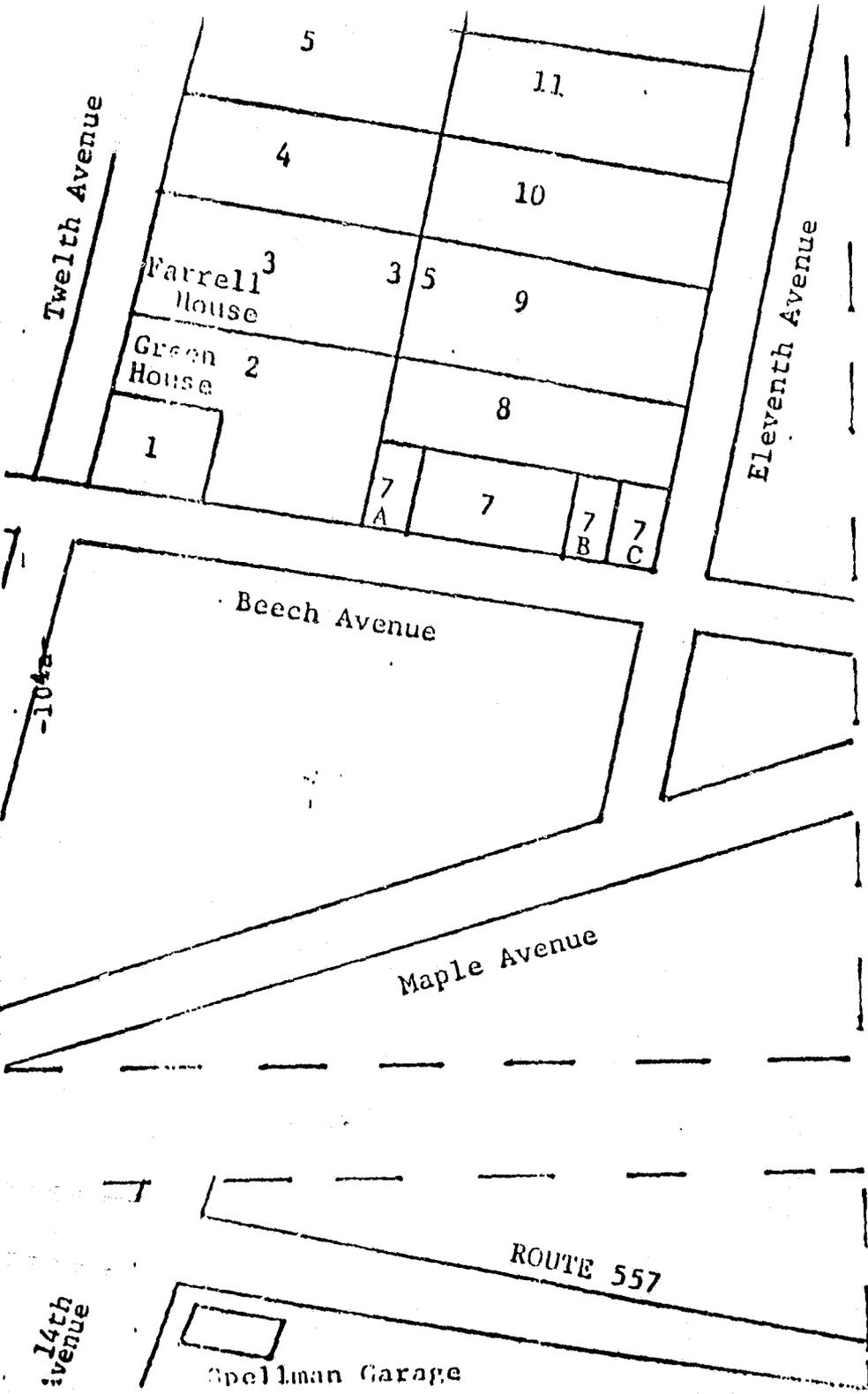
Beech Avenue

Maple Avenue

Twelfth Avenue

Eleventh Avenue

-14-



Q. Okay. Ecological Improvement you have previously identified as a corporation made up of you and your husband. Is that correct?

A. Yes.

Having acquired the Manor House through their personal corporation, the Farrells proceeded to lease it to their Manor Woods Academy.

Q. Okay. And the Manor House being located in the front. Did you thereafter lease to Manor Woods Academy from Ecological Improvement Corporation the Manor House?

A. Yes, with the approval of the Division of Youth and Family Services.

Q. All right. Division of Youth and Family Services approved that lease?

A. Based on the minimum standards on their Section 9, and we had to file a disclosure statement. I have a copy here.

MR. STAVAGE: Okay. We will have it marked as an exhibit, if you like.

(Letter from Manor Woods Academy to Division of Youth and Family Services, dated September 5, 1975, received and marked Exhibit C-66).

Q. C-66, for the purposes of the record, is a letter, dated September 5, 1975, from Manor Woods Academy to Mr. Carl Epstein, Chief, Division of

Youth and Family Services, Trenton, New Jersey, concerning the program of Manor Woods Academy, and we will put that in the record, Mrs. Farrell.

Now, that is dated September 5, 1975. I would assume, therefore, that there was no lease between the original purchase of the Manor House in December of 1974 and the school year beginning 1975. Is that correct?

A. We really didn't have many leases.

Q. Okay.

A. The state asked us to create the leases when we got involved with--

Q. Okay. Why did they ask you to do that?

A. Because we needed to substantiate the claim.

Q. What do you mean by "substantiate the claim"? Did they tell you that it would be beneficial to your cash flow to rent properties?

~~A. No, they didn't tell us that~~

Q. What do you mean beneficial to your claim? You mean it would help your application?

A. Evidence that we actually did have a lease between the Division of Youth and Family Services, or whomever, and ourselves as Manor Woods Academy or Ecological. I'm sorry.

Q. Were they aware that Ecological was a wholly held corporation by you?

A. I think so. We were asked to come to Trenton to explain and discuss that.

Q. Okay. Then the first lease that you entered into would have been for the period 1st of January, 1975?

A. I'm not sure.

A two-year lease dating from January 1, 1976, was put into the record showing that Ecological Improvement Corp. would receive \$2,000 per month from the Academy for the Manor House and some adjoining property. But the Division of Youth and Family Services cut back the formula on which the lease was based. As another chart* on the Manor House shows, the annual rental of \$24,000 would provide income to the Farrell Corporation of more than \$12,000 over the annual carrying cost of the mortgage on the property. When the lease was renegotiated as of March 1, 1977, the annual rental of \$17,745 would produce income to the corporation of more than \$5,800 over the mortgage carrying cost. This lease included some vacant property next to the Manor House.

Q. And DYFS approved--

A. That's just a lot for play with a stream.

Q. That's a lot for playing?

A. We used it for horseback riding and the stream for the kids to fish, swim, whatever they wanted to do, because it was without going across the street

*See Chart, P. 107a

MANOR HOUSE
 MANOR HOUSE
 COLLINS ROAD HOUSE
 LOT 6E*

-107a-

<u>LEASES</u>		<u>MORTGAGE</u>			<u>INCOME</u>
<u>DATE</u>	<u>ANNUAL RENT</u>	<u>DATE</u>	<u>TERM</u>	<u>ANNUAL CARRYING COST</u>	
1-1-76	\$24,000	12-18-74	12 YRS.	\$11,897.04	\$12,102.96
3-1-77*	\$17,745	12-18-74	12 YRS.	\$11,897.04	\$5,847.96
1-1-78*	\$18,120	12-18-74	12 YRS.	\$11,897.04	\$6,222.96

to the pond and they wouldn't let us in the pond across the street, anyway.

Q. Did DYFS approve adding that to the lease?

A. Yes, and that was then the three properties.

Q. Is that considered a residential related to the residential experience, the use of the lot?

A. Well, it's used for residential and educational, because it's right there where we have the classrooms.

Finally, as the Manor House chart shows, DYFS approved still another lease to begin on January 1, 1978, involving the Manor House, the Collins House and the lot leading from Manor House that was used for fishing, swimming and other recreation. This lease was for \$18,120, and would give the Farrell-owned corporation \$6,200-a-year income in excess of mortgage costs. Counsel asked for details:

Q. Okay. By the way, the eighteen-thousand-one hundred-twenty-dollar figure was an increase from the last lease, which was a total of \$17,745. Is that correct?

A. Yes. That was based on a percentage allowance for taxes and a normal increase.

Q. It works out to 5%. Was it an--

A. Yes.

Q. --inflation factor, essentially?

A. Yes.

Q. With regard to the mortgage on the property, the annual carrying costs work out to \$11,897 and the income from the rental is on this column, giving Ecological Improvement an income of approximately \$6200 a year; that is, the excess of the lease over the carrying costs. Would you agree with that?

A. I hadn't looked at it that way.

Q. Okay.

A. Can I ask my accountant?

(Whereupon, the witness confers with Mr. Smitka.)

A. He informed me that it would be true if we collected the money.

COMMISSIONER KADEN: Mr. Siavage, can we have the accountant identified for the record?

THE WITNESS: Mr. John Smitka.

Mrs. Farrell recounted how she leased other properties in the area ostensibly for the purposes of the Special Education program for the handicapped at the Academy -- including an old schoolhouse in Weymouth Township, and the so-called Spellman Garage, which the witness said was used for vocational training and to repair vehicles.

Q. Was that lease ever approved by DVFS on the Department of Education?

A. Yes, it was approved by DYFS. Department of Education never looked at our leases.

Q. Okay. Why would--the Department of Education never looked at the leases?

A. I don't know.

Q. Strike "Why." You said the Department of Education never looked at your leases?

A. No, they didn't look at our leases.

Q. You have to file expense reports with both the Department of Ed. and the Division of Youth and Family Services; is that correct?

A. Yes.

Q. Typically, you have pro-rated or attributed half of each lease one to residential and one to educational for reporting purposes; is that correct?

A. Percentages out of each lease--

Q. Right.

A. --that we felt were attributable to education or residential.

Q. It's usually been 50/50 in most cases, hasn't it?

A. I don't think so, not in residential section.

Q. At least with respect to some of the buildings, however, the Department of Education Expense Report contains figures for rentals on those properties.

Is that fair?

A. Yes.

Q. And they have never asked you to approve any of those leases; have they?

A. To view the leases?

Q. Right.

A. No.

COMMISSIONER POLLOCK: Mrs. Farrell, you have indicated that there are two branches of state government that, to some extent, supervise your activities in conducting your school; the Division of Youth and Family Services and the Department of Education. You report your lease expenses in your budget to the Department of Education, in effect, don't you?

THE WITNESS: Yes.

COMMISSIONER POLLOCK: And, nonetheless, no one asked to look at the underlying leases?

THE WITNESS: Not to my knowledge.

COMMISSIONER POLLOCK: And similarly with respect to the Division of Youth and Family Services?

THE WITNESS: Yes, they asked for the leases.

COMMISSIONER POLLOCK: But they didn't look at the budget?

THE WITNESS: At my education budget?

COMMISSIONER POLLOCK: Yes.

THE WITNESS: No.

By Mr. Siavage:

Q. Did DYFS look at the Spellman Garage?

A. I'm not sure.

Q. Was that considered more contributable to the residential portion?

A. Yes. See, we felt that, even though things were handled during the residential part of the program, they were still educational, and costs that we incurred such as vocational school and evening programs, transportation, those things would have gone, also, to educational costs. Under our consideration, they would have been pro-rated to education.

State Paying the Farrell Leases

The testimony confirmed that DYFS had approved payment of \$100 a month toward leasing the Weymouth Liquor Store that the Farrells owned in their own name. DYFS also approved a \$3,600-a-year lease between the Farrells' Old Stagecoach Trail and the Farrells' Academy that included the Farrells' personal residence and the campground's "full recreational facilities"

Commission Counsel:

Q. Essentially, Mrs. Farrell, what is taking place is: Both Ecological Improvement and the Farrells personally are acquiring certain assets that are on that chart. Is that a fair statement?

A. Yes.

Q. At least partially or sometimes in its entirety with a profit, the carrying costs of the mortgages of those properties are being carried by the leases that have been approved by the state. Is that correct?

A. Yes.

Q. Okay. After those mortgages are paid out, either Ecological or the Farrells personally will own this entire parcel of land. Is that correct?

A. Yes, and that was the only alternative that we had from the beginning of the program, from 1972 up until whenever the purchase was to have the program.

Q. Okay. Who advised you that that was your only alternative?

A. I tried to get resources. I tried to get houses locally. No one would allow us to come in with emotional disturbed children, and we had a program started in 1972. We took them into our own home and we had, if I may explain this, we had up to sixteen children when we went into the Manor House. We worked very comfortably with sixteen children, and we wanted it to be a small program. However, we were presented with two other programs that were closing down, with two other directors, so we overnight grew to more than thirty children

and we didn't have anyplace to put them.

Q. Did anyone, either at DYFS or the Department of Education, ever express any concern or understanding that, essentially, the leases which they were approving and paying for were resulting in the acquisition of assets by you personally and Ecological Improvements? Was that issue ever discussed?

