



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

Division of State Government Accountability

Compliance With the Reimbursable Cost Manual

**State Education Department
Brookville Center for Children's
Services, Inc.**



Executive Summary

Purpose

To determine whether the costs reported by Brookville Center for Children's Services, Inc. (Brookville) on its Consolidated Fiscal Reports (CFRs) were reasonable, necessary, directly related to the special education program, and sufficiently documented pursuant to the State Education Department's (SED) Reimbursable Cost Manual (Manual). The audit included expenses claimed on Brookville's CFR for the fiscal year ended June 30, 2014, and certain expenses claimed on its CFRs for the two fiscal years ended June 30, 2013.

Background

Brookville is a Nassau County-based not-for-profit organization authorized by SED to provide preschool special education services to children with disabilities between the ages of three and five years. During the 2013-14 school year, Brookville served about 456 students. Local counties refer students to Brookville and pay for their services using rates established by SED. Counties are reimbursed by SED for a portion of their payments to Brookville. For the three fiscal years ended June 30, 2014, Brookville reported approximately \$72.2 million in reimbursable costs for the audited programs. During the same three fiscal years, NYSARC, Inc. - Nassau County Chapter (AHRC), a related party, provided Brookville with management services under the Corporate and Administrative Services Agreement (Management Agreement).

Key Findings

For the three fiscal years ended June 30, 2014, we identified \$1,089,215 in reported costs that did not comply with the Manual's requirements and recommend such costs be disallowed, as follows:

- \$305,207 in administrative costs for services to Brookville that should have been covered under the Management Agreement, and as such, the costs were unnecessary and duplicative;
- \$273,100 in ineligible management fees, including \$42,897 in non-reimbursable bonuses paid to AHRC officials and \$41,594 in unsupported vehicle expenses;
- \$240,673 in lease expenses that were not in compliance with the Manual, including costs attributable to excessive space (square footage) allocations;
- \$234,291 in ineligible and/or insufficiently documented fringe benefit expenses; and
- \$35,944 in over-allocated compensation, ineligible tuition reimbursements, and other insufficiently documented expenses.

Key Recommendations

To SED:

- Review the recommended disallowances resulting from our audit and make the appropriate adjustments to Brookville's CFRs and reimbursement rates, as warranted.
- Work with Brookville officials to help ensure their compliance with the provisions of the Manual.

To Brookville:

- Ensure that all costs reported on future CFRs fully comply with the requirements in the Manual.

Other Related Audits/Reports of Interest

[Yeled v'Yalda Early Childhood Center: Compliance With the Reimbursable Cost Manual \(2015-S-19\)](#)

[New York League for Early Learning, Inc.: Compliance With the Reimbursable Cost Manual \(2015-S-43\)](#)

State of New York
Office of the State Comptroller

Division of State Government Accountability

October 4, 2017

Ms. MaryEllen Elia
Commissioner
State Education Department
State Education Building - Room 125
89 Washington Avenue
Albany, NY 12234

Mr. Stanford Perry
Executive Director
Brookville Center for Children's Services, Inc.
189 Wheatley Road
Brookville, NY 11545

Dear Ms. Elia and Mr. Perry:

The Office of the State Comptroller is committed to helping State agencies, public authorities, and local government agencies manage government resources efficiently and, by so doing, providing accountability for tax dollars spent to support government-funded services and 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, entitled *Compliance With the Reimbursable Cost Manual*, of our audit of the expenses submitted by Brookville Center for Children's Services, Inc. to the State Education Department for the purposes of establishing the tuition reimbursement rates. 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.

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 draft report, please feel free to contact us.

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

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Background

Brookville Center for Children's Services, Inc. (Brookville) is a Nassau County-based not-for-profit organization authorized by the State Education Department (SED) to provide Special Education Itinerant Teacher (SEIT), full-day Special Class (SC), and full-day Special Class in an Integrated Setting (SCIS) preschool special education services to children with disabilities between the ages of three and five years. For purposes of this report, these programs are collectively referred to as the SED cost-based programs.

During the 2013-14 school year, Brookville served about 456 students. In addition to the SEIT, SC, and SCIS cost-based preschool special education programs, Brookville operated seven other programs: School Age - Special Class, School Age - Autism, Evaluations, Related Services, 1:1 Aides, Daycare, and Early Intervention. However, payments for services under these other programs were based on fixed fees, as opposed to the cost-based rates established through financial information reported on Consolidated Fiscal Reports (CFRs).

Local counties refer students to Brookville based on clinical evaluations, and pay for their services using rates established by SED. The rates are based on the financial information that Brookville reports to SED on its annual CFRs. To qualify for reimbursement, Brookville's expenses must comply with the criteria set forth in SED's Reimbursable Cost Manual (Manual), which provides guidance to special education providers on the eligibility of reimbursable costs, the documentation necessary to support these costs, and cost allocation requirements for expenses relating to multiple programs. Reimbursable costs must be reasonable, necessary, directly related to the special education program, and sufficiently documented. The State reimburses the counties 59.5 percent of the statutory rate they pay to Brookville.

Section 4410-c of the Education Law requires the State Comptroller to audit the expenses reported to SED by special education service providers for preschool children with disabilities. For the three fiscal years ending June 30, 2014, Brookville reported approximately \$72.2 million in reimbursable costs for the cost-based programs. Our audit focused primarily on fiscal year 2013-14. However, we expanded our review to include certain items claimed on the CFRs for the two fiscal years 2011-12 and 2012-13.

Audit Findings and Recommendations

For the three fiscal years ended June 30, 2014, we identified \$1,089,215 in reported costs that did not comply with the Manual's requirements for reimbursement. The ineligible costs included \$569,763 in personal service costs and \$519,452 in other than personal service (OTPS) costs (see Exhibit).

Management Agreement

On June 21, 2010, Brookville entered into a Corporate and Administrative Services Agreement (Management Agreement) with NYSARC, Inc. - Nassau County Chapter (AHRC). The Management Agreement, which is automatically renewed and extended annually, required AHRC to provide Brookville with certain administrative and executive management services, including leadership oversight, purchasing and accounts payable processing, billing and collection services, payroll services, human resources, corporate compliance, and technology support. In addition, AHRC was responsible for providing financial services, including preparation of the annual budget, financial statements, and all forms, reports, and returns, such as corporate filings and IRS Form 990 (Return of Organization Exempt From Income Tax), required by law in connection with Brookville's operations. For the three-year period ended June 30, 2014, Brookville claimed \$4.5 million in costs related to the Management Agreement. We interviewed Brookville and AHRC employees, and reviewed the two entities' business arrangements, as well as certain transactions and supporting documentation. We found that:

- On its CFR for the fiscal year ended June 30, 2014, Brookville reported the Management Agreement with AHRC as a related-party transaction;
- Brookville did not employ an Executive Director, Assistant Executive Director, or Chief Financial Officer (CFO) on its payroll. Instead, these key senior management functions were performed by AHRC executives, with the associated costs billed to Brookville (and the SED cost-based programs) under the terms of the Management Agreement;
- Brookville's Assistant Controller and certain other Brookville employees reported to, and were supervised by, AHRC executives;
- Brookville's and AHRC's Boards of Directors (Boards) shared three common members; and
- AHRC's executives and certain other employees routinely briefed Brookville's Board on the financial soundness and operational aspects of Brookville.

Consequently, we determined that the business arrangements and transactions between Brookville and AHRC constituted a less-than-arm's-length (LTAL)¹ relationship, as defined by the Manual and the Regulations of the Commissioner of Education (Regulations).

¹ As stated in Section I.4.A of the Manual, in general, an LTAL relationship exists when there are related parties and one party can exercise control or significant influence over the management or operating policies of another party, to the extent that one of the parties is or may be prevented from fully pursuing its own separate interests. Section I.4.E of the Manual defines a "related party" as "any party transacting or dealing with the agency/entity of which that party has ownership of, control over, or significant influence upon the management or operating policies of a program(s)/entity(ies) to the extent that an arm's-length transaction may not be achieved."

Management Fees

According to the Manual, charges to programs receiving administrative services, insurance, supplies, technical consultants, etc. from a parent or related organization are reimbursable, provided they are not duplicative in nature, provide a direct benefit to that subsidiary, are based on actual direct and indirect costs, are allocated to all programs on a consistent basis, and are defined as reimbursable in the Regulations, the Manual, and the Consolidated Fiscal Reporting and Claiming Manual (CFR Manual). We determined that \$273,100 (\$188,609 + \$42,897 + \$41,594) in management fees, reported as OTPS costs and allocated to the cost-based programs, were not in compliance with the Manual's provisions, as detailed below.

Excessive Executive Compensation

According to the Manual, compensation (i.e., salaries plus fringe benefits) for an entity's staff whose function is that of Executive Director, Assistant Executive Director, or CFO will be directly compared to the regional median compensation for comparable administration job titles of public school districts, as determined and published annually by SED's Basic Educational Data System. Reimbursement of employee compensation for these job titles shall not exceed the median compensation paid to comparable personnel in public schools for similar work and hours of employment in that region.

For the three years ended June 30, 2014, Brookville did not have an Executive Director, Assistant Executive Director, or CFO on its staff. Instead, the management fees Brookville reported on its CFRs for the cost-based programs included \$428,843 in compensation paid to an Executive Director, two Assistant Executive Directors, and a CFO who were employees of AHRC and who provided management services to Brookville. We determined that only \$240,234 of their compensation should have been allocated to the cost-based programs, as follows:

- Brookville allocated \$180,846 (\$71,450, \$55,551, and \$53,845, respectively, for the three years ended June 30, 2014) in compensation for the two Assistant Executive Directors. However, based on the regional median compensation limits, only \$75,815 in compensation should have been charged to the cost-based programs. As a result, the amounts of compensation allocated to the cost-based programs were overstated by \$105,031 (\$180,846 - \$75,815);
- Brookville allocated \$147,339 (\$47,203, \$46,875, and \$53,261, respectively, for the three years audited) in compensation for an Executive Director. However, based on the regional median compensation limits, only \$88,606 in compensation should have been allocated to the SED cost-based programs. Thus, the amount of the Executive Director's compensation that Brookville allocated to the cost-based programs was overstated by \$58,733 (\$147,339 - \$88,606); and
- Similarly, Brookville allocated \$100,658 (\$33,124, \$33,284, and \$34,250, respectively, for the three years) in compensation for a CFO. However, based on the regional median compensation limits, only \$75,813 should have been allocated to the cost-based programs. As a result, Brookville over-allocated the amount of compensation to the cost-based programs by \$24,845 (\$100,658 - \$75,813).

As such, we recommend that SED disallow \$188,609 (\$428,843 - \$240,234) in excessive executive compensation that was allocated to the cost-based programs.

Ineligible Bonuses

According to the Manual, 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. A bonus may be reimbursed if it is based on merit as measured and supported by employee performance evaluations. Moreover, bonus compensation is restricted to direct care employees.

For the three fiscal years ended June 30, 2014, the management fees Brookville reported on its CFRs included \$42,897 (\$32,139 in salaries and \$10,758 in related fringe benefits) in bonuses paid to certain AHRC administrative (non-direct care) employees, including the CFO, Controller, and Senior Director of Human Resources. Thus, we recommend that SED disallow the \$42,897 in bonus payments because they did not comply with the Manual's requirements.

Unsupported Vehicle Expenses

According to the Manual, the use of vehicles must be documented with individual vehicle logs that include, at a minimum, the date and time of travel, destinations, mileage between each destination, purpose of travel, and the name of the traveler. The Manual also states that costs associated with the personal use of program-owned or leased vehicles are not reimbursable.

On its CFRs for the three fiscal years ended June 30, 2014, Brookville's management fees included \$41,594 in vehicle-related expenses – gasoline, repairs, and maintenance – that were allocated to the cost-based programs. Brookville officials advised us that vehicle logs, required by the Manual, were not maintained. Therefore, we recommend that SED disallow the \$41,594 in vehicle-related expenses because these costs were insufficiently documented.

Brookville officials disagree with the disallowances, asserting that AHRC is an independent contractor unrelated to Brookville. However, we disagree with this assertion. As previously noted, the business arrangements and transactions between Brookville and AHRC constituted a LTAL relationship. Therefore, AHRC costs allocated to the cost-based programs should have complied with the Manual's applicable provisions.

Personal Service Costs

According to the Manual, costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the special education program, and sufficiently documented pursuant to the guidelines in the Manual. In addition, personal service costs, which include all taxable and non-taxable salaries and fringe benefits paid or accrued to employees on the agency's payroll, must be reported on the CFR as either direct care costs (e.g., teachers' salaries) or non-direct care costs (e.g., administrators' salaries). For the three fiscal years ended June 30, 2014, Brookville reported approximately \$56.7 million in personal service costs for its

SED cost-based programs. We identified \$569,763 in personal service costs that did not comply with the Manual's guidelines for reimbursement.

Services Covered Under the Management Agreement

According to the Manual, charges from a parent or related organizations to programs receiving administrative services, insurance, supplies, technical consultants, etc. are reimbursable, provided they are not duplicative in nature, provide a direct benefit to the subsidiary, are based on actual direct and indirect costs, are allocated to all programs on a consistent basis, and are defined as reimbursable in the Regulations, the Manual, and the CFR Manual. According to the Management Agreement, AHRC was responsible for certain administrative and executive management services, including leadership oversight, purchasing and accounts payable processing, billing and collection services, payroll services, human resources, corporate compliance, and technology support. In addition, AHRC was responsible for providing financial services, including preparation of the annual budget, financial statements, and all forms, reports, and returns, such as corporate filings and IRS Form 990 (Return of Organization Exempt From Income Tax), required by law in connection with Brookville's operations.

For the three years ended June 30, 2014, we determined that Brookville used its own employees (e.g., accountants) for services that were otherwise covered by the Management Agreement with AHRC. We interviewed Brookville employees and reviewed transactions and supporting documentation (e.g., job descriptions) related to the costs Brookville reported on its CFRs for administrative staffing. We determined that, during fiscal years 2011-12 and 2012-13, five Brookville employees performed services that AHRC was required to provide. During fiscal year 2013-14, a total of eight Brookville employees (including the five employees from the previous two fiscal years) performed similar services. For example, one of the employees in the three fiscal years we audited performed services such as the preparation of the budget and financial statements, CFR schedules, and other reports filed with the State agencies. Of the remaining seven employees, four worked in corporate compliance, two provided technology support, and one performed various accounting tasks. In all instances, these services were required to be provided by AHRC under the Management Agreement.

Brookville officials contend that the Management Agreement does not state that AHRC would exclusively perform all responsibilities related to those services. However, we noted the services that AHRC "will be" responsible for are specifically detailed in the first paragraph of the Management Agreement and include, among other services: financial services, including preparation of the annual budget and financial statements; payroll services; human resources; government filings and research, including preparing "all" forms, reports, and returns required by law in connection with Brookville's operations; billing and collection services; corporate compliance; executive management; technology support; distribution services; and administrative and clerical services.

We recommend that SED disallow \$305,207 (\$90,451, \$110,878, and \$103,878, respectively, for the three fiscal years ended June 30, 2014) in administrative costs that were claimed on the CFRs and allocated to the cost-based programs for the eight Brookville employees. The services performed by these eight employees should have been provided by AHRC under the terms of the Management Agreement, resulting in duplicative and unnecessary charges.

Fringe Benefits

The Manual states that fringe benefits will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the special education program, and sufficiently documented. We found \$234,291 (\$159,762 + \$74,529) in fringe benefits that did not meet the requirements of the Manual, as detailed below.

Unsupported Fringe Benefits

We compared the fringe benefit costs reported on Brookville's CFRs for the three fiscal years ended June 30, 2014 with the supporting documentation and corresponding expenses reported on Brookville's general ledgers. We determined that Brookville overstated the fringe benefit costs for the SED cost-based programs by \$159,762 (\$66,194, \$61,832, and \$31,736, respectively, for the three fiscal years).

Brookville officials maintained that the methodology used to allocate fringe benefit costs to each program complied with the requirements in the Manual. However, they could not provide the required documentation to support the fringe benefit costs charged to the cost-based programs; therefore, we recommend SED disallow the \$159,762 in overstated costs.

Unnecessary Fringe Benefits

During the three fiscal years ended June 30, 2014, Brookville paid \$137,474 in health insurance premiums for certain retired employees. Brookville officials could not provide documentation to show that these payments were contractually required. Therefore, we recommend that SED disallow \$74,529 of the \$137,474 in retiree health insurance premiums – the amount allocated to the cost-based programs – as these costs were not necessary.

Over-Allocated Compensation

The Manual states that costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the special education program, and sufficiently documented. Further, direct care expenses incurred by the provider should be charged to the appropriate programs, with the actual hours of service as the preferred statistical basis for allocating salaries and fringe benefits for shared staff who work on multiple programs. Entities must maintain appropriate documentation reflecting the hours used in this allocation. Documentation may include payroll records or time studies. This is especially important when a provider, such as Brookville, operates multiple programs.

On its CFR for the fiscal year ended June 30, 2014, Brookville allocated four employees' compensation, totaling \$29,511, to the cost-based programs. We determined that \$27,115 of the \$29,511 was incorrectly allocated, as follows:

- \$16,808 in compensation for three assistant group leaders. Brookville allocated a total of \$19,204 in compensation to the cost-based programs for these employees; however, we

reviewed Brookville's Change of Status Forms (used to indicate percentage of work time each employee spent on a program), and determined that Brookville over-allocated their compensation by \$16,808 (\$11,822 in salaries and \$4,986 in related fringe benefits).

