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**New York State Office of the State Comptroller**  
Thomas P. DiNapoli

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Division of State Government Accountability

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# **Compliance With the Reimbursable Cost Manual**

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**State Education Department  
The Arc of Orange County**

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Report 2015-S-45

March 2016

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# Executive Summary

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## Purpose

To determine whether the costs reported by The Arc of Orange County (Arc Orange) on its Consolidated Fiscal Reports (CFRs) were properly calculated, adequately documented, and allowable under the State Education Department's (SED) guidelines, including the Reimbursable Cost Manual (RCM). We audited costs that Arc Orange reported on its CFR for the year ended December 31, 2013. In addition, we expanded our audit work to review certain costs that Arc Orange reported on its CFR for the year ended December 31, 2012.

## Background

Arc Orange is an SED-approved, not-for-profit special education provider located in Orange County, New York. Arc Orange provides preschool special education services to children with disabilities who are between the ages of three and five years. Arc Orange is reimbursed for preschool special education services through rates set by SED. The reimbursement rates are based on financial information, including costs, that Arc Orange reports to SED on its annual CFR. To be eligible for reimbursement, reported costs must comply with RCM requirements. For the calendar year ended December 31, 2013, Arc Orange reported over \$5.5 million in reimbursable costs on its CFR for four rate-based preschool special education programs (Programs).

## Key Findings

For the two years ended December 31, 2013, we identified \$94,969 in ineligible costs that Arc Orange reported on its CFRs for the Programs. The ineligible costs included:

- \$70,950 in personal service costs, which consisted of \$69,310 in severance pay and \$1,640 for staff service awards; and
- \$24,019 in other than personal service costs, which consisted of \$18,606 in costs that were not related to the Programs, \$3,474 in food, \$1,206 in gifts, \$437 in retainer fees, and \$296 in other non-reimbursable costs.

## Key Recommendations

### To SED:

- Review the disallowances identified by our audit and make the necessary adjustments to the costs reported on Arc Orange's CFRs and to Arc Orange's tuition reimbursement rates, as appropriate.
- Remind Arc Orange officials of the pertinent SED guidelines that relate to the deficiencies we identified.

### To Arc Orange:

- Ensure that costs reported on annual CFRs fully comply with SED's requirements, and communicate with SED to obtain clarification as needed.

## **Other Related Audits/Reports of Interest**

[Rivendell School: Compliance With the Reimbursable Cost Manual \(2015-S-25\)](#)

[Starting Point Services for Children: Compliance With the Reimbursable Cost Manual \(2014-S-64\)](#)

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**State of New York  
Office of the State Comptroller**

**Division of State Government Accountability**

March 17, 2016

Ms. MaryEllen Elia  
Commissioner  
State Education Department  
State Education Building  
89 Washington Avenue  
Albany, NY 12234

Mr. Christopher Fortune  
Executive Director  
The Arc of Orange County  
249 Broadway  
Newburgh, NY 12550

Dear Ms. Elia and Mr. Fortune:

The Office of the State Comptroller is committed to helping State agencies, public authorities, and local government agencies manage government resources efficiently and effectively and, by so doing, providing accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of State agencies, public authorities, and local government agencies, as well as their compliance with relevant statutes and their observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations. Audits can also identify strategies for reducing costs and strengthening controls that are intended to safeguard assets.

Following is a report of our audit of the expenses submitted by The Arc of Orange County to the State Education Department for the purpose of establishing the preschool special education tuition reimbursement rates used to bill public funding sources that are supported by State aid payments entitled *Compliance With the Reimbursable Cost Manual*. This audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution; Article II, Section 8 of the State Finance Law; and Section 4410-c of the State Education Law.

This audit's results and recommendations are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. If you have any questions about this report, please feel free to contact us.

Respectfully submitted,

*Office of the State Comptroller  
Division of State Government Accountability*

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 Division of State Government Accountability  
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This report is also available on our website at: [www.osc.state.ny.us](http://www.osc.state.ny.us)

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## Background

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The Arc of Orange County (Arc Orange) is a not-for-profit organization that provides a range of community-based programs and special education services throughout Orange County, New York. Arc Orange is authorized by the State Education Department (SED) to provide, among other programs, preschool special education services to children with disabilities who are between the ages of three and five years. During our audit period, Arc Orange provided four rate-based preschool special education programs to 377 students. These rate-based programs included: Preschool Special Class – 2.5 hours per day; Preschool Special Class – over 2.5 hours per day; Preschool Integrated Special Class – 2.5 hours per day; and Preschool Special Education Itinerant Teacher services (collectively referred to as the Programs). Arc Orange is managed by an Executive Director, who is overseen by a board of directors.

