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
NYSARC, Inc. – NYC Chapter

Report 2017-S-47

November 2018

Executive Summary

Purpose

To determine whether the costs reported by NYSARC, Inc. – NYC Chapter (NYSARC), also known as AHRC NYC, 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 (RCM). The audit focused primarily on expenses claimed on NYSARC's CFR for the fiscal year ended June 30, 2015, and included certain expenses claimed on NYSARC's CFRs for the two fiscal years ended June 30, 2014.

Background

NYSARC is a New York City-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 our audit period, NYSARC operated full-day and half-day special education classes and a full-day Integrated Special Class. For the purposes of this report, these programs are referred to as the SED cost-based programs. According to NYSARC officials, they served 759 preschool students during the 2014-15 school year. The New York City Department of Education (DoE) refers students to NYSARC and pays for its services using rates established by SED. The DoE is reimbursed by SED for a portion of its payments to NYSARC. For the three fiscal years ended June 30, 2015, NYSARC reported approximately $61.8 million in reimbursable costs for the SED cost-based programs. During the audit scope period, NYSARC also provided management and administrative services to eight related entities.

Key Findings

For the three fiscal years ended June 30, 2015, we identified $1,311,070 in reported costs that did not comply with the RCM's requirements and recommend such costs be disallowed. These ineligible costs included $791,114 in personal service costs and $519,956 in other than personal service costs, as follows:

- $519,956 in ineligible rent expenses, including $368,104 in unsupported/overallocated rent and utility expenses for its Central Park instructional site and $151,852 in overallocated agency administrative facility expenses;
- $402,520 in employee bonuses that were not in compliance with the RCM's guidelines;
- $132,026 in costs applicable to the 1:1 Aides program that were incorrectly allocated to the SED cost-based programs;
- $121,570 in non-mandated fringe benefits contributions that were not proportionately similar to the amounts received by other classes or groups of NYSARC employees;
- $55,387 in excess executive compensation;
- $48,986 in overallocated compensation costs for 18 shared employees; and
- $30,625 in non-program compensation costs for three program directors that were incorrectly allocated to the SED cost-based programs. NYSARC officials could not support the costs reported for reimbursement for these employees and could not provide evidence that these costs were directly related to the SED cost-based programs.

We also identified $4,938,101 in agency administration costs that NYSARC charged to the SED cost-based programs. As NYSARC did not maintain records of actual costs associated with providing management and administrative services to its affiliates, we could not determine if the $4,938,101 should have been charged to the SED cost-based programs. Therefore, we did not recommend that the $4,938,101 be disallowed. Instead, we recommend that SED work with NYSARC to formulate a fair and reasonable allocation of these costs to NYSARC's SED cost-based programs.

Key Recommendations

To SED:

- Review the recommended disallowances resulting from our audit and make the appropriate adjustments to NYSARC's CFRs and reimbursement rates, as warranted.
- Work with NYSARC officials to help ensure their compliance with the provisions of the RCM.
- Determine how much of the $4,938,101 in agency administration costs should be allocated to the SED cost-based programs. Work with NYSARC officials to formulate an allocation methodology that meets the requirements of the RCM and will result in a fair and reasonable allocation of agency administration costs to the SED cost-based programs.

To NYSARC:

- Ensure that costs reported on future CFRs comply with SED's reimbursement requirements.

Other Related Audits/Reports of Interest

New York League for Early Learning, Inc.: Compliance With the Reimbursable Cost Manual (2015-S-43)
Brookville Center for Children's Services, Inc.: Compliance With the Reimbursable Cost Manual (2016-S-75)

State of New York
Office of the State Comptroller

Division of State Government Accountability

November 21, 2018

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

Mr. Marco Damiani
Executive Director
NYSARC, Inc. – NYC Chapter
83 Maiden Lane, 11th Floor
New York, NY 10038

Dear Ms. Elia and Mr. Damiani:

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

Following is a report, entitled *Compliance With the Reimbursable Cost Manual*, of our audit of the costs submitted by NYSARC, Inc. – NYC Chapter to the State Education Department for the purposes of establishing preschool special education tuition reimbursement rates. This audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution; Article II, Section 8 of the State Finance Law; and Section 4410-c of the State Education Law.

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

NYSARC, Inc. – NYC Chapter (NYSARC), also known as AHRC NYC, is a New York City-based not-for-profit organization authorized by the State Education Department (SED) to provide full-day and half-day preschool special education classes and a full-day Preschool Integrated Special Class to children with disabilities who are between the ages of three and five years. For the purposes of this report, these programs are collectively referred to as the SED cost-based programs.

According to NYSARC officials, they served 759 preschool students during the 2014-15 school year. In addition to the preschool cost-based programs, NYSARC operated two other SED programs: the 1:1 Aides program, which is based on fixed fees as opposed to the cost-based rates established through financial information reported on Consolidated Fiscal Reports (CFRs), and the School Age - Special Class program. As reported by NYSARC officials, they also operated other non-SED programs, such as Head Start; private-pay day care; universal pre-kindergarten; day rehabilitation and residential services; family and clinical services; employment and business services; and recess, respite, and recreation services. During the three fiscal years ended June 30, 2015, NYSARC also provided management and administrative services to eight related entities (affiliates). These affiliates included: AHRC NYC Properties, Inc.; AHRC NYC New Projects, Inc.; NYC AHRC Development Company, Inc.; Superior Direct Care, Inc.; AHRC Homecare Services, Inc.; AHRC/NYC Guardianship Fund, Inc.; AHRC New York City Foundation, Inc.; and AHRC HealthCare, Inc. During this period, NYSARC also shared resources with some of its affiliates. Shared resources include its administrative building, which was also owned by a related party (AHRC NYC New Projects, Inc.).

The New York City Department of Education (DoE) refers students to NYSARC based on clinical evaluations and pays for NYSARC's services using rates established by SED. The rates are based on the financial information NYSARC reports to SED on its annual CFRs. To qualify for reimbursement, NYSARC's expenses must comply with the criteria set forth in SED's Reimbursable Cost Manual (RCM) and its Consolidated Fiscal Reporting and Claiming Manual (CFR Manual), which provide 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 DoE 59.5 percent of the statutory rate it pays to NYSARC.

Section 4410-c of the Education Law provides that the State Comptroller shall audit the expenses reported to SED by special education service providers for preschool children with disabilities. For the three fiscal years ended June 30, 2015, NYSARC reported approximately $61.8 million in reimbursable costs for the cost-based programs. Our audit focused primarily on fiscal year 2014-15. However, we expanded our review to include certain items claimed on the CFRs for the two fiscal years 2012-13 and 2013-14.

Audit Findings and Recommendations

For the three fiscal years ended June 30, 2015, we identified $1,311,070 in reported costs that did not comply with SED's requirements for reimbursement. These ineligible costs included $791,114 in personal service costs and $519,956 in other than personal service (OTPS) costs (see the Exhibit at end of this report). SED, pursuant to a desk review, previously disallowed some of these costs.

Personal Service Costs

According to the RCM, 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 RCM. In addition, personal service costs, which include all 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, 2015, NYSARC reported approximately $44.4 million in personal service costs for its SED cost-based programs. We identified $791,114 in personal service costs that did not comply with the RCM's guidelines for reimbursement.