A. I think it was, yes.

Q. Well, how did they feel about that?

A. I don't know what the outcome of their feeling was, but I did have to make a declaration, which we did, and I gave you that.

Q. Which was that you were aware of, and they were aware of, the corporations, et cetera, and the--

A. We informed them that we had become personally involved because we had no other alternative.

Q. Okay. And they approved it?

A. They gave me my contract.

Q. Right.

A. And they also asked to see leases, and that's when the leases were made.

They Started with Nothing

Because of the maze of the transactions involved, and Mrs. Farrell's inability to recall all of the financial details of individual transactions, Commissioner Lewis B. Kaden

led the witness back over the trail, starting with the Mainland Bank's 100 percent financing arrangement for the Farrells.

EXAMINATION BY MR. KADEN:

Q. In any event, the bank granted you a mortgage of 85,000 to cover the full purchase price of the Manor House, and either under the original lease or under the subsequent modifications of the lease, those lease payments have covered, more than covered, all your expenses under that mortgage. Is that accurate?

(Whereupon, the witness confers with Mr. Smitka).

A. I don't know.

Q. You don't know. Well, Mr. Siavage took you through those figures, and I'm going through them again because I think they are very important.

You had an annual carrying cost of \$11,897.04 on that eighty-five-thousand-dollar mortgage.

Right?

A. I agreed to those figures, whatever they were, so they would have to be correct.

Q. And that in the three years since January 1, 1976, the result of these net/net leases paid for entirely with school funds is that you wound up with some \$24,173.88 above your total costs, in other words, profit? Those were the figures that Mr. Siavage took you through. Is that right?

(Whereupon, the witness confers with Mr. Smithka).

A. I suppose it is. I'm not sure. I'm not following you because I'm not familiar with all these figures.

Q. Okay.

A. However, I'm sure that--

Q. Those are the figures taken from the leases. All those leases were submitted to DYFS?

A. Yes.

Q. And approved by DYFS?

A. Yes.

Q. And the result of that entire transaction was that you acquired a house for zero investment, which at some point when the mortgage is paid off with the school funds you will own, and at the same time realized a net so far in these three years of 24,000-plus profit. Thank you.

A. If I may respond to that.

Q. Go ahead.

THE CHAIRMAN: Go ahead.

A. I'm sure that the prices are all lower than fair prices than anyone else would have charged, and I say again that we were forced to do all of this to maintain the program.

Q. You are sure that a two-thousand-dollar-a-month rent on a eighty-five-thousand-dollar house

is below the fair market rent for that house on a net/net lease?

A. It included the other house, also.

COMMISSIONER KADEN: Okay. Well, that's something we may look at further.

EXAMINATION BY THE CHAIRMAN:

Q. Mrs. Farrell, isn't it true that some point down the line after the properties are purchased, that you choose to terminate your association with the state, the property would be privately owned by you and your husband?

A. We have no intention of terminating our program.

Q. In the event it did right now, the way the title stands, the property would be owned privately by you and your husband, or a corporation owned by the two of you?

A. It appears to be that way.

SOMERSET HILLS SCHOOL

A different type of real estate transaction was highlighted -- and questioned -- during testimony by Laurence Steinbaum of Scotch Plains, executive director of Somerset Hills School, a combined residential facility for 74 students and day school for 22 students in Warren Township. All of the 96 students enrolled at this facility were males in the emotionally disturbed category.

Mr. Steinbaum also is president of the non-profit corporation that owns the Somerset Hills School. His salary, as negotiated with the Division of Youth and Family Services some three years ago, was \$31,200. He also is president of Home School of Warrentville, a corporation formed by his parents in 1926, which evolved into a holding corporation which owns and leases to Somerset Hills School all of that school's property.

The property is extensive, consisting of about 50 acres and including some five heated buildings, attached educational buildings, several dormitories, a number of summer cottages. The property also includes, Mr. Steinbaum testified, recreational fields for football and other sports, a hiking trail, a five-acre lake, bathroom facilities, two swimming pools.

The Commission questioned Mr. Steinbaum about the rental arrangements between the holding corporation and the school corporation, both of which he heads.

Q. Now, Somerset Hills School, I think you have described, essentially, as the corporation which operates the school on the site that you have previously described and pays rent to, does it not, Home School of Warrentville, Inc., which owns the land?

A. That is correct.

Q. I show you what's been marked Exhibit C-60 for the purposes of identification, which purports

to be a copy of the lease between Home School of Warrenville, Inc., and Somerset Hills School, Inc., as the lessee, dated September 1, 1977, and ending August 31, 1978 for the current school year, in the amount of \$126,000 per year plus installments of real estate taxes, insurance, fuel oil, utilities, repairs, or more particularly set forth in the rider attached hereto and made part of the rider. I ask you if you recognize that as the current lease of the school.

A. I do.

Q. Thank you.

Now I'm going to show you a series of leases, well, two more leases, between, essentially, the same two prior years, one ending August 31, 1977, in the amount of, again, 126,000 plus other expenses, and that's been marked Exhibit C-59, and I ask you if you recognize that as the prior lease.

A. I do.

Q. Thank you.

One more ending August 31, 1976, which has been marked C-58, essentially the same terms except that this one calls for \$120,000, or \$6,000 less than the last two.

A. Again, I recognize it.

Q. Thank you.

A. There was a lease between Somerset and Home School at the beginning of the corporate entity of Somerset.

Q. Okay. Let me ask it this way: Is the lease which ends August 31, 1976, and begins September 1, 1975, that is Exhibit C-58, the first time when Home leased to Somerset when Home was only a holding corporation?

A. Correct.

Q. Okay. Now, the lease, by its terms and the description of the property located therein, contains the entire tract that you have previously referred to in your testimony as including the Home School of Warrenville. Is that correct?

A. Not only the tract, but also all of the equipment, furniture.

Q. All right.

A. All of the facilities.

Q. And it is contemplated within that instrument that Somerset School uses that entire tract for education. Is that correct?

A. That's correct.

Q. And residential?

A. That's correct.

Q. And I believe you previously described it, maybe you could again. Why does Somerset need that

large tract on the other side of the road for their educational and residential experience of the children?

A. For recreational purposes.

Q. The thirty-acre tract?

A. Correct.

Q. What kind of recreation do they do?

A. Football, soccer, boating, swimming, archery, shuffleboard.

Q. Could Somerset Hills School exist if suddenly that tract floated away, tract on the other side, the fifteen-acre tract?

A. I would--I've thought of it often, because there have been some tempting propositions in the sale of that industrial property. I think we would have to build additional facilities on the south side in order to compensate for the loss of those facilities.

Capital Improvement -- or Just a Repair?

While certain repairs at private schools for the handicapped could be "expensed out" for reimbursement from public funds, capital improvements of such school property could not be. But, as questioning of Mr. Steinbaum indicated, there was a fine line between what constituted a repair and what was a capital improvement:

Q. Do you have a running account with a firm called Santo Gardeners, in Watchung, New Jersey?

A. Yes, I do.

Q. All right. If I told you that your maintenance and repair account, as exhibited by your expense form delivered to the Department of Education, essentially shows payments for capital improvements completed by Santo Gardeners, would you disagree with me or would you agree with me?

A. I'd have to see the figures.

Q. All right. I show you what's been marked Exhibit C-65 for the purposes of identification, which purports to be a copy of an invoice from Santo Gardener, Santo Gardeners, to Somerset Hills School, Inc., Harmony Day Camp, in the amount of \$21,640. I first would ask you whether you would consider some of the matters suggested on that invoice as capital improvement and then, secondly, whether you know whether Somerset Hills School paid for those capital improvements.

A. Some of them would be capital improvement and some of them would be repairs.

Q. Okay. Could you tell the Commissioners what you think would be capital improvements?

A. I don't know how you would describe fifteen shrub, one dogwood; whether landscaping would be a capital improvement or a repair. Often times

we repair shrubbery that has been damaged and destroyed. I don't know where that would be placed.

I see an expenditure for a septic system. I would mark that as a repair.

This is something that I think the professional accountants will have to work out. If a septic system is destroyed by children misusing it and you have to replace it, I would normally think that that's a repair. If you're going to expand it for other facilities, perhaps that would then be a capital improvement.

Q. You would rather not pinpoint any capital improvements?

A. I'm not capable of doing it.

Q. The final response I had assumed, when you said you saw some obvious capital improvements, that you were going to tell me what they were, but you would rather not do that?

A. Well, if you want to get into a long discussion with me on how to develop a program in a residential school and adjust financing, I'll be delighted to do it. We had--

THE CHAIRMAN: Mr. Steinbaum, rather than taking the time to debate, the question simply is: Did you see any on there that were obvious to you,

not those that would be in an area that you would choose to question?

THE WITNESS: I have not spent any time reviewing that. If you want a later answer on that, I'll review it carefully and be happy to respond.*

*Mr. Steinbaum's testimony in his executive session appearance before the S.C.I. was more revealing on this billing irregularity. His private testimony on this issue, in part, was as follows:

- Q. Okay. Has Carl Santo & Company or Carl Santo installed a new septic system in your facilities?
- A. Yes, it has.
- Q. At what approximate cost, if you recall?
- A. Yes. They built one new one and repaired one. The repair was \$4500.
- Q. How about the building of the new one?
- A. And the construction of the new one, approximately 6,000.
- Q. What about a parking lot or did he expand the parking facilities?
- A. Yes, he did.
- Q. Now the septic system or the parking lot or student assembly area, would you consider any of them under the category of capital expenses?
- A. Certainly.
- Q. Capital expenditures.
- A. Sure.
- Q. Would you consider a septic tank, the installation of a septic tank, a capital improvement?
- A. No.
- Q. Why not?
- A. Because it is a repair on a present and existing facility.
- Q. I asked about the installation of a new one. I thought you said --
- A. All right.
- Q. --Mr. Santo also installed one.
- A. The new one would be a capital expense.

The "Tennis Court" That Was, or Wasn't

When is a tennis court not a tennis court? The issue focused more attention on what Mr. Steinbaum regarded as a

- Q. Okay. Let me ask you this: Are you aware that under the New Jersey Code of Administrative Regulations promulgated by the Department of Education capital expenses cannot be included within the expenses listed on your school budget?
- A. I'm not aware of it, but it sounds reasonable.
- Q. Okay. Let me just go through then a couple of more checks because that may answer that question. The next two checks are to Hamrah Emerson; is that correct?
- A. That's correct.
- Q. What were they for?
- A. These are December 29th. Hamrah Emerson, the amount of a thousand twenty. This would be, I would suspect that this would be carpeting for one of the dormitories.
- Q. Would you suspect it was new carpeting or replacement carpeting?
- A. I would think that it would be perhaps a combination.
- Q. Okay. Have they at other times and with other bills installed new carpeting for you?
- A. Yes, they have.
- Q. In what areas?
- A. Dormitories, classrooms. They're presently placing carpeting in one of the cafeteria areas.
- Q. Again, would you concede that that would be a capital expenditure if it's new carpeting?
- A. If it is new carpeting not replacing existing carpeting, it would be.
- Q. You have no way of knowing, however, whether any of these bills paid to Hamrah Emerson for capital expenditures wind up in this budget or not?
- A. I would not know. I would, I would make some comment about that perhaps when we finish all of the checks.
- Q. Okay. How about the next two, which are --
- A. Frank Perkowsky.
- Q. And what are they for?
- A. Either repairs or replacement of tile. He is a ceramic tile installer.

repair versus a capital improvement:

COMMISSIONER POLLOCK: May I see the exhibit?

Mr. Steinbaum, do you have any doubt about what construction of a tennis court is?

THE WITNESS: I responded to that at the last inquiry. That is not a tennis court. It does not qualify as a tennis court. It is short by some forty feet. It is an assembly area; the resurfacing of an assembly area that has been traditionally the assembly area of that school since 1926.

COMMISSIONER POLLOCK: Does it have lines on it like a tennis court?

THE WITNESS: Yes, it does.

COMMISSIONER POLLOCK: Does it have a net?

THE WITNESS: Occasionally.

COMMISSIONER POLLOCK: Okay. Do people hit balls across the net at each other?

Q. How about the \$3600 one, the larger of the two?

A. That would be the replacement of all of the tile in the kitchen.

Q. And would this be considered capital improvement or --

A. I would think that the accountants would call this a capital improvement.

The S.C.I.'s audit of the financial records of Somerset Hills School confirmed that capital improvements were charged to state funds. According to the Commission's audit of expenses charged to "maintenance and repair" and billed to the State Education Department for reimbursement, almost 60 percent were capital improvements. The audit showed that half of all capital improvements were charged to education.

THE WITNESS: They parade on it as well.

COMMISSIONER POLLOCK: And it was constructed for a cost of \$3400?

THE WITNESS: .If you can tell me you can build a tennis court today for \$3400, you'll be a millionaire.

COMMISSIONER POLLOCK: I'm asking, did you pay a statement which has an item, "Construct tennis court \$3400"?

THE WITNESS: That's mislabeled. It is not a tennis court.

COMMISSIONER POLLOCK: Okay. Then that's a question, I guess, that's for decision.

THE WITNESS: Well, I think that's by definition of a sport facility. Tennis court is 120 feet long and no less than 60 feet wide.