The counties that use Arc Orange’s preschool special education services pay tuition to Arc Orange using reimbursement rates set by SED. The State, in turn, reimburses the counties 59.5 percent of the tuition that counties pay. SED sets the special education tuition rates based on financial information, including costs, reported by Arc Orange on its annual Consolidated Fiscal Reports (CFRs) that it submits to SED. Costs reported on the CFR must comply fully with the guidelines in SED’s Reimbursable Cost Manual (RCM) regarding the eligibility of costs and documentation requirements, and meet the reporting requirements prescribed in the Consolidated Fiscal Reporting and Claiming Manual (CFR Manual). For the year ended December 31, 2013, Arc Orange reported more than \$5.5 million in reimbursable costs for the Programs.

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## Audit Findings and Recommendations

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According to the RCM, costs reported on the CFR are considered for reimbursement if they are reasonable, necessary, directly related to the special education program, and adequately documented. For the two years ended December 31, 2013, we identified \$94,969 in costs reported by Arc Orange on its CFRs that did not comply with the RCM's requirements for reimbursement. The ineligible costs included \$70,950 in personal service costs and \$24,019 in other than personal service (OTPS) costs. Prior to our audit fieldwork, SED had made certain disallowances to some of the expense categories we identified. In addition, we determined Arc Orange did not maintain adequate documentation to support the allocation methodologies they used, as otherwise required by the RCM.

### Personal Service Costs

For the two years ended December 31, 2013, we identified \$70,950 in ineligible personal service costs that included \$69,310 in severance payments and \$1,640 in service awards to staff.

#### *Excessive Severance Pay*

Severance pay is compensation paid to employees whose services are being terminated. According to the RCM, severance pay is reimbursable provided the cost does not exceed two weeks' pay for a full-time employee. However, we identified \$69,310 in ineligible severance pay for one employee which Arc Orange claimed for reimbursement on its 2013 and 2012 CFRs. The severance pay was ineligible because it exceeded the two weeks of pay allowed by the RCM. The \$69,310 included \$55,448 that was reported on Arc Orange's 2013 CFR and \$13,862 that was reported on the 2012 CFR for the same employee.

#### *Bonus/Service Awards*

According to the RCM, a bonus is a non-recurring and non-accumulating (i.e., not included in base salary of subsequent years) lump sum payment in excess of regularly scheduled salary, which is not directly related to hours worked. Bonus compensation may be reimbursed if it is based on merit and supported by employee performance evaluations. However, we identified \$1,640 in ineligible costs for staff service awards that Arc Orange claimed for reimbursement on its 2013 CFR. The costs were ineligible because they were based on the employees' years of service with Arc Orange, and not based on employee evaluations, as required by the RCM.

### Other Than Personal Service Costs

For the calendar year ended December 31, 2013, we identified \$24,019 in ineligible OTPS costs that included \$18,606 in costs that were not related to the Programs and \$5,413 in food, gift cards, and other ineligible expenses.

### *Non-Program-Related Costs*

According to the RCM, costs should be charged directly to specific programs whenever possible. For the calendar year ended December 31, 2013, we identified \$18,606 in costs that were ineligible for reimbursement because they were not related to the Programs. The ineligible costs included \$17,720 for tuition paid on behalf of a non-preschool employee and \$886 in other non-Program-related costs for training, employee background checks, and medical supplies.

### *Other Ineligible Expenses*

According to the RCM, costs for food, gifts, and donations are not reimbursable. Also, costs associated with retainers for legal services are not reimbursable unless the fee represents payment for actual services rendered. For the calendar year ended December 31, 2013, we identified \$5,413 in costs that were ineligible for reimbursement because they were not in compliance with the RCM requirements. The ineligible costs included the following:

- \$3,474 for food and catering;
- \$1,206 in gift cards;
- \$437 for legal retainer fees for services that had not yet been provided; and
- \$296 in other non-reimbursable costs, including \$121 in donations and \$175 for attendance at charitable events.

## **Other Matter**

### *Allocation Methodology*

According to the RCM, special education providers are required to maintain documentation of the methodologies used to allocate costs to the various programs they operate. Allocation methods and the statistical basis used to calculate allocation percentages must be documented and retained for each fiscal year for a minimum of seven years.