Ineligible Bonuses

According to the RCM, a merit award (or bonus compensation) 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 that 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. The provider's governing entity must adopt a written performance evaluation policy and form that contains sufficient details as to the criteria and methods used to determine each employee's final evaluation rating. The written employee performance evaluation policy must also describe how the final evaluation rating will directly correlate to any amount of a bonus award. Moreover, bonus awards are restricted to direct care employees as defined by the RCM and those in the 100 position title code series and position title codes 505 and 605, as defined by the CFR. For the three fiscal years ended June 30, 2015, NYSARC reported $1,167,616 in bonus compensation for 469 employees. This includes $172,695 in payments made in fiscal year 2012-13 to ensure that NYSARC staff would not feel the effect of a required payroll lag. However, we determined that $402,520 in bonuses were not in compliance with the RCM's requirements for reimbursable bonus compensation because they were not based on merit.

NYSARC officials disagreed with our findings and provided performance evaluations for 87 of the 469 employees. NYSARC officials also claimed that they could not limit the bonus compensation using annual evaluations because of NYSARC's collective bargaining agreements with its staff. In addition, NYSARC officials advised us that this compensation should not be considered bonus compensation because they repeated these payments in subsequent years and gave each staff a permanent salary increase in the fiscal year 2015-16. However, according to NYSARC records, this compensation was to be a one-time payment to all its employees. Likewise, we found that NYSARC approved these costs with no discussion of merit or qualification requirements. Consequently, we recommend that SED disallow $402,520 in non-reimbursable bonus compensation.

1:1 Aides

According to the RCM and the CFR Manual, all costs (compensation and allocated direct and indirect costs) for 1:1 aides should be reported on the provider's CFRs under the fixed-fee 1:1 Aides program. In addition, funding received from a governmental agency for specific education programs or cost items will be offset by SED against the appropriate program costs in the calculation of tuition rates so that costs will not be reimbursed by public funds more than once. Salaries of employees who perform tasks for more than one program must be allocated among all programs for which they work. Entities must maintain appropriate documentation reflecting the hours used in this allocation. According to NYSARC's contract with the DoE for the three fiscal years ended June 30, 2015, NYSARC would receive payments for 1:1 aides based on each aide's beginning and end date of service.

For the three fiscal years ended June 30, 2015, NYSARC reported $17,531,062 ($12,908,262 in salaries and $4,622,800 in fringe benefits) in compensation costs for 291 full-time and part-time employees. Of this amount, NYSARC allocated $15,685,796 for 251 employees to the SED cost-based programs. NYSARC officials asserted that the 251 employees provided services as substitutes and 1:1 aides to NYSARC's SED cost-based programs. To determine whether the costs reported for reimbursement complied with the RCM's guidelines, we reviewed NYSARC's records (personnel files, payroll records, class rosters, substitution records, Position Change Notice forms, and class assignment records) for 40 of the 251 employees. However, NYSARC officials could not provide records in support of $132,026 in compensation costs applicable to 32 of the 40 employees. As a result, we recommend that SED disallow $132,026 in compensation costs because they were insufficiently documented and/or should not have been charged to the SED cost-based programs.

Non-Mandated Fringe Benefits

According to the RCM, fringe benefits (including pensions, life insurance, and tax-sheltered annuities) for individual employees or officers/directors should be proportionately similar to those received by other classes or groups of employees. According to guidance provided to us by SED, fringe benefits are proportionately similar if the benefits-to-salaries ratio is the same or similar among all employees. According to the Internal Revenue Service website, "A nonqualified deferred compensation (NQDC) plan is an elective or non-elective plan, agreement, method, or arrangement between an employer and an employee (or service recipient and service provider) to pay the employee or independent contractor compensation in the future." NQDC plans include salary reduction arrangements, bonus deferral plans, top-hat plans, and excess benefit plans.

For the three fiscal years ended June 30, 2015, NYSARC reported $12,014,472 in fringe benefits expenses for reimbursement. Included in this amount was $124,518 in Tax Sheltered Annuity (TSA) contributions and an accompanying match for 13 select officers. NYSARC officials said that these employees were a part of its Tier III employee contribution program. Under this program, after two years of service, NYSARC provides Tier III employees with a tier payment up to the

Internal Revenue Service maximum amount the employee is allowed to contribute to their 403(b) plan. We found that, although such contributions are not specified in NYSARC's policy and procedures manual or its appendixes, which its officials provided as the agency's guidelines, the minutes from a June 27, 1988 meeting of NYSARC's board of directors show a discussion of this contribution. In the meeting minutes, NYSARC's board explained that the Tier contribution program was implemented because "management staff now receive from 7 to 10 percent of salary as a [Tax Sheltered Annuity] TSA contribution paid by the employer, a method to make them "whole", and improve their position was needed. This is provided by 2 methods: (1) The agency provides the employee's share through his/her salary, with a prior commitment to defer the funding; (2) additional incentives which increase according to level of responsibility." During the three fiscal years ended June 30, 2015, NYSARC officials also provided these select individuals with an additional match on the contribution made for them in the TSA program. However, we determined that this level of contribution was not proportionately similar to the amounts received by other classes or groups of NYSARC's employees. We previously disallowed $2,948 of the $124,518 in the "Non-Program Staff Compensation" section of this report. As a result, we recommend that SED disallow $121,570 ($124,518 - $2,948) of the $12,014,472 in fringe benefits charged to the SED cost-based programs.

Excess Executive Compensation

According to the RCM, 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 (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 fiscal years ended June 30, 2015, NYSARC reported $3,555,987 as the total compensation for ten key executive officers. This includes two Executive Directors, seven Assistant Executive Directors, and one CFO. However, the total regional median reimbursement limit for the ten executives for the three years was $2,495,219. Consequently, the executives' compensation exceeded SED's limits by $1,060,768 ($3,555,987 - $2,495,219). We recommend that SED disallow $55,387, the portion of the excessive compensation allocated to the SED cost-based programs. SED, pursuant to a desk review, previously disallowed some of these costs.

Excessive Allocation of Shared Employees' Compensation

The RCM requires that compensation paid to employees who work for multiple programs be allocated among these programs based on the employees' actual work effort or other allocation methods that are fair and reasonable. This is especially important when a provider, such as NYSARC, operates multiple programs. Entities must maintain appropriate documentation reflecting the hours used in this allocation. In addition, Appendix H of the CFR Manual instructs providers to report all costs of their day care program in excess of the approved duration of their Integrated program. For example, if their day care program operates from 7 a.m. to 5 p.m. (ten hours) and the integrated program operates from 9 a.m. to 2 p.m. (five hours), providers are instructed to report the costs of the five hours of day care operation using Program Code 9164.

During the three fiscal years ended June 30, 2015, NYSARC reported $4,224,346 in compensation costs for 18 program administrative employees, of which $3,220,028 was allocated to the SED cost-based programs. The program administrative staff includes shared program directors, program nurses, school principals, program clerks, a program clinical director, and a program director of finance. These employees provided services to both the SED cost-based programs and to the non-SED day care programs operated at NYSARC's instructional sites. These non-SED day care programs operated for 1.5 hours longer than the SED cost-based programs. However, NYSARC officials did not allocate any of the shared staff's compensation to NYSARC's non-SED day care programs. As a result, we recommend that SED disallow $48,986 in overallocated compensation.