- \$10,307 (\$7,810 in salaries and \$2,497 in related fringe benefits) in compensation for a teacher who, after reviewing her session notes, we determined did not work for the cost-based programs during the three fiscal years ended June 30, 2014. Instead, the teacher provided services to students in Brookville's school-age programs. As a result, \$10,307 was incorrectly allocated to the cost-based programs.

Consequently, we recommend that SED disallow the \$27,115 (\$19,632 in salaries and \$7,483 in the related fringe benefits) in compensation that was incorrectly or over-allocated to the cost-based programs.

Ineligible Tuition Reimbursement

The Manual states that employer-provided educational assistance costs (limited to tuition and materials) are reimbursable only when the course or degree pursued is relevant to the field in which the employee is working. Moreover, employees must complete and receive passing grades for the course(s) and appropriate records of course completion must be maintained. For fiscal year 2013-14, we reviewed supporting documents for two employees who received tuition reimbursements, as follows:

- \$1,830 for a teaching assistant who pursued a nursing degree. However, the nursing degree was not relevant to the field in which this employee was working.
- \$1,320 for another employee for a course he/she took. Officials could not provide evidence to show that this employee received a passing grade for the course.

We recommend that SED disallow the \$3,150 (\$1,830 + \$1,320) in ineligible tuition costs because these costs did not comply with the requirements in the Manual.

Other Than Personal Service Costs

According to the Manual, OTPS costs must be reasonable, necessary, directly related to the special education program, and sufficiently documented. For the three fiscal years ended June 30, 2014, Brookville reported \$15.5 million in OTPS expenses for the cost-based programs. We identified \$519,452 of these expenses, including the \$273,100 that was recommended for disallowance in the Management Fees section of this report, that did not comply with SED's reimbursement requirements, as outlined below.

Excessive Allocation of Rental Property Expenses

To operate their SED cost-based programs, Brookville leased additional space in New Hyde Park and Woodbury on Long Island. The Manual requires that entities operating programs use allocation methods that are fair and reasonable. In addition, each fiscal year's allocation methods, as well as

the statistical basis used to calculate allocation percentages, must be documented and retained for review upon audit for a minimum of seven years. Moreover, when programs share the same location, property and rental expenses (such as utilities, leases, repairs, and maintenance) must be allocated between the programs benefiting from the resources applied. Further, allocation of property costs to the program should be based on square footage. Administrative or shared space should be allocated based upon the square footage and percentage of time used by the various programs. An alternative basis of allocation, such as staff full-time equivalents (FTEs), may be used when the square footage might not accurately reflect the cost to be allocated to a program when it uses a significant amount of space, but not much space exclusively.

During the fiscal year ended June 30, 2014, Brookville reported \$1,365,669 in property-related allocation expenses, such as rent and utilities, at their New Hyde Park and Woodbury locations. Of that amount, we determined that Brookville reported \$240,673 in rental and other property-related costs that were not in compliance with the Manual's requirements, as follows:

- Brookville officials provided us with a spreadsheet detailing the 37,343 square foot space at their New Hyde Park location. This space was shared by SED cost-based and other aforementioned programs. We reviewed the spreadsheet and determined that Brookville officials had incorrectly assigned 122 square feet to the cost-based programs. They also were unable to account for an area totaling 8,228 square feet. Consequently, the square footage reported in the spreadsheet was overstated by 22 percent, or 8,350 (8,228 + 122) square feet. As a result, we determined that Brookville over-allocated \$238,060 in property costs to the cost-based programs.
- Brookville operated an SED fixed-fee program (code 9190) as well as SED cost-based programs at its Woodbury location. We determined that Brookville officials failed to allocate property costs to the fixed-fee program, and instead charged all of the rental and related property expenses to the cost-based programs. Since the fixed-fee program did not have a designated space, we applied the staff FTE-based methodology recommended by the CFR Manual. As a result, we determined that Brookville over-allocated \$2,613 in expenses to the cost-based programs.

Therefore, we recommend that SED disallow \$240,673 (\$238,060 for New Hyde Park and \$2,613 for Woodbury) in rental and other property-related costs that were not in compliance with the Manual's requirements.

Miscellaneous Costs

The Manual states that costs will be considered for reimbursement provided they are reasonable, necessary, directly related to the special education program, and sufficiently documented. Adequate documentation for consultants includes, but is not limited to, the consultant's résumé, a written contract that includes the nature of the services to be provided, the charge per day, and the service dates. Moreover, all payments must be supported by itemized invoices that indicate the specific services actually provided and, for each service, the date(s), number of hours provided, fee per hour, and total amount charged. Further, when direct care services are provided, the documentation must indicate the names of students served, the actual dates of

service, and the number of hours of service provided to each child on each date.

Brookville reported \$5,679 in miscellaneous expenses, as follows:

- \$2,935 for a consultant’s services. The documentation provided to support these expenses was missing the required description of services, dates of service, and names of children who received the services.
- \$2,340 in expenses, including \$1,338 labeled as “non-allowable” in the General Ledger. Brookville officials could not provide documentation to support the \$2,340.
- \$404 in non-program-related expenses, including \$140 in fingerprinting fees for an employee who did not work for the cost-based programs and \$264 in expenses erroneously charged to the cost-based programs.

We recommend that SED disallow the \$5,679 in miscellaneous expenses because they were insufficiently documented and/or ineligible for reimbursement.

Recommendations

To SED:

1. Review the recommended disallowances resulting from our audit and make the appropriate adjustments to Brookville’s CFRs and reimbursement rates, as warranted.
2. Work with Brookville officials to help ensure their compliance with the provisions of the Manual.

To Brookville:

3. Ensure that all costs reported on future CFRs fully comply with the requirements in the Manual.

Audit Scope, Objective, and Methodology

We audited the costs reported on Brookville’s CFRs to determine whether they were properly documented, directly related to the special education program, and allowable pursuant to the Manual. The audit included all claimed expenses for the fiscal year ended June 30, 2014, and certain expenses claimed for the two fiscal years ended June 30, 2013.

To accomplish our objective, we reviewed the Manual, the CFR Manual, Brookville’s CFRs, and relevant financial records for the audit period. We also interviewed Brookville officials, staff, and independent auditors to obtain an understanding of Brookville’s financial and business practices. In addition, we assessed a judgmental sample of reported costs to determine whether they were supported, program-related, and reimbursable. Specifically, we reviewed costs that were considered high risk and reimbursable in limited circumstances, such as management fee

expenses, fringe benefit expenses, and property expenses. Our samples were not designed to be projected to the entire population of reported costs. Also, our review of Brookville's internal controls focused on its CFR preparation process.

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 during our audit 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 to certain boards, commissions, and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these management functions do not affect our ability to conduct independent audits of program performance.

Authority

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

Reporting Requirements

We provided draft copies of this report to SED and Brookville officials for their review and formal comment. Their comments were considered in preparing this final report and are attached to it. In their response, SED officials agreed with our recommendations and indicated that they will take steps to address them. However, in their response, Brookville officials disagreed with most of our proposed disallowances. Our rejoinders to certain Brookville comments are included in the report's State Comptroller's Comments. Brookville officials also included a lengthy set of attachments with their response. Those attachments are not included in this report. However, they have been retained on file at the Office of the State Comptroller.

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.

Contributors to This Report

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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

**Brookville Center for Children's Services, Inc.
Summary of Submitted and Disallowed Costs
for the 2011-12, 2012-13, and 2013-14 Fiscal Years**

Program Costs	Amount per CFR	Amount Disallowed	Amount Remaining	Notes to Exhibit
Personal Services				
Direct Care	\$55,697,028	\$264,556	\$55,432,472	
Agency Administration	1,052,943	305,207	747,736	
Total Personal Services	\$56,749,971	\$569,763	\$56,180,208	A-D, G, I, L
Other Than Personal Services				
Direct Care	\$12,649,894	\$245,015	\$12,404,879	
Agency Administration	2,821,693	274,437	2,547,256	
Total Other Than Personal Services	\$15,471,587	\$519,452	\$14,952,135	A-F, H, J-L
Total Program Costs	\$72,221,558	\$1,089,215	\$71,132,343	

Notes to Exhibit

The following Notes refer to specific sections of the Manual used to develop 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 Brookville officials during the course of our audit.

- A. Section 1.4.A - In general, a LTAL relationship exists when there are related parties and one party can exercise control or significant influence over the management or operating policies of another party, to the extent that one of the parties is or may be prevented from fully pursuing its own separate interests. These relationships must be disclosed in the notes to the audited financial statements.
- B. Section 1.4.E - Related parties consist of all affiliates of an entity, including but not limited to: Its management and their immediate families; Its principal owners and their immediate families; Any party transacting or dealing with the agency/entity of which that party has ownership of, control over, or significant influence upon the management or operating policies of a program(s)/entity(ies) to the extent that an arm's-length transaction may not be achieved.
- C. Section II - Costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the education program, and sufficiently documented.
- D. Section II.10 - Charges to programs receiving administrative services, insurance, supplies, technical consultants, etc. from a parent or related organization are reimbursable provided they are not duplicative in nature, provide a direct benefit to subsidiary charged and based on actual direct and indirect costs, allocated to all programs on a consistent basis and defined as reimbursable in the Regulations of the Commissioner of Education, the CFR Manual or this Manual.
- E. Section II.13.A(4)(a) - Compensation (i.e., salaries plus fringe benefits) for an entity's staff whose function is that of Executive Director, Assistant Executive Director or Chief Financial Officer will be directly compared to the regional median compensation for comparable administration job titles of public school districts, as determined and published annually by the Department's Basic Educational Data Systems (BEDS). Reimbursement of employee compensation for these job titles shall not exceed the median compensation paid to comparable personnel in public schools for similar work and hours of employment in the region in which the entity is located.
- F. 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. Merit awards are restricted to direct care titles/employees.
- G. Section II.13.B(2)(e) - Employer-provided educational assistance costs are reimbursable as compensation only when the course or degree pursued is relevant to the field in which the employee is working and the employer has exhausted all Federal and other grant funds available to cover the education costs. The employee must complete and receive a

passing grade for the course(s) for which the employer/provider paid. Appropriate records of course completion must be maintained by the employer/provider.

- H. Section II.59.D(1) - Costs of personal use of a program-owned or leased automobile are not reimbursable.
- I. Section III.1.B - Actual hours of service are the preferred statistical basis upon which to allocate salaries and fringe benefits for shared staff who work on multiple programs. Entities must maintain appropriate documentation reflecting the hours used in this allocation. Acceptable documentation may include payroll records or time studies.
- J. Section III.1.C(2) - Adequate documentation includes, but is not limited to, the consultant's resume, a written contract which includes the nature of the services to be provided, the charge per day and service dates. All payments must be supported by itemized invoices which indicate the specific services actually provided; and for each service, the date(s), number of hours provided, the fee per hour; and the total amount charged. In addition, when direct care services are provided, the documentation must indicate the names of students served, the actual dates of service and the number of hours of service to each child on each date.
- K. Section III.1.J(2) - Vehicle use must be documented with individual vehicle logs that include at a minimum: the date, time of travel, to and from destinations, mileage between each, purpose of travel and name of traveler.
- L. Section III.1.M(2) - Entities operating programs must use allocation methods that are fair and reasonable, as determined by the Commissioner's fiscal representatives. Such allocation methods, as well as the statistical basis used to calculate allocation percentages, must be documented and retained for each fiscal year for review upon audit for a minimum of seven (7) years. Allocation percentages should be reviewed on an annual basis and adjusted as necessary.

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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July 5, 2017

Mr. Kenrick Sifontes
Audit Director
Division of State Government Accountability
110 State Street – 11th Floor
Albany, NY 12236

Dear Mr. Sifontes:

The following is the New York State Education Department's (SED) response to the draft audit report, 2016-S-75, Compliance with the Reimbursable Cost Manual: Brookville Center for Children's Services, Inc. (Brookville).

Recommendation 1:

Review the recommended disallowances resulting from our audit and make the appropriate adjustments to Brookville's CFRs and reimbursement rates, as warranted.

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

Recommendation 2:

Work with Brookville officials to help ensure their compliance with the provisions of the Manual.

We agree with this recommendation. SED will continue to provide technical assistance whenever requested and will strongly recommend the Brookville officials take advantage of our availability to help them better understand the standards for reimbursement as presented in Regulation and the Reimbursable Cost Manual (RCM). Furthermore, Consolidated Fiscal Report (CFR) training is available online on SED's webpage. SED recommends that all individuals signing the CFR certification statements, namely Executive Directors and Certified Public Accountants, complete this training. At the direction of the Board of Regents, the Department intends to require that this training be mandatory and will require individuals to verify that they have completed the training.

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: Christopher Suriano
Suzanne Bolling

Agency Comments - Brookville Center for Children's Services, Inc.

**Re: Compliance with the Reimbursable Cost Manual
Brookville Center for Children's Services, Inc.
Audit # 2016-S-75
Response to Draft Report**

Barclay Damon, LLP
2000 Five State Bank Plaza
100 Chestnut Street
Rochester, New York 14604
By: James S. Grossman, Esq.
Margaret Surowka Rossi, Esq.

13649137.3

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BARCLAY DAMON ^{LLP}

James S. Grossman
Partner

July 10, 2017

**VIA ELECTRONIC MAIL
AND OVERNIGHT DELIVERY**
tzino@osc.state.ny.us

Tania Zino, Examiner-in-Charge
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New York, New York 10038
Attn: Alina Mattie (via electronic mail amattie@osc.state.ny.us)

Re: Compliance with the Reimbursable Cost Manual
Brookville Center for Children's Services, Inc.
Audit # 2016-S-75
Response to Draft Audit Report

Dear Ms. Zino:

We represent the Board of Directors, the governing body of Brookville Center for Children's Services, Inc. ("BCCS"), and submit on its behalf this response to the Draft Audit Report reviewing BCCS' personal services, other-than-personal services ("OTPS") and management fees expense for the three fiscal years ended June 30, 2014 ("Draft Audit Report") received on June 9, 2017. BCCS submitted an extensive response to the preliminary findings on March 31, 2017, attended the April 12, 2017 Exit Conference and provided information in response to additional requests thereafter. BCCS submits the following responses to each of the findings within the Draft Audit Report, with specific reasons for its dissent where it disputes the New York Office of the State Comptroller ("OSC") findings. BCCS reserves all of its rights and interests in this matter and nothing in this response shall operate or be construed as a waiver of any of BCCS' rights or interests to challenge findings issued by the OSC, rate adjustments made by the New York State Department of Education pursuant to the OSC's findings or to otherwise exercise its legal and equitable rights.

The OSC's key findings are based on a fundamental misunderstanding of the relationship between BCCS and NYSARC, Inc. – Nassau County Chapter ("AHRC"). The OSC seeks to create a new and novel legal theory as to what constitutes control of an entity. Its position is contrary to basic corporate law and jurisprudentially unsupportable. The American economic

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<p>*</p> <p>Comment</p> <p>1</p>

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* See State Comptroller's Comments, Page 59.

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system has flourished over the centuries based upon a recognition of corporate independence and the ability for a corporation to have a distinct, separate identity so long as the entity is controlled by a board of directors with a majority of its members being independent directors not controlled by any other entity. It is this concept that the OSC inexplicably ignores without justification or explanation as to the reasoning applied to deviate from the most basic of corporate principles. Here, AHRC has absolutely no control over the governing body of BCCS, and the audit findings to the contrary are inexplicable.

BCCS provides its specific responses to each finding in Section II. Additionally, BCCS provides its general objections to the overall audit and OSC's fundamental errors in reviewing BCCS and its operations in Section III. BCCS believes that the Draft Audit Report is based on flawed reasoning which permeates the individual findings. BCCS' general objections trace the factual findings, assumptions and legal conclusions of the Draft Audit Report which BCCS submits are not justified. The extent of the errors in the Draft Audit Report, as set forth in the general objections response mandate that the report be withdrawn and a new report issued which reflects the actual relationship between BCCS and AHRC, the independent contractor retained to assist in management and administration. We urge the OSC to reconsider its findings in light of these facts, principles and the specific responses to each of the findings set forth below.

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I. BACKGROUND: BCCS

BCCS provides educational services to children with intellectual and other developmental disabilities including preschool special education services in both integrated and segregated programs. The preschool program serves children between three and five years of age.