We determined Arc Orange did not maintain adequate documentation to support the details of the percentages used to allocate certain costs to individual programs on its CFR. For example, Arc Orange allocated certain costs to the Programs using percentages based on the Programs' student enrollments. Although Arc Orange officials provided us with the allocation percentages that were used, they could not provide details on how they calculated those percentages. Officials indicated the percentage calculations were done by former staff, and they had not maintained documentation describing how the enrollment data was used in the calculations. As such, we could not readily determine if certain costs allocated to the individual programs were accurate. However, through our testing and observations, we concluded that the allocated costs reported on the CFRs were generally reasonable. In addition, Arc Orange officials informed us that, subsequent to our audit period, they took steps to ensure that detailed cost allocation information was documented and retained.



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## Recommendations

### To SED:

1. Review the disallowances identified by our audit and make the necessary adjustments to the costs reported on Arc Orange's CFRs and to Arc Orange's tuition reimbursement rates, as appropriate.
2. Remind Arc Orange officials of the pertinent SED guidelines that relate to the deficiencies we identified.

### To Arc Orange:

3. Ensure that costs reported on annual CFRs fully comply with SED's requirements, and communicate with SED to obtain clarification as needed.
4. Ensure allocation methodologies, including the statistical basis for allocation percentages, are sufficiently documented in accordance with the RCM and that such documentation is retained on file.

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## Audit Scope and Methodology

We audited costs that Arc Orange reported on its CFR for the year ended December 31, 2013. In addition, we expanded our audit work to review certain costs that Arc Orange reported on its CFR for the year ended December 31, 2012. The objective of our audit was to determine whether the reported costs were allowable, properly calculated, and adequately documented in accordance with applicable SED requirements.

To accomplish our objective and assess internal controls related to our objective, we reviewed the RCM as well as the CFR Manual and related appendices. We became familiar with Arc Orange's internal controls as they related to costs Arc Orange reported on the CFRs. We also interviewed Arc Orange personnel to obtain an understanding of the practices for reporting costs on the CFR. We reviewed Arc Orange's CFRs and relevant financial records for the audit period and obtained accounting records and supporting information to review costs that were considered high risk and reimbursable in limited circumstances, such as food and gifts.

We conducted our performance audit in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating

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

## Authority

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The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution; Article II, Section 8 of the State Finance Law; and Section 4410-c of the State Education Law.

## Reporting Requirements

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We provided a draft copy of this report to SED and Arc Orange officials for their review and formal comment. We considered their comments in preparing this report and have included them in their entirety at the end of it. In their response, SED officials agreed with our audit recommendations and indicated the actions they will take to address them. In their response, Arc Orange officials disputed our proposed disallowance pertaining to excessive severance pay. Our rejoinder to comments by Arc Orange on this matter is included in the report's State Comptroller's Comment.

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

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## Contributors to This Report

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**Andrea Inman**, Audit Director  
**Dennis Buckley**, Audit Manager  
**Brian Krawiecki**, Audit Supervisor  
**Claudia Christodoulou**, Examiner-in-Charge  
**Amy Tedesco**, Staff Examiner

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## Division of State Government Accountability

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### Vision

A team of accountability experts respected for providing information that decision makers value.

### Mission

To improve government operations by conducting independent audits, reviews and evaluations of New York State and New York City taxpayer financed programs.

## Exhibit

**The Arc of Orange County  
Schedule of Submitted and Disallowed Program Costs  
for the Calendar Year Ended December 31, 2013**

<b>Program Costs</b>	<b>Amount Per CFR</b>	<b>Amount Disallowed</b>	<b>Amount Remaining</b>	<b>Notes to Exhibit</b>
Personal Services	\$4,569,659	\$57,088*	\$4,512,571	D,H
Other Than Personal Services	954,207	24,019	930,188	A-C, E-G
<b>Total Program Costs</b>	<b>\$5,523,866</b>	<b>\$81,107*</b>	<b>\$5,442,759</b>	

\*This table reflects amounts reported and disallowed for the year ended December 31, 2013. Our report also included \$13,862 in disallowances for severance pay reported on the 2012 CFR. Accordingly, we identified total personal service disallowances of \$70,950 (\$57,088 in 2013 and \$13,862 in 2012), and the total personal service and OTPS disallowances amounted to \$94,969 (\$81,107 in 2013 and \$13,862 in 2012). Also, we note that prior to our audit fieldwork, SED had already made certain disallowances to some of the expense categories we identified.

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## Notes to Exhibit

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The following Notes refer to specific sections of the RCM that we used as a basis for our recommended disallowances. We summarized the applicable sections to explain the basis for each disallowance. We provided the details supporting our recommended disallowances to SED and Arc Orange officials during the course of the audit.