Non-Program Staff Compensation

The RCM requires that compensation paid to employees who work for multiple programs be allocated among these programs based on the employees' actual work effort or other allocation methods that are fair and reasonable. This is especially important when a provider, such as NYSARC, operates multiple programs. Entities must maintain appropriate documentation reflecting the hours used in this allocation. Costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the special education program, and sufficiently documented.

During the two fiscal years ended June 30, 2014, NYSARC reported $512,386 in compensation costs for three program directors, of which $47,584 was allocated to the SED cost-based programs. However, according to NYSARC's records (e.g., employee files and job descriptions), these employees did not provide services directly related to the SED cost-based programs. Instead, NYSARC's records indicated the three employees oversaw NYSARC's non-SED programs, including residential services, Medicaid service coordination, family and clinical services, guardianship, and employment and business services. We recommend that SED disallow $30,625 in non-program costs.

Other Than Personal Service Costs

According to the RCM, OTPS costs must be reasonable, necessary, directly related to the special education program, and sufficiently documented. For the three fiscal years ended June 30, 2015, NYSARC reported $17.4 million in OTPS expenses for the SED cost-based programs. We identified $519,956 of these expenses that did not comply with SED's reimbursement requirements, as outlined in this report.

Unsupported and Overallocated Facility Expenses

According to the CFR Manual, when programs share the same geographical location or more than one agency/program is served at the same location, property-related costs, such as utilities, repairs, maintenance, depreciation, and lease or mortgage interest, must be allocated among the agencies/programs benefiting from those costs. In addition, square footage is the recommended method for allocating property and property-related costs. Further, the RCM states an expenditure that cannot be charged to a specific program must be allocated across all programs that benefited from the expenditure. Moreover, entities must use allocation methods that are fair and reasonable, and allocation percentages should be reviewed and adjusted on an annual basis. The RCM also states that allocation methods, as well as the statistical basis used to calculate allocation percentages, must be documented and retained for each fiscal year. Final costs are determined upon field audit and will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the special education program, and sufficiently documented. We determined that $519,956 in reported expenses did not comply with the RCM and CFR Manual, as follows:

- $368,104 in unsupported rent and utilities expenses related to NYSARC's Central Park instructional site. During the three fiscal years ended June 30, 2015, NYSARC officials operated SED cost-based programs and non-SED day care programs at this site. However, despite our requests, NYSARC officials did not provide sufficient documentation to show that these costs were related to the Central Park instructional site and the SED cost-based programs. According to its lease agreement, NYSARC's Central Park instructional site rent was $2,546,908. This included an annual rent escalation (4 to 5 percent rent increase of the prior year's rent in each of the three fiscal years ended June 30, 2015). In addition to this annual rent escalation, the lease required NYSARC to reimburse the landlord for 9.54 percent of the building's operating, repair, maintenance, and servicing costs. The additional escalations are referred to in the lease agreement as an "Additional Rent." Although the additional rent varied annually, NYSARC officials reported a total of $340,343 in additional rent expenses for the three fiscal years ended June 30, 2015 to the SED cost-based programs. However, NYSARC officials did not provide sufficient documentation to show that these costs were related to the Central Park instructional site and the SED cost-based programs, as required by the RCM. NYSARC officials also did not comply with the RCM's guidelines for allocating the shared space between the SED cost-based programs and the non-SED day care programs operated at this site. We also determined that NYSARC officials incorrectly allocated $27,761 in rent and utilities expenses to the SED cost-based programs. According to the RCM's guidelines on allocating shared space, the $27,761 should have been allocated to NYSARC's non-SED day care programs. As such, we determined that $368,104 ($340,343 + $27,761) of the Central Park instructional site's expenses did not comply with the RCM's guidelines.
- $151,852 in rent, utilities, repairs, and maintenance costs should have been allocated to the other NYSARC programs that shared the same location.

Consequently, we recommend that SED disallow $519,956 ($368,104 + $151,852) in property-related costs.

Indeterminable Allocation of Agency Administration Costs

According to the RCM, agency administration costs are defined as those expenses that are not directly related to a specific program, but are attributable to the overall operation of the agency. These costs include: costs for the overall direction of the organization; costs for general record-keeping, budget, and fiscal management; costs for public relations (non-fundraising); and costs for parent agency expenditures. Agency administration costs are reported on Schedule CFR-3. The CFR Manual states that when an agency, such as NYSARC, provides management services to another entity as a separate business activity through an ongoing contract, the expenses related to these services are not considered a part of the administration of the agency providing the services; thus, these expenses should not be reported on Schedule CFR-3. Instead, the expenses and related revenues of providing the management services must be reported on Schedule CFR-2 under "Other Programs." The RCM also states that salaries of employees who perform tasks for more than one program must be allocated among all programs for which they work. Actual hours of service is 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. If hours of service cannot be calculated or a time study cannot be completed, then alternative methods that are equitable and conform to generally accepted accounting principles may be utilized. All reported costs must be reasonable, necessary, directly related to the special education program, and sufficiently documented.

During the three fiscal years ended June 30, 2015, NYSARC recorded $60,321,396 in total management and administration costs. Included in these costs were agency administration expenses as well as the expenses associated with NYSARC providing management and administrative services (e.g., business administration, finance, human resource management, information technology, compliance, and real property consulting functions) to eight related[1] affiliates. NYSARC officials told us that the costs associated with providing these services, which they reported as $4,278,274, were not included as part of the agency administration costs they reported on Schedule CFR-3. Further, NYSARC also deducted an additional $2,322,754 because it identified these costs as non-reimbursable. Accordingly, NYSARC reported $53,720,368 in agency administration costs on Schedule CFR-3 ($60,321,396 - $4,278,274 - $2,322,754). Of this amount, $4,938,101 ($3,371,860 in personal service costs and $1,566,241 in OTPS costs) was allocated to the SED cost-based programs.

Cost of Providing Management and Administrative Services

We requested supporting documentation for the actual cost of the services NYSARC provided to its affiliates in order to ensure that all costs attributed to providing these management

[1] According to the CFR Manual, a related entity is an organization/individual furnishing services, facilities, or supplies that the service provider – to a significant extent – is associated or affiliated with, has control of, or is controlled by. In addition, the CFR Manual defines closely allied entities as corporations, unincorporated associations, or other bodies formed or organized to provide financial assistance and aid for the benefit of the service provider or receive financial assistance and aid from the service provider. Financial assistance and aid include engaging in fundraising activities, administering funds, holding title to real property, having an interest in personal property of any nature, and engaging in any other activities for the benefit of the service provider or the closely allied entity.

and administrative services to its eight affiliates were recognized and not included as part of the reported agency administration costs. However, NYSARC officials informed us they did not maintain records for the actual cost of services provided to its affiliates (e.g., actual hours of service, time studies). Instead, NYSARC officials provided us with a summary of the management and administrative service fees they assessed to each of its affiliates, which totaled $4,278,274 over the three-year audit period. However, we have no assurance that the cost of providing management and administrative services was limited to $4,278,274 because of the lack of support for the actual costs NYSARC incurred in providing these services. In fact, we have indication that the $4,278,274 is understated, as we found instances of costs that should have been direct charges to the affiliates, as follows:

- During the three fiscal years ended June 30, 2015, one of NYSARC's affiliates utilized NYSARC's staff to process its grant awards and payments of such awards; however, NYSARC did not maintain records identifying the costs it incurred to provide such services. These should have been charged as direct costs to the affiliate. Instead, these costs were included in the total management and administration costs.
- During fiscal year 2014-15, NYSARC charged $158,256 of its Controller's $170,343 compensation on Schedule CFR-3. However, NYSARC could not show how much time the Controller actually spent providing services to the CFR entities versus the affiliates.
- During fiscal year 2014-15, NYSARC hired consultants to review the by-laws of its affiliates. However, NYSARC officials did not include this cost as part of the management and administrative service fee cost. Instead, NYSARC officials included this cost as part of their total management and administrative cost, which was $60,321,396. As a result, the SED cost-based programs were allocated a portion of this cost.