COMMISSIONER POLLOCK: And if it's less than that, even though it has lines like a court and a net like a court--

THE WITNESS: It does not--

COMMISSIONER POLLOCK: --and you hit balls across it, it is not a tennis court?

THE WITNESS: No, sir. It does not qualify.

THE CHAIRMAN: Mr. Steinbaum, I think the point is: The creator of the invoice was under the impression he had constructed a tennis court and so designated on the invoice.

THE WITNESS: We're getting back to: If it looks like a duck and walks like a duck and sounds like a duck, it must be a duck.

THE CHAIRMAN: *That's a pretty safe way to determine what a duck is.*

THE WITNESS: Well, not in my experience.

The Holding Corporation

The testimony revealed a complicated collection of loans and mortgages on the Somerset Hills property, including about \$92,000 held by Stein-Rose Realty Co., which Mr. Steinbaum identified as "both my mother and father."

In addition, there was one mortgage held by Concord Investment Group, which had been reduced from \$56,100 in 1975 to about \$10,000 at the time of the public hearing. Peculiarly, it was not included among the mortgages requested by and submitted to the S.C.I. during its investigation. Prodded by counsel, Mr. Steinbaum managed to recall the unusual high interest charges for the money this Concord group loaned to his Home School's company:

Q. Do you know the percentage, what percent the money was loaned to your corporation at?

A. Yes. It was extremely high at one point, and other mortgages are a lot less. I recall figures from eight percent to fourteen.

Q. Does twenty-one percent ring a bell to you?

A. It's very possible.

Q. Is twenty-four percent also a possibility?

A. I would recall thirty at the time. If I could have gotten it for thirty percent, when I needed the money desperately, I would have paid any amount.

Q. That was secured by a third mortgage on the building; is that correct?

A. That's correct.

Q. And when did you first cast that mortgage? Do you recall?

A. No, I don't. Again, I would say perhaps three or four years ago.

Q. All right. Is there any other indebtedness of Home School of Warrenville, that you can think of, on a long-term basis?

A. No.

Q. Does it have several short-term notes which it's paying?

A. Yes, it does.

Q. All right. In fiscal 1976 there were six short-term notes cast in the amounts of the following: \$660, \$6,600, \$8,500, \$12,500, \$11,500, \$7,000. What was that money used for?

A. To operate the school.

Q. Were they secured loans?

A. No. They were personal signature.

Q. Of whom?

A. Myself.

Mr. Steinbaum's Income

At one point Mr. Steinbaum said he had no income other than his \$31,200 salary as head of Somerset School but exhibits subsequently entered into the record indicated otherwise.

BY MR. STAVAGE:

Q. Mr. Steinbaum, do you devote one hundred percent of your time to Somerset Hills School?

A. Yes, I do.

Q. Do you have any other business or occupation?

A. No, I do not.

Q. Do you receive any income from any other business or occupation?

A. No, I do not.

Q. Do you receive any income from any other entity other than Somerset Hills School, Inc.?

A. No, I do not.

A few minutes later Counsel Siavage returned to the subject of Steinbaum's compensation:

Q. Do you hold a position of president of Home School of Warrentville?

A. Yes, I do.

Q. Are you presently compensated for that position?

A. I believe I am. I haven't seen the tax returns, but I'm certain at the end of the year my accountants either develop a bonus for me--I don't think that I'm on salary.

Q. I show you what's been marked Exhibit C-53 for the purposes of identification, which is the U.S. Corporation Income Tax Return for Home School of Warrentville for the period September 1, 1975, thru August 31, 1976, and I would refer you to Page 2 of that income tax return listing: "Name of Officer: Laurence Steinbaum. Title: President. Time devoted to business: All. Percentage of corporation stock owned: Fifty. Annual amount of compensation: \$22,100." I would ask you if that comports with your recollection?

A. I would, I would accept this.

Q. How much did you receive for Somerset during that fiscal year?

A. What year are you referring to?

Q. Fiscal year 1976. '75. Excuse me.

A. That would be 31,200.

Q. Was that the same situation in prior years, also?

A. I don't know. I haven't the document in front of me.

Q. Okay.

A. This is a specific the accountants work out.

Q. Okay. I show you what's been marked Exhibit C-52 for the purpose of identification, which purports to be a copy of the U.S. Corporation Income

Return for Home School of Warrenville ending August 31, 1975, and refer you to Page 2 of that Exhibit. Again, "Compensation of Officers. Laurence Steinbaum. Title: President. Time devoted to business: All. Percentage of stock owned: 50. Amount of compensation: \$37,000." I ask you whether that comports with your recollection.

A. I would think this would be accurate.

Q. How much did you receive from Somerset in that year? Is that thirty-one-two? From Somerset, now.

A. This is what year? '75?

Q. Yes.

A. It would be thirty-one-two again.

Q. Do you know how much you are receiving in the current year?

A. No, I have no idea. That's an adjustment that the accountants make.

Q. If I told you that for the fiscal year ending 8/31/1977, beginning in September, 1976, that you had received from Home, according to the books and records of Home, as salary \$30,900, would that comport with your recollection?

A. As salary?

Q. Yes.

A. From Home School?

Q. Yes.

A. No, that would not.

Q. Okay.

A. I would not agree with that.

Q. All right. What would you agree with?

A. I couldn't agree that it was salary. I don't know what adjustments they make.

Q. Well, how much did you get? Let's call it anything you want.

A. You know, this is something that you had every reason to discuss with my accountants. You're asking me technical questions of a very complex nature, which I would be happy to discuss with you if I had intelligent answers for you.

I think the important thing, as you direct these questions to me, is did I, in fact, get this money and did I, in fact, pocket it. I have to tell you, no, I did not, and that this money, all of it, is reinvested in Home School for the purposes of Somerset Hills School.

Now, you want to investigate that, certainly direct your interest at that and I'd be happy to respond.

Q. Is your answer, then, that you are not responding to the last question.

A. No, I'd be happy to respond to it except I don't know. You asked me a question--

Q. Your answer is you don't know?

A. --would I be surprised if I received thirty-odd thousand dollars in that period of time.

I can't tell you whether I did.

Q. Your answer is you don't know?

A. I don't know.

Q. That's all.

COMMISSIONER POLLOCK: How far back is this time period we are talking about?

MR. STAVAGE: We are talking about the time period September 20th, 1976, to 8/31/1977.

COMMISSIONER POLLOCK: And you can't remember whether you received that sum of money in that time period?

THE WITNESS: I didn't receive any of it. It is a bookkeeping entry.

COMMISSIONER POLLOCK: But you do acknowledge an awareness of the bookkeeping entry?

THE WITNESS: I'm aware of many of these entries.

COMMISSIONER POLLOCK: And this one in particular?

THE WITNESS: The last one that was just entered?

COMMISSIONER POLLOCK: Your salary.

THE WITNESS: My salary from Somerset I am very aware of. I get that check every two weeks and that is my salary.

COMMISSIONER POLLOCK: You are also aware of the sum that you did not receive?

THE WITNESS: In many instances, correct.

COMMISSIONER POLLOCK: And in this particular instance?

THE WITNESS: Again, I say, in many instances. I don't know in this particular instance.

COMMISSIONER KADEN: Mr. Steinbaum, it doesn't seem to me that the questions are quite as complex as you are making them. Mr. Siavage read to you from the corporate income tax return for this corporation which owns the land, and that corporate tax return indicated as compensation for you in those relevant years the sums of 22,100 in fiscal '76; 37,000 in fiscal '75; and, I gather, Mr. Siavage, 30,900 in fiscal '77. Now, that corporation submitted that return indicating that it paid you that compensation. Now, is it your testimony that you never received that compensation?

THE WITNESS: My testimony is that this is accurate. The accountants accurately post monies that are attributable to either salary or bonuses to me. Often times those monies, rather than getting into my pocket personally, are reinvested into the operation before I ever see it.

COMMISSIONER KADEN: I'm not concerned with whether the money was reinvested. I asked you whether you received as compensation the sums as reported

on your Federal tax returns.

THE WITNESS: The answer is correct.

COMMISSIONER KADEN. Okay.

A Different Story

After consulting with his lawyer, Mr. Steinbaum said his attorney had advised him that the Commission had been referring to monies from the Home School to him that "are the overages between the lease, Somerset to Home School, less any of the expenses, mortgages expenses, et cetera, and whatever that allowance may have been."

BY MR. SIAVAGE:

Q. That's the money that you do get out of Home School--

A. Correct.

Q. --as opposed to what you told us at the beginning of this session. Correct?

A. Well, I don't, I don't consider it in conflict.

Q. Okay. It's a matter of judgment, though, I would suppose.

Those Checks to Mr. Steinbaum

Counsel Siavage listed as Exhibits a "packet of checks" from the Home School to Mr. Steinbaum, non-payroll checks in the amounts of \$9,800, \$1,100, \$500, \$5,000, \$1,500, which Mr. Steinbaum described as "either loan or repayments of loans or money due the corporation to me."

Q. How much do you currently owe the corporation?

Do you know?

A. No, I don't.

Q. Do you have any idea how much you owe?

A. At one time my--at one my indebtedness was in excess of \$100,000 to the corporation.

Q. Would it be approximately \$94,000 now?

A. It's very possible.

Q. Okay. Other than the payroll and the loans from the corporation, are there any other matters in which Home School pays you? Or transfers money to you? Let me characterize it that way.

A. Yes.

Q. How is that?

A. There are accounts--

Q. Pardon?

A. I was waiting for you.

Q. Go ahead. You can give me the answer.

A. There are accounts that are paid in my behalf and, again, adjusted against my salary and my interest in Home School at the end of the year.

Again, this is something that the accountants that met with your accountants discussed.

There are transfers, inter-company transfers, that take place weekly and at the end of each year the books are closed of record and whatever adjustments need be made, whether they are personal expenses

on my behalf, they are attributed to me personally. If there are monies that I have extended to the corporation, to either Somerset or Home School, that then reflects itself in the adjustments and at the end of each year the position I hold is identified.

Mr. Steinbaum's "Cash Flow"

Commission Counsel asked the witness to identify three "debit memos" dated in March, 1977, for a total of \$5,000 which were transferred from the account of the Home School corporation to Mr. Steinbaum's checking account.

Mr. Steinbaum was asked if the purpose of these debit memos from Home into his checking account were "for your personal cash flow."

A. Again, I have to tell you that these transfers are typical of our operation. There is nothing unusual about it. The only unusual thing is that these amounts are rather small. They sometimes go in excess of 5000 and 10,000. That's a money flow between myself, Home School and Somerset, and it has been continuing ever since the State of New Jersey delayed payment, when I found myself having to borrow between 75 and \$100,000 to meet my current expenses. This is the reason that you see these exchanges of monies.

Q. You are not denying, are you, that the corporation paid you the salaries that you previously identified on the corporate income tax returns?

A. Not at all.

Q. Nor that you claim that amount as income on your personal income tax return?

A. Not at all.

Q. Do you recall how much you claimed as income from Home School on your personal income tax return?

A. This past year?

Q. For any year.

A. No, I don't.

Q. Between those debit memos and the checks representing the loans there is a total of \$23,000 in fiscal 1976, which would be added to your salary of \$31,000 from Home School, for a total of \$54,000, and then added again to your salary from Somerset School of \$31,200, the total would be \$85,200 from Somerset and Home in that fiscal year. Would you disagree with that figure?

A. With one exception.

Q. What is that?

A. You're stacking the cards.

A Lucrative Rental Arrangement

The Commission wanted to know how the \$126,000 rental

figure for Somerset Hills School was arrived at. Mr. Steinbaum said it resulted from "a number of meetings between banking officials, our accountants, attorneys, real estate representatives for the value of the property." He said it originally was "pegged" at \$135,000 but reduced to \$126,000 after meetings with DYFS.

EXAMINATION BY COMMISSIONER KADEN:

Q. And this is rent in a transaction between the school of which you are the director and the corporation of which you are the president?

A. Correct.

Q. On a property which can raise mortgages in excess of \$300,000. Correct?

A. I don't know what the sum total of the mortgages are, but I wouldn't be surprised if they were that, in that amount.

Q. And that rental of 120,000 more than covers the full cost of the property as evidenced by the fact that it produces, also, a surplus which is then transformed into compensation for yourself?

A. Uh-huh

Q. Right. And the result of that whole transaction is that, for example, in 1975, fiscal '75, you received 31,200 as director of the school. Correct?

A. That's correct.

Q. \$37,000 as compensation as the corporation reported it on their tax return from the land company; from the Home School of Warrenville Corporation?

A. Correct

Q. On a total of over 68,000 in that year. Now, Mr. Siavage also asked you about these transfers in the last school year to your account, and I think you said there were some \$5000 transferred directly into your checking account?

A. Often, correct.

Q. And what was the nature of those funds?

A. Repayment of loans, adjustments of investments from one company into another. When I--

Q. So that you--

A. When I said to Mr. Siavage that the cards were stacked, I referred to the combination of monies that were attributable to me. But there was no compensating balance of monies that I returned to either Home School or to Somerset, which again is a matter of record, and parallels the sums that were presented to me.