- A. Section II: Generally, costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the special education program, and are sufficiently documented. Such reimbursable costs will be included in the calculation of tuition rates up to any limits or cost parameters approved annually in the rate-setting methodology.
- B. Section II.14.B: Costs associated with retainers for legal, accounting, or consulting services are not reimbursable unless the fee represents payment for actual documented reimbursable services rendered, provided the services are not for lobbying efforts.
- C. Section II.16: Political and charitable contributions and donations made by the program are not reimbursable.
- D. Section II.13.A.10: A merit award (or bonus compensation) shall mean a non-recurring and non-accumulating (i.e., not included in base salary of subsequent years) lump sum payment in excess of regularly scheduled salary which is not directly related to hours worked. A merit award may be reimbursed if it is based on merit, as measured and supported by employee performance evaluations. In addition, merit awards are restricted to direct care titles.
- E. Section II.22.C: Costs of food provided to any staff including lunchroom monitors are not reimbursable.
- F. Section II.24: Gifts of any kind are non-reimbursable.
- G. Section II.30.C: Costs for food, beverages, entertainment, and other related costs for meetings, including Board meetings, are not reimbursable.
- H. Section II.46.B: The cost of severance pay is reimbursable provided that such payment is required by law or by employer-employee agreement or contract and the cost of severance pay does not exceed two weeks' pay for a full-time employee.

# Agency Comments - State Education Department



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

DEPUTY COMMISSIONER  
Office of Performance Improvement and Management Services  
O: 518.473-4706  
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March 8, 2016

Ms. Andrea Inman  
Audit Director  
Office of the State Comptroller  
Division of State Government Accountability  
110 State Street – 11<sup>th</sup> Floor  
Albany, NY 12236

Dear Ms. Inman:

The following is the New York State Education Department's (Department) response to the draft audit report, 2015-S-45, Compliance with the Reimbursable Cost Manual: The Arc of Orange County (Arc Orange).

**Recommendation 1:** Review the disallowances identified by our audit and make the necessary adjustments to the costs reported on Arc Orange's CFRs and to Arc Orange's tuition reimbursement rates, as appropriate.

We agree with this recommendation. The Department will review the recommended disallowances as noted in the report and make adjustments to the reported costs to recover any overpayments, as appropriate, by recalculating tuition rates.

**Recommendation 2:** Remind Arc Orange officials of the pertinent SED guidelines that relate to the deficiencies we identified.

We agree with this recommendation. The Department will continue to provide technical assistance whenever requested and will strongly recommend that Arc Orange officials take advantage of our availability to help them better understand the standards for reimbursement as presented in Regulation and the Reimbursable Cost Manual. In addition, Consolidated Fiscal Report (CFR) training is available at six locations across the State and online on the Department's webpage. The training is recommended for all individuals signing CFR certification statements, namely Executive Directors and Certified Public Accountants, and is required for preschool special education providers upon approval and reapproval. Furthermore, the Department intends to require that the training be mandatory for all providers.

If you have any questions regarding this response, please contact Suzanne Bolling, Director of Special Education Fiscal Services at 518/474-3227.

Sincerely,



Sharon Cates-Williams

c: Pat Geary  
Suzanne Bolling

# Agency Comments - The Arc of Orange County



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March 10, 2016

Founded in 1954

Gary K. Fox  
President

Christopher Fortune, MA  
Executive Director

Lis Goris  
Chief Financial Officer

Mr. Brian Krawiecki, Supervisor  
Office of the State Comptroller  
110 State Street, 11th Floor  
Albany, NY 12236

RE: Audit 2015-S-45

Dear Mr. Krawiecki:

The following is the Arc of Orange county response to the draft audit report, 2015-S-45, compliance with the Reimbursement Cost Manual for the Consolidated Fiscal Report 2013:

**Severance pay:**

Orange Arc reported \$69,310 of ineligible severance payments on its CFR that exceeded the allowable two weeks.

**The Arc of Orange Response:**

Recommendation No. 1—Disagree.

As noted in your report above, the assistant executive director, received severances pay totaling \$69,310. The Assistant Executive Director was a senior level executive responsible for managing and directing the Educational Services division of the agency. The Educational Services division is an integral part of the Agency overall operations and accounts for approximately one-third of its' total employees. Although the RCM provides for only two weeks severance pay, given the status and position with the agency, and given the terms of his departure, we decided that it was in the best interest of the agency to compensate the former employee a larger severance package in an effort to avoid the cost and time of potential litigation.