Since 2010, BCCS has a sole member, Nassau County AHRC Foundation, Inc. (the "Foundation"). In its capacity as sole member of BCCS, the Foundation has the power to elect the Board of Directors of BCCS. As with BCCS, AHRC had no controlling authority over the Foundation, an independent self-sustaining entity. The BCCS Board of Directors controls BCCS. Under the New York Not-for-Profit Corporation Law §102, both its prior and current definitions, the majority of the BCCS Board of Directors is independent and therefore, it is an independent Board, an incontrovertible fact. BCCS's Board of Directors entered into a corporate and administrative services agreement with AHRC as of June 21, 2010 (the "Management Agreement"). See **Attachment 1**. As a result, BCCS' agency administrative costs as a percentage of total expense is significantly lower than industry standards. Specifically, BCCS' agency administrative costs represent only 6% of its total expenditures versus industry-accepted standards, which range between 10-15% of total agency expenditures. Total BCCS agency administration expenses were 6.51%, 6.44% and 5.55% (CFR-3 - line 52) in each of the fiscal years ended June 30, 2014, 2013 and 2012, respectively. These factors reflect exemplary fiscal management resulting from BCCS' management structure and controls, which should set a standard for other statewide programs to achieve. It is significant to note that the recent audit, rather than factually commending non-duplicative efficiencies, seeks to use broad-brush definitions of administrative functions in a manner which would ultimately discourage schools

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for the disabled from delivering administrative and management necessities in a streamlined and cost efficient manner. Stated differently, the audit, rather than relying on actual facts which have produced an extraordinarily cost effective structure at BCCS, relies on a broad, strained and incorrect analysis of items to somehow suggest those items represent spending which they simply do not represent.

The fundamental flaw in the Draft Audit Report is OSC's mischaracterization of BCCS' relationship with AHRC. AHRC is independent from BCCS as it has no control over BCCS' Board of Directors and BCCS has no control over AHRC's Board of Directors. Rather, AHRC is an independent entity with which BCCS contracted for the legitimate and non-duplicative purpose of providing specific administrative and management functions. Management fees paid to AHRC for the fiscal years ended June 30, 2014, 2013 and 2012 (collectively, "the Audit Period") were \$1,623,658, \$1,437,684 and \$1,411,634, respectively. AHRC maintained a systematic and rational allocation methodology applied on a consistent basis from year to year in assessing management fees to affiliated entities, including BCCS. BCCS allocates the management fee expense to each program based upon a ratio value method as mandated in the Management Agreement. These expenses did not, and do not, duplicate the cost of any administrative functions conducted by BCCS, and serve to foster an effective, below market cost standard for operating the BCCS school programs with a rate standard that benefits the State Education Department and New York State taxpayers. OSC's Draft Audit Report ignores these corporate structures and basic corporate law principles. Its findings totally contradict such precedent and must therefore be adjusted.

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Pursuant to the terms of the Management Agreement, AHRC provides certain corporate and administrative services including, but not limited to, financial, payroll, human resources, governmental filings, billing, corporate compliance, executive management, technology support, distribution services, administrative and clerical services and other services which are reasonable and necessary to the ongoing operations of BCCS. The Management Agreement provided that the fee for these services would be based on the actual cost to AHRC of the specific services provided. The OSC has apparently determined that all of the necessary actions taken by BCCS employees could have been assigned to AHRC and that the cost thereof would not have been equivalent to the cost BCCS incurred by providing in-house services. There is simply no empirical evidence which would support such a conclusion. More pointedly, the Management Agreement did not provide that AHRC would exclusively perform all responsibilities related to those services, and there is no support that the parties to that contract contemplated that anyone would ever interpret the contract in such an unjustifiable fashion. It is well settled in New York courts that when interpreting a contract, the agreement be construed in accord with the parties' intent. Here, the parties to the Management Agreement do not disagree as to their intent and it is extraordinary for a third party to contend that parties to an agreement (and who have lived by that agreement) have misconstrued what they agreed to. Yet, this is precisely what OSC is doing and is the basis for its findings. Further, only when the actual parties to an agreement disagreed about its intent, have courts of law looked at a written agreement to determine its intent. See *Slatt v. Slatt*, 64 N.Y.2d 966, 967, *rearg denied* 65 N.Y.2d 785, (1985); *Slamow v. Del Col*, 79 N.Y.2d 1016, 1018 (1992); *R/S Assocs. v New York Job Dev. Auth.*, 98 N.Y.2d 29, 32, *rearg.*

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denied 98 NY2d 693 (2002); *W.W.W. Assocs. v. Giancontieri*, 77 N.Y.2d 157, 162 (1990). Here, it is submitted that any logical reading of the Management Agreement would arrive at a determination that it necessarily meant what the parties to the Management Agreement believed it meant as evidenced by their conduct.

Any salient analysis of the Management Agreement and the efficiency of this arrangement would require drilling down on a line item analysis of services provided and the cost thereof. No such analysis was completed by OSC, despite extensive detail provided by BCCS. Rather, the OSC auditors relied on global assumptions and erroneous interpretation of services provided without accompanying verification of the precise nature of the services provided in order to properly determine if any perceived duplication occurred. In fact, BCCS has done that line by line analysis from the very start of assigning tasks and assured that no assigned task was duplicated. Independent auditors conducted annual financial statement audits. BCCS's independent auditors did not propose any audit adjustments, did not issue a Management Letter and did not report any findings of cost duplication for the Audit Period. See Affidavit of Willard T. Derr attached hereto as **Attachment 2**.

The failure to view the financial transactions of BCCS in a reasonably appropriate forensic manner caused the OSC to incorrectly contend that the salaries and benefits paid to other agency administrative employees at BCCS are not reimbursable because their services duplicated services that were or should have been provided by AHRC under the Management Agreement. The OSC's contention is completely baseless for many reasons.

BCCS disagrees that these administrative costs are unnecessary and duplicative. These costs consist of amounts paid to BCCS employees among twelve different positions including accounting, billing, financial reporting and corporate compliance. Such costs are not duplicative of administrative costs covered under the Management Agreement. Administrative costs incurred via management fees include the full services of purchasing, accounts payable, information technology, executive leadership and corporate compliance, necessary to conduct business operations and functions not otherwise provided by BCCS employees. Among the OSC allegations are that billing functions should have been performed by AHRC, under the terms of the Management Agreement, despite the intent of the parties thereto, and that some duplication existed with amounts charged in AHRC management fees. In fact, as evidenced by the detailed management fees accounting reports provided by BCCS to the OSC, there were no management fees for billing functions by AHRC. The two BCCS employees with the titles of Senior Accountant and Accounts Receivable Supervisor performed all of the billing and collection functions for BCCS education programs with no such function provided by AHRC nor any amount charged by AHRC. Further, if the parties had intended AHRC to perform these billing services, then, under the Management Agreement, those services would have been charged at AHRC's cost and the costs thereof would have been reflected in higher management fees and lower BCCS salary expense. The OSC's position that the actual cost to provide billing services should somehow be completely ignored and rejected as if the services did not need to be provided is contrary to reason. The BCCS consolidated fiscal reports ("CFR") reflect actual

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costs incurred for essential services; each of those costs was equivalent to appropriate and necessary non-duplicative costs of BCCS.

The Management Agreement offered a wide range of services, as noted above. The administrative functions provided under the management agreement were incremental to that performed by BCCS employees. All management fees were based on actual costs for services rendered and comply with the (Reimbursable Cost Manual for Programs Receiving Funding under Article 81 and/or 89 of the Education Law to Educate Students with Disabilities ("RCM") which defines reasonable cost in Section I.10, as explained thoroughly below.

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In addition, the OSC bases its proposed disallowances on the premise that allowance of AHRC's costs used to determine the management fee are subject to the same RCM rules governing BCCS' own costs based on RCM Section II.10, which provides:

"Charges to programs receiving administrative services, insurance, supplies, technical consultants, etc. from a parent or related organization are reimbursable provided they are not duplicative in nature, provide a direct benefit to a subsidiary charged and based on actual direct and indirect costs, allocated to all programs on a consistent basis and defined as reimbursable in the Regulations of the Commissioner of Education, the CFR Manual or this Manual. (Refer to Section 1.1.B.(5). Less-Than-Arm's-Length (LTAL) Relationships.)"

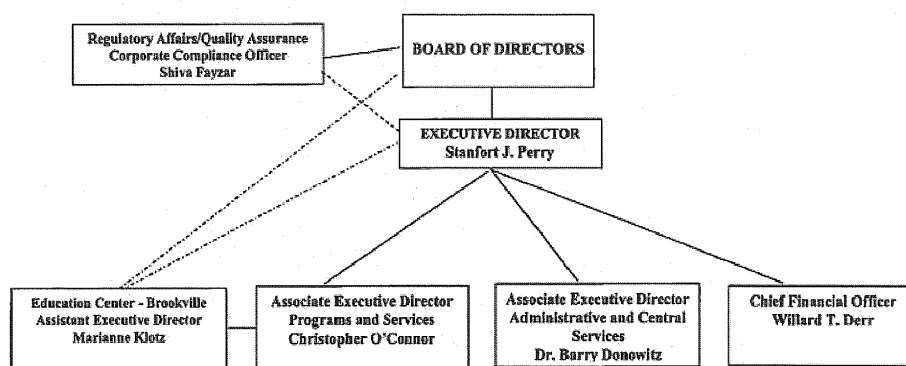
The OSC's contention is incorrect because AHRC was not BCCS' "parent or related organization" and the Management Agreement was an arm's-length transaction. There is an independent governing structure of BCCS and of AHRC.

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A summary of the corporate structure and legal relationship of AHRC and BCCS is provided below:

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**BROOKVILLE CENTER FOR CHILDREN'S SERVICES, INC.
ORGANIZATION CHART - GOVERNANCE**



AHRC had no authority or ability to act as a parent or exercise control over BCCS and, in fact, it exerted no such control. The Foundation is the sole member/parent corporation of BCCS. The Foundation is also an independent organization that is not controlled by AHRC. *See Attachment 3* which describes the corporate and legal framework. The independent governance of AHRC and BCCS, as shown in Attachment 3 clearly refutes any claim that AHRC operates as a parent of BCCS.

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II. BCCS' RESPONSES TO SPECIFIC DRAFT AUDIT REPORT FINDINGS

BCCS' responses herein correspond to the sections of the Draft Audit Report, together with the OSC recommended disallowance amounts, as follows:

- A. Management Fees - \$273,100
- B. Personal Services - \$741,508
- C. Other than Personal Services ("OTPS") - \$349,409
- Total - \$1,364,017

For each item, BCCS provides a summary of the applicable OSC audit finding and submits its response with reference to further details supporting our position. The captions correlate to the Draft Audit Report.

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A. Management Agreement

AHRC “median salaries”, AHRC Agency Administrative Vehicles and Bonuses paid to AHRC Employees.

1. “Excessive Executive Compensation” - \$188,609
 2. “Ineligible Bonuses”- \$42,897
 3. “Unsupported Vehicle Expenses” - \$41,594
- Total - \$273,100***

Audit Findings:

See pages 6-8 of the “Management Agreement” Section of the Draft Audit Report.

BCCS Response:

BCCS disagrees with these findings. In addition to the analysis of these issues in Section I (Background) above and in Section III (General Objections) below, BCCS offers the following specific information in response to the OSC’s findings.

RCM Applicable Provisions.

BCCS’ Board, controlled by its Independent Directors, made a prudent decision to contract with a qualified entity to provide certain identifiable management functions for BCCS pursuant to the Board’s responsibility to carry out the mission of BCCS. Much of the OSC’s findings involve the auditor’s attempt to construe the contract entered into between BCCS and AHRC in a manner inconsistent with the intent of the parties to that agreement.

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“The fundamental, neutral precept of contract interpretation is that agreements are construed in accord with the parties’ intent.” *See Slatt*, 64 N.Y.2d 966, 967. Where the parties disagree as to the intent of a document. “The best evidence of what parties to a written agreement intend is what they say in their writing.” *Slamow*, 79 N.Y.2d 1016, 1018. “Thus, a written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms.” *See, e.g. R/S Assocs.*, 98 N.Y.2d 29, 32, *rearg. denied* 98 NY2d 693; *W.W.W. Assocs.*, 77 N.Y.2d 157, 162.

The terms of the Management Agreement are clear and unambiguous, providing AHRC with a delineation of its management obligations which it has carried out without dispute or duplication by BCCS. AHRC charges actual costs for the enumerated management services to BCCS as more fully set forth herein. In fact, the intent of the parties to adhere to the terms of the Management Agreement is even more clear based on the conduct of both AHRC and BCCS since the execution of the agreement. There is simply no dispute between AHRC and BCCS regarding the execution of the Management Agreement. Rather, it is the OSC who has

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erroneously taken an overly technical interpretation of the Management Agreement, well beyond its plain meaning and undisputed execution of the terms by the parties.

Presumably, if the OSC had not wrongfully interpreted the Management Agreement in its determination that AHRC controlled BCCS, the auditors would not have made interpretative judgments as to what the contract between the parties meant or intended to cover. Contracts need to be construed to carry out the intent of the parties. It is totally inappropriate for an auditing body to reach a conclusion that is inconsistent with the parties' intent which is clear from the construction and execution of the contract. While BCCS and AHRC are in accord that the Management Agreement is clear and unambiguous, assuming *arguendo* that the Management Agreement were deemed ambiguous:

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Evidence of custom is permitted for the purpose of qualifying the meaning of a contract where otherwise ambiguous and of providing for incidents not in contradiction of the fundamental provisions of the contract and of supplying omissions under certain circumstances which have occurred in the agreement of the parties. Evidence of it is not permitted for the purpose of contradicting the agreements which the parties have made or for the purpose of accomplishing an unfair or immoral construction of their contract. *Gravenhorst v. Zimmerman*, 236 N.Y. 22, 33-34 (1923); *Western Union Tel. Co. v. American Communications Ass'n*, 299 N.Y. 177, 184 (1949).

It is improper for the OSC to look beyond the plain meaning of the Management Agreement. However, if any doubt exists for the OSC regarding the meaning of the explicit terms, the conduct, custom and historical performance of the Management Agreement by both AHRC and BCCS is indicia of the parties' intent. AHRC charging the actual costs to BCCS associated with the management services it provides is further indicia of the parties intent. Notably, neither AHRC or BCCS dispute the meaning of the Management Agreement, the division of duties therein, nor do they espouse the flawed interpretation by the OSC.

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More specifically, BCCS' Board intended that certain, identified functions would be contracted to be performed by AHRC and other identifiable functions BCCS would have its own employees perform. The analysis that follows shows that this structural methodology was not only well thought out, but was also exceptionally, fiscally responsible. Yet, the OSC audit by characterizing the contract in a fashion not contemplated by the parties, and as not fiscally responsible, would argue for a structure that would simply be financially unsustainable and thereby detrimental to the continuation of appropriate educational services provided to the individuals served by BCCS.

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SED rate Setting Unit Officials continued to promulgate periodic program rate changes over several years, with the knowledge that BCCS operating expenses include contractual management fees paid to AHRC as well as BCCS employee costs. CFRs are subject to periodic regulatory review. To date, BCCS has received no inquiries relative to the amount of such costs.

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Retaining AHRC to provide certain administrative services to BCCS provides enhanced value to the education programs operated by BCCS. Leveraging “back-office” services from AHRC allows BCCS to avoid the costs that would otherwise be incurred to establish its own administrative services. For example, AHRC handles the accounts payable processing for BCCS. This service is performed by six employees, including the Accounts Payable Manager, who handles processing of all vendor invoices, vendor account reconciliations, payments, vendor relationships, and Form 1099 reporting. Total management fees charged for accounts payable salary cost was \$51,185, \$51,102 and \$53,439 for each of the years ended June 30, 2012, 2013 and 2014, respectively. Using this example of accounts payable processing, BCCS incurs the cost of approximately 1.2 full-time equivalent (“FTE”) but benefits from skills of several employees, while handling a diverse set of responsibilities.

OSC’s claim: “On its CFR for the fiscal year ended June 30, 2014, [BCCS] reported the Management Agreement with AHRC as a related-party transaction.”

New York State Consolidated Fiscal Report instructions for Schedule CFR-5 require the following:

“For purposes of this schedule, “related organizations and/or individuals” shall include closely allied entities as described and defined in Article 25.06 of Mental Hygiene Law and on page 18.2 of the CFR Manual.”

Disclosure of AHRC as a closely allied entity which administers funds for BCCS does not rise to the level of a related party nor confer any level of management control. BCCS has properly reported its business relationship with AHRC as a non-controlled affiliate. To provide full disclosure, BCCS reported the amounts paid to AHRC on Schedule CFR-5 based upon BCCS’ affiliation with its non-controlled affiliate. OSC mistakenly equates “closely allied entity” for purposes of the CFR reporting with control. This is simply wrong.

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OSC’s claim: “[BCCS] did not employ an Executive Director, Assistant Executive Director, or Chief Financial Officer on its payroll.”

BCCS agrees with this as a statement of fact, but does not agree with the conclusion the OSC draws from that fact; *i.e.*, that there is duplication of services. In fact, there is no cost duplication to the extent that AHRC charged for a portion of these positions based on ratio value for actual cost incurred by BCCS. Further, while the OSC did not dispute the amounts charged for these services as being anything other than an appropriate allocation of actual cost, the OSC nevertheless claimed that the portion of total compensation charged (approximately 21.6% of total) exceeded median salary limits for these positions. BCCS disagrees that the portion of such costs charged to BCCS were excessive. Further, as demonstrated, the leveraging of AHRC executive leadership and many other administrative functions are most cost-beneficial,

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contributing to agency administrative cost of only 6% of its total expenditures compared to industry-accepted standards, which range between 10% to 15% of total agency expenditures.

OSC's claim: "[BCCS's] Assistant Controller and certain other Brookville employees reported to, and were supervised by, AHRC executives."

BCCS agrees with this as a statement of fact, but disagrees that the provision of these services pursuant to the terms of the Management Agreement constitute control of BCCS and do not reflect duplicative services. The services provided by AHRC personnel are incremental to those services provided by BCCS employees. The distinct job responsibilities of each BCCS employee are supplemented by additional work performed by AHRC personnel.