It is important to note that, although NYSARC officials provided records regarding the direct/site cost of NYSARC's education programs as well as the program administrative costs of its education programs, they could not provide us with the records used to determine its management and administrative service functions or its oversight.

Non-Compliance With the RCM and CFR Manual

NYSARC's treatment of its management and administrative service costs does not comply with the CFR Manual's guidance on how to report the cost of providing management services because such costs must be reported in a separate cost center on Schedule CFR-2, which is distinct from agency administration costs. If these costs were reported separately on Schedule CFR-2, they would have also been allocated a portion of the entity's agency administrative expenses because agency administration costs are allocated to all programs operated by the entity based on the ratio value method of allocation. As a result, the SED cost-based programs were charged excessive agency administration costs.

NYSARC officials disagreed with our preliminary audit report. They advised the audit team to consider using the ratio value of each entity's operating expenses to the total operating expenses of NYSARC and its eight affiliates to determine each entity's share because the resulting amount is not materially different from the result achieved under NYSARC's allocation method. However, the suggested method does not comply with the RCM and CFR Manual, which require providers to report the cost of management service contracts in a separate cost center in Schedule CFR-2. Further, the ratio value methodology of allocation in this instance would not result in an accurate or reasonable allocation because the expenses reported on Schedule CFR-2, which is a separate cost center, would have incurred a portion of NYSARC's agency administration costs. Further, as stated earlier in the report, we found indications that the expenses of the affiliates were understated, making the ratio value method of allocation neither fair nor reasonable.

As a result of NYSARC's failure to maintain actual costs associated with providing management and administrative services to its affiliates, we were unable to determine how much of the agency administration costs reported by NYSARC should have been allocated to the SED cost-based programs. We recommend that SED work with NYSARC officials to formulate an allocation methodology that will result in a fair and reasonable allocation of agency administration costs to the SED cost-based programs. Please note that some of the concerns noted in this section of the report include costs that were identified in the "Personal Service Costs" and the "Other Than Personal Service Costs" sections of the report, notably the sections "Ineligible Bonuses," "Non-Mandated Fringe Benefits," "Excess Executive Compensation," "Non-Program Staff Compensation," and "Unsupported and Overallocated Facility Expenses."

Recommendations

To SED:

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

2. Work with NYSARC officials to help ensure their compliance with the provisions of the RCM.

3. Determine how much of the $4,938,101 in agency administration costs should be allocated to the SED cost-based programs. Work with NYSARC officials to formulate an allocation methodology that meets the requirements of the RCM and will result in a fair and reasonable allocation of agency administration costs to the SED cost-based programs.

To NYSARC:

4. Ensure that costs reported on future CFRs comply with SED's reimbursement requirements.

Audit Scope, Objective, and Methodology

We audited the costs reported on NYSARC's CFRs to determine whether they were properly documented, directly related to the special education program, and allowable pursuant to the RCM. The audit included all claimed expenses for the fiscal year ended June 30, 2015 and certain expenses claimed for the two fiscal years ended June 30, 2014.

To accomplish our objective, we reviewed the RCM, the CFR Manual, NYSARC's CFRs, and relevant financial records for the audit period. We also interviewed NYSARC officials and staff to obtain an understanding of NYSARC'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 fees, 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 NYSARC's internal controls focused on its CFR preparation process.

We conducted our 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 State Education Law.

Reporting Requirements

We provided draft copies of this report to SED and NYSARC 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, NYSARC officials disagreed with most of our proposed disallowances. Our rejoinders to certain NYSARC comments are included in the report's State Comptroller's Comments. NYSARC 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 after 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

NYSARC, Inc. – NYC Chapter
Summary of Submitted and Disallowed Costs
for the 2012-13, 2013-14, and 2014-15 Fiscal Years

Program Costs	Amount per CFR	Amount Disallowed	Amount Remaining	Notes to Exhibit
Personal Service Costs				
Direct Care	$41,003,020	$607,088	$40,395,932	A-G, I-O
Agency Administration	3,371,860	184,026*	3,187,834	
Total Personal Service Costs	**$44,374,880**	**$791,114***	**$43,583,766**	
Other Than Personal Service Costs				
Direct Care	$15,858,183	$481,577	$15,376,606	A, E, H, J, N, P-R
Agency Administration	1,566,241	38,379	1,527,862	
Total Other Than Personal Service Costs	**$17,424,424**	**$519,956**	**$16,904,468**	
Parent Agency Administration Allocation	**$28,904**	**$0**	**$28,904**	
Total Program Costs	**$61,828,208**	**$1,311,070***	**$60,517,138**	

*Includes certain adjustments previously made by SED.

Notes to Exhibit

The following Notes refer to specific sections of SED's RCM and the CFR Manual used to develop our recommended disallowances. Unless otherwise specified, all notes refer to all three years reviewed. We summarized the applicable sections to explain the basis for each disallowance. We provided the details supporting our recommended disallowances to SED and NYSARC officials during the course of our audit.

A. RCM Section II - Generally, costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the special education program, and are sufficiently documented.
B. RCM Section II.13.A.(4a) - Compensation (i.e., salaries plus fringe benefits) for an entity's staff whose function is that of Executive Director will be directly compared to the regional median compensation for comparable administration job titles of public school districts. Reimbursement of employee compensation for Executive Director 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.
C. RCM Section II.13.A.(10) (July 2012 Edition) - Bonus compensation shall mean a non-recurring and non-accumulating (i.e., not included in base salary of subsequent years) lump sum payment(s) in excess of regularly scheduled salary that is not directly related to hours worked. Bonus compensation is restricted to direct care titles/employees.
D. RCM Section II.13.A.(10) (July 2013 and July 2014 Editions) - 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 that is not directly related to hours worked. A merit award may be reimbursed if it is based on merit as measured and supported by employee performance evaluations. In order to demonstrate that a merit award is based on merit and measured and supported by employee performance evaluations, the provider's governing entity must adopt a written employee performance evaluation policy and form that contains sufficient detail as to the criteria and methods used to determine each employee's final evaluation rating. The written employee performance evaluation policy must also describe how the final evaluation rating will directly correlate to any amount of a merit award, should funds be available for such an award.
E. RCM Section III.1 - Costs will not be reimbursable on field audit without appropriate written documentation of costs.
F. RCM Section III.1.A - Compensation costs must be based on approved, documented payrolls. Payroll must be supported by employee time records prepared during, not after, the time period for which the employee was paid. Employee time sheets must be signed by the employee and a supervisor, and must be completed at least monthly.
G. RCM 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 for seven years.
H. RCM Section III.1.D - All purchases must be supported with invoices listing items purchased and indicating date of purchase and date of payment, as well as canceled checks. Costs

must be charged directly to specific programs whenever possible. The particular program(s) must be identified on invoices or associated documents.