Q. So that this \$5000, for example, transferred to your checking account you did not consider to be income to you?

A. Not at all.

Mr. Steinbaum, pressed to justify the rental arrangement, contended that it not only conformed to the value of the property but also reflected what he described as the financial problems of running a private school. When he spoke of his "nagging, annoying, anxiety-creating" effort to "keep the ship afloat and to maintain standards," Commissioner Kaden noted that he was being well paid for his troubles:

Q. Well, while this ship is being kept afloat, you are collecting somewhere in excess of \$65,000 in state school funds at the same time, for example, as you may know, the Commissioner of Education receives \$43,000 or the president of Rutgers receives somewhere in the neighborhood of 50,000. Does that seem to you to be a sound allocation of public resources?

A. Oh, I would love for the president of Rutgers to take my place for a month and let him assume my position.

As far as the Commissioner of Education is concerned, I really don't know what his responsibilities are. I'm certain educationally and as far as qualifications are concerned he excels.

I have stated before that you have not traced back the expenditures. While you see all of this money coming to me, you do not see the money returning invested in a plant for children from the State of New Jersey. There has been no comment about that;

no comment about the need to borrow money; no comment to guarantee those loans. There has been not one word said here about my exposure. I think that's unfair.*

X X X X

THE CHAIRMAN: But to get back to one principle, though. There may be little question that you have a lot of expenses, and let's assume for the moment they're all legitimate expenses that you are incurring. They're the barnacles on your ship. You are not suggesting, are you, sir, that your accountant breaks out the money from Home School in a designation of salaries so that you can reinvest and put it back into legitimate expenses for the school? You are not suggesting that?

THE WITNESS: I don't understand.

THE CHAIRMAN: You are not suggesting by saying about your ship having all these barnacles on it, which are legitimate expenses, that you have to keep putting money back in, that your accountant breaks the money out to you in the designation--

THE WITNESS: Oh, no.

THE CHAIRMAN: --of salary for you to pay a legitimate expense of the school?

THE WITNESS: No, no, not at all.

THE CHAIRMAN: Okay, Thank you, Mr. Steinbaum.

*See Pp. 128-130 for numerous loans to Mr. Steinbaum, according to his testimony, on his personal signature alone.

ABUSES LED TO ASAH

The next witnesses were Dr. David Holmes, President of the Association of Schools and Agencies for the Handicapped (ASAH), and Mrs. Suzanne Greenman, Secretary. Each also directed highly reputable private schools for the handicapped -- Dr. Holmes being Director of the Eden Institute for Autistic Children in Princeton and Mrs. Greenman being Executive Director of the Glen Kirk School for the Handicapped in Morristown.

Dr. Holmes told how ASAH was formed in 1973 in the wake of reports of abuses by certain private schools similar to the improprieties that were aired at the Commission's public hearings.

However, only 23 to 25 private schools were listed as members of ASAH, reflecting according to testimony by both Dr. Holmes and Mrs. Greenman an inability on the part of a number of schools to meet the relatively strict standards for membership imposed by the association.

The Commission first questioned Dr. Holmes about ASAH standards and procedures:

Q. Now, what does the Association of Schools and Agencies for the Handicapped do to try to delimit those abuses?

A. Well, we have a rather extensive and intensive application, and within the application we trust that we have control for a majority of the kinds of problems that we are bringing up right now, with a series of

checks and balances. And as we had developed these, we said, well, we can sit down and talk with administrators of private schools and they could probably do a good job of influencing us in saying what a good school they have and so forth.

One check we have, which we think is one of the most efficient checks we have, is we meet with each of the teachers in the school system and sit down and say, you have budgeted X number of dollars for supplies and you have budgeted X number of dollars for curriculum development and X number of people on staff responsible for supervision. Is this happening in reality? And what we are finding is that the classroom teacher is the one going to be most sensitive to where the money flow is going.

Q. Now, the association has, I think, three categories of membership. Is that correct?

A. Yes, it is.

Q. And those categories are?

A. Applicant, and applicant level, basically, is a non-member, but an individual who has either received an application or we have received an application but have not had an opportunity to act on it. We also have an associate membership level and we have a full membership level.

Q. And the twenty-three schools that you mentioned as members were full members or did that include

associate and full?

A. That includes associate and full.

Q. Okay. As a portion of the application process, do you require that the school submit to an audit?

A. Yes, indeed.

Q. Can you explain that a little bit?

A. Well, that we ask for in the preliminary, or actually in the application, and we expect to receive this through the mail, is a copy of their latest C.P.A. audit and, also, a copy of their budget and we do cross reference. And then, of course, when we do the on-site evaluation, actually, there's two levels to the evaluation. One is the paperwork evaluation within our own offices and then the on-site evaluation to see if what they're saying in the particular application holds true in actuality.

Q. You go out and visit the site?

A. Yes, we do. We spend a full day there.

Q. Okay. Is the audit that is submitted with the application process reviewed by anyone?

A. The audit is reviewed by our own evaluation team, which are comprised of administrators of other membership schools who know how to interpret audits and so forth.

Q. Okay. What would happen once a member becomes a member if you were to perceive a particular problem with either the management or the fiscal responsibility

of that member school?

A. Well, we have a safeguard, primarily because we have asked ourselves the same question. We are saying, if a school looks really good in 1974 but we start to hear rumblings of problems, and problems can happen after six months of an assessment, although we feel that our assessment is so thorough that the conditions of this are rather slim, but if we hear rumblings and we were quite concerned as to what we mean by "rumblings," we finally decided that any rumbling, whether it be from a parent, from a staff member, from the Department of Education or from a concerned citizen, would warrant our following up on it. And our follow up procedures, basically, are to make telephone conversation with the school in question, and if the response we receive from the telephone conversation, we feel, is not adequate, and this is determined by our executive committee, which is the president, vice president and secretary-treasurer, then an on-site visitation, and we don't call it evaluation, we call it an on-site visitation, is scheduled, and scheduled within two or three days so there is no opportunity for rectification of whatever problems were identified, and we do an on-site visitation.

Q. Thank you.

Have you, through the association, entered into any interface with the Department of Education?

A. We have regular monthly meetings, and we are currently in the process of developing and executing a grant for formalization of our evaluative procedures in concert with the State Department of Education's evaluative procedures to control much of what has been discussed over the past two days.

Q. Have you been discussing that for sometime now?

A. We have been discussing that since the latter part of this past summer.

X X X X

Q. Okay, Dr. Holmes, you mentioned before that there was a substantial increase in the number of schools seeking membership in ASAH. Has that gone up in the very recent past at all?

A. I think that we have noticed a larger increase in application or requests for applications in the past, as I said earlier, in the past few months, and I would, just to cover myself, I would say within the past six months.

Bigger Boards, More Meetings

Mrs. Greenman, speaking from the standpoint of five years as Executive Director of the Glen Kirk School, described how difficult it would be to run a proper private school following procedures outlined previously in the S.C.I. hearings by other school officials:

Q. Okay, you have heard board of directors consisting of, in most cases, two to three to four people. How many members are on your board of directors?

A. Twenty-four.

Q. Twenty-four people?

A. Yes.

Q. How often does your board of directors meet?

A. The board, the full board, meets every other month. The executive committee of that board meets on the alternate months, so we have meetings every month.

Q. You heard, I think, testimony that some boards of directors meet once or twice or three times a year in these hearings. Would it be possible to run your school in that manner?

A. No, it certainly would not. We depend on our board too much.

Q. What kind of people are on the board of directors?

A. We have been able to secure for our board, a variety of educational and supervisory people from the school system. We have businessmen from various walks of life, including corporation presidents. We have a lawyer. I take that--yes, we do have a lawyer now. We have a C.P.A., who is a senior partner in a large accounting firm in New York. We have women, whose role is perhaps more social, also to do more of the day-by-day legwork that women trustees can do.

Q. Now, you had a hand personally in the founding of Glen Kirk School, did you not?

A. Yes.

Q. As a matter of fact, I think it's fair to say that you were the founder of Glen Kirk School?

A. Yes.

Q. Is that correct?

A. With a good deal of help, but, yes, I was.

Q. In the early time shortly before the school went into operation, did you review the plans for the operation of the school with various resource people in the different professions, including accounting, law, et cetera?

A. Yes, indeed, we did. In fact for two years we reviewed plans with professional and lay people alike. Actually, with the state department. Yes.

Q. Okay, We have had, also, some testimony that several of the problems related in the last two days were created by the fact of lack of cash flow. Was there any particular recommendation from those resource people to Glen Kirk School when they were starting up regarding the manner of dealing with that fiscal problem?

A. Yes, there was, and I must say, I'm very grateful to them. They felt very strongly, the founding board of seven trustees; before we actually opened our doors

we would have to have a fund to get started with, and that fund at that time was \$20,000 and they gave us exactly two months to raise that fund. But we did, and ever since then we have been able to add to it.

So, in the beginning of the year, which, as has been testified, is a period of time when no money is coming in from the sending districts, we have our fund that we can rely upon.

Reserve Fund Eases School Board Delays

Commissioner Lane was concerned about the pattern of tardiness on the part of local school boards in making their required payments to the private schools:

COMMISSIONER LANE: *How much delay do you encounter with the school district paying you? Do you have a problem despite your fund, or you'd have a problem without that fund donated?*

MRS. GREENMAN: We would have a very serious problem without it.

COMMISSIONER LANE: *Has there been any move made to have the school district respond on time, or somewhat sooner than they have responded on payments?*

MRS. GREENMAN: We have sent them the usual bills. We have sent them the usual bills. We have sent them the usual reminders, and we followed up with phone calls. But that's it. We haven't gone further than that.

COMMISSIONER LANE: *You don't get the answer you want; is that correct?*

MRS. GREENMAN: *In many cases we do. Again, I'm not generalizing. In many cases, I would say, most of our money is in by the month of November. But, for instance, right this minute we are still behind about \$35,000.*

COMMISSIONER POLLOCK: *Well, what is the time lag between the submission of your statement requesting payment, if you will, your invoice, to the school district and receipt of the money?*

MRS. GREENMAN: *Again, I think it varies. I think some of them get it right in, and with others it could be a time--well, the ones who are still in arrears to make up the total of thirty-five, they must be, they must be five or six months behind.*

COMMISSIONER POLLOCK: *What explanation do they offer for delay in payment?*

MRS. GREENMAN: *I really--I can't quote them. I'm sorry. I don't have an answer for that. Problems, but I can't be specific.*

COMMISSIONER POLLOCK: *Would you think it would be helpful to have some kind of a regulation or rule that required payment within a certain number of days?*

THE WITNESS: *I do, because it's got to be a problem. We're just very fortunate having this fund that we can draw from.*

DR. HOLMES: Just to interject, if I might. According to the rules and regulations, private schools that work with handicapped youngsters cannot bill for the educational procedures or practices until after the services have been rendered, and, so, for the month of September tuition is submitted, or the bill for tuition is submitted at the end of September and then the schools will not receive it until the end of October or November. So, even a thirty or sixty-day limitation would still be a problem, but a little bit less than a problem for some schools that are five or six months in arrears.

COMMISSIONER LANE: *Well, a ten-day rule or twenty-day rule would be more helpful.*

DR. HOLMES: It would, yes.

COMMISSIONER POLLOCK: *The problem you have, I suppose, is the local school board, which meets monthly, perhaps, has to approve your statement.*

MR. STAVAGE: *Would you think a system that would suggest prepayment of the bill as long as the expenses were properly audited after the monies were paid out by the local school districts would be unwise, if you understand me?*

DR. HOLMES: Yes, I understand you, and I think I can only speak for myself and speak for the members of the association, but I feel that would help in the cash

flow problem. There is a tremendous void between when you start seeing monies coming in.

EXAMINATION OF MRS. GREENMAN BY MR. SIAVAGE:

Q. All right. Mrs. Greenman, returning to the Glen Kirk School, what are your duties as Executive Director of Glen Kirk School?

A. I, as they say, I am where the buck stops. I am the organizational leader of the school under the board of trustees. My duties are not classroom duties. We have a program coordinator who really runs our educational program. She and I share the responsibility of integrating our clinical services into our educational program. I'm a troubleshooter. I'm always there. I do fund raise. That is a part of my responsibility. Fund raise, now, from private sources.

Is that what you want to know?

Q. Yes, it is.

How many hours a week would you say it takes you to attend your duties at the school; that is, hours wherever spent, at the school or elsewhere?

A. Well, that's important. I would say, if you mean literally wherever spent, it probably takes me fifty, sixty, hours.

COMMISSIONER LANE: May I ask you if you think it's possible to properly conduct a school with your duties at a headquarters center some four miles removed from the school and you, somebody in your

position, not going to the school but once or three or four times a year?

MRS. GREENMAN: I certainly can't begin to see how it could be done.

COMMISSIONER LANE: Does your corporation--I suppose it's a nonprofit corporation. Does it own title to the real estate that you occupy?

MRS. GREENMAN: No. We rent two floors from the Morristown Unitarian Fellowship Church. We rent, in other words.

COMMISSIONER LANE: And you say you have forty-eight? Was it forty-eight in number in your school?