OSC's claim: "[BCCS] Brookville's and AHRC's Board of Directors (Boards) shared three common members; and AHRC's executives and certain other employees routinely briefs Brookville's Board on the financial soundness and operational aspects of BCCS."

Please refer to Section III below for BCCS response (BCCS' General Objections to Draft Audit Report Findings).

I. "Excessive Executive Compensation."

The OSC has proposed a disallowance aggregating \$188,609 for salary and fringe costs of the Executive Director, Associate Executive Director and Chief Financial Officer based on a median salary calculation for the three fiscal years ended June 30, 2014. However, as stated previously, the purported findings are not applicable based on the relevant sections of the RCM. The RCM makes clear that the provision in question applies to *employees* of BCCS. However, the Executive Director, Associate Executive Director and Chief Fiscal Officer are *not* employees of BCCS; they are employees of AHRC. Therefore, their compensation should not be compared with the median salaries listed in the Basic Educational Data System. As stated previously, the charges for these administrative services are reported on schedule CFR-3 under Contracted Personal Services and therefore, must comply with the requirements set forth under Item 14 "Consultants" of the RCM.

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Comment
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BCCS does not have its own dedicated Executive Director, Associate Executive Director, or Chief Financial Officer. Rather, BCCS is controlled by a Board of Directors who do not receive a salary. The savings of having a .216 FTE Executive Director and .216 CFO supplied by AHRC as compared to a 1.0 FTE Executive Director and 1.0 FTE CFO hired by BCCS within median salary range is approximately \$990,000, or \$513,000 to the audited programs, for the three fiscal years ended June 30, 2014. See **Exhibit 10** and **Exhibit 11** for supporting calculations.

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Based on the foregoing, BCCS demonstrated that AHRC is an unrelated consultant who entered into an arm's-length relationship with BCCS. In accordance with the RCM provisions relating to consultant services, such costs are reimbursable provided the fee does not exceed the prevailing rate for such services.

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A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. In determining reasonableness of a given cost, consideration shall be given to:

- Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the approved special education program. Public special education funding shall be used in accordance with Article 89 of Education Law Section 4401 and Section 4410 10.(e.)
- The restraints or requirements imposed by such factors as: sound business practices; arm's length bargaining; Federal, State or local laws and regulations.
- Prices for comparable goods or services determined by reviewing similar entities.
- Whether the individuals concerned acted with prudence given their responsibilities to the entity's Board of Directors, its employees, the public at large and the State government.

BCCS meets all these criteria and, therefore, the OSC claim of excessive salaries and corresponding disallowance should be removed from the Draft Audit Report.

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2. **"Ineligible Bonuses."**

The OSC has proposed a disallowance aggregating \$42,897 for alleged "ineligible bonuses." The OSC's findings relating to bonuses lack any merit. AHRC is an unrelated party, as discussed above, which entered into the Management Agreement with BCCS and served as a "consultant." See Section I (Background) and Section III (BCCS General Objections to Draft Audit Report Findings) below.

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In light of the foregoing, the charges incurred by BCCS were properly reported in BCCS' CFR on schedule CFR-3 – line 17 and reported as management fees for all three audited school years.

As also set forth above, AHRC is an unrelated consultant who entered into an arm's-length relationship with BCCS. In accordance with the RCM provisions relating to consultant

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services, such costs are reimbursable provided that the fee does not exceed the prevailing rate for such services.

The OSC claims that bonus compensation for certain AHRC staff should be disallowed. Again, the RCM provisions that OSC appears to rely upon to support its finding are not applicable here because AHRC is not an employee of BCCS. Section II.13.A(10) provides that “[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.” For the reasons explained above, AHRC is not an employee of BCCS but rather an independent contractor who entered into an arm’s-length relationship with BCCS. In accordance with the RCM provisions relating to consultant services, such costs are reimbursable provided that the fee does not exceed the prevailing rate for such services. Therefore, the OSC’s proposed disallowance is unwarranted and should be removed.

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3. “Unsupported Vehicle Expenses.”

The OSC has proposed a disallowance aggregating \$41,594 for supposed “unsupported vehicle expenses.” With respect to the proposed travel disallowances, the OSC incorrectly applied an RCM provision that relates to agency employees to support its determination. Specifically, Section III.1.E. provides that “Logs must be kept by each employee indicating dates of travel, destination, purpose, mileage and related costs such as tolls, parking and gasoline and approved by supervisor to be reimbursable.” The OSC’s application of this provision is misguided. As stated previously, AHRC is not an employee of BCCS but rather an independent contractor entity which entered into an arm’s-length agreement with BCCS. The vehicle expense incurred by AHRC is an integral part of agency administration expense including central maintenance and part of AHRC’s employees’ reimbursement. Therefore, in accordance with the RCM provisions relating to consultant services, such costs are reimbursable provided that the fee charged under the Management Agreement does not exceed the prevailing rate for such services. This finding should be withdrawn.

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B. Personal Service Costs

AHRC Management Services, Fringe Benefits, Compensation paid to AHRC Employees, and Tuition.

1. “Services covered under the Management Agreement” - \$476,952
 2. “Unsupported (\$159,762) and Unnecessary Fringe Benefits (\$74,529)” - \$234,291
 3. “Over-Allocated Compensation” - \$27,115
 4. “Ineligible Tuition Reimbursement” - \$3,150
- Total - \$741,508

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Audit Findings:

See pages 8-11 of the "Personal Service Costs" section of the Draft Audit Report.

BCCS Response:

BCCS disagrees with these findings. In addition to the analysis of these issues in Section I.(Background) and Section II. A. above, BCCS offers the following information in response to the OSC's finding.

1. "Duplicative Management Services" - \$476,952.

Audit Finding:

The OSC auditors concluded that BCCS employees performed duplicative services to those for which management fees were incurred for services provided by AHRC. Accordingly, the Draft Audit Report indicates total recommended BCCS salary and fringe cost disallowances of \$130,806, \$176,074 and \$170,072 for each of the fiscal years ended June 30, 2012, 2013 and 2014, respectively.

BCCS Response:

BCCS disagrees with this audit finding. The OSC's interpretation of the Management Agreement to include service requirements by AHRC is totally outside the contemplation or intent of the parties. "Contract interpretation involves construing agreements in accord with the parties' intent." See *Slatt*, 64 N.Y.2d at 967. AHRC simply could not have provided all of the services both AHRC and BCCS performed and it strains credulity to suggest that AHRC and BCCS intended for AHRC to perform all of the independent and necessary job functions that BCCS employees performed. Simply stated, BCCS would agree that it could not identify any duplicative work performed by two or more individuals. No two individuals ever performed the same task, as they did not duplicate each other's job duties. Further, each of those line item job duties were necessary and appropriate to carry out the mission of BCCS. But the OSC Draft Audit Report suggests that because of the OSC's misreading of the intent of the Management Agreement and the job titles of individuals as opposed to their job functions, BCCS is somehow entirely forbidden from accounting for each necessary and appropriate job function. It appears the OSC has taken liberties to place its own flawed interpretation of the Management Agreement into the findings of this audit, as neither of the parties had intended. The facts set forth throughout this response evidence the intent of the parties to the Management Agreement, and illustrate how professional services are necessary and non-duplicative. In sum, no services are duplicative to services charged by the AHRC management fees.

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In accordance with the RCM, Section III, General Requirements, 2. Accounting Requirements, F: “[e]ntities operating programs must establish adequate systems of internal controls and conduct annual risk assessments in accordance with guidelines of the Committee of Sponsoring Organizations (COSO).

Further, according to the RCM, Appendix F, Statement on the Governance Role of Trustee or Board Member, the “duty of care” means that “[a] trustee or board member must act in good faith and exercise the degree of diligence, care, and skill that an ordinary prudent individual would use under similar circumstances in a like position.” To satisfy this standard, trustees and board members should:

- Have a fiduciary responsibility for the assets, finances, and investments of the institution and exercise due diligence, care, and caution as if handling one’s own personal finances; and
- Use one’s own judgment in analyzing matters that have an impact on the institution.

BCCS conducted its operations consistent with its mission and in accordance with the directives of its Board of Directors to ensure that each student’s Individualized Education Plan (“IEP”) goals were met. Contrary to the OSC’s interpretation of the Management Agreement, the Board did not intend for BCCS to rely solely on one vendor to provide its direct or non-direct services, which would create a dysfunctional management structure. Rather the BCCS Board executed the Management Agreement with the mutual understanding between BCCS and AHRC that BCCS could hire additional administrative and fiscal staff necessary to comply with COSO guidelines; this included both BCCS employees and additional contracted staff.

The following information sets forth the relevant RCM provisions and explains BCCS’s administrative management structure, which clearly demonstrates how BCCS adhered to all RCM requirements including the provision of non-duplicative services. In fact, BCCS conducted its financial and administrative operations as well as assigned job duties efficiently and cost effectively while maintaining fiscal viability.

In accordance with RCM, Section II, Cost Principles, 2. Administration: “Entities who contract for administrative services must review their own administrative costs to avoid duplicate services that can be disallowed during the rate-setting process or upon audit.”

In accordance with this provision, on behalf of BCCS, AHRC proactively engaged two separate firms to review the appropriateness and reasonableness of its methodology to ensure that policies and procedures relating to the allocation of management fees to BCCS were both reasonable and in compliance with all applicable regulations. See **Attachment 4** and **Attachment 5** which include copies of reports from Loeb and Troper, LLP and MBAF dated July 19, 2011 and September 14, 2012, respectively. In addition, BCCS reviewed its workload distribution and efficiency among its internal staff and outside consultant assistance required to

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cost effectively perform all of its administrative responsibilities and comply with the rate setting methodology and RCM requirements.

Section 200.9 (d) of the Commissioner's Regulations requires entities operating approved programs to retain all pertinent accounting, allocation and enrollment/attendance records supporting reported data directly or indirectly related to the establishment of tuition rates for seven years following the end of each reporting year.

Costs will not be reimbursable on field audit without appropriate written documentation of costs.

Again, BCCS complied with the RCM by reporting costs on its CFRs based on actual and appropriate documentation of costs incurred for administrative services provided by BCCS employees and AHRC contracted services during each school year. Therefore, given that both entities did not perform the same service, financial positions were not defined similarly and staff FTE's were not excessive in comparison to the administrative workload, no duplication existed.

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Comment
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According to the Draft Audit Report, the OSC determined services were duplicated based on its flawed interpretation of the Management Agreement. Instead, a correct interpretation would be based on the parties' intent, identification of actual services provided, actual costs charged to BCCS for such services and the actual amounts reported on BCCS's CFR. BCCS hired its own employees (e.g., accountants) to perform necessary accounting services that AHRC could not and did not perform. BCCS should not be penalized based on the OSC's incorrect interpretation of the Management Agreement when the facts are simple: (1) The Management Agreement did not require AHRC to exclusively provide all of the services listed in the Management Agreement; (2) AHRC did not perform all of those services; and (3) BCCS incurred no additional expenses related to services which AHRC did not provide. Therefore, the OSC lacks the facts to support its audit finding.

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Comment
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During the course of the audit which was conducted from September 2016 through April 2017, BCCS afforded full access to its staff, AHRC staff and all requested documentation. At no time through the current date, did the OSC auditors report the observation of any duplicative functions or persons performing duplicative functions. In fact, complete and timely responses were provided by BCCS as a result of the additional efforts made by AHRC staff beyond that of BCCS staff capabilities. There were some occasions when seeking additional detail in certain areas or additional documentation, that the OSC auditors would ask if we could pursue their questioning further with AHRC staff. There have been no structural changes since the Audit Period. Throughout the course of the OSC audit, timely responses with relevant reports were provided to the OSC auditors by AHRC staff, in addition to the audit support provided by BCCS employees. This activity should serve as compelling evidence that BCCS does not have adequate resources to handle all of its business requirements and must utilize the supplemental and incremental services provided under the Management Agreement.

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BCCS Employees and AHRC Representatives

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Based on actual data and supporting documentation, six of the 12 BCCS employees, of whom OSC claims duplicative services were conducted, performed accounting services. See **Exhibit 1** for the OSC compilation of BCCS salary amounts and **Exhibit 2** for management fees schedule. BCCS provided each of those employees' job descriptions and the OSC interviewed those employees who were still employed by BCCS. Based on relevant data and interviews, it was clear that AHRC representatives did not perform the same accounting functions performed by BCCS. Further, the supporting documentation to AHRC's management fees provided to the OSC, did not include any of those positions.

The following is a list of BCCS employees who provided accounting and billing related functions:

RB: Accountant

- Assists in preparation of agency budget using financial statements, projected changes and estimated revenues.

DD: Accounting Supervisor

- Prepares monthly financial statements and conducts financial analysis of actual to budgeted results, student enrollment, revenue rates and expenses..
- Assists with preparation of annual operating budget.

LG: Accounts Receivable Supervisor

- Prepares data entry of program participants' attendance information resulting in complete reimbursement data eligible for billing.
- Copies data onto computer diskette. Submits diskette and completed transmittal form to produce billing information.
- Forwards diskette and transmittal to government organizations to process reimbursement.
- Forwards checks to Department Administrative Assistant for deposit.
- Rebill any denials that are eligible for payment.

IM and LQ: Senior Accountants

- Responsible for the completion of the CFR schedules and other reports submitted to state agencies for appropriate reimbursement to the agency.
- Assists in the preparation of monthly financial statements. Records monthly journal entries and performs data entry.
- Responds to problems that may arise and takes corrective actions.
- Assists in preparation of agency budget using financial statements, projected changes and estimated revenues.

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KL: Assistant Controller

- Prepares monthly financial statements and reviews discrepancies that arise in comparing actual results to budget.
- Prepares and submits papers, reports, etc. to state required for agency contract reimbursement.
- Prepares CFR.
- Prepares Form 990.

With respect to the OSC's claim regarding duplicative corporate compliance services, it should be noted that the aggregate cost of corporate compliance services reflects less than one FTE in each fiscal year. The total salary cost of Corporate Compliance personnel for each of the fiscal years ended June 30, 2014, 2013 and 2012 was \$60,527, \$81,236 and \$69,754 of which \$11,107, \$81,236 and \$69,754, respectively, was charged by AHRC. *See Exhibit 2.* In fiscal year 2014, BCCS hired Shiva Fayzar as its own Corporate Compliance Officer. Therefore, the amounts charged by AHRC were reduced to \$11,107 for the fiscal year ended June 30, 2014. The amount of OSC proposed disallowances is \$36,676, \$29,826 and \$48,981 for each of the fiscal years ended June 30, 2014, 2013 and 2012, respectively. Since corporate compliance is a required and necessary part of an agency's obligations, BCCS chose to hire its own staff in order to adhere to part 200 of the regulations of the Commissioner as well as Medicaid. *See Appendix R of the New York State Consolidated Fiscal Reporting and Claiming Manual ("NYSCFRCM"), Position Title Code 521 and 621.* AHRC is one of only four agencies (eight agencies during the three fiscal years ended June 30, 2014) recognized as a COMPASS Agency within New York State. COMPASS is an OPWDD initiative that recognizes and promotes provider agencies that have progressed beyond minimal regulatory compliance and have achieved excellence in service delivery. Accordingly, BCCS benefitted from the superior level of internal controls and oversight provided by AHRC.

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Regarding OSC's claim that duplicative technology services were performed by two employees, one employee was hired directly by BCCS in November 2013, but the person was terminated shortly thereafter. In the month of February 2014, BCCS hired a new employee to perform management information functions that AHRC could not provide. BCCS' educational programs were rapidly expanding technology use requiring changes to support those technology needs. Accordingly, the AHRC Information Technology ("I/T") Director analyzed BCCS' technology needs and recommended hiring of a full-time BCCS support position, *i.e.* "BCCS Educational Systems Coordinator." The position was designed to provide full time support for the technology deployed across the BCCS locations. The person chosen for the position was oriented specifically to the school programs. A line item analysis of the functions and cost clearly shows the audit finding has no factual support.

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After reviewing these job descriptions (*see Exhibit 3*), which the OSC relied upon to support its duplicative services claim, we determined that none of these BCCS accounting and billing related positions were found on AHRC's supporting schedules to its management fees. The job descriptions and job titles for these BCCS employees never duplicated any of the actual

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services provided by AHRC representatives. The job descriptions of the BCCS accounting positions included necessary day to day and/or weekly operational activities, and the supporting documents generated from their work activities under their overall job description contributed to part of the accounting processes, including but not limited to, preparing budgets, monthly financial statements, contract reimbursement reports and preparation of CFR schedules. Without that documentation, none of the supporting reports could be prepared, which would result in BCCS's inability to continue the program. Notwithstanding that none of these services were performed by any AHRC representative, the OSC disallowed the percentage of time each BCCS employee performed these functions solely because the OSC believed that the Management Agreement required AHRC to be the sole provider of these services.