I. RCM Section III.1.M.(1)(i) - Salaries of employees who perform tasks for more than one program and/or entity must be allocated among all programs and/or entities for which they work.

J. RCM 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 years. Allocation percentages should be reviewed on an annual basis and adjusted as necessary.

K. RCM Section IV.2.F - All 1:1 aide costs (salaries, fringe benefits of the aide, and allocated direct and indirect costs) should be reported in one separate cost center on the providers' financial reports.

L. CFR Manual, page 8.6 - Expenses and revenues and FTE enrollment for approved 1:1 teacher aides (preschool and school age) must be reported as a separate column (Program Code 9230).

M. RCM Section II.44.A.(2) - Funding received from a governmental agency or unit for specific education programs or cost items will be offset by the Department against the appropriate program costs in the calculation of tuition rates so that costs will not be reimbursed more than once by public funds.

N. CFR Manual, page 8.14 - When a CFR agency provides management services to another entity as a separate business activity through an ongoing contract, the expenses related to these services are not considered a part of the agency administration of the agency providing the services. They are, therefore, not reported on Schedule CFR-3. The expenses and related revenues must be reported on Schedule CFR-2, in Column 7, "Other Programs." The management services expenses will be allocated agency administration expenses via the Ratio Value allocation method.

O. CFR Manual, page 41.3 - Report all costs of day care programs in excess of the approved duration of the Integrated program in Program Code 9164. For example, if their day care program operates from 7 a.m. to 5 p.m. (ten hours) and the Integrated program operates from 9 a.m. to 2 p.m. (five hours), providers must report the costs of the five hours of day care operation using Program Code 9164. In addition, if the provider is funded by the Division of Early Care and Education, such providers are directed to report all costs, revenues, and related statistical data using Program Code 9164.

P. RCM Section II.41.B.(4) - 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.

Q. RCM Section II.41.B.(2) - Occupancy costs are based on actual documented rental charges, supported by bills, vouchers, etc. Donated rent is not reimbursable.

R. CFR Manual, page 42.2 - If agency administrative offices and program offices are located in the same building, property related costs must be allocated using square footage as the statistical basis. These costs include expenses such as utilities, repairs and maintenance, depreciation, leases, or mortgage interest.

Agency Comments - State Education Department

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

DEPUTY COMMISSIONER
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September 10, 2018

Mr. Kenrick Sifontes
Audit Director
Division of State Government Accountability
NYS Office of the State Comptroller
59 Maiden Lane, 21st Floor
New York, NY 10038

Dear Mr. Sifontes:

The following is the New York State Education Department's (SED) response to the draft audit report, 2017-S-47, Compliance with the Reimbursable Cost Manual: NYSARC, Inc. – NYC Chapter (NYSARC).

Recommendation 1:

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

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

Recommendation 2:

Work with NYSARC officials to help ensure their compliance with the provisions of the RCM.

We agree with this recommendation. SED will continue to provide technical assistance whenever requested and will strongly recommend the NYSARC 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, 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. This training is a requirement for preschool special education providers upon approval and reapproval.

Recommendation 3:
Determine how much of the $4,938,101 in agency administration costs should be allocated to the SED cost-based programs. Work with NYSARC officials to formulate an allocation methodology that meets the requirements of the RCM and will result in a fair and reasonable allocation of agency administration costs to the SED cost-based programs.

We agree with this recommendation. SED will work with NYSARC officials to formulate an allocation methodology that is in compliance with the provisions outlined in the RCM and CFR Manual and will result in a fair and reasonable allocation of agency administration costs to the SED cost-based programs.

If you have any questions regarding this response, please contact James Kampf, Supervising Accountant, at (518) 474-3227.

Yours truly,

Sharon Cates-Williams

Sharon Cates-Williams
Deputy Commissioner

c: Christopher Suriano
Samuel Zimmerman
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Agency Comments - NYSARC, Inc. – NYC Chapter

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September 7, 2018

BY FEDEX AND E-MAIL

Mr. Kenrick Sifontes
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Re: **NYSARC, Inc., New York City Chapter ("AHRC NYC")**
Response to Office of the New York State Comptroller ("OSC")
Audit No. 2017-S-047: Draft Audit Report

Dear Mr. Sifontes:

This letter and the accompanying documentation are in response to certain findings contained in the draft audit report for Audit 2017-S-047 issued by OSC on August 8, 2018 (the "Draft Audit Report"), which examined costs claimed by AHRC NYC for its pre-school special education programs certified and funded by the New York State Education Department ("SED") in the three fiscal years ended June 30, 2015 (the "Audit Period"). Consistent with OSC's reporting requirements and New York State audit procedures for SED certified and funded programs, this letter contains AHRC NYC's written arguments in opposition to certain of OSC's detailed audit findings. For each of the specific audit findings to which AHRC NYC hereby objects, we set forth our arguments in support of the claims submitted and describe the documentation furnished with this letter that further substantiates our position. As more fully argued herein, we respectfully request that OSC reconsider its initial recommendations to SED to disallow these costs and that it give full credit to all costs claimed by AHRC NYC in its final audit report.

I. Background

As indicated in the Draft Audit Report, AHRC NYC is correctly described as a New York City-based New York Not-For Profit Corporation approved by SED to operate preschool and school-age special education services to children with disabilities between the ages of three and five, and five to twenty-one, respectively. The New York City Department of Education refers special education students to AHRC NYC based on clinical evaluations and pays for their services using rates established by SED. As noted by the Draft Audit Report, during the Audit Period, these services included operation of full-day and half-day special education classes and a

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Response Letter to OSC Audit 2017-S-047 September 7, 2018

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full-day Integrated Special Class. Additionally, AHRC NYC operated two other SED programs: the 1:1 Aides program and the School Age – Special Class Program. AHRC NYC also operated non-SED daycare services during the audit period, including Head Start, private-pay day care, universal pre-Kindergarten, day habilitation and residential services, and family and clinical services. During the 2014-15 school year, AHRC NYC served 759 preschool students in the programs being audited by OSC.

The Draft Audit Report fails to recognize, however, that AHRC NYC operates far more than its school-based programs. AHRC NYC is a family governed organization dedicated to enhancing the lives of people with intellectual and developmental disabilities and their families. Each member of AHRC NYC is committed to promoting cultures that embrace:

*
Comment 1

- **Passion:** Committing wholeheartedly to the mission of AHRC NYC;
- **Respect:** Responding to all members of the AHRC NYC community with courtesy, kindness and open and honest communication;
- **Integrity:** Making decisions based on fairness, honesty, morality and ethical principles;
- **Diversity:** Respecting and appreciating the differences found among people with intellectual and developmental disabilities, their families and colleagues;
- **Excellence:** Providing an environment, in which distinction and merit are affirmed, celebrated and enhanced.

These cultural tenets are of critical importance to AHRC NYC, not just in serving students enrolled its SED-certified and funded programs, but in all of its programs that touch the lives of over 15,000 individuals throughout the five boroughs. Beyond the SED-certified and funded programs that were subject to this audit, AHRC NYC operate community based, residential, work training, job placement, clinical service, home care and family support programs at over 200 locations that are certified, licensed or funded by the New York State Office for People with Developmental Disabilities ("OPWDD") and other New York State and New York City agencies. In addition, AHRC NYC is fully accredited by the Council on Quality and Leadership.