MRS. GREENMAN: No, it was fifty-four. But we have forty-seven--I'm sorry. We have forty-six on that campus. We have an off-campus satellite program.

COMMISSIONER LANE: And you own no real estate?

MRS. GREENMAN: No real estate.

COMMISSIONER LANE: What rental do you pay for those two floors of the--

MRS. GREENMAN: 11,000.

COMMISSIONER LANE: For the whole year or nine or--

MRS. GREENMAN: Yes.

COMMISSIONER LANE: And do you find the quarters you have adequate for your operation?

THE WITNESS: Yes, we find them adequate. We do not find them a hundred percent appropriate. For instance, we would like to have preschool children enrolled at

Glen Kirk. We would like to start with the child who's very young, and we can't do it because we have two sets of very steep stairs and it just would not be appropriate for very little children. So, we are looking for a more appropriate facility, either to rent from a vacated public school or buy our own.

The Commission asked the school association experts to explain what they regarded as a proper proportion of administrative costs to the total costs of a school.

EXAMINATION OF MRS. GREENMAN BY MR. STAVAGE:

Q. Mrs. Greenman, I have marked as Exhibit C-70 what purports to be the budget of Glen Kirk School from 9/1/77 to 8/31/78. I show it to you and ask you if it appropriately represents what I described.

A. Yes, it does.

Q. Thank you.

Some of the facts that we have had in this hearing represented administrative cost as the average of the overall budget of the school between twenty-five and forty percent in some cases. Do you have any idea what your administrative costs are compared to your overall budget as far as a rough percentage in looking at those figures?

A. I would say they were pretty close to ten percent.

EXAMINATION OF DR. HOLMES BY MR. STAVAGE:

Q. Dr. Holmes, does the association have any thumbnail sketch of what they think the administrative costs should bear in relationship to the total budget?

A. This is one area we are very cautious about and we get very, very--we question quite heavily any costs that exceed twenty percent. We figure fifteen percent to twenty percent is a reasonable amount, and we smile a lot when we see ten percent.

What about "arms-length" rentals? The ASAH witnesses said they were the rule, that the "rent-lease" arrangement described earlier in the hearing was unheard of.

COMMISSIONER LANE: I would like to ask Dr. Holmes about whether any of your members of your association deal at less-than-arm's-length in rentals. Do any of your member associations, non-profit corporations, rent from a corporation that is owned or operated by some of the members of the non-profit corporation?

DR. HOLMES: I think I can't answer for every particular school that's a member of the association, But I would say the majority of the member schools rent, for the most part, rent from religious-affiliated operation; for example, renting church facilities and so forth. But there are also full members who own their own facilities, and we don't know of any--as of this asking, I don't know of any of the member schools who have a rent-lease-purchase agreement that's indicative of what we have been hearing today.

COMMISSIONER LANE: When you say some of them own their own properties, you mean that non-profit corporation owns the property they occupy?

DR. HOLMES: Exactly.

COMMISSIONER LANE: Now, let's assume that we have a situation where the non-profit corporation or its incorporators and its operators have some property over here, and owned under another corporation, and rent that property from themselves, in effect. Do you have any ideas as to how an evaluation of a proper rental should be made in such a case?

DR. HOLMES: I think what we have to do is, we have to look at the reason for doing that. Many, many times state agencies, whether it be Department of Human Services or Department of Education, make it difficult to put mortgage money on the budget. Therefore, they almost require the particular school to rent, which is a reasonable expenditure of state funds, and so, therefore, there are situations such as that.

We do have--the one thing we've got going for us is, as an association we happen to know what each member school is paying for rent and we are able to look at that and keep it within reasonable--within a degree of reasonableness.

To answer your question more specifically than that, it would be difficult at this point.

COMMISSIONER LANE: I'm suggesting, and really asking your opinion of it, whether or not when we do have this less-than-arm's-length dealing, whether there shouldn't be an independent appraisal, not the owner's appraisal or his asking figure, but whether it shouldn't be an entirely independent appraisal of that property, independent declaration as to its rental value and so forth.

DR. HOLMES: I think if there was any question about the amount of money or maybe even as a safeguard about what are considered, what are not considered appropriate parameters, to have that independent appraisal, I think, would be a very valid and appropriate kind of recommendation.

The more compact the private school complex, the more efficient and productive, the ASAH officials indicated. S.C.I. Chairman Rodriguez recalled testimony earlier in the day by the operators of schools with offices and educational facilities spread out over miles of terrain.

EXAMINATION BY THE CHAIRMAN OF DR. HOLMES:

Q. Is there anyone in your association, or does your association consider the efficiency with which the school, for instance, obtains property to be used as a school facility? And let me make that as clear as I can.

We heard this morning that there was one facility

that, in purchasing a variety of parcels, that houses were somewhat spread apart, which, in my opinion, would appear to be an inefficient way of expensing out money for the handicapped children. Is there any thought, or does your association conduct any efficiency studies in that regard?

A. What we look at is, if, for example, between the facilities or between the houses or buildings on the property, if there is a lot of student flow, and we figure that, and we feel that the student flow requires more than fifteen minutes, then we would request that kind of distance, and, of course, because of inclement weather and so forth, I think, there would be large consideration brought to this particular fact. And-- but I doubt that we would question if in each of these particular buildings separate programs were being performed.

I think from the standpoint of efficiency, you have to look at what the cost of grounds were at purchase time and what it would cost to actually build buildings closer and so forth.

EXAMINATION OF DR. HOLMES BY COMMISSIONER LANE:

Q. How about administrative flow, four or five miles apart.

A. We have problems. I have problems, and I think the association would have problems with the idea of

having administrative offices that are separated from the actual ongoing education practices.

My office at the Eden Institute is right in the middle of the school, and even I have difficulty sometimes keeping track of what's going on at the various levels of various programs, and it's a full-time job just to keep track of everything.

So, any kind of distance from the program would make it very, very difficult, if not impossible.

Tuition Reimbursements

The ASAH officials testified at some length on the problem of non-public school tuition reimbursements, particularly on the need to have the rates more accurately reflect the cost of educating the child in the rate category to which the student is assigned.

EXAMINATION OF DR. HOLMES BY COMMISSIONER KADEN:

Q. Has the association tried to evaluate at all alternatives to the system of cost reimbursements that we now have?

A. What we have done, and this is something I would like to get on the record as well, is we have on various occasions brought to the attention of the Department of Education some of the problems of the current system of tuition, and in August we presented to the State Board of Education, and presented our

problems and our feelings; the problems with tuition.

Right now, not only do we have cash flow problems from the standpoint of delay of payment, but we also have cash problems because of the status quo that tuition has reached to the private schools. 1976 and '77 there was X number of dollars allocated for the various categories of exceptional children. 1977-78 we found that in some of these categories it was actually a deduction in tuition.

We went to the State Board of Education saying you can't feasibly operate again. Again, we are only representing quality schools who are members, not all the quality schools throughout the state. We represent our quality schools in saying we, as an association and members, find it very difficult to operate at a reduced tuition level. So, we did make recommendations. We have talked with various people at the Department of Education level and we are currently in negotiation, although we feel somewhat frustrated.

Q. As I understand the current system, the board sets these maximum tuition rates on a category-by-category basis, and then the individual school asks for the maximum usually or some other rate. In following the testimony of the last two days, I think it fair to say, at least, with a couple of those schools that either it doesn't cost that much money, that maximum rate to provide an education to a child in that category, or, if it does, indeed, cost that much, the child is being

shortchanged because we have seen substantial amounts of money going into either wholly improper areas or excessive overhead, excessive rent payments and the like.

A. I think it would be the latter case, as I understand you right now.

Q. That the children are being shortchanged?

A. What we are finding as an association when we go in to assess a program, we assess it at a fiscal administration level and we assess it at a programmatic level. You can actually charge less than the maximum tuition rate and still shortchange the level and charge the maximum and not have the services in a quality sense because you need more than the maximum.

Q. Depending how you are allocating that?

A. Exactly. If you allocate to the director, any personnel, or for whatever reason, into capital funds, thousands of dollars, no matter what the tuition rate, the children are the ones suffering. That's our problem right now. That's what we are trying to rectify.

Q. Does that suggest that a reimbursement system that focused more on a cost-by-cost approach, what some people call a cost-box approach, locking approach, looking at administrative expenses, and operating expenses, and curricula expenses and so forth, category by category rather than on a simple per-child formula, would be a more appropriate system of--

MRS. GREENMAN: You mean program-oriented budgeting?

COMMISSIONER KADEN: *Exactly.*

A. Something like that would be much more sensible, I believe. In actuality, probably could be costed out on a per-child basis in the long run. That would be much more sensible.

To do that, the Department of Education has recently developed a system of cost accounting, and each private school has to send these forms in. This is the step in the right direction.

The position of the association is to have each school, each private school that works with the handicapped, be reimbursed on the factors that it cost for the education of those children, allowing for the opportunity of the private school to do its own private fund raising to add services they feel are necessary for the child.

MRS. GREENMAN: So that each school will be reimbursed based on the services that they render to the child.

ASAH and the State

Commissioner Kaden asked Dr. Holmes and Mrs. Greenman to describe their relationship with the "relevant" departments and officials of state government. He asked Dr. Holmes to discuss it "in terms of the future of that relationship."

A. Our position right now, and I will reiterate it, is that we have developed, and I think we have a rather

amiable relationship with the Department of Education, a rather close relationship with Jim Richardson and Eleanor Engelbrecht. I feel they're going out of their way to be cooperative with us, and us with them, because they realize the problems and realize the association is trying to help them monitor and control some of the difficulties being presented as of late. So, I think we've got a good relationship.

Q Without jumping ahead of ourselves at all, I think my impression as a result of exposure to this problem is that we are dealing with a seriously defective statute; that even the best-intentioned people in the relevant departments are at a serious disadvantage given the statute and given the resources they're given to administer this program. Is that a characterization that you would share?

A. I would think so. In fact, one of the things that we extend to the Department of Education is our services to help in just these issues.

MRS. GREENMAN: I think Mrs. Engelbrecht testified yesterday that she was a one-person bureau to go out and monitor a hundred fifty schools, which we did a little arithmetic on. She'd be able to do it once every twenty years, really.

COMMISSIONER KADEN: Right. I think my comments reflected, in part, on that testimony. Perhaps out

of these hearings and out of the efforts of your association, one thing that will come is a proposal for legislative reform that your association and this Commission can cooperate on.

Many Outstanding Schools

As they concluded their testimony, the ASAH officials said they hoped the media would in some manner demonstrate that there are a large number of private schools who are "providing quality education for the handicapped." Chairman Rodriguez emphasized that the Commission had sought to make this fact clear throughout its proceedings:

THE CHAIRMAN: I think the statements from the Commission have consistently been that at no time are we trying to suggest that there aren't good schools and a lot of dedicated people working for the benefit of the handicapped children. Our instincts are somewhat heightened, however, when, and especially now since I heard from Dr. Holmes, that if the tuition may not always be exactly adequate and then we hear of some abuses, that we have to get on with some rather dramatic changes. But I think we have consistently said we don't want to say those things to detract from those who are dedicated in the field, and I know there are many.

DIFFICULTIES AT THE STATE LEVEL

The final witness was Dr. James Richardson, State Director of Special Education in the Department of Education since 1973. His appearance climaxed a long period of cooperation with the Commission during the earlier phases of its inquiry, during which he also testified at private hearings of the S.C.I. Counsel Siavage directed Dr. Richardson's attention to some of the problems of fiscal controls exposed by the Commission public sessions:

Q. I would suppose that you are aware of the Commission's concern at this point in its inquiry of special education is the fiscal responsibility of the schools and means and manners of payouts of public monies through the educational reimbursement system of special education.

We have dealt in executive session with some of the regulations that deal with special education. I wondered whether those regulations are under scrutiny as a result of the hearing here today, or were they under scrutiny prior to the hearings here today?

I wonder if you can review that a little bit with me.

A. I think they are under scrutiny. I think I did explain to the Commission that up until 1975 I was prohibited from collecting data related to financial status of private schools under a section, Title 18A, which was passed in 1903. At that point in time I requested an opinion from the attorney general's office and received back an opinion that the private sector under special education was, in essence, quasi-public and, therefore, at this particular point in time I can go forward and begin to collect data.

The first financial data was collected in July of 1975 from the private schools in the State of New Jersey.

Q. Okay. Now, you had attempted, had you not, to get a decision as to whether you could collect such data for some time during your position in the department; is that correct?

A. Yes, that's correct.

Q. And you finally got it, I think, when a division-level person above you changed?

A. That's correct.

Q. Had you applied to an assistant Commissioner?

A. Yes.

Q. And been told no for sometime?

A. Yes.

Q. And then later on were allowed to apply to the attorney general for that particular decision?

A. That's correct.

Q. Was the decision a clear one in your reading of it?

A. Yes, very clear.

Q. Now, since you have been collecting the financial data, I would assume that you have also had it reviewed by your department?