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Comment
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With regard to the only two AHRC professional finance positions allocated to BCCS, the Chief Financial Officer ("CFO") and Controller, these individuals provided administrative services to BCCS which included interpretation and review of reports and documents prepared by BCCS accounting staff. The CFO and Controller utilized these documents in order to perform analytical reviews and protect the agency's assets. Additionally, the AHRC CFO and Controller assisted BCCS in managing its cash flow, monitored daily operating cash balance, provided accounting and analysis of all business insurance policies provided for by AHRC, provided accounting and analysis of all employee benefit plan costs and ensured continuity of all necessary business functions by executing timely and accurate employee payroll and vendor payments. BCCS did not hire employees to fulfill these positions nor did it incur any additional expense to have these services performed. All of these services were performed by these two AHRC employees aggregating an approximate 0.44 FTE. Combined with the six BCCS employees, the AHRC management fees for financial services was approximately 7% of the overall financial staff cost (0.44/6.44), which is hardly duplicative.

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In addition to the job descriptions and interviews (*see Exhibit 3*), BCCS clearly demonstrated that none of its employee accounting positions duplicated any of the CFR job titles or codes performed by the AHRC's fiscal representatives. In fact, those six BCCS employees set forth in the final draft audit report were primarily reported in CFR title codes 605 and 606; the two AHRC fiscal representatives were reported in CFR title codes code 602 and 603. Further, none of these CFR codes include similar definitions according to the NYSCFRM under Appendix R which, therefore, undermines OSC's claim of duplicative services.

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As another specific example, a BCCS senior accountant handles the BCCS billing functions. The actual daily responsibilities and scope of work of a senior accountant are more detailed than the original job description page. Associated billing reports and the support for recording revenue and accounts receivable by the Accounting Department personnel comes from the billing reports generated by the senior accountant. Furthermore, the OSC indicates that billing is one of those functions which is duplicative of management fees paid to AHRC. This is incorrect. In fact, as shown in its supporting documentation to the AHRC management fees, the amount paid to AHRC for billing services to the BCCS educational programs is \$0 (*see Exhibit 2* at pages 3 and 5). Thus, there is no duplication.

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BCCS does not have enough full-time equivalents (“FTE’s”) to handle all required services of an agency producing annual revenue of over \$40 million. Distinct job responsibilities exist within BCCS and a clear, non-duplicative segregation of duties exist within BCCS and among BCCS and its service vendor, AHRC, all in accordance with the intent of the parties to the Management Agreement.

For example, AHRC installed a new payroll system in July 2013 for the benefit of AHRC and its affiliated organizations for which it provides payroll services. AHRC maintains this system, processes periodic payroll and handles human resources and employee benefit plan management for BCCS. Simultaneously, the BCCS Assistant Controller prepares and maintains the employee accounting control documents and prepares the CFR utilizing such payroll information. The BCCS accounting staff reconcile and record payroll information from payroll registers supplied by AHRC. Again, the services provided by AHRC are incremental to services performed by BCCS employees as intended by the parties to the Management Agreement. The cost to BCCS is certainly less than the use of other third-party payroll services, such as ADP.

According to the RCM, personnel costs required to meet State program or fiscal mandates are reimbursable provided that the size of the staff recruited and maintained is appropriate and reasonably proportionate to workload requirements. BCCS accomplished its workload requirements by hiring the appropriate number of employees for job responsibilities that required full-time staff and contracted with AHRC to meet its administrative needs for accountability purposes, which amounted to only 22% of AHRC’s agency administrative service time. Not hiring full-time employees for these accountability positions demonstrates not only a cost-effective approach but also that no duplication occurred.

BCCS is the only entity responsible and “required” to meet its fiscal mandates, not AHRC nor any other vendor contracted by BCCS. Therefore, if AHRC was unable to provide certain fiscal administrative services, BCCS still remained accountable to meet its fiscal requirements. As a result, BCCS and its Board had to find an appropriate, efficient and cost-effective solution, which it did without duplicating any services. That responsibility would remain the same for BCCS with respect to any vendor for any service.

Cost Principles – Compensation for Personal Services¹

For non-direct care staff, owners or related parties who are employed in any job title or combination of job titles by the entity operating the approved programs, compensation up to 1.0 FTE for that individual in total, will be considered in the calculation of the portion of 1.0 FTE reimbursable in the tuition rates.

¹ The OSC has not identified which AHRC employees performed those functions deemed to be duplicative of those services conducted by BCCS employees. Nor has OSC explained why each function noted in Exhibit 3 is deemed to have been executed by AHRC personnel. The identification of certain job responsibilities set forth on BCCS job descriptions does not fully reflect the details of the actual scope of work performed by each BCCS employee and therefore cannot be used as the sole determinant to identify duplication of services.

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For non-direct care staff under the 500 and 600 position title code series per Appendix R of the CFR Manual, owners or related parties who work in more than one entity (including organizations that have a less-than-arm's-length relationship with the approved program), the FTE in total across entities cannot exceed 1.0. Compensation beyond 1.0 FTE for non-direct care staff, owners or related parties will not be considered reimbursable in the calculation of tuition rates.

Based on the foregoing, the RCM limits certain administrative positions to 1.0 FTE per position. This means that regardless of the number of entities that assist in providing services related to that position, so long as the FTE does not exceed one, no duplication has occurred.

According to the OSC, six remaining employees hired for corporate compliance and educational systems coordinator services were deemed duplicative yet none of those positions exceeded a 1.000 staff FTE between BCCS and AHRC during each audited school year. BCCS hired the educational systems coordinator to provide on-site services relating to specialized educational information technology tools utilized by staff and children to meet IEP goals and to ensure programmatic support. As a result, BCCS complied with RCM guidelines regarding acceptable staff FTE limitations. In each of the fiscal years ended June 30, 2014, BCCS consistently maintained a Corporate Compliance function (an essential function to maximize quality and integrity of the program). The Draft Audit Report recommends disallowance of the salary and fringe benefits of the Corporate Compliance Officer in the fiscal year ended June 30, 2014. Further, the Draft Audit Report recommends disallowance for the allocated salary and fringe cost of the AHRC Corporate Compliance Officer position and Quality Assurance Director for each audited year. Upon hire of the BCCS Corporate Compliance Officer in December 2013, the aggregate amount of salary costs charged to BCCS for AHRC Corporate Compliance Officer and Quality Assurance Director decreased from \$69,754 in Year 2011/12 and \$81,236 in Year 2012/13 to \$11,106 in Year 2013/14. In each period, the aggregate costs of the Corporate Compliance Department were less than 1.0 FTE.

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For all of these reasons, no claim should be made regarding duplicative services for the corporate compliance or technology position provided by BCCS.

Conclusion

The OSC's claim that the Management Agreement supposedly "required" AHRC to provide all enumerated administrative services is incorrect (the Management Agreement was not "exclusive"²) and should not be the basis for finding duplication of services. Reimbursable costs must be based on costs reported on the CFR and supporting documentation. If the services were not provided by AHRC and there was no cost charged to BCCS, there can be no claim for duplication.

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² See Section 1(e) of the Management Agreement noting AHRC's responsibility as "primary" not exclusive.

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2. **“Unsupported/Unnecessary Fringe Benefits” - \$234,291.**

Audit Finding:

The OSC claims that: a.) BCCS overstated fringe benefit costs for the SED cost-based programs by \$159,762; and b.) BCCS paid \$74,529 for retiree health insurance premiums for which OSC recommends a disallowance

BCCS Response:

BCCS disagrees with both components of this audit finding. BCCS offers the following specific responses to the OSC’s findings.

- a.) BCCS incurred and reported costs that were reasonable, necessary and directly attributable to the programs for which they were incurred. The majority of BCCS service personnel work in multiple programs. It is necessary to allocate the proportionate share of employer fringe benefit cost to the corresponding salary expense in each program. BCCS complies with RCM Section II 13. B (2) (b) – “Costs of benefits for employees who provide services to more than one program and/or entity must be allocated to separate programs and/or entities in proportion to the salary expense allocated to each program.” Based upon the foregoing, and additional facts provided in **Exhibit 4**, BCCS disagrees with this audit finding. *See Exhibit 4* for full response.
- b.) BCCS disagrees with the disallowance of \$74,529, the allocated amount to the cost based programs, but affirms that a partial disallowance of \$14,137 is appropriate. The reconciling component is that OSC failed to consider the amount of cash collected from ex-employees for their retiree health insurance.

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BCCS supplied: (i) a schedule of actual monthly payments for retirees’ health insurance together with check number, check date and check amount for each of the fiscal years ended June 30, 2012, 2013 and 2014; (ii) schedules of actual receipts for retirees’ health insurance for each of the fiscal years ended June 30, 2012, 2013 and 2014; and (iii) net amounts on the schedule noted in (i) above showing \$4,511, \$10,722 and \$4,254 for each of the fiscal years ended June 30, 2012, 2013 and 2014, aggregating to \$19,487. Subsequent to receiving the Preliminary Report dated March 10, 2017, OSC auditors requested additional information with respect to the month of May 2013 for which one monthly payment was apparently missing. Adding the monthly amount paid for May 2013 and applying the audited programs factor of \$30,720/\$55,525 identified by the OSC in its Preliminary Report, the resultant aggregate, calculated

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disallowance is \$14,137 for the Audit Period. OSC did not consider the amounts received from retirees, which totaled \$111,922. We believe that one cannot look at only one-half of a transaction and conclude as to the fair statement and accounting for 100% of the transaction.

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Comment
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Despite providing OSC with cash receipt details by name of retiree, together with actual payments made for retiree coverage, the Draft Audit Report only reflects gross amounts paid by BCCS without offsetting cash received from ex-employees, which was properly accounted for and reported in the CFR as a reduction to amounts paid.

In its Draft Audit Report, the OSC reported that:

1. "Brookville paid \$137,474 in health insurance for certain retirees." We agree and such amount agrees to the schedule of 'Retirees Health Insurance' provided to the OSC.
2. "Brookville officials could not provide documentation to show that these payments were contractually required." At no time did Brookville officials claim that these amounts were contractually required and therefore had no responsibility to prove otherwise.
3. "These individuals were no longer employed by Brookville at the time the premiums were paid." At no time did Brookville officials claim that these retirees were anything other than ex-employees when these amounts were paid and therefore had no responsibility to prove otherwise.

Consistent with our prior response to the OSC preliminary report, the gross amount paid of \$137,474 should be reduced by amounts collected of \$111,922. The net amount of \$25,552 should be allocated to the audited cost-based programs with a resultant disallowance of \$14,137.

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Based upon the foregoing, BCCS agrees to a disallowance for retirees' health insurance in the amount of \$14,137 for the Audit Period and respectfully requests the OSC to adjust its disallowance claim. See **Exhibit 5** for the schedule of retirees' health insurance payments, total receipts and net expense incurred.

3. **"Over-Allocated Compensation" - \$27,115 including: a.) \$16,808 for compensation for three group leaders and b.) \$10,307 in teacher compensation.**

- a. "Over-Allocated Compensation" – "Three Assistant Group Leaders" - \$16,808 in administrative costs -

BCCS disagrees with the disallowance of \$16,808, the allocated amount to the cost based programs. The OSC auditors incorrectly concluded that costs were incorrectly allocated to cost based programs based upon their calculation of time worked "for month of September" which

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was applied to the entire time frame within the fiscal year ended June 30, 2014 ("FY2014"). See **Exhibit 6**. It is unnecessary to calculate salary expense when actual salary expense for the entire period was provided. This calculation is unnecessary and incorrect, as BCCS management supplied the actual time and expense worked by employee in FY2014 by program. The Change of Status forms are the documents dated Sept. 17, 2013 indicating that for the month of September that the employees subject to this inquiry were covering "in Kangaroo Room 9160 (employee has T/A cert.)." See **Exhibit 6**. In fact, each of these employees worked in the same capacity through the earlier of their respective employment termination dates or June 30, 2014, for which payroll records, position control documents. A subsequent change of status form would have been the ideal flow of documentation to clarify that their status continued beyond that one month as noted in the September 2013 Change of Status forms. See **Exhibit 6**. The OSC argument is one of form over substance. In fact, the employees worked in the same capacity through their dates of termination for which our payroll records, position control documents and resultant financial statements and CFR properly reflect actual time and expense worked by program.

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The OSC used an e-mail from the Westbury Program Director to the CFO indicating that one of the Group Leaders was "daycare only not sure why she would be on here" as part of their supporting audit documentation. This statement is not correct relative to the Audit Period.

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Based upon actual time worked and actual expense by program, BCCS affirms that expenses were correctly reported by program in its CFR for which adequate records were made available. Further, actual records best serve as supporting documentation, preferable to that of calculations and e-mail correspondence.

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Based upon the foregoing, we respectfully request that the OSC eliminate its disallowance of \$16,808.

4. **"Ineligible Tuition Reimbursement" - \$3,150.**

Audit Finding:

Two employees were reimbursed for tuition that OSC believes does not meet criteria for reimbursement.

BCCS Response:

BCCS disagrees with this audit finding based on attributes discussed in **Exhibit 7**.

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C. Other Than Personal Services (“OTPS”)

1. “Excessive Allocation of Rental Property” - \$252,882 (Marcus Ave. – New Hyde Park location).
2. “Ineligible Leasehold Amortization Expenses” – \$90,848.
3. “Miscellaneous Expenses” - \$5,679.
Total - \$349,409

Audit Findings:

See pages 11-13 of the “Other Than Personal Services Costs” Review section of the Draft Audit Report.

BCCS Response:

BCCS disagrees with these findings. BCCS offers the following specific responses to the OSC’s findings.

1. “Excessive Allocation of Rental Property” - \$252,882 (Marcus Ave. – New Hyde Park location).

The OSC is proposing a disallowance of \$252,882 in rental and property costs for the Marcus Avenue, New Hyde Park education center. This proposed disallowance was increased by the OSC auditors from \$76,523 in its Preliminary Report dated March 10, 2017.

OSC’s Claim: Brookville officials provided us with a spreadsheet detailing the 37,343 square foot space at their New Hyde Park location. This space was shared by SED cost-based and other aforementioned programs. We reviewed the spreadsheet and determined that Brookville officials had incorrectly assigned 122 square feet to the cost-based programs. They also were unable to account for an area totaling 8,771 square feet. Consequently, the square footage reported in the spreadsheet was over stated by 24 percent, or 8,893 (8,771 +122) square feet. As a result, we determined that Brookville over-allocated \$250,269 in property costs to the cost-based programs.

Response:

1. BCCS agrees to the incorrectly assigned 122 square feet which approximates \$3,433 of disallowed cost.

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2. On April 20, 2017, the New Hyde Park Assistant Program Director, and CFO, accompanied OSC representatives Tania Zino, Claire Jameson and Artun Fejza to conduct measurements, as requested.
3. On April 26, 2017, BCCS provided its full response to further questions presented after the April 12, 2017 exit conference and as follow-up to the April 20, 2017 site visit.
4. BCCS provided a spreadsheet referred to in the OSC Draft Audit Report. BCCS has subsequently identified the disallowed cost amounts and the alleged overstated square footage reflected in the OSC Draft Audit Report. This is attached hereto as **Exhibit 8**.
5. In contrast to the measurements taken by the OSC auditors of each room indicated in the attached spreadsheet, we agree that the 8,771 square footage area could not be measured, as this area is a portion of space within the building allocated to each tenant. However, BCCS fully accounted for that space by reconciliation to the total square footage in the lease agreement. Further, BCCS verified with a complete reconciliation that the lease agreement includes charges for this space.
6. We acknowledge the RCM requires that the share of rental expense allocated to programs funded pursuant to Article 81 and/or Article 89 is based on documented and reasonable criteria, such as square footage utilization, when more than one program is operated in a rented facility. Accordingly, we allocated rent based upon the measured square footage of each classroom and office identified to the programs served. In addition, in accordance with NYSCFCRM Appendix J, section 43.0, BCCS allocated rent for the space not used exclusively by BCCS based on staff FTE's (*see 7 below*).
7. The allocation of the specifically identified rented space in 6. above was added to the building areas comprising the 8,771 square feet of space in question to total the sum of all the rented space in the lease agreement. According to the NYSCFCRM, "[w]hen programs share the same geographic location or more than one State Agency is served at the same geographic location, property and related costs must be allocated between the programs/State Agencies benefiting from those resources. These costs include expenses such as utilities, repairs and maintenance, depreciation, leases or mortgage interest. The most common method uses square footage as the statistical basis. However, if the use of this method in a specific situation does not result in a fair allocation of the costs, another reasonable method can be used. As such, included in that same section of the NYSCFCRM is a provision, which provides that "[o]ne reason why the square footage method might not accurately reflect the cost to be allocated to a State Agency/Program

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would occur when a program uses a significant amount of space, but not much space exclusively. In that case, units of service or staff FTEs might be a better choice as the basis for the allocation. BCCS complied with the foregoing provision, utilizing staff FTE's in its cost allocation base for the remaining 8,771 documented square feet, in order to accurately allocate that square footage to the State Programs based on the staff FTEs employed to provide the mandates set forth in each student's IEP which relate to the development of specific skills such as the following:

- Social –emotional including awareness of self, peers and adults: sharing, requesting, turning-taking, commenting, following expectations and rules of the playground environment, participating in small and large group activities.
- Language-identifying, labeling, requesting, following directions, commenting, responding to questions.
- Motor- balance, coordination, stamina, strengthening, ball skills, walking, running, jumping, jumping over objects, climbing, alternating foot pattern on steps, avoiding obstacle when running.
- OT- core skills, sensory processing, fine motor skills, visual motor processing.
- Cognitive- following directions, attending, identifying objects, math skills, science skills, matching objects to function, more/less, identify colors, characteristics, distinguish between real and make believe, letters, numbers, animals, predictions, etc.
- Self-help/adaptive-pouring, measuring, knows what shoes go on the correct feet, hang coat/jacket in designated location, cleans up spills, etc.