Given the size of AHRC NYC and its array of programs offered to individuals and families, we recognize that OSC's audit work was likely more complex and difficult, as compared to other audits of SED funded providers of school programs. We appreciate the time and attention OSC and its auditors devoted to understanding the size and scope of AHRC NYC and how these operations are reported on the AHRC NYC's annual Consolidated Fiscal Reports ("CFRs"), but we believe that many of the objectionable findings contained in the Draft Audit Report are a function of this complexity and OSC not accounting for the complicated interplay between AHRC NYC's SED and non-SED programs, especially as it relates to how these costs were allocated and reported on the CFRs in the Audit Period.

*
Comment 2

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*See State Comptroller's Comments, Page 40.

Response Letter to OSC Audit 2017-S-047 September 7, 2018

II. Preliminary Procedural Matters and Overview of Response

Before providing our responses to OSC's findings, AHRC NYC wants to commend the OSC auditors for their professionalism and attention to detail while completing the audit. Moreover, AHRC NYC recognizes that the Draft Audit Report reflects many areas where OSC has already given credit for costs that may have been disallowed based on the content of the Preliminary Audit Findings issued by OSC. Notwithstanding this appreciation, we would like to note certain perceived irregularities in the way that the OSC audit proceeded, which we view as inconsistent with recognized audit processes.

First, according to the OSC, issuance of Preliminary Audit Findings should follow the completion of the fieldwork phase for each audit segment. However, OSC continued to request documentation and information from AHRC NYC, as well as conduct on-site measurements, following the issuance of the related Preliminary Audit Findings. Similarly, according to the OSC, the exit conference of an audit should not occur until completion of the fieldwork phase. However, in this audit, the exit conference occurred while AHRC NYC continued to fulfill information requests from OSC and provide access for physical space measurements. These deviations from the standard audit process may have denied AHRC NYC the opportunity to develop complete responses to the Preliminary Audit Findings in the OSC imposed timeframe. Relatedly, one of the critical audit findings regarding unsupported rent and utilities expenses, as discussed below, relies on OSC's request for documentation from a third party (i.e., AHRC NYC's landlord), which was never in AHRC NYC's possession, custody and control. The entire nature of this informational request, and the disallowance resulting from it, is a deviation from what AHRC NYC was required to retain and should reasonably be expected to produce as part of an audit.

* Comment 3

* Comment 4

* Comment 5

Second, although OSC issued four rounds of Preliminary Audit Findings, OSC continued to provide significant work papers and other underlying documents to AHRC NYC late in the audit process, even after the release of the Draft Audit Report. As noted below, several of these work papers have proven critical and necessary for AHRC NYC to develop a complete and accurate response to the Draft Audit Report. As a result, AHRC NYC has not had a full opportunity to validate and assess the information provided by OSC in preparing this response. Given that AHRC NYC was very likely deprived of the standard audit process, where all information requests are made and all relevant information is provided prior to the exit conference and the issuance of the Draft Audit Report, the following responses are made only to the best of our ability. To the extent OSC continues to release its work papers and other supporting information relevant to its findings, AHRC NYC may have to modify these responses, or add others, contained in this letter.

* Comment 6

* Comment 4

* Comment 7

Based on the foregoing understandings, AHRC NYC has reviewed the results and recommendations in the OSC's Draft Audit Report, and, for the reasons provided below, ask that OSC reconsider its recommendations for the following proposed audit findings (addressed in the ordered contained in the Draft Audit Report):

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	Section	Finding and Description[1]
1.	Personal Service Costs	**Ineligible Bonuses:** $402,520 in employee bonuses that were not in compliance with the RCM's guidelines.
2.		**Excess Executive Compensation:** $30,625 in non-program compensation costs for three program directors that were incorrectly allocated to the SED cost-based programs.
3.		**Excess Allocation of Shared Employees' Compensation:** $48,986 in overallocated compensation costs for 18 shared employees.
4.	Other than Personal Services	**Unsupported and Overallocated Facility Expense:** $653,034 in ineligible rent expenses, including $368,104 in unsupported / overallocated rent and utility expenses for its Central Park instructional site and $284,930 in overallocated agency administrative facility expenses.
5.		**Cost of Providing Management and Administrative Services:** Although OSC is not recommending its disallowance of $4,938,101 in agency administration costs allocated to AHRC NYC's SED programs, it had advised to SED to work with AHRC to determine how best to allocate management and administrative costs to SED's programs.

We will now proceed to discuss and rebut OSC's specific proposed disallowances regarding the above-described findings.

III. Responses to Disallowances Related to Personal Service Costs

A. Finding 1: Ineligible Bonuses

Summary of Response: The disallowed costs are fully reimbursable as the funds were either (1) merit awards issued in full compliance with RCM requirements and appropriately supported by performance evaluations; or (2) not merit awards at all because they were part of an employee's base salary.

AHRC NYC disagrees with the proposed disallowance of $402,520 in bonus compensation charged to the SED programs during the Audit Period. To restate our understanding of OSC's position, the Draft Audit Report contends that AHRC NYC failed to provide documentation showing that non-accumulating and non-recurring merit awards were measured and supported by employee performance evaluations in conformance with a written

[1] Findings not listed herein are not being challenged by AHRC NYC as part of this response to the Draft Audit Report.

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performance evaluations policy ("Merit Awards"), which is a requirement of SED's Reimbursable Cost Manual ("RCM") regarding the reimbursement of such Merit Awards. As discussed more fully below, AHRC NYC disagrees with this determination and views these costs as either fully allowable based on the documentation furnished to OSC or as correctly self-disallowed on the CFR.

The lump sum payments cited in the Draft Audit Report remitted to the education staff related to one of the following:

- **Merit Awards:** Merit Awards claimed during fiscal year ended June 30, 2014, which were supported by performance evaluations;[2] and
- **Recurring Payments Built into Base:** Other lump sum payments that were recurring and ultimately built into the base, such that they do not fall under the definition of a Merit Award.

Enclosed with this response as Exhibit A is a schedule for the fiscal year ended June 30, 2014, showing in which of the above categories these payments belong.

1. Merit Awards

The Merit Award portions of the lump sum payments AHRC NYC furnished to direct education staff for the fiscal year ended June 30, 2014 were in full compliance with the requirements of the RCM. Specifically, the RCM requires that—in order to demonstrate that a Merit Award is based on performance—the provider must adopt a written employee performance evaluation policy and form that contains sufficient detail on the criteria and methods used to determine each employee's evaluation rating and how those evaluation ratings correlate to a merit award.[3] As set forth in Section 6.1.4 of AHRC NYC's Education Department Policies & Procedures Manual (enclosed with this letter as Exhibit B), AHRC NYC requires annual performance evaluations to be conducted for all staff. Staff performance is measured using the Standards of Teaching Rubric and Performance Review Checklist, which divides staff performance into four levels: (1) Ineffective, (2) Developing, (3) Effective, and (4) Highly Effective. Section 6.1.4 also states that only staff with consistently Effective or Highly Effective ratings (90%+ rating) will be considered for merit increases.