A. Yes, we have it reviewed.

Q. Who is responsible for that review?

A. Mrs. Eleanor Engelbrecht.

Q. Have you also had audits done of particular schools?

A. Yes, we have.

Q. How have you worked that? Have you worked that with your own resource people or moved outside the bureau?

A. We have used our own resource people through the Department of Administration and Finance.

Q. And that is also in the Department of Education?

A. In another division.

Q. Is it unusual to use those kinds of resources for you?

A. For me, yes.

Q. Okay.

A. We do use them as it relates to auditing public schools in terms of all programs.

Q. Is their function within the Department of Education to supply resource people for all auditing needs or do they work in another specific division and just supply you with your needs on an as-needed ad hoc basis?

A. They supply us as needed on an ad hoc basis.

Q. They have their own specific responsibilities and are not, in effect, a pool of accountant talent?

A. We're really drawing on people who have another responsibility.

Q. I suppose you see I'm getting the question of whether it would be better for you to have your own auditing capability within the bureau.

A. I believe it would be better.

Q. What is your staffing level now with regard to the people you have available to you to review the budgets?

A. In addition to Mrs. Engelbrecht, we have about twenty-five staff people, who can be available at various points in time when there are days that they are not assigned into one of the other areas of special education, who can work with her as it relates to the visitations and the approval of the private school.

Mrs. Engelbrecht does almost all of checking the audits or checking the financial data that comes into the office. That begins in July and ends early in the month of September.

Q. Have you ever personally assisted her on occasion in that function?

A. Yes, I have.

150 Schools, One Overseer

Dr. Richardson's testimony demonstrated the hardship of maintaining a quality program with the limited personnel at his disposal.

EXAMINATION BY COMMISSIONER LANE:

Q. You're talking about paperwork, reviewing paperwork?

A. Just reviewing all of the budgets of the hundred-fifty private schools in state and the hundred out of state.

Q. Just one person doing that?

A. That's correct.

Q. And that gives little time to go out in the field and look about, does it?

A. We try and do our visitations during the school year. This takes place during July, August and the beginning of September before programs are really in operation.

Q. How many people do you have doing that?

A. In visitation? It will depend upon, as I indicated, the members of the staff that are available at that particular point in time. I would guess we've done maybe fifteen validations since September at this particular point in time in the private sector.

Q. Of a hundred-fifty schools?

A. Uh-huh.

EXAMINATION BY MR. STAVAGE:

Q. Do those visitations include any financial review?

A. Yes, they do.

Q. Okay. What is the nature of the financial review?

A. For some of these we've been taking the auditor from Business and Finance out with us. For others, it's simply our review of the budget as we go out with our team of people to look at the schools.

Q. Would you approximate as a necessary staff level of an auditing capability within your own bureau that could handle the system as it is personally set up; that is, budget submission, auditing and then a tuition-per-child cost, which is delivered to the school by the Department of Education?

A. Number of personnel?

Q. Yes.

A. Minimally, probably three.

Q. Okay. The Department of Education has recently passed a body of regulations dealing with special education; is that correct?

A. That's correct.

Q. Do those regulations address themselves to the amelioration of any problems that have been portrayed in these hearings?

Q. Is their function within the Department of Education to supply resource people for all auditing needs or do they work in another specific division and just supply you with your needs on an as-needed ad hoc basis?

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Q. Okay. The Department of Education has recently passed a body of regulations dealing with special education; is that correct?

A. That's correct.

Q. Do those regulations address themselves to the amelioration of any problems that have been portrayed in these hearings?

A. Some.

Q. Okay. They don't specifically address auditing and things of that nature?

A. No, they do not.

Q. Have you, either personally or the department, given any thought to a suggestion, that you probably heard as you sat in the gallery, that Commissioner Kaden made of a possibility of a cost box or reasonable cost approach rather than as opposed to a per-child tuition rate to solve some of the difficulties we have heard over the past two days?

A. I think that would be a way to move. Part of our problem now, as I think was indicated, was the law itself, which says we can spend no more than the maximum amount of money being spent in the public sector. If we move on a per-pupil cost, there is a likelihood that, because of the severity of some of the youngsters, we would far exceed the maximums allowed us now by law and by regulation.

Coping With Fiscal Abuses Difficult

The Commission questioned how the department could "respond to exploitation of the system" -- particularly, as counsel stated, "if you have allegations or even proven cases where persons were exploited." Would Dr. Richardson have a mechanism at his disposal?

A. To a degree. Primarily on program issue rather than a fiscal issue, we have closed private schools

on a lack of program base. When you get to the fiscal issue, because of the way the laws read and the regulations, there is more difficulty for us in terms of what we do once we determine that there is a problem.

Would regionalization of the system help?

EXAMINATION BY COMMISSIONER LANE:

Q. I've been somewhat surprised, I'm sure everybody has, that some of these private schools will have brought to them from as many as thirty miles, twenty-five miles, day students back and forth. Isn't there some way of regionalizing the system so that the pupils brought to a school would be reasonably close, within ten miles or five miles, or whatever educationally is deemed wise and proper?

A. We attempt to do that. I think part of the problem is that there are 612 public school districts in the state of New Jersey, each one autonomous unto itself, to a degree, and they are the people that place the youngsters in private schools. So that supervisor of child study reviews that application, generally has put an hour's time limit on travel as a maximum that the handicapped youngster should travel in the State of New Jersey at this particular point in time. So, we've got an hour radius as it relates to that.

Q. Even an hour each way, two hours on the road for a handicapped child seems pretty excessive, doesn't it?

A. Yes, it is.

Q. And can't that problem be looked at and corrected?

A. We are attempting to do that as it relates to building five regional day schools in the State of New Jersey to handle the severe population. That, of course, has not gotten under way as we had planned it would.

We are now in the process of reassessing all of the regions in the state as it relates to determining appropriate sites and building.

The Commission sought more details on the critical problem of auditing the non-public schools:

EXAMINATION BY COMMISSIONER KADEN:

Q. I think Mr. Siavage asked you what kind of auditing staff you would need to do a proper job with these schools. I'm not sure I got the answer.

A. I said, a minimum of three. If we are talking about program people in addition, it would probably be a larger staff. I now, as I indicated, send my own staff out as it relates to looking at the private sector as they look at the public sector.

Q. Did the department include in its budget request for the next year any increased auditing capacity?

A. I included positions in my budget. I can't say

to you whether or not that passed on to the Commissioners.

Q. Perhaps it would be in order, even before this Commission proceeds to any formal recommendations, to suggest that you go back and talk to the Commissioner and see if he might be willing to look at that issue and communicate some request to the Treasurer before the executive budget is submitted.

Have you ever evaluated the alternative of using outside auditors as a substitute for creating an auditing staff in the department?

A. To the extent that we are using the Association for Schools and Agencies as it relates to our dual capacity looking at the private sector, we use public school people. Sometimes business managers from a public school will go out with us to look at the private sector. So, we have tried to involve people in that way as it relates to the evaluation process.

Q. It might also be worth evaluating both the cost and effectiveness of conducting more thorough-going audits with outside auditors as opposed to developing a staff in the Education Department. I suspect you share with us the sense that to the detriment of all those dedicated people who are running good schools if you have even one school where 30 or \$40,000 or more is being diverted to personal use--

A. That's correct.

Q. --out of Special Education funds.

Profiteering on the Handicapped

The Commission recalled testimony earlier in the day by Mrs. Farrell of the Manor Woods Academy.

EXAMINATION BY MR. SIAVAGE:

Q. Mr. Richardson, we heard some testimony this morning from a school in South Jersey that it was essentially receiving \$5,300 per student on the educational end and then was having the students educated in public school districts for approximately \$3,300 payment from that school to a public school district. Essentially, it was making what the Commission might feel was a profit of \$2,000. Now, the witness explained that that \$2,000 was not, in effect, profit because the child's educational experience continued when the child reentered the residential school, because it was a residential school, and that they were helped with their homework or put in an educational environment after they got back from the public school.

Are you aware of that kind of situation existing in the system?

A. In that particular instance, a year ago I approved one youngster to go out to the public school as it relates to a transition program so that the youngster could then return to his home and receive an educational program. The only other experimental program, so to speak, is one I have approved with the Glen Kirk

School where we have a transition program where the private school children are actually in a public school program and receiving services.

Q. With regard to Manor Woods, I think the witness did say you approved it. It was as a pilot project for a reentry program.

A. That's correct.

Q. And you have no knowledge, I guess, till shortly before today, or today, that that program has mushroomed to be approximately eight or--

A. None whatsoever, no.

THE CONCLUDING STATEMENT

Chairman Rodríguez summed up the public hearing testimony and indicated the thrust of the Commission's subsequent recommendations for corrective action:

THE CHAIRMAN: There being no further witnesses, I would like at this time to make a statement on behalf of the Commission.

In these public hearings there has been demonstrated the greed of a few non-public school operators who have profited personally at the expense of handicapped children. There also has demonstrated critical deficiencies in the statutory and administrative system for the monitoring of the \$26 million program of Special Education that is to serve these unfortunate children.

We will submit to the Governor and the Legislature soon our recommendations for a strengthened system.

Let me first restate on behalf of the Commission what was emphasized at the start of this public forum.

Our inquiry concerns both a gross misuse of the Special Education program by certain private schools and the statutory and administrative deficiencies of the program's funding system. This system serves more than 5,000 children who are suffering from one or more of such serious mental and physical handicaps that they are unable to attend the public schools. Most of these children are enrolled in New Jersey's 125 private day schools and 25 private residential schools. Local school districts pay the tuition rates -- partially funded by the state -- ranging from \$3,500 to \$6,800, according to about a dozen handicap categories.

The necessity for this program is undisputed, as attested by its strong public financial and philosophical backing.

These hearings have exposed examples of a callous abuse of the system by some private schools and have demonstrated the inadequacy of the law and rules by which the system is administered. These administrative weaknesses also were illustrated by certain questionable practices by some entrepreneurs that further threatened the reputation of the entire system as well as the dedicated and continuous public endorsement upon which the success of the program depends.

The range of misdeeds actual and apparent, as revealed by witnesses at this public forum, reflected an appalling high-handed disregard by some for the personal as well as educational well-being of handicapped children in a minority of private schools. The outright improprieties and the questionable practices and procedures were depressingly wide-ranging -- despite the relatively small sampling of such activities:

•The administrator of the Calais School utilized tax funds allocated to his non-public facility to roll up more than \$40,000 in personal non-educational payouts in a two-year period. These included a \$750 "gift" to his brother-in-law, a trip to Las Vegas, the acquisition of expensive paintings and sculptures disguised as "books and supplies," excessive pensions and insurance coverage for himself and his wife, and a multitude of tax-exempted personal purchases with school checks of such items as a stereo

system, books and magazines, lawn equipment, swimming pool chemicals, cameras -- even tennis balls and sneakers.

•A former teacher at the above school testified that the son of the administrator and his wife (each of whom is drawing \$30,000 in annual salaries) was at \$13,000 a year the highest paid member of the school's teaching staff, was not certified and showed up at the school only in the afternoon twice a week.

•The business manager of the Lincoln School admitted she and her associate journeyed to Florida each year at the school's expense in a \$4,000 van paid for out of public funds allocated to the school. In addition, she confirmed payment by the school of a \$7,000 addition to her home.

•The administrative associate of the above witness confirmed the employment by the school of a person who served chiefly as her personal valet.

•A former Lincoln School employee confirmed she handled most of the managerial duties, at a salary of \$15,000, that were the stated responsibility of the two previous witnesses, who received \$36,000 yearly compensation each.

•A car salesman testified that the Lincoln School operators purchased a five-passenger van, with luxury accessories, which was unsuited for the hauling and business purposes for which the operators said they bought the vehicle.

•The executive director of Manor Woods Academy was depicted as using school funds to acquire and expand real estate holdings, at a substantial personal profit, that appeared to have little or no relationship to her publicly funded private school.

•The executive director of Somerset Hills School told how the school's operating corporation leases the school's land and building from another corporation, with the same ownership -- illustrating a self-dealing procedure that calls for examination in depth.

•Officials of the highly respected Association of Schools and Agencies for the Handicapped (ASAH), both of whom operate outstanding non-public facilities, have stated that only 20-25 schools qualified for

membership because of that association's strict accounting requirements and that that association's efforts to improve the Special Education funding system were unsuccessful.

Testimony was recorded on the difficulty of persuading agencies with related responsibilities to compile and adopt uniform procedural guidelines, on the lack of manpower with which to manage and watchdog the system, and other problems that beset program administrators within the State Education Department.

The diversion of public monies to personal or non-educational uses, where admitted, is a serious abuse in the system and an indictment of the law that provides inadequate means to guarantee compliance.

The hearings confirmed that there is ample opportunity for present and prospective operators who desire only to gain a fair and reasonable return from private facilities that fill a critical void in the public school system. Therefore we believe we can face the problem of proposing stringent reforms -- such as making auditing requirements more strict, accountability more effective, monitoring more frequent and alert and staffing more capable and adequate -- without undue concern that any reduction of educational opportunity will be the result.

In fact, even more than aggressive and expeditious legislative and regulatory reforms is warranted.

Those who have flagrantly profited by the diversion of funds to personal acquisitions and activities unrelated to the education of handicapped children, should -- through criminal or civil action, or both -- be forced to disgorge themselves of all such profits.