Based on the foregoing, staff FTE's is the most appropriate allocation base for the remaining 8,771 square feet, as reported in BCCS's square footage allocation schedule (*see Exhibit 8*).

8. Attached is a report obtained from Brookville's landlord, CLK Associates, prepared by James A. Gaddis, Architect, P.C in **Exhibit 9**. We obtained the architect's report to clarify responses previously provided to OSC auditors by BCCS regarding total rentable space and to fully explain the 8,771 square feet referred to in the OSC Draft Report. BCCS rents its classroom and office space within a large office building along with non-affiliated tenants. Therefore, the building contains a significant amount of space which is shared among all tenants.
9. The total rent paid includes use of the BCCS playground which consists of approximately 1,820 of space outside of the building. The OSC auditors physically observed this playground area upon its April 20 site visit. The cost of the playground area is included in the total rent charges. The New Hyde Park playground is used during scheduled instructional classroom time and the classroom teams and therapists work on IEP goals and skills as noted in 7 above.

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10. Denial of reimbursement for the space necessary to gain access to the classrooms and an integral part of the lease agreement, is also a denial of reimbursement for the playground use.
11. Based on the foregoing, we believe that the full cost of actual rent paid should be reimbursed according to the appropriate allocation to each program. The total cost incurred for approximately 37,000 square feet per the lease agreement is necessary to operate the education programs at the Marcus Avenue, New Hyde Park location. The overall space has been properly accounted for in proportion to allocated cost of specifically identified classrooms. The nature of the lease agreement, typical of office building lease agreements, includes an allocated portion of the entire building's shared space. BCCS cannot pay for its entire rent charge without reimbursement, which is properly accounted for as a percentage as outlined in the attached third-party architect's report.

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2. "Ineligible Leasehold Amortization Expenses"

OSC is proposing a disallowance of \$90,848 in leasehold amortization costs. In its Draft Audit Report, the OSC cites that this disallowance is according to the RCM, "losses from sales or impairments are not reimbursable." In its prior report dated March 10, 2017 ("the Preliminary Report"), the OSC recommended this same amount for disallowance on the basis that "bad debt expenses are not reimbursable. Actual or estimated losses resulting from uncollectible accounts or other claims, including related finance charges are not reimbursable operating expenses under Article 81 and/or Article 80 funded programs."

Both claims mischaracterize the actual circumstances in connection with the BCCS departure from the Leeds Building on Community Drive in Manhasset, New York.

Accelerated depreciation expense was recorded in the quarter ended June 30, 2014 based on a change in estimated useful life of the associated assets. BCCS was notified that it could no longer continue to operate its educational programs in the Leeds Building on Community Drive in Manhasset, New York.

In accordance with generally accepted accounting principles, BCCS adjusted depreciation expense to record depreciation over the remaining useful life of the asset. Based upon the last day of occupancy as of August 31, 2014, BCCS recorded depreciation over the remaining useful life instead of the original estimated life of 15 years.

The Preliminary Audit Report mischaracterizes circumstances surrounding the transfer from Manhasset to Westbury by stating, "the provider decided to move out of the location during FY 2014-15." Rather, BCCS was forced to move out because the landlord would not renew the

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lease. The Village of North Hills held a hearing in April 2014 and determined that BCCS could not remain in the building and continue to operate the educational programs at that location. Otherwise, there is no way that BCCS would have closed down the Leeds location, forcing a relocation within four months. BCCS did not decide to move out during FY 2014-15. Immediately after the April 2014 hearing, steps were in process to look for a new operating location because of the forced relocation. Correspondence which outlined the sequence of events during this period was provided to the OSC auditors.

BCCS agrees that bad debt expenses, losses from sales and impairments are not reimbursable. This cost is not a bad debt, loss from sale nor an asset impairment. This cost does not reflect a loss from uncollectible accounts receivable, nor is it a loss resulting from claims or a loss from disposition of property. Rather, the cost is a depreciation expense, reflecting a change in estimate based on the limited remaining useful life of the non-detachable assets in the Leeds building.

In its Draft Audit Report, the OSC states: "To recover all of Brookville's leasehold improvement project costs, Brookville officials accelerated amortization charges for fiscal year 2013-14 by claiming \$60,801 in additional amortization for May 2014 and \$30,047 for June 2014." This is a false allegation. Rather, Brookville officials recorded additional depreciation expense to comply with generally accepted accounting principles ("GAAP") by recording the cost over the remaining useful life of the associated assets.

This expense does not reflect a gain or loss on the disposition of assets. BCCS was forced to vacate the location. While we appreciate that the OSC has now recognized that we were forced to move out of the location and no longer claims that we "decided to move out of the location" as was presented in its Preliminary Report, nonetheless, BCCS recorded all expenses in accordance with GAAP over the corresponding useful life of the assets. No gain or loss was otherwise recorded in connection with this transaction.

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Based upon the foregoing, BCCS disagrees with the proposed disallowance of \$90,848 in depreciation expense.

III. BCCS' GENERAL OBJECTIONS TO DRAFT AUDIT REPORT FINDINGS

The findings in the Draft Audit Report relating to alleged duplication of services and the alleged inappropriate allocation of time are fundamentally flawed and not consistent with the facts. Notably, the Draft Audit Report does not contain a line item cost analysis that would have otherwise clearly explained any alleged cost duplication. This flawed reasoning is compounded by the OSC auditors positing that BCCS should have expanded the amount of contractual work to AHRC in place of the alleged duplicative work performed by BCCS. BCCS outsourced work tasks to AHRC for that work which was performed more economically by use of an independent contractor than if performed by its own BCCS workforce. As a result, the overall administrative

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and management cost incurred to operate the BCCS programs sets the platinum standard when compared to cost levels other schools incur to provide similar functions.

The New York Not-For-Profit Corporation Law §102(21) defines an Independent Board Member as follow:

(21) [Eff. May 27, 2017] “Independent director” means a director who: (i) is not, and has not been within the last three years, an employee or a key person of the corporation or an affiliate of the corporation, and does not have a relative who is, or has been within the last three years, a key person of the corporation or an affiliate of the corporation; (ii) has not received, and does not have a relative who has received, in any of the last three fiscal years, more than ten thousand dollars in direct compensation from the corporation or an affiliate of the corporation; (iii) is not a current employee of or does not have a substantial financial interest in, and does not have a relative who is a current officer of or has a substantial financial interest in, any entity that has provided payments, property or services to, or received payments, property or services from, the corporation or an affiliate of the corporation if the amount paid by the corporation to the entity or received by the corporation from the entity for such property or services, in any of the last three fiscal years, exceeded the lesser of ten thousand dollars or two percent of such entity's consolidated gross revenues if the entity's consolidated gross revenue was less than five hundred thousand dollars; twenty-five thousand dollars if the entity's consolidated gross revenue was five hundred thousand dollars or more but less than ten million dollars; one hundred thousand dollars if the entity's consolidated gross revenue was ten million dollars or more; or (iv) is not and does not have a relative who is a current owner, whether wholly or partially, director, officer or employee of the corporation's outside auditor or who has worked on the corporation's audit at any time during the past three years. For purposes of this subparagraph, the terms: “compensation” does not include reimbursement for expenses reasonably incurred as a director or reasonable compensation for service as a director as permitted by paragraph (a) of section 202 (General and special powers) of this chapter; and “payment” does not include charitable contributions, dues or fees paid to the corporation for services which the corporation performs as part of its nonprofit purposes, or payments made by the corporation at fixed or non-negotiable rates or amounts for services received, provided that such services by and to the corporation are available to individual members of the public on the same terms, and such

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services received by the corporation are not available from another source.

BCCS's Board consists of a majority of Independent Directors under this definition, which means that it is an independent Board. OSC seems to ignore this definition and this basic principle. Any action taken by the Independent Directors must also comply with Not-For-Profit Corporation Law § 708(d) which provides:

... the vote of a majority of the directors present at the time of the vote, if a quorum is present at such time, shall be the act of the board. Directors who are present at a meeting but not present at the time of a vote due to a conflict of interest or related party transaction shall be determined to be present at the time of the vote...

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Under General Construction Law § 41, a majority of the whole number (meaning the total authorized membership) of persons making up the board or body constitutes a quorum. The board or body may not exercise its power, authority or duty in the absence of a quorum. Further, a majority vote of the whole number is necessary for the board or body to take action. 1997 N.Y. Op. Att'y Gen. 11. Even assuming, *arguendo*, that a BCCS Board member had a conflict of interest resulting in the inability to participate in a determination relating to the Management Agreement, there would be enough remaining Board members who are Independent Directors to meet the quorum requirements of the Not-For-Profit Corporation Law to ensure the BCCS Board maintains independence and control over its decisions relating to management.

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Furthermore, and contrary to OSC's allegations, AHRC is not a "related organization" to BCCS. The RCM Section I.4.E. defines "related party" as follows:

"E. *Related parties consist of all affiliates of an entity, including but not limited to:*

- (1) *Its management and their immediate families;*
- (2) *Its principal owners and their immediate families;*
- (3) *Any party transacting or dealing with the agency/entity of which that party has ownership of, or control over, or significant influence upon the management or operating policies of a program(s)/entity(ies) to the extent that an arm's-length transaction may not be achieved."*

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The relationship between BCCS and AHRC does not meet any of these criteria, and for the OSC to construe the relationship in such a manner is not only improper, but would also fail to

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allow an entity such as BCCS to purchase necessary and identified services in the most cost effective manner. *See also Attachment 2.*³

AHRC is an unrelated party who entered into the Management Agreement with BCCS and served as a “consultant.” Section I, paragraph 4 – Less than Arm’s-Length (“LTAL”) Relationship and Regarding Conflicts of Interest, the RCM states: “[I]n general, a LTAL relationship exists when there are related parties and one party can exercise control or significant influence over the management or operating policies of another party, to the extent that one of the parties is or may be prevented from fully pursuing its own separate interests.” Accordingly, the charges incurred by BCCS were properly reported in BCCS’ CFRs on schedule CFR-3 – line 17 and reported as management fees in each of the fiscal years ended June 30, 2014, 2013 and 2012.

Accordingly, OSC’s contention that BCCS and AHRC are related, and the Agreement was not an arm’s-length transaction is contrary to the actual independent governing structure of these separate entities and the clear documentary evidence establishing those governing structures. The Agreement was arm’s-length, and the relationship between BCCS and AHRC created no possibility that AHRC could exert influence over BCCS that could prevent BCCS from pursuing its own separate interest. As such, the definition of “related parties” is not met, and the Management Agreement is arm’s-length. Moreover, the Management Agreement clearly reflects that two distinct entities entered into the Management Agreement, and it was severally executed by the Board presidents of AHRC and BCCS, respectively.

Indeed, the relationship is more akin to AHRC being an unrelated, independent contractor wherein AHRC is contractually bound to perform duties for BCCS. The Attorney General opined in a circumstance where questions arose concerning a relationship between the New York State Independent Living Council (“Council”), a not-for-profit corporation, and the State Education Department, whom the Council entered into a contract for purposes of distribution of funding, salaries, office space and supplies. 1997 N.Y. Op. Att’y Gen. 11. “The Attorney General determined that the Council members were independent contractors who were not subject to direct supervision or control by the Education Department, which is an indicator of independent contractor status.” *Id.*; *see also* Op. Atty Gen. No. 97-F1. “Moreover, the Federal law delineating the Council’s powers and roles specifically requires that the Council remain independent from the State. Under the Act, such a Council “shall not be established as an entity within a State Agency” and a majority of the members must not be State employees or employees of centers for independent living. 29 USC § 796d(a). Thus, the relationship between the State and the Council is limited to a contractual one. The contract between NYSILC and the State Department of Education confirms that NYSILC is an independent contractor.” *Id.* AHRC is independent from BCCS as it has no control over BCCS’ Board of Directors and BCCS has no

³ The arrangement between BCCS and AHRC is clearly distinguishable from the arrangement in the recent OSC report for New York League for Early Learning, Inc. (“NYL”), dated March 29, 2017 (2015-S-43). Here the agreement was arm’s length, the entities are independent and do not exercise control over the other, resulting in the overall efficiency evidenced by an exemplary low administrative cost. For the reasons set forth herein, the finding of duplicative services in the NYL report cannot be similarly sustained herein.

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control over AHRC's Board of Directors. Rather, AHRC is an independent entity with which BCCS contracted for the legitimate and non-duplicative purpose of providing specific administrative and management functions, which BCCS has proven based on the documentation submitted herein.

Section 1 (g) of the Management Agreement entitled "Executive Management" provides in pertinent part: *"AHRC will provide leadership oversight and consulting services to Company as may be required to assist the management of Company in operating the organization in accordance with rules and regulations governing the program services rendered by Company."* This language together with Section 2 of the Management Agreement entitled "Management and Operation of Company" (see **Attachment 1**) properly describes the assisting role of AHRC and the full retention of management responsibility in BCCS and its Board. Section 2 provides: that *"... the parties agree that the Company Board [Brookville Center for Children's Services] has ultimate authority and control over the management of Company affairs."* Additionally, Section 7 entitled "Relationship of the Parties" states: *"AHRC's relationship with Company in the performance of this Agreement is that of an independent contractor, and no partnership, agency, or joint venture is intended or created. Any persons providing the services to be performed by AHRC under this Agreement will at all times be under the direction and control of AHRC and will be employees of AHRC and not employees of Company."* BCCS reports payments made to AHRC in Part VII – Section B-Independent Contractors in its annual Form 990, signed by a BCCS officer. Further, Section 1(b) of the Management Agreement provides that *"the payroll services provided by AHRC are administrative in nature and AHRC will be under no obligation to pay payroll or payroll taxes relating to [BCCS] or its employees."*

For all of these reasons, there was no related party relationship, AHRC exhibits no control over BCCS, and therefore Section II.10 of the RCM does not apply to the management fee. Instead, the standard that must be applied to the management fee is one of reasonableness, as set forth in the RCM.

The management fees paid to AHRC plainly met this test, as the services were provided at actual cost, which amounted to a cost significantly lower than what most agencies incur to receive similar services under a similar agreement. As discussed throughout this response, the Management Agreement was very clear that whatever services AHRC was asked to provide by BCCS would be billed at AHRC's actual cost. Specifically, paragraph 3 of the Management Agreement included this unambiguous language: *"The fee will be computed by AHRC based on the actual cost to AHRC of services provided, with pro rata allocations made where necessary or appropriate."*

Administrative costs clearly include all non-duplicate costs whether the services were provided by AHRC or BCCS. Specifically, BCCS' total administrative expense percentage has averaged 6% over the three audited school years, which is a clear indication of its conservative administrative management as well as its consistency in complying with RCM administrative cost screens. In fact, BCCS believes its administrative expense percentage is likely among the lowest 1% of all Section 4410 providers in its region and across the remaining regions in New York State. Significantly, OSC neither contended that the management fee was unreasonable,

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nor identified facts that would support such a contention. It also bears repeating that BCCS' overall agency administration expenses which included the management fee, were well within all applicable RCM cost screens.

Based on the foregoing, BCCS demonstrated that AHRC is an "unrelated" consultant who entered into an "arm's-length relationship" with BCCS to provide specific, non-duplicative services. In accordance with the relevant RCM provision relating to consultant services, such costs are reimbursable provided that the fee does not exceed the prevailing rate for such services.

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Finally, BCCS requested OSC to identify AHRC employees performing those functions it deemed duplicative of those services conducted by BCCS. BCCS provided the management fee calculation disclosing each employee for whom amounts were charged to BCCS. OSC failed to conduct a line item analysis to match actual services with actual costs. Any such analysis would necessarily show no duplication of services. To further establish with clarity that fact, BCCS submits the following explanation regarding how the services provided by AHRC and BCCS were (and are) distinct, unique and without duplication.

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Simply because the Management Agreement provided in the third Whereas clause that *"AHRC will provide certain corporate and administrative services to enhance the effectiveness of the two organizations in achieving their mutual goals and objectives and to further their respective nonprofit tax-exempt purposes"* (emphasis supplied) does not mean that AHRC was exclusively required to perform all responsibilities related to those services. In fact, the clear language quoted mandates the opposite conclusion. The RCM requires BCCS to determine whether it must hire additional staff to satisfy its fiscal and programmatic operations so long as such costs are reasonable, necessary, directly related to the special education program and sufficiently documented.

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Specifically, the RCM provides in Section III.2.F that "[E]ntities operating programs must establish adequate systems of internal controls and to conduct annual risk assessments in accordance with guidelines of the Committee of Sponsoring Organizations (COSO)."

BCCS complied with this provision during the three audited fiscal years ended June 30, 2014, 2013 and 2012 by entering into an arm's-length administrative services agreement with AHRC in order to appropriately monitor funds, maintain adequate internal control systems and conduct annual risk assessment evaluations. In fact, AHRC's obligations under the Management Agreement enabled BCCS to meet fiscal compliance standards by providing adequate and practical staffing measurements necessary to operate an agency of its magnitude and adhere to rate methodology requirements set forth by the New York State Education Department Rate Setting Unit ("RSU"). In addition to compliance with the above RCM requirement, BCCS fully complied with other relevant RCM provisions including, *e.g.*, Principles, Recordkeeping and Accounting requirements, as well as adhered to acceptable position titles defined in the New York State Consolidated Fiscal Report Manual under Appendix R.