*
Comment 8

2. Recurring Payments Built into Base Salary

According to the RCM, Merit Awards are "non-recurring and non-accumulating (i.e., not included in base salary of subsequent years) lump sum" payments.[4] The lump sum payments to administrative staff made in fiscal years ended June 30, 2014 and June 30, 2015 were not one-time, non-recurring payments, as determined by OSC, because they were repeated in subsequent years and they were built into the staff's base pay in fiscal year ended June 30, 2016, as soon as

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[2] Annual Performance Evaluations can often cross years, depending upon date of hire.
[3] RCM § II.13.A.(10), p. 21 (July 2013 edition).
[4] *Id.*

the funding for our SED programs and OPWDD programs was finalized. Despite the statements made in the Draft Audit Report, AHRC NYC did not intend these step-up payments to be one-time payments and the fact that they were subsequently built into the base salary is sufficient evidence of AHRC's NYC intent when it first made these payments.

* Comment 9

Based on the foregoing explanation, we respectfully request that OSC reconsider its recommended disallowance of $402,520 in bonus compensation.

B. Finding 2: Excess Executive Compensation

Summary of Response: AHRC NYC was appropriately reimbursed at the median level for the disallowed executive compensation, as reimbursement was already adjusted to the median compensation level by SED as part of its normal rate-setting process. Furthermore, AHRC NYC is permitted to report the full compensation of the staff positions in dispute and, as the median salary levels are not established by SED until after the CFRs are filed, entitled to rely on the post hoc reimbursement adjustment by SED.

We disagree with the OSC's basis for proposing disallowance of $55,387 of executive compensation charged to the SED pre-school cost-based programs. As noted in the Draft Audit Report, the RCM requires that reimbursement of employee compensation for staff whose function is that of Executive Director (e.g., Chief Executive Officer, or "CEO"), Assistant Executive Director ("AED"), or Chief Financial Officer ("CFO") "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." However, as the reimbursement to AHRC NYC has already been adjusted to the median compensation level by SED as part of its normal rate-setting process, AHRC NYC was already appropriately reimbursed at the median level for these costs.

* Comment 10

In addition, contrary to the position asserted by OSC in the Draft Audit Report, neither the RCM nor CFR Manual restricts the reporting of the full compensation of these staff positions on the CFR. Moreover, SED has never instructed AHRC NYC, at any of the numerous opportunities it has had to do so when it calculates our reconciliation rates each year, to make this adjustment. Based on this experience, AHRC NYC fully understands that SED considers it appropriate to report the full compensation of the CEO, AED and CFO on the CFR. Given that AHRC NYC's cost reporting and reimbursement are in full compliance with the RCM and CFR Manual, the Draft Audit Report provides no additional rationale for this finding and we believe that it should be excluded from the Draft Audit Report entirely.

* Comment 11

Furthermore, it is important to note that the median salary levels used by SED to make this rate-setting adjustment are not determined or published by SED until after the CFRs are filed for each respective year. Since the median salary levels are not established by SED until after the CFRs are file, there is no way for the AHRC NYC to calculate with any accuracy the adjustment to the median salary level when reporting on the CFR. As such, programs are entitled to rely on the post hoc reimbursement adjustment by SED after they review AHRC NYC's CFR to ensure compliance with the RCM. Notwithstanding the above, we wish to point out that the amounts calculated by OSC as the "Total Compensation Reported" on the CFR subject to the median salary limitation are overstated for the following three reasons:

1. OSC calculated the amount of Total Compensation Reported utilizing the full salary for the administrative staff before the reductions relating to the amounts charged to the non-CFR entities for which AHRC NYC provides administrative services. The component of the administrative staff's salaries relating to the administrative charge to non-CFR entities was not reported on the CFR. As such, it should not be included in the amounts subject to the median salary limitation.

* Comment 12

2. When calculating the fringe benefit component of the salaries that are subject to the median salary limitation, OSC incorrectly utilized the percentage of fringe benefits reported on CFR-3, instead of the actual fringes paid for the particular staff whose salaries are subject to the median salary limitation. The fringes reported on CFR-3 include all agency administration staff, not just the CEO, AED and CFO. Moreover, because fringes as a percentage of salary for the top three positions are considerably lower than the overall agency administration staff fringe benefit percentage, this calculation resulted in an overstatement of the amount of fringe benefit costs used in this calculation. Utilizing the actual amount of fringes paid for these staff as reported on CFR-6 is also in conformity with SED's protocol for calculating the median salary limitation. As such, the fringe amounts used in the calculation need to be revised to reflect actual fringes paid for these staff.

* Comment 13

Enclosed with this response as Exhibit C is a schedule recalculating the salaries subject to the median salary adjustment. As this schedule shows, only fiscal year ending June 30, 2013 had salaries subject to the median salary limitation, totaling $41,721, reported on the CFR. However, as previously discussed, because the school reported the compensation correctly on the CFR and was *not* reimbursed for these costs, we believe that this finding should be excluded entirely.

C. Finding 3: Excessive Allocation of Shared Employees' Compensation

Summary of Response: OSC's recommendation to disallow a portion of the compensation for staff members for time they spent in non-SED programs is factually incorrect and not based on the actual job responsibilities of these individuals.

AHRC NYC disagrees, in large part, with the proposed disallowance of $48,986 in compensation charged to SED pre-school cost-based programs for the Audit Period. To restate our understanding of OSC's position, the Draft Audit Report contends that AHRC NYC failed to allocate costs of shared administrative and indirect care service staff to its non-SED, after-school daycare service (Program 9164), which resulted in additional costs being allocated to its SED pre-school cost based programs. As discussed more fully below, the after-school daycare service did not require direct oversight by the SED program administration staff; as such, the lack of allocation to this program was correct and consistent with the way that this program is operated.

* Comment 14

Response Letter to OSC Audit 2017-S-047 September 7, 2018

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Specifically, the administrative and indirect care service staff whose costs OSC recommends be allocated to the non-SED daycare service cost-center did not have responsibility for, and did not furnish any services to, the after-school daycare. That said, AHRC NYC agrees that a very modest portion of the Assistant Director of Finance's costs could have been appropriately allocated to the after-school day care service, as the Assistant Director was responsible for receiving and processing the after-school daycare tuition checks from parents once a month. However, the remaining staff identified by OSC did not work at, or have any oversight responsibility for, the non-SED daycare. As such, their costs were correctly reported on the CFR as allowable costs in the tuition-based programs.

* Comment 14

The after-school daycare services operated by AHRC NYC start each day after the conclusion of the integrated program, and the scheduled duration is for one and a half hours. This service is offered as an accommodation to the parents of the children without intellectual and developmental disabilities in the integrated program, and is a means of attracting these children to an integrated program that benefits both cohorts. Without this accommodation, many parents would be unable to have their children participate in the integrated program. For these reasons, the after-school daycare service is necessary in order to operate the integrated program with the correct ratio of children with intellectual and developmental disabilities ("IDD") to children without IDD. Given the nature of the services offered in the after-school daycare program (e.g., napping, self-directed play), the program does not include an educational component that would require oversight by the administrative staff of AHRC NYC's Education Department. The service requires only an adult be present in the classroom; this role is staffed by a Teacher Aide whose costs were appropriately reported in the 9164 column of the CFR. The Teacher Aide is responsible for all direct and indirect services for the after-school daycare, including supervising the children and taking attendance. Although a certified teacher is required to be in the building, the New York City Health Code does not require that this individual have an active, supervisory or participatory role in the classroom. At AHRC NYC, the on-site principal is a certified teacher and fulfills the Health Code requirement; however, she does not perform any direct supervisory or teaching responsibilities for the after-school daycare. After the integrated program ends for the day, which initiates the period during which the after-school daycare service is offered, the principal is working on tasks associated with the funded school program, not the after-school daycare services. Accordingly, it is consistent with the operation of the program, the functions performed by staff and the governing regulations that no portion of the principal's compensation be allocated to Program 9164.