The S.C.I. intends as is its practice to cooperate fully with all law enforcement, prosecutorial and other governmental agencies by a full and continuous referral and disclosure of its findings to them for appropriate action.

We will suggest that the Attorney General consider filing civil suits against the individual beneficiaries of "unjust enrichment" from

Special Education abuses, as narrated at these proceedings, as well as criminal action when justified, or both.

The Commission, as I have indicated, intends to prepare as soon as possible a detailed report of its findings to date -- even as our investigation continues into other facets of the Special Education program.

The problem is as complex as it is heart-rending. But what stands out starkly as we end these hearings is the undisputed conclusion that the Special Education program for handicapped children isn't working the way it can and should, that some children are being shortchanged, that some public funds are being wasted because money's going into private pockets instead of educational programs. We intend to report to the Governor and the Legislature our detailed, recommendations on these problems.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions and Recommendations

TABLE OF CONTENTS

	Page
I. INTRODUCTION.....	184
A. Background.....	184
B. Cost Accounting/Rate Establishment.....	185
C. Implementing Methodology.....	186
II. ADMINISTRATIVE RESPONSIBILITIES.....	187
A. Background.....	187
B. Recommendation	187
C. Comment.....	188
III. ALLOWABLE AND NON-ALLOWABLE COSTS.....	189
A. Background.....	189
B. Recommendations.....	189
1. Salaries to Owners/Family.....	189
2. Expenses/Offices Not on School Site..	190
3. Entertainment Costs.....	191
4. Carrying Costs/Lands, Buildings.....	191
5. Interest Charges/Borrowed Capital....	192
6. Research and Development Costs.....	192
7. Fund Raising Expenses.....	193
8. Dividends and Losses.....	193
9. Investment Expenses.....	193
10. Legal and Legislative Expenses.....	194
11. Contributions, Fines, Etc.....	194
12. Bad Debts.....	194

	Page
13. Capital Expenditures.....	194
14. Medical Expenses.....	195
15. Donated Goods/Services.....	195
16. Transfer to Reserve/Contingency Accts.	195
17. Intangible Costs.....	196
C. Comment.....	196
IV. REPORTING REQUIREMENTS.....	197
A. Background.....	197
B. Recommendations.....	197
1. Expense Budget/Cost Report.....	198
2. Salary Component Function Report.....	199
3. Depreciation Costs Limited.....	200
4. Floor/Land Space Report Required.....	200
5. Program "Change Reports" Requirement.	201
C. Comment.....	202
V. RATE SETTING.....	204
A. Background.....	204
B. Recommendations.....	206
1. Timing.....	206
2. Change Reports.....	207
3. Adjustments in Succeeding Years.....	207
4. Reasonableness.....	207
5. Implementation.....	209
C. Comment.....	209
EXHIBIT "A".....	211

CONCLUSIONS AND RECOMMENDATIONS

I. INTRODUCTION

A. Background

New Jersey's system of non-public education for handicapped children is addressed by law under N.J.S.A. 46:18A-1 et seq. and N.J.A.C. 6:28-1.1 et seq. Additionally, where the setting is both residential and educational, N.J.S.A. 30:4C-1 et seq. and N.J.A.C. 10:127-1.1 et seq. are applicable. Finally, state programs in the area of special education are also substantially affected at the federal level by 20 U.S.C., §1401 et seq., commonly known as "Public Law 94-142".

The Commission's public hearings disclosed obvious areas of reform, including the staffing and functioning of the Branch of Special Education and Pupil Personnel Services (hereinafter referred to as BSEPPS), the specific description of allowable and non-allowable private school expenses, the record-keeping and reporting requirements of participating schools, and the procedures for rate setting.

As with all such complex areas, the Commission approached the recommendation phase of this report mindful that cost savings are not the only concern. Because certain operators are able to exploit a system's inadequate reporting requirements, it does not necessarily

suggest that rates are exorbitant. Equally supportable is the conclusion that state and local funds which are barely adequate are being partially diverted to the personal benefit of certain operators. Thus, the S.C.I.'s recommendations emphasize both cost consciousness and cost effectiveness.

B. Cost Accounting and Rate Establishment

In exploring existing and proposed special education systems in other states, the Commission learned that Connecticut is implementing a program known as the Cost Accounting and Rate Establishment System (CARES). This system was developed pursuant to Special Act 77-90 of the Connecticut General Assembly. The recommendations of the Commission on cost reporting and rate establishment are based upon CARES' plan, with modifications stemming from the S.C.I. staff's familiarity with similar systems of reimbursement in the health care field.*

The advantage of CARES is that it computes the cost components of each service provided for the benefit of each distinct handicap classification. Thus, the system both monitors cost and serves as a ready reference for the monitoring agency of instances where insufficient allocations are being made. Addi-

*See Exhibit "A", Page 211.

tionally, since the system accurately pinpoints amounts expended on each classification, it becomes an excellent basis for enlightened rate setting. Finally, institutions operating under this system will be apprised of the definitions of allowable costs as against non-allowable costs so that uniformity will be established and the possibility of fraud reduced.

C. Implementing Methodology

A recurring issue with regard to recommendations such as those proposed in this report is whether legislative change or administrative alteration is the most appropriate avenue. Because neither laws nor regulations exist in most of the areas which the Commission addresses, it is the S.C.I.'s considered judgment that most of its recommendations should be implemented through the clear mandate of legislative change, specifically by means of amendments to N.J.S.A. 18A:46-1 et seq.

II. ADMINISTRATIVE RESPONSIBILITY

A. Background

The Commission's inquiry disclosed a critical lack of resources within the Department of Education for monitoring the public funds utilized in reimbursing non-public institutions authorized to educate handicapped students.* Additionally, where children were housed and educated in the same facility, a marked overlap of authority was revealed between the Division of Youth and Family Services in the Department of Human Services and BSEPPS. This situation, aided by a lack of interdepartmental communication, has had detrimental results for the State, especially with regard to inappropriate allocation of costs and services.

B. Recommendation

The Commission recommends the creation -- by statute -- of a bureau within the Department of Education with responsibility for overseeing the reimbursement of non-public educational institutions for the handicapped. This bureau should have day, residential and summer programs under its supervision. It should function under an administrative head with a staff of at least five auditors (who will be responsible

* Since the Commission's public hearings, the Legislature and the Governor added funds to the Department's budget for additional personnel.

for fiscal control and rate setting). The bureau should have the potential for expansion into areas such as program analysis and control. It is suggested that an Article 8 be added to Chapter 46 of the New Jersey Statutes to create the new bureau and to prescribe for it certain powers and procedures as specified below.

C. Comment

The new bureau should have the capability -- either internally, by contract, or through another state agency -- to evaluate the building and grounds of non-public schools with particular regard to the space necessary for (and superfluous to) appropriate programs.

Under a new system of reporting and rate-setting, the entire staff should be occupied in reviewing forms, reports, accounts and other submissions by the institutions for appropriateness of filing and for mathematical accuracy. Thereafter, the rate-setting process would be a simple matter of computation (as explained hereinafter). The entire process of review and rate-setting should not occupy more than four to six weeks of staff time, permitting the balance of the work year to be allotted to field auditing.

III. ALLOWABLE AND NON-ALLOWABLE COSTS

A. Background

The public hearings held by the Commission depicted expenditures by some non-public schools for purposes which were considered to be extremely improper. Several operators, however, complained that there was little direction supplied by the Department of Education regarding the validity of expenditures. The Commission emphasizes that it regards most of the practices examined in the hearings to be highly inappropriate -- by any standard -- and it urges the adoption of strict guidelines concerning allowable and non-allowable costs.

B. Recommendations

The following costs should be considered non-allowable:

1. Salaries to Owners and Members of Their Families.

Individuals who directly or indirectly control the board of directors, board of trustees or other decision-making body of an educational institution should not be eligible to receive a reimbursable salary as an employee of the school.

Explanation: One of the abuses illustrated in the Commission's public hearings was the ability of ownership interests to receive additional profit through exorbitant salaries. There was no check on the unfettered power to set and receive these salaries because the recipients also controlled the decision-making body. The Commission's recommendation, although it requires owners to make a decision between being policy makers versus program administrators, establishes a basis for appropriate monitoring. It is not suggested that an individual with a controlling ownership interest must avoid sitting on the board of directors if he or she is also a salaried employee. What should be prohibited is the control of the board of directors in combination with the holding of a salaried position.

2. Expenses for Offices Not Located on School Grounds.

The main educational institution should provide sufficient office space for administration. The maintenance of offices in homes or in other locations separated from the main facilities of an institution should not be a reimbursable expense.

Explanation: It is the Commission's view that requiring all teaching and administrative staff to be located on the grounds will reduce the opportunity for personal expenditures unrelated to the school's operation.

3. Entertainment Costs.

All costs for social activities or amusements and related incidental costs should be disallowed unless they are proven to be part of the regular educational program.

4. Carrying Costs for Land and Building.

If the operating entity also owns the land and building, or is a lessee in the normal course of business, or is a lessee in a sale and leaseback arrangement, or is a lessee from a related entity, the allowable rental or carrying charges should not exceed the normal costs of ownership, such as allowable mortgage interest, depreciation, taxes, insurance and maintenance.

Explanation: One of the serious questions raised by the Commission at its public hearings was the ability of certain operators to use rental costs as a means of creating an increased profit.

The above recommendation will prevent profiteering through leases by allowing costs only for actual carrying charges or leases which do not exceed actual carrying charges. Additionally, in order to prevent overmortgaging or leases which are increased in anticipation of the new statute, there should be added a provision which gives the Department of Education authority and responsibility to review and approve all reimbursable mortgages or leases executed.

5. Interest Charges on Borrowed Capital and
Installment Purchases Other than Mortgage
Loans on Fixed Assets.

The S.C.I. recommends that interest payments on loans and installment purchases be allowed only up to two points above the prime interest rate on the date of the loan. Any interest cost exceeding this limitation would not be allowable. Interest costs for mortgage loans upon fixed assets would be controlled as described in #4 above.

6. Research and Development Costs.

Research and development costs should be allowable only to the extent that they improve existing special education programs. The Commission recommends that research and development costs

for new programs should not be allowed. Additionally, if the research and development programs involve travel, the reporting system should clearly state the nature of the trip, who participated in it and how and why it related to any allowable research and development.

Explanation: It was clear from the Commission inquiry that abuses existed concerning travel which bore no relationship to any special education program and, in one case, a payment to a relative ostensibly for research and development. The Commission's recommendation would prevent abuses in this area.

7. Fund Raising Expenses.

The Commission recommends that fund raising expenses be classified as not allowable.

8. Dividends and Losses.

Dividends paid to shareholders and losses on the sale of capital assets should not be allowed as costs.

9. Investment Expenses.

Costs incurred by a facility in conjunction with an investment program and the losses on the sales of such investments also should not be allowed.

10. Legal Expenses and Legislative Expenses.

Costs incurred for lobbying activities and legal expenses other than for general consultation should not be allowable. However, legal expenses paid on a retainer basis at a reasonable level for consultation can be an allowable cost.

11. Contributions, Donations, Awards, Scholarships, Fines and Penalties.

It is recommended that all of the above items be listed among non-allowable costs.

12. Bad Debts.

Any uncollectible accounts should be non-allowable.

Explanation: The Commission hearings disclosed a cost reimbursement by one institution for the repayment of a loan. Such an item should be considered non-allowable, and would be so considered because of generally accepted accounting principles.

13. Capital Expenditures.

The Commission recommends that capital expenditures in excess of \$100, which increase the useful life of the asset, should be non-allowable, except in the calculation of future depreciation of the asset in question.

Explanation: The Commission's public hearings exhibited a marked degree of confusion by one operator concerning the definition of a capital expenditure. The Commission's examination also illustrated that this operator had, on several occasions, sought reimbursement for costs which could only be characterized as capital expenditures. Although departmental regulations already prohibit reimbursement for capital expenditures, the new reporting system and auditing capability should produce sufficient safeguards to prevent inappropriate costing of capital expenditures.

14. Medical Expenses.

Medical expenses should be allowable only to the extent that a physician acts in a advisory capacity to the school or conducts diagnoses of students for the purposes of developing educational programs.

15. Donated Goods and Services.

Recommended, that the imputed value of donated goods and services be non-allowable.

16. Transfers of Amounts of Funds to Reserve
or Contingency Accounts.

Recommended, that any funding of accounts which
make provision for contingencies be non allowable.

17. Intangible Costs.

Recommended, that all intangible costs are non-allowable.

18. Non-Current Costs.

All expenses which were incurred during a prior period or those prepaid expenses which will be applied to a subsequent period should not be allowed on the current report. They should be appropriately charged in the period in which they accrue.

C. Comment

A listing of non-allowable expenses, as above, implemented through specific statutory language in the new Article 8 of Title 46, would set standards for the industry and establish clear guidelines as to what is or is not appropriate. These guidelines should be enacted as soon as possible. Implementation can take place quickly since the cited non-allowable costs can be mandated prior to the enactment of the overall statutory program recommended by the Commission.