\*  
Comment  
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Additionally, this position was vacant for approximately 18 months, and during this time the executive director and the CFO provided direct oversight to the Education Department and worked with them routinely on financial, quality and Human Resources issues, saving the education department more than \$65,000. Accordingly, given the overall savings to the education department, we believe that the amount of severance paid to was minimal when couple with the amount saved by the agency.

**Staff Appreciation Awards:**

Orange Arc reported \$1,640 for staff appreciation award payments that were ineligible for reimbursement

**The Arc of Orange Response:**

Recommendation no. 2 –Agreed.



www.thearcoforange.org 1

\*See State Comptroller’s Comment on Page 18.





Founded in 1954

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While the Arc of Orange philosophically disagrees with the disallowance on various food and staff incentive awards we are not going to dispute them. However, it is our opinion that SED needs reconsider its position with regard to non-merit based employee appreciation awards for preschool providers for several reasons. First, such a policy promotes inconsistent treatment of employees within the same organization. While SED may view this policy as fiscally responsible, it actually has an opposite effect since other employees within the agency does benefit from the program; SED's policy results in low employee morale and reduced efficiency. Second, given the competitive environment of this industry, continued employee turnover caused by low employee morale and a perceived double standard, increases the overall cost to the organization. Third, employee moral issues and employee turnover will also affect the impact on the people we serve. Fourth, the benefit received far exceeds the cost of such a minimal amount.

#### **Other than Personal Services Costs**

Orange Arc reported \$24,019 in non-reimbursable costs on its CFR.

#### **The Arc of Orange Response:**

Recommendations no. 3 –Agreed See Below.

- a. Agreed - The \$18,606 miscoded and should not have been an education expense.
- b. Agreed – We agree that RCM prohibits the allocation of certain administrative cost to Educational Services, but again, it is our position that such a policy is inequitable. The \$3,474 relates to a charitable event, which leads to third party donations to ours agency. These donations benefit the entire organization including Educational Services. This policy is inequitable in that Educational Services benefits from the organization's fund raising effort, but does not bear any costs or risk associated with charitable donations. Additionally, the current construction of the CFR does not permit for the separation of these expenses. These expenses should follow the same guideline as the value ratio method which is allowable under RCM/SED.
- c. Agreed – \$1,206 for (\$10) gifts cards for staff during year-end appreciation. See response to Staff Appreciation Awards above.
- d. Agreed – \$437 for legal fees for which services have not been provided. We have contacted the attorney for supporting documentation.
- e. Agreed – \$296 for donations See response to b above.

The Consolidated Fiscal Report (CFR) does not allow for different cost allocation methods within the one document. I would like to recommend that SED have a separate CFR so that organizations that supply services through multiple State Agencies that have different allowable cost requirements can complete a separate CFR for SED programs.



[www.thearcoforange.org](http://www.thearcoforange.org)

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#### **Allocation Methodology**

Through our review of time and attendance and payroll records, we believe that total personal service costs charged to the programs we reviewed were reasonable. However, because of the lack of documentation we could not be certain the amounts charged to the individual programs were appropriate.

We also observed the location used to determine the square footage percentages for allocating certain OTPS costs and believe those percentages to be reasonable. However, without sufficient documentation showing how square footage was actually used to determine the allocation percentages, we again could not be certain amounts charged to each of the three programs were appropriate.

Additionally, the lack of documentation was compounded because the personnel responsible for preparing the 2013 CFR were no longer employed by Orange Arc at the time of our review. As a result, the current finance staff had difficulty explaining the allocation methodologies that had been used on the 2013 CFR

This turnover of key personnel further highlights the importance of maintaining sufficient supporting documentation for allocation methods.

#### **The Arc of Orange Response:**

Recommendations no. 3—Agreed.

The Arc of Orange agrees and acknowledges the recommendation made by OSC. Since 2014, the agency has implemented policies and procedures that ensure that all information including but not limited to static analysis, plans, and background information related to allocations are available to financial administrative staff on the share server.

We would like to thank the OSC Audit Team for their courtesy and professionalism. If you have any further questions regarding this response, please contact Lis Goris, Chief Financial Officer or Christopher Fortune, Executive Director.

Sincerely,

Christopher Fortune,  
Executive Director

cc: File  
Lis Goris, CFO  
Beth Laub, Assistant ED  
Finance Committee  
Corporate Compliance Committee



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## State Comptroller's Comment

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1. As acknowledged in Arc Orange's response, the RCM is clear that severance pay is limited to two weeks' pay for full-time employees, when preparing and submitting a CFR. Arc Orange can provide a severance package it deems appropriate; however, any amount in excess of two weeks' pay cannot be charged through the CFR to the Programs. We, therefore, maintain that the amount in question should be disallowed.