- (a) The services provided by AHRC personnel are incremental to those services provided by BCCS employees and the Management Agreement

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clearly recited language throughout that the parties both anticipated that division of labor. In addition to the third Whereas Clause, cited above, paragraph 1(b) provided in pertinent part:

“For the avoidance of doubt, the payroll services provided by AHRC are administrative in nature and AHRC will be under no obligation to pay payroll or payroll taxes relating to Company or its employees.”

The recitation that BCCS employees exist, unambiguously shows that BCCS would have employees performing tasks not given to AHRC.

Similarly paragraph 1 (e) , as well as other paragraphs define AHRC ‘s responsibility as “primary” , as opposed to exclusive. Further, paragraph 1 (k) recites that “AHRC will provide other services necessary to the ongoing operation of the Company as reasonably may be requested by Company.” (emphasis supplied). The power to either perform duties in-house or to request those services from AHRC was thus clearly reserved to BCCS.

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The distinct job responsibilities of each BCCS employee are supplemented by additional work performed by AHRC personnel. The BCCS staffing resources are not sufficient to complete all of the required responsibilities to manage BCCS operations. The OSC failed to identify which responsibilities performed by the enumerated BCCS employees purportedly duplicated AHRC’s, which individuals at AHRC performed the same responsibility or how the OSC reached its determination. While the OSC’s report failed to identify the documentation the OSC relied upon in reaching its unsupported conclusion, it did imply that during a face-to-face meeting, there were several employees it believed were working with both entities assisting with BCCS’ budgeting process. However, the OSC failed to consider each individual’s position title, primary duties and responsibilities and how each person’s responsibilities contributed to the budget process of an agency producing approximately \$40 million in revenue and performing multiple services in multiple programs at multiple sites. The OSC identified alleged cost duplication based on the estimated percentage of time per BCCS job descriptions, for which such job descriptions matched similar services provided by AHRC. In doing so, the OSC apparently viewed BCCS as an average size provider without considering the necessary scope of support required. Apparently, the OSC ignored the fact that BCCS procured a cost effective and efficient means of supporting its programs relative to its size and scope of operations. The fact is BCCS needed to contract more globally for all such services. Again, the ultimate test as to whether this was effectively determined by BCCS should be the overall efficiency exhibited by the low administrative cost BCCS achieved to run its programs.

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On behalf of BCCS, AHRC proactively engaged two separate firms to review the appropriateness and reasonableness of its methodology to ensure that policies and procedures relating to the allocation of management fees to non-controlled organizations are both reasonable and in compliance with all applicable regulations. See **Attachment 3** and **Attachment 4** which include copies of reports from Loeb and Troper, LLP and MBAF dated July 19, 2011 and September 14, 2012, respectively.

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BCCS disagrees with OSC’s analysis of the Management Agreement and its assertion that the CFR required Brookville to report the Management Agreement with AHRC as a related-

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party transaction (Draft Audit Report page 6). The instructions for New York State Consolidated Fiscal Report instructions for Schedule CFR-5 require the following that “[f]or purposes of this schedule, “related organizations and/or individuals” shall include closely allied entities as described and defined in Article 25.06 of Mental Hygiene Law and on page 18.2 of the CFR Manual.” Disclosure of AHRC as a closely allied entity which administers funds for BCCS does not rise to the level of a related party nor confer any level of management control.

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BCCS has properly reported its business relationship with AHRC Nassau as a non-controlled affiliate. To provide full disclosure, BCCS reported the amounts paid to AHRC Nassau on Schedule CFR-5 based upon BCCS’ affiliation with its non-controlled affiliate.

The OSC seems to rely on the fact that BCCS did not employ an Executive Director, Assistant Executive Director, or Chief Financial Officer on its payroll for its erroneous finding. Although BCCS agrees with the basic facts, the OSC’s conclusion is wrong. There simply is no cost duplication to the extent that AHRC charged for a portion of these positions with services provided by AHRC to BCCS.

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Further, while the OSC did not dispute the amounts charged for these services as being anything other than an appropriate allocation of actual cost, the OSC nevertheless claimed that the portion of total compensation charged (approximately 22% of total) exceeded median salary limits for these positions. BCCS disagrees that the portion of such costs charged to BCCS were excessive. Further, BCCS has more than adequately demonstrated that the leveraging of AHRC executive leadership and many other administrative functions are cost-beneficial, contributing to the agency administrative cost of only 6% of its total expenditures compared to industry-accepted standards, which range between 10% to 15% of total agency expenditures.

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Comment
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BCCS fully disclosed that the management agreement includes executive leadership, accounting and financial reporting services. To effectively conduct these functions, it is necessary for appropriate review and supervision of BCCS employees providing those services. Alternatively, BCCS could have employed these supervisory positions, which would increase its payroll costs and would have decreased the costs of those services provided under the management agreement. In either case, the total cost would be the same or more if BCCS employed its own workforce to conduct those functions.

BCCS’s and AHRC’s Boards of Directors (Boards) shared three common members, yet the three common board members do not constitute a majority of either board. Accordingly, a majority vote to affect control does not exist.

AHRC’s extensive experience providing these types of administrative services for the last several decades contributes significantly to BCCS. BCCS carefully determines appropriate administrative employee staffing size and the types and amount of responsibilities each BCCS employee could fulfill at maximum output. It then ensures the uniqueness of the services provided by AHRC. Moreover, the SED Rate Setting Unit (“RSU”) never communicated any issue with the provision of administrative services and associated costs pursuant to the terms of the Management Agreement. The RSU continued to promulgate program reimbursement rates

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over several years, with full knowledge of the existence of management fees included in total CFR reported costs.

The OSC also incorrectly claims that the Management Agreement should have covered all of the services noted above. Based on the clear language of the Management Agreement and intention of the parties, it should not and did not. However, purchasing the expertise of a sophisticated CFO on a less than full time basis provides the agency with a level of service and competence that BCCS could not purchase otherwise. The fallacy of the audit is again that it does not drill down on functions actually performed and, therefore, does not reach sound judgments as to either the appropriateness of costs or the economic soundness achieved by BCCS.

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Comments
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When interpreting a contract, the agreement is to be construed in accord with the parties' intent as evidenced by the written agreement. *See Slatt, supra; Slamow, supra; R/S Assocs. supra; and W.W.W. Assocs., supra*

The OSC's incorrect interpretation of the Management Agreement defies logic in terms of the characterization of BCCS' relationship with AHRC. AHRC is independent from BCCS as it has no control over BCCS' Board of Directors and BCCS has no control over AHRC's Board of Directors. Rather, AHRC is an independent entity with which BCCS contracted for the legitimate and non-duplicative purpose of providing specific administrative and management functions, which BCCS has proven based on the documentation submitted herein.

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Comment
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IV. CONCLUSION

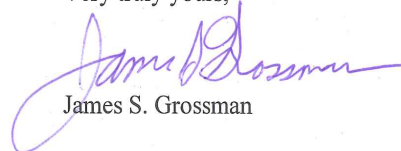
BCCS submits that upon your review of this documentation and analysis of the issues, you will agree that the OSC's findings should be rejected and removed. In particular, the findings relating to duplication of services are wholly lacking merit, based on the explanation provided above, as well as the fact that BCCS expends administrative costs at percentages significantly below industry-accepted standards. Accordingly, BCCS' management efficiencies should be lauded rather than criticized for unsupportable reasons.

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Comment
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We thank you for your attention to the evidence and positions set forth herein.

Very truly yours,



James S. Grossman

cc: Jeffrey Kraut, President, BCCS Board of Directors
Stanford J. Perry, Executive Director
Willard T. Derr, Chief Financial Officer
Margaret Surowka Rossi, Esq.

State Comptroller's Comments

1. There is no fundamental misunderstanding of the relationship between Brookville and AHRC. Section I.4.E(3) of the Manual, July 2013 Edition, provides that related parties consist of all affiliates of an entity, including but not limited to, "any party transacting or dealing with the agency/entity of which that party has ownership of, control over, or significant influence upon the management or operating policies of a program(s)/entity(s) to the extent that an arm's-length transaction may not be achieved." Section I.4.A of the Manual states that "in general, a LTAL [less-than-arm's length] relationship exists when there are related parties and one party can exercise control or significant influence over the management or operating policies of another party, to the extent that one of the parties is or may be prevented from fully pursuing its own separate interests." For the reasons outlined below, we determined that Brookville and AHRC were related parties and the Management Agreement between them was a LTAL transaction.

At all times relevant, Brookville's Board of Directors was composed of seven members, three of whom were also on AHRC's Board of Directors. Brookville did not have its own dedicated Executive Director, Assistant Executive Director, or CFO. Instead, Brookville entered into a Management Agreement with AHRC to have AHRC employees provide Executive Management functions. As such, these AHRC employees exercised control and significant influence over Brookville; they managed the entity, prepared materials for consideration by the Brookville Board, and often briefed the Board. Additionally, Brookville's Assistant Controller and certain other Brookville employees reported to, and were supervised by, AHRC employees. During our audit, we found that AHRC maintained control, or exercised significant influence over many, if not all, aspects of Brookville's operations. In addition, management (AHRC employees) insisted, on multiple occasions, that Brookville employees were incapable of answering our audit questions and corrected information that Brookville had previously provided us. Moreover, on its CFR for the fiscal year ended June 30, 2014, Brookville reported the Management Agreement with AHRC as a related-party transaction.

2. As prescribed by the Manual, the regulatory references for our findings are detailed in the report's Notes to Exhibit. We reviewed and considered all evidence and/or information provided by Brookville and maintain that the evidence obtained during the audit provides a reasonable basis for our findings and conclusions. Further, SED officials concur that Brookville and AHRC have a LTAL relationship.
3. The audit's objective was to determine whether the costs reported by Brookville on its CFRs were reasonable, necessary, directly related to the special education program, and sufficiently documented pursuant to the Manual. The alleged cost-effectiveness of the arrangements between Brookville and AHRC is not relevant to this audit.
4. We determined that Brookville reported expenses for services that were to be provided by AHRC, and for which AHRC had already billed under the Management Agreement. In its response to our draft report, Brookville insists that the Management Agreement allowed AHRC and Brookville to decide which services will be provided by AHRC and which will be

done by Brookville's staff. In addition, Brookville maintains that OSC did not complete a line-by-line analysis of the services provided by AHRC and Brookville. However, Brookville did not provide us with sufficient documentation to perform such an analysis. For example, in response to our draft audit report, Brookville contends that AHRC performed certain Corporate Compliance services. However, Brookville did not provide us with the names of AHRC's staff, their titles, or the specific Corporate Compliance services performed. Therefore, while Brookville claims that it has done a line-by-line analysis to ensure that no task performed by AHRC was duplicated by Brookville's employees, it did not provide this analysis for our review. Further, although Brookville cited cost savings allegedly generated by using AHRC services, Brookville must, per the requirements in the Manual, further provide sufficient documentation for the expenses reported to SED, as such expenses will not be reimbursable on a field audit without sufficient written documentation. Refer to Comments No. 1 and No. 3.

5. We acknowledge that the Management Agreement provided that the fee for the services outlined in the Agreement was based on the actual cost to AHRC for the specific services provided. However, we question the necessity of certain Brookville costs. For example, we found that Brookville hired its own employees to perform IT, Compliance, and Accounting services that were supposed to be performed by AHRC as per the Management Agreement. We disagree with the statement that there was no empirical evidence to support our conclusions, as these conclusions were arrived at by our analysis and review of AHRC billings and Brookville job descriptions, as well as by interviews of employees and their supervisors.
6. Under the Management Agreement, Brookville contracted with AHRC to provide "Administrative and Management Services" (Management Agreement Section 1). Specifically, the Management Agreement provided that "AHRC will be responsible for the services listed in this Section 1." The services specifically identified:
 - Financial Services, including, but not limited to treasury and cash management activities; purchasing and accounts payable processing, filing of IRS Forms 1099; annual budget preparation and submission to Brookville's Board; and financial statement preparation and analysis.
 - Payroll Services, including payroll processing; preparing and filing payroll tax returns; administering direct deposit payments and mailing payroll checks; participating in payroll-related audits; and preparing and issuing IRS Forms W-2 to Brookville's employees.
 - Human Resources; including ensuring that Brookville is in compliance with all Federal, state and county laws and regulations pertaining to employment; ensuring that Brookville's staff members comply with agency policies and procedures as outlined in the Employee Handbook; recruitment and selection of Brookville's staff, subject to the approval of Brookville's Board; maintenance of employee personnel records; selection, implementation and administration of all employee benefits, including pension administration; and employee/management labor relations.
 - Governmental Filings and Research, including preparing all forms, reports and returns required by law in connection with Brookville's operations, including, corporate filings

with the Secretary of State of New York and IRS Forms 990.

- Billing and Collection Services, including production of periodic billing to regulatory authorities and other third parties; and the management of open account receivables, including the collection of past due amounts and ensuring timely collections.
- Corporate Compliance, including compliance with regulatory rules and obligations governing the conduct of Brookville's programs.
- Executive Management, including providing leadership oversight and consulting services to Brookville; and preparing and distributing materials in advance of each regularly scheduled meeting of Brookville's Board.
- Technology Support, including providing technology user support services to Brookville; providing management and support services for the telephone and data networks at Brookville; managing the phone systems, business applications and back office systems including application servers, data servers, e-mail systems, and Internet services; providing system planning and budgetary reviews; and managing computer desktop deployment and support.

The language of the Management Agreement is clear – AHRC was required to provide the services listed above. In light of the clear language of the Management Agreement (which in no manner limited the scope of the referenced services to be performed by AHRC), there is no need to look to the intent of the parties. It is well-settled law in New York that, when determining the obligations of parties to a contract, "courts will first look to the express contract language used to give effect to the intention of the parties, and where the language of a contract is clear and unambiguous, the court will construe and discern that intent from the document itself as a matter of law." *Shook v. Blue Stores Corp.*, 30 A.D.3d 811 (3d Dep't 2006) *citing Hawkins Home Groups v. Southern Energy Homes*, 276 A.D.2d 866 (3d Dep't 2000), *quoting Dryden Cent. School Dist. v. Dryden Aquatic Racing Team*, 195 A.D.2d 790 (3d Dep't 1993).

Here, the Management Agreement speaks for itself, and to the extent that Brookville's employees performed the services that should have been provided by AHCR under the Management Agreement, these services were duplicative and/or unnecessary and therefore not reimbursable under the requirements in the Manual.

7. As detailed above in Comment No. 6, the Management Agreement explicitly states which services were to be provided by AHRC. We reviewed AHRC's billings (broken down by department), compared these to the services that Brookville provided, and determined that Brookville reported expenses on its CFRs for services that AHRC was to provide, and had already billed, under the Management Agreement.
 - For Financial Services, we determined that Brookville reported expenses on its CFRs for two employees, including an Assistant Controller, whose job duties included the financial services listed in the Management Agreement. As such, we found these services to be duplicative of the services provided by AHRC's CFO and Controller and billed for under the Management Agreement. We also found that Brookville's Accounts Receivable Supervisor did not provide services to the SED preschool cost-based program. Based on this finding, we recommended a disallowance of \$146,187.

- For Corporate Compliance, we determined that Brookville reported expenses on its CFRs for four employees whose job duties included the corporate compliance services listed in the Management Agreement. As such, we found these services to be duplicative of the services provided by AHRC's Corporate Compliance and billed for under the Management Agreement. Based on this finding, we recommended a disallowance of \$145,758.
- For Technology Support, we determined that Brookville reported expenses on its CFRs for two IT staff members whose job duties included the technology support listed in the Management Agreement. As such, we found these services to be duplicative of the ten IT staff members that AHRC provided and billed for under the Management Agreement. Based on this finding, we recommended a disallowance of \$13,262. See also Comment No. 4.

We revised our report to reflect instances where AHRC did not charge Brookville for certain services – even though AHRC, under the terms of the Management Agreement, was responsible for providing these services.

8. Brookville's auditors conducted a financial audit and we conducted a performance audit. The scope of the financial audit is to ensure that the amounts reported on the financial statements are accurate. The scope of our performance audit is to assess whether the expenses reported on Brookville's CFRs are in conformity with the Manual. Moreover, the fact that Brookville's independent auditors did not propose audit adjustments for possible duplications and did not issue a management letter commenting on internal control issues does not mean that the same conclusions would be reached by OSC auditors focusing on compliance with the Manual.
9. We agree that AHRC did not charge Brookville for billing services. Accordingly, our report did not recommend disallowances for billing services.
10. The Management Agreement did not state, nor does it imply, that the services to be provided by AHRC were "incremental" to those performed by Brookville's employees. In fact, the Management Agreement stated that AHRC's Human Resources Department will have "primary" responsibility for specified Human Resources services. In addition, the Management Agreement stated that AHRC's Billing and Collections Department will have "primary responsibility" for specified services. There are other instances where the Management Agreement states that AHRC "will be" responsible for specific services – not that AHRC would be primarily responsible for specific services. Accordingly, we did not recommend disallowances where AHRC had primary responsibility. Rather, we only recommended disallowances in instances where the Management Agreement stated that AHRC "will be" responsible for specific services. Refer to Comment No. 6.
11. Our audit report did not state that AHRC was the parent company of Brookville. Rather, we stated that Brookville and AHRC were related parties and the Management Agreement between them was a LTAL transaction. Refer to Comment No. 1.
12. Brookville's comment is misleading. In one instance, Brookville claims that the terms of the Management Agreement are clear and unambiguous in delineating its management

obligations. In another instance, Brookville points out that the Management Agreement did not require AHRC to exclusively perform all the services, but left it up to Brookville and AHRC to agree on which party would be responsible for the specific tasks and services. Refer to Comments No. 4, No. 6, and No. 7.