IV. REPORTING REQUIREMENTS

A. Background

Audits conducted by Commission staff, as well as examination and analysis of present financial reporting instructions and forms of BSEPPS, illustrated many deficiencies in informational requirements. Apparently, a lack of adequate and accurate information was caused by numerous factors -- from ambiguity in instructions to outright manipulation of the records by the operators. Lack of comprehensive directions for the financial operation of a private facility has allowed many schools to exist with chaotic accounting records.

Adequate direction and instruction by the proposed bureau, together with cooperation and compliance by the private school, should produce uniformity in the records and reduce any confusion on the part of administrators as to their minimum accounting responsibilities.

B. Recommendations

In general, reports should provide the bureau with sufficient information upon which to make a determination of a fair tuition rate. The rate should be based on reasonable costs budgeted by the school, with subsequent adjustments when accrued expenses vary beyond an acceptable limit above or below budget. The Commission recommends:

1. Expense Budget Summary and Actual Cost Report.

Both of these reports, one prepared as a budget forecast and the other as a recap of expenses, should provide on an accrual basis, by function, all costs of the school. The format requested should be a reasonably detailed itemization of expense categories. Total expenses must be reported and subsequently apportioned according to definitions of allowable and non-allowable costs. Allowable costs should then be further divided among programs: Residential cost if applicable, other programs and services, and educational. Educational costs should be further subdivided and reported for each handicap classification.

A subsidiary report should be required which reconciles the projection of expenses with actual disbursements. An additional subsidiary report, should be prepared and maintained by the school which reconciles accrued expenses reported and total disbursements. (These reports would provide the "starting point" for audits conducted to determine the level of internal control and corresponding ability to rely on the reports filed and the underlying accounting records as well.)

2. A Report Supporting by Function the Salary Component of The Above Described Report Should Be Required.

If the school had a summer session program, two salary reports would be necessary. Salary costs would be considered on an individual basis. If salary apportionment were to be used as the basis for distribution of general and administrative expenses, as in the CARES model, donated services should be recognized under specific circumstances. The facility would not be compensated, in any way, for donated services. These would only be used in establishing "overhead cost" apportionment factors.

For each session, regular or summer, salaries should be apportioned on an individual basis to the required general expense report. Thus, each employee's total salary would be listed and then apportioned between allowable and non-allowable. The allowable salaries, based once again on clear definitions, would be further divided as to room and board, other programs and services, and special education total. The last program, the "educational component", would be allocated among each of the individual handicap categories.

A school would have to devise a time-card work schedule to be used as the basis of the information entered on its report.

3. Depreciation Costs Should be Clearly Detailed in a Work-Paper Report Which Supports the Cost Reported in Both Expense Budget and the Actual Cost Report.

Assets having a useful life in excess of one year and costing over \$100 should be capitalized and depreciated. A uniformly established depreciation policy, set by the State, not only will allow comparability among schools for reasonableness determinations but also, on an individual basis, will reduce capital acquisition costs that cause fluctuations in "operating expenses" and distort the true financial experience.

4. For The Purpose of Certain Expense Allocations, a Reporting Schedule of Floor Space and Land Should be Required.

This first would show the allocation on a program basis: room and board, other programs and services, and special education. The special education component subsequently would be sub-divided by handicap classification served.

5. Certain Program Reporting Information
Should be Required, Including Estimated
and Actual Enrollment Information.

Material changes in program or enrollment should be reported at the time they take effect. Such "change reports" should be due within 30 days. The nature of the requirements of program reporting would be essential statistical information for determining a reasonable tuition rate.

It may be advisable to include in the program reporting requirements a narrative explanation and justification for material changes.

Since the fiscal year for tuition rate determination is July 1 - June 30, reports should be due as follows:

- | | |
|-----------|--|
| May 1 | Projected budget for subsequent year (starting July 1) |
| August 31 | Actual cost report for immediately preceding year ending June 30) |
| August 31 | Reconciliation of the accompanying Actual Cost Report with the <u>prior year's</u> corresponding projected budget. |

A complex reporting system generally lends itself to implementation through administrative regulation rather than through legislation. The Commission is of the opinion, however, that a clear indication of legislation preference can be established by statute through a section dealing with reporting requirements. The statutory language need not describe the system in minute detail. It should contain, however, the vital aspects of the CARES system. Such a legislative provision could be a portion of the new statutory chapter setting up the new bureau. The program should be implemented by the 1979-80 scholastic year.

C. Comment

The reporting requirements suggested by the S.C.I. closely parallel those of the CARES system. The two major strengths of the CARES reporting system are:

- . The compilation of financial information which will supply an accurate cost for each service supplied by each school, and
- . A uniformity of reported information which will provide a basis for auditing, cost comparison and rate monitoring.

It should become immediately apparent to the new bureau when any institution is expending inordinate amounts on any cost component. Furthermore, any prospective savings that should also become apparent because of increased efficiency could then be utilized as an example of similar cost savings throughout the system.

For exemplification purposes, a suggested master form for cost filing is attached hereto as Exhibit "A".* Reference to Exhibit "A" illustrates the allocation of each cost component to the nature of the service provided. Subsidiary forms would supply a further breakdown within certain classifications appearing in Exhibit "A".

It should become clear to the school that:

- . Prior years expenses cannot be paid with current tuition revenue.
- . Capital expenses must be depreciated
- . Excess revenue, beyond a prescribed limit, cannot be retained by the school.

*See Exhibit "A", Page 211.

V. RATE SETTING

A. Background

For the years 1976-77 and 1977-78, tuition rates for private schools were set by the BSEPPS, predicated upon an outline of estimated expenses. A maximum rate was established annually based upon the 85th percentile of costs of handicap classification in public schools providing those services. The timing and availability of information was such that most non-public schools eligible to receive children requested and received the maximum rate.

Since the placement of a public school pupil in a private school is generally a last resort action, the Commission observed that in many cases the pupils placed are the most difficult cases. It follows that the necessary costs incurred by the private school, therefore, are at the upper end of the cost spectrum. The objective of setting maximum tuition rates based on handicap classification is predicated upon the assumption that uniform or similar costs will be incurred in like handicap category by other non-public schools as well as the public schools. This is often not the case. In addition to the reason described above, it became obvious that the special programs, commonly known as individual educational plans, provided for special education pupils vary due to

the severity of the handicap.

For example, according to the N.J. Administrative Code, the classification "emotionally disturbed" includes within it "all children whose behavior can be characterized by a pattern of functioning which is so inappropriate as to call attention to itself and which severely limits the individual from profiting from regular classroom learning experiences or severely hinders other pupils in the class from profiting from regular classroom experiences." Also, emotional disturbance "is characterized by a pattern of expression of emotion inappropriate to the situation in a manner of degree and quality."

In two of the private schools examined by the Commission, the entire enrollment was made up of pupils classified as emotionally disturbed. The programs provided and resultant costs incurred, however, were widely divergent. In one school, which also happened to be a residential facility, most of the pupils were of a type some might describe as incorrigible. However, several of the students were able to live with little direct supervision and were capable of attending a local public school. In the other school, all children were autistic and in need of -- and receiving -- an extensive program of education and training on a nearly individual basis. The services provided by the schools were not similar and the costs incurred were not similar -- yet both schools received exactly the same tuition rate.

Since rate setting has been based on cost projections -- and despite the fact that actual cost reports have been required -- there is no mechanism which prevents a private school from requesting and receiving tuition revenue in excess of reasonable costs. Further, there is no mechanism for a sending district or the State to recover excess tuition revenue based on the schools change in program or the actual cost report.

B. Recommendations

Tuition rates for each private school should be set annually, based on the reports required, as described in Section IV, The objective basis of these reports is the reasonable costs projected, adjusted for actual costs expended by the school, in order to provide the necessary program. Once a total reasonable cost per day is determined for each private school, based on the appropriate report, the rate will be presented to the local sending districts in such a manner as to identify the cost components which, in the aggregate, comprise the per diem rate. In addition:

1. Timing.

The proposed budgets, submitted by May 1 for the subsequent year, should be reviewed by BSEPPS and should provide the basis for a rate. Rates should be set by June 15. The schools should have the right to appeal.

2. Change Reports.

Rates set at the beginning of the school year should be flexible, at least to the extent of major changes in the program being provided. If a change report, received during the year by BSEPPS, materially changes the program, and accordingly the reasonable costs, in excess of an acceptable percentage limit such as 10 percent, BSEPPS should recalculate the tuition rate and notify the sending districts of the change.

3. Adjustments in Succeeding Years.

Actual cost reports filed at the end of the year should provide the basis for recalculation of that year's rate. If per diem revenue exceeds actual costs, that excess should be offset in the rate set for the coming year. If the amount is relatively small, the adjustment can be waived at the discretion of the Director of BSEPPS. But the school must fund the excess and account for it. This does not include donated funds and their effect on surplus.

4. Reasonableness.

Although rates will be set based on budgets and actual cost reports submitted, BSEPPS should make an attempt to determine the reasonableness of the private school's request. A program for making this determination should

include a comparison among cost component categories of schools providing similar services.

For example, all schools which provide a program for communication handicapped pupils should be compared on the basis of the cost components of each such school. If the costs of services are grouped in a dollar amount, further examination may not be necessary. But if the cost of one school exceeds an acceptable percentage (perhaps 15 percent) of the median cost for schools providing similar services, further justification may be necessary or the excess should be eliminated as unreasonable. Such a disallowed excess would not be included in the tuition rate.

An examination of the actual cost report would insure that any sum eliminated in this way was not expended by a school to the detriment of some other approved cost component.

Activity such as that would cause a reduction in the subsequent year's rate, since it would be treated in the same way as tuition revenue in excess of allowable (reasonable) cost.

The rate would be delimited by services provided. A significant decline in expenditures in individual cost component groups would cause a reduction in tuition.

5. Implementation.

With regard to the implementation of this system, the Commission is again of the opinion that general direction should be mandated through legislation and specific requirements should be added through regulation. The required legislation should be a part of the same package of provisions for structuring the new bureau.

C. Comment

The objective of the recommendations on rate setting is to support essential programs and services by setting a tuition rate which will reimburse the private school for reasonable costs.

Rate setting by BSEPPS will be done prospectively and will include an analysis of the cost of programs and services provided. Costs may be questioned by BSEPPS if they appear to be out of line with costs at other facilities, and, if unjustified, will be eliminated. Generally, however, all reasonable costs will be included in an approved tuition rate.

Rates will no longer be "cast in stone." Not only will substantive changes in programming during the year cause a review of the rate, but also the actual cost report will provide the basis of a recalculated rate. This revised rate, with certain exceptions, will be reflected in the subsequent year's tuition.

It will be necessary to make other provisions in the event a school goes out of business, such as returning excess funds to the original sending school districts.

The system should insure that a sending district receives, for each child, the services for which it is paying. Further, the rate, based on fair and reasonable costs, should insure the availability and provision of continuing quality programs.

It should be apparent to a sending district and its child study team which actual services are being delivered and the precise cost thereof. This is necessary because one objective of the child study team is to place the pupil in a facility providing appropriate services. The child study teams will then be in a position to make comparisons of the rates among schools providing similar services. The rate will reflect the services provided and the market will limit the rate. In general, it is the Commission's recommendation that components of the rate should include cost component categories as set forth in the projected budget and actual cost reports. For those private schools which are incorporated for profit, the amount of profit requested and allowed should be set forth as a separate component of the rate.

EXHIBIT "A"

(A SAMPLE WORKSHEET)

INSTRUCTIONS FOR WORKSHEET A - SUMMARY EXPENSE REPORT (See Following 6 Pages):

Worksheet A is the summary report of a facility's total operating expenses, allocated (per the manual guidelines, instructions and other supporting worksheets) to the facility's functions, programs and special education program categories.

Column Headings:

Column A - Functional Expenses: Represents the grouping of operating expenses into the functions normally performed by private facilities providing special education services.

Column B - Total Operating Expenses: Includes all operating expenses for the fiscal year as reported on the facility's books of account.

Column C - Unallowable Expenses: Includes certain expenses or portions of expenses reported in Column B that are unallowable for reimbursement.

Column D - Allowable Operating Expenses: Represents facility expenses that are allowable for reimbursement.

Column E - Program: That portion of allowable operating expenses for any functional expense which has been incurred directly or indirectly in the operation of programs indicated in Columns F, G, and H described below.

Column F - Room and Board Program: That portion of allowable operating expenses incurred in providing room and board services to residential students.

Column G - Other Programs and Services: That portion of allowable operating expense not properly allocable to the room and board and special education programs in Column F and Column H below.

Column H - Special Education Program: Column H-1 represents that portion of allowable operating expense incurred in the provision of special education services.

Columns H-2 through H-13 represents categories of Special Education programs required by statute and by regulations of the State Department of Education.

Column

Special Education

H2	RD	Emotionally Disturbed
H3	NI	Neurologically Impaired
H4	EMR	Educable Mentally Retarded
H5	SM	Socially Maladjusted
H6	PI	Perceptually Impaired
H7	AH	Auditorially Handicapped
H8	OH	Orthopedically Handicapped
H9	VH	Visually Handicapped
H10	TMR	Trainable Mentally Retarded
H11	CI	Chronically Ill
H12	CH	Communication Handicapped
H13	MH	Mulitple Handicapped

END