13. The Manual states that the “designation of a cost as reimbursable during the initial rate-setting process or during the reconciliation process does not mean that the cost will be reimbursed through the final audit rate since all rates are subject to adjustment on field audit, in accordance with Section 200.18 of the Commissioner’s Regulations and this Manual.” Therefore, SED’s rate changes, based on SED’s desk review of reported CFR data, are not to be deemed the final determination of a cost’s reimbursement.
14. Section 18.0 of the CFR Manual defines “closely allied entities” as a type of related organization. Brookville acknowledges that it reported the amount paid to AHRC on Schedule CFR-5. The CFR Manual, Section 18, expressly states that Schedule CFR-5 “is used to report all transactions, including compensation, between the reporting entity, its affiliates, principal owners, management and members of their immediate families and any other party (including an organization) with which the reporting entity may deal *when one party has the ability to significantly influence management or operating policies of the other to the extent that one of the transacting parties might be prevented from fully pursuing its own separate interests*” (emphasis added).
15. Brookville’s comment is incorrect. We determined that Brookville and AHRC are related parties. As stated in Section II.10 of the Manual, “Charges to programs receiving administrative services ... from a parent or related organization are reimbursable provided they are not duplicative in nature ... and based on actual direct and indirect costs, allocated to all programs on a consistent basis and defined as reimbursable in the Regulations of the Commissioner of Education, the CFR Manual or this Manual.” The reported compensation expenses are therefore subject to the limits imposed by Section II.13.A(4)(a) of the Manual. Refer to Comment No. 1.
16. Brookville and AHRC have a LTAL relationship. Accordingly, expenses must meet the reimbursement guidelines stated in the Manual. Refer to Comments No. 1 and No. 6.
17. We found that AHRC and Brookville were, in certain instances, billing for the same services. For example, AHRC billed Brookville for IT and compliance services even though Brookville had its own employees providing these services, and reported these costs on its CFRs. Brookville officials stated that none of these tasks were duplicative. However, they did not provide us with a detailed analysis of the specific tasks that were actually performed by AHRC and Brookville employees. Refer to Comment No. 6.
18. The purpose of OSC’s audit was to determine whether the costs reported by Brookville on its CFRs were reasonable, necessary, directly related to the special education program, and sufficiently documented pursuant to the Manual; it is irrelevant whether Brookville engaged two separate firms to review the appropriateness and reasonableness of its costs.
19. We disagree. Officials did not provide us with sufficient documentation, such as names, titles, and specific tasks performed to support the assertion that the two entities are not

performing the same services. Refer to Comment No. 4.

20. The Management Agreement clearly states that AHRC “will be” responsible for providing Brookville with financial services, including preparation of the annual budget, financial statements, and all forms, reports, and returns, such as corporate filings and IRS Form 990. However, Brookville employed an Assistant Controller to perform financial services, despite the fact that AHRC billed Brookville for the services of a CFO and Controller. We questioned the services, if any, provided by AHRC’s Controller, since Brookville has its own Assistant Controller performing these accounting services. During the three audited years, Brookville’s Assistant Controller prepared budgets, financial statements, CFRs, and all forms, reports, and returns for filing with governmental agencies. Similarly, we found that Brookville incurred additional expenses for services provided by two IT employees despite the fact that the Management Agreement clearly required AHRC to provide Technology Support. Moreover, AHRC’s IT Department is located in the same building as Brookville. Refer to Comments No. 6 and No. 7.
21. We disagree. As a result of the fieldwork, auditors prepared a preliminary report that included the findings of duplicative functions and costs that were required to be covered under the Management Agreement (see Preliminary Report, entitled [PS Preliminary Report], dated [March 10, 2017]). In addition, these issues were discussed in detail at the Closing Conference.
22. We disagree. We questioned the services performed by Brookville’s Accounts Receivable Supervisor. We interviewed this employee’s supervisor (because the Accounts Receivable Supervisor was no longer employed while the auditors were on site), reviewed her job description, and found no evidence that the employee worked for the SED cost-based programs. In fact, her supervisor told us that this employee worked only for the day care program (a non-SED cost-based program). We also questioned the services performed by the Assistant Controller (code 603). Based on information provided with Brookville’s Response to the Draft Report, we allowed staff accountants’ costs that were previously disallowed.
23. According to the Management Agreement, AHRC’s Corporate Compliance Department was to ensure compliance with regulatory rules and obligations governing the conduct of Brookville’s programs. However, we found that Brookville maintained its own Corporate Compliance Department with staff performing compliance services, as well as utilization and quality reviews. While Brookville acknowledges that AHRC provided certain compliance services to Brookville, the officials did not provide sufficient documentation, including AHRC employee names and the nature of compliance services that were rendered. Refer to Comment No. 7.
24. In fiscal year 2013-14, based on an analysis performed by an AHRC IT Director, AHRC recommended that Brookville hire a full-time Educational Systems Coordinator to provide full-time support for its expanding technology needs. However, we were not provided with the analysis performed by the IT Director to justify the need for Brookville to employ full-time IT staff in addition to the ten employees that AHRC billed to Brookville for IT services.

25. Upon review of additional information provided by Brookville, we revised our report and allowed previously disallowed staff accountants costs (code 606), except for costs associated with the Accounts Receivable Supervisor and Brookville's Assistant Controller (code 603).
26. The Management Agreement states specifically that AHRC "will be responsible" for financial services including annual budget, financial statements, and CFR preparation. However, we found that Brookville's Assistant Controller performed these functions. Although AHRC billed Brookville for the services of a CFO and a Controller, it only provided services such as managing cash flow, business insurance policies, and other daily accounting tasks. According to the Brookville response to our draft report, AHRC's CFO and Controller only interpreted and reviewed reports and documents prepared by Brookville's staff. This position is inconsistent with the terms of the Management Agreement.
27. We agree that AHRC did not charge Brookville for billing services. Accordingly, in our report, we did not recommend disallowances relating to billing services.
28. We disagree. We provided Brookville officials with the names of the Brookville employees whose services were deemed duplicative of the services to be provided by AHRC under the Management Agreement.
29. We disagree. We found insufficient support for Brookville's assertions. AHRC officials admitted that AHRC provided Corporate Compliance-related services to Brookville. However, AHRC's billings under the Management Agreement did not show a Corporate Compliance Department and did not provide names of AHRC employees who performed these services. Furthermore, while Brookville cites a reduction in the AHRC Corporate Compliance Officer's salary reported to SED cost-based programs, Brookville officials did not provide sufficient documentation, including the name and title of the employee and services performed, to support this reduction.
30. The signed Management Agreement between AHRC and Brookville clearly states that certain functions are to be provided by AHRC. These functions include leadership oversight, purchasing and accounts payable processing, billing and collection services, payroll services, human resources, Corporate Compliance, and IT support. The services to be performed under the Management Agreement are comprehensive and the Management Agreement is devoid of any indication that certain aspects of financial, payroll, human resources, etc. services were to be performed by Brookville employees.
31. We disagree. Brookville did not provide the relevant documentation to support the fringe benefit costs charged to the SED cost-based programs.
32. Brookville acknowledged that these payments were made on behalf of former employees and, therefore, were not contractually required. Such expenses should not have been reported on Brookville's CFRs.
33. We disagree. The Status Change Forms indicated that the three employees worked for one of the SED cost-based programs in September 2013. Brookville did not provide class rosters to support the actual classroom assignments for the three group leaders.

Instead, Brookville provided payroll records and position control worksheets. However, these documents only indicated the program where Brookville reported the employees' compensation.

34. We disagree that the email from the Westbury Program was irrelevant to the audit period. As part of our audit process, we routinely reach out to a provider's employees to obtain information. In this instance, the Program Director (who supervised one of the three employees) told us that the employee worked for the non-SED cost-based day care program.
35. We reviewed and considered all evidence and information provided by Brookville. Consequently, we maintain that the evidence obtained during the audit provides a reasonable basis for our findings and conclusions.
36. Section II.13.B(2)(e) of the Manual states: "Employer-provided educational assistance costs are reimbursable as compensation only when the course or degree pursued is relevant to the field in which the employee is working and the employer has exhausted all Federal and other grant funds available to cover the education costs. ... Appropriate records of course completion must be maintained by the employer/provider." Brookville did not provide the course completion records for one of the two employees in question. The other employee pursued a degree (nursing) that was not relevant to his or her teaching assistant position. Consequently, the expenses did not meet the requirements in the Manual.
37. The proposed disallowance increased from \$76,523 to \$252,882 due to a change in the allocation methodology. For our preliminary report, we used FTEs as a basis for allocating rental and property expenses because Brookville officials maintained that their original spreadsheet listing the square footage of the building was inaccurate. In its response to our preliminary report, Brookville requested that we use the square footage methodology which, according to Appendix J of the CFR Manual, is the recommended allocation methodology. Thereafter, Brookville provided us with an updated spreadsheet listing the square footage of the building. We measured the space and determined that the square footage Brookville reported in the updated spreadsheet was overstated by 8,771 square feet. Consequently, we recalculated the costs allocated to the cost-based programs and determined that those costs were overstated. We recommended that the overstated costs be disallowed. This resulted in an increase in the disallowance previously recommended in the preliminary report. Based on the school's responses, and consistent with the CFR Manual, we amended our audit criteria and adjusted our audit findings, as warranted. By definition, preliminary findings are non-final audit observations and provided Brookville officials the opportunity to formally respond to our audit issues prior to the conclusion of audit fieldwork.
38. We noted that Brookville's square footage analysis, in Exhibit 8, shows that 8,228 square feet were not assigned to a particular location. In its response, Brookville asserts that the space, which could not be measured, was used for a variety of student-related activities. Absent documentation to the contrary, we deemed the space to be common area. This designation is consistent with Brookville's response, which states "we agree that the 8,771 square footage could not be measured, as this area is a portion of space within

the building allocated to each tenant.” It also stated, “Brookville rents its classroom and office space within a large office building along with non-affiliated tenants. Therefore, the building contains a significant amount of space which is shared among all tenants.” As Appendix J of the CFR Manual omits common area space from the space/cost allocated to programs, treating the space as a common area results in the same proposed disallowance. This is consistent with how the original disallowance was calculated. We revised our recommended disallowance for the 543 square feet identified in Exhibit 8 as program office space with a specific location.

39. We revised our report to allow the leasehold amortization expenses for the Leeds Building.
40. The evidence obtained and reviewed during the audit provides a reasonable basis for our findings and conclusions. We reviewed and considered all evidence and information provided by Brookville officials. However, Brookville officials did not provide sufficient documentation to support their position that the work Brookville performed was necessary or not duplicative of that performed by AHRC under the Corporate and Administrative Services Agreement. SED officials agreed with our report’s findings and recommendations.
41. Brookville’s Board of Directors was composed of seven members, three of whom were also on the AHRC Board of Directors. While the shared members of the Boards were not a “majority” of the Brookville Board, that is not the standard used by the Manual to identify related parties of LTAL transactions. For the reasons set forth in Comment No. 1 above, Brookville and AHRC were related parties under the Manual and the Management Agreement. Therefore, transactions between them were LTAL.
42. The definition of a quorum is irrelevant to the finding of a LTAL transaction as defined by the Manual. Refer to Comment No. 41.
43. We disagree. Section I.4.E of the Manual states, “related parties consists of all affiliates of an entity, including but not limited to: ... (3) any party transacting or dealing with the agency/entity of which that party has ownership of, or control over, or significant influence upon the management or operating policies of a program(s)/entity to the extent that an arm’s-length transaction may not be achieved.” Brookville and AHRC meet this definition. Refer to Comments No. 1 and No. 14.
44. In discussing the relationship between Brookville and AHRC, Brookville cites a 1997 Attorney General opinion in support of its assertion that the relationship between AHRC and Brookville is “more akin” to AHRC being an “unrelated, independent contractor.” The opinion of the Attorney General is absolutely inapplicable to this matter. This opinion reviewed whether members of the New York State Independent Living Council (NYSILC) are public officers and, if so, whether they are afforded defense and indemnification protection under New York’s Public Officers Law. As such, this opinion is wholly irrelevant to the nature of the Brookville and AHRC relationship under the Manual. See Comments No. 1 and No. 41.
45. Contrary to Brookville’s statement that “the arrangement” between Brookville and AHRC is distinguishable from the “arrangement” set forth in OSC’s recent audit report of the expenses submitted by New York League for Early Learning, Inc. to SED, wherein we found

that the business arrangements between the provider and related parties constituted LTAL transactions as defined by the Manual, we find the “arrangement” strikingly similar. We disagree with AHRC’s contention that its Management Agreement was arm’s length and that AHRC and Brookville do not exercise control over each other. Refer to Comment No 1.

46. We disagree. We provided Brookville with a list of its employees who were performing services that were also being billed by AHRC. It was Brookville’s responsibility to provide us with sufficient documentation to demonstrate that duplication of services between Brookville and AHRC did not occur. Brookville disregards the fact that the Manual makes the provider responsible for providing sufficient documentation to support the expenses reported on its CFRs. Specifically, the Manual states that costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the education program, and sufficiently documented. The Manual also states that costs will not be reimbursable on field audit without appropriate written documentation of such costs.
47. Brookville cites the third “Whereas clause” in the Management Agreement to argue that AHRC was required to perform only certain responsibilities related to the services in question. However, it is well-settled law in New York that while a “‘whereas’ clause can be used to clarify the meaning of an ambiguous contract,” a recital “cannot be used to modify or create substantive rights not found in the contract’s operative clauses.” *RSL Commc’ns, PLC v. Bildirici*, 2010 WL 846551, at *4 (S.D.N.Y. Mar. 5, 2010) (citing, inter alia, *Ross v. Ross*, 233 A.D. 626 [1st Dep’t 1931] [“The recitals in a contract form no part thereof....”]). In this Management Agreement, the services that AHRC contracted to perform are clear and specific and span two pages of a five-and-a-half-page agreement. The services to be performed under the Management Agreement are comprehensive and the Management Agreement is devoid of any indication that certain aspects of financial, payroll, human resources, etc. services were to be performed by Brookville employees. Refer to Comment No. 6.
48. Brookville’s assertion is misleading. We agree that, in certain instances, the Management Agreement states “primary,” as opposed to exclusive, for services such as human resources. Other paragraphs in the Management Agreement do not say primary; instead, it states that AHRC “will be responsible” for services such as IT. However, we did not recommend disallowances in instances where AHRC had primary responsibility. Refer to Comment No. 10.
49. Brookville did not provide sufficient documentation to identify those specific tasks performed by both AHRC and Brookville employees. For example, Brookville acknowledged that AHRC bills Brookville for its own Corporate Compliance staff, even though Brookville has its own Corporate Compliance Department.
50. We disagree. We reviewed the documentation provided by Brookville. This documentation included personnel files, job descriptions, and Change of Status Forms. We also interviewed employees and their supervisors. On several occasions, we provided Brookville with our analysis of Brookville’s job responsibilities. We also considered each individual’s position title and determined that Brookville was being billed for AHRC’s IT and Corporate

Compliance services while having its own IT and Corporate Compliance staff.

51. Brookville's statement is baseless. Our audit objective was to determine whether the costs reported by Brookville on its CFRs were reasonable, necessary, directly related to the special education program, and sufficiently documented pursuant to SED's Manual. While it is commendable that Brookville strived to operate its programs efficiently and with low administrative costs, it does not justify non-compliance with the Manual's provisions.
52. While the independent CPA reviews may help Brookville ensure reasonableness of AHRC's fees and compliance with all applicable regulations, they do not mitigate Brookville's responsibility to comply with the Manual's requirements. Refer to Comment No. 8.
53. None of our recommended audit disallowances were applicable to the services provided by the Executive Director, Assistant Executive Director, and CFO.
54. Brookville and AHRC are related parties under the Manual. Therefore, any AHRC expenses reported on Brookville's CFRs must comply with the Manual's requirements (Section II.10). Our disallowance was based on the Manual's Section II.13.A(4)(a), which requires that compensation (i.e., salaries plus fringe benefits) for an entity's staff whose function is that of Executive Director, Assistant Executive Director, or CFO will be directly compared to the regional median compensation for comparable administration job titles of public school districts, as determined and published annually by SED's Basic Educational Data Systems. Reimbursement of employee compensation for these job titles shall not exceed the median compensation paid to comparable personnel in public schools for similar work and hours of employment in the region in which the entity is located. Our audit objective was to determine whether the costs reported by Brookville on its CFRs were reasonable, necessary, directly related to the special education program, and sufficiently documented pursuant to the requirements in the Manual. The cost-effectiveness of the operations does not justify non-compliance with the Manual. Refer to Comment No. 1.