* Comment 15

Furthermore, as the after-school daycare does not provide any educational program services, AHRC NYC central office Education administrative staff has no role in, or responsibility for supervising or directing the after-school daycare service. OSC auditors confirmed this fact during interviews with the administrative staff. Therefore, it was appropriate to not charge the time for these staff members to the after-school daycare services. To that end, enclosed with this response as Exhibit D are revised schedules for fiscal years ended June 30, 2013, June 30, 2014 and June 30, 2015 reflecting the updated calculation of administrative costs to be allocated to Program 9164 on the CFR. Based on the forgoing, we respectfully request that OSC reconsider its proposed disallowance of $48,986 in compensation.

* Comment 15

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IV. Other Than Personal Service Costs

In addition to the personal services related costs discussed above, OSC found that $653,034 in other than personal services ("OTPS") costs were incorrectly claimed by AHRC NYC on its CFR related to its SED-certified or funded pre-school programs. This disallowance of OTPS costs related primarily to expenses incurred by AHRC NYC with regard to its facilities. We address this specific finding below, but also reiterate our position regarding OSC's recommendation to SED regarding the appropriate and justifiable allocation methodology used by AHRC NYC for its agency administration costs, even though this recommendation did not yield a proposed disallowance for the Audit Period.

A. Finding 4: Unsupported and Overallocated Facility Expenses

Summary of Response: The disallowed rent escalation charges were part of an arm's length lease agreement, are standard for commercial leases in New York City, and are a reasonable and necessary rental expense. Furthermore, AHRC NYC's use of a 25-year useful life to calculate depreciation costs is a justifiable and reasonable measure, and complies with CFR reporting guidelines.

OSC is seeking to disallow $653,034 in ineligible rent expenses, which was divided into two components: (1) $368,104 in unsupported rent and utilities expenses related to its since relocated Central Park instructional site; and (2) $284,930 in rent, utilities and other expenses that should have been allocated to co-located SED and non-SED programs. For the reasons described below, AHRC NYC disagrees with these findings and seeks full reinstatement of these expenses as appropriately allocated to its SED programs.

1. Unsupported Rent and Utilities Expenses.

OSC's proposed disallowance of $340,343 of additional rent charges for the Central Park instructional site related to space rented from the Jewish Guild for the Blind ("JGB") during the three fiscal years ended June 30, 2015. To restate our understanding of OSC's position, the Draft Audit Report contends that AHRC NYC failed to provide documentation supporting these additional rental charges, and failed to establish that the additional charges were directly related to the SED pre-school cost-based programs. AHRC NYC disagrees with this finding and believes it has furnished the appropriate supporting documentation relating to these rental charges. Under the terms of AHRC NYC's lease with the JGB, annual "additional" rent charges are based on the percentage of the building's total square footage occupied by AHRC NYC's school (9.54%) and that are intended to reimburse JGB for the proportional use of the following maintenance items:

* Comment 16

1. Maintenance staff and all expenses related for the upkeep of AHRC NYC's occupancy
2. Custodial services–washing and waxing of floors; maintenance of walls and ceiling tiles

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3. Maintenance of plumbing, water, HVAC systems including any required inspections
4. Snow removal
5. Garbage removal
6. Window cleaning
7. Elevator maintenance, inspections and permits
8. Insurance
9. Building reception and security personnel
10. Staff to control traffic flow on driveway for the buses at arrival and departure
11. Fire Safety Director who conducted building wide fire safety and evacuation
12. Fire alarm monitoring and maintenance
13. Central alarm system monitoring and maintenance
14. Pest control

Rent escalation charges, based on increases in a landlord's operating costs, are standard for commercial leases in New York City and are routinely approved by other state agencies, including OPWDD as part of the Prior Property Approval process for programs serving individuals with IDD. In order to operate the SED pre-school cost-based programs, AHRC NYC must enter into leases with such charges in their terms. As additional rent charges are normal and typical in lease agreements, these costs are part of reimbursable rent, directly relate to the SED pre-school cost-based program, and should be allowed for CFR reporting purposes.

The lease of these education facilities was an arm's-length lease from an unrelated entity and thus the rent is tied to the market factors and the rates charged by landlords for similarly rated space, rather than the landlord's costs for the space. Towards that end, the requirement for AHRC NYC to support its expense should be limited to the lease itself and invoices received from the landlord. AHRC NYC has provided OSC with a copy of the lease detailing all required charges, including the basis for the additional rent charges. Additionally, AHRC NYC has provided OSC with copies of invoices from the JGB clearly showing the rental costs are inclusive of the additional rent charges, and the basis by which they are calculated.

*
Comment 17

Furthermore, the additional and unnecessary detail being sought by AHRC NYC relates to documents within the possession, custody and control of JGB, as the landlord, rather than AHRC NYC, as the tenant. It is inconsistent with typical audit procedures and reasonable expectations for auditors to seek specific supporting documentation from parties not subject to the audit and who would have no specific need to retain the documentation beyond the retention periods required by law or contract. Indeed, through the audit process, AHRC NYC made repeated attempts to request the additional detail supporting the additional rent charges from JGB, but JGB confirmed that it either did not possess nor could easily locate the documentation sought by OSC, especially given that the building that housed the Central Park instructional site has since been sold by JGB and demolished.[5] Despite these challenges and pathways for

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Comment 17

[5] In support of this audit request, OSC cited a provision in the lease that requires JGB, as landlord, to "provide [AHRC NYC] with such documentation *as may be necessary* to verify the amount of any such Additional Rent" (emphasis added). This lease provision grants AHRC NYC with the ability to request such documentation, but puts

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requesting the documentation, AHRC NYC obtained from JGB the supporting schedule for the additional monthly rent charges (operating charges) billed to AHRC NYC by JGB on each of the monthly invoices for the Audit Period, which is enclosed with this letter as Exhibit E. This supporting schedule, as verified by AHRC NYC, served as the basis for AHRC NYC's payment of the monthly additional rent charges to JGB. The schedule also indicates how JGB calculates the monthly additional rent (operating expenses) billed to AHRC NYC. In addition, AHRC NYC provided to OSC each of the monthly rent invoices received from JGB, which outline the additional rent for the Audit Period.

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Comment 17

Based on the foregoing explanation, AHRC NYC feels that the additional rent charge was sufficiently documented for OSC and reasonable for an arm's length lease in New York City. As such, these additional rent costs should be deemed fully allowable.

2. *Overallocated Agency Administrative Facility Expenses.*

AHRC NYC disagrees with the proposed disallowance of $284,930 in rent, utilities, repairs, and maintenance costs at its 83 Maiden Lane program location. First, a review of OSC's work papers supporting the proposed $284,930 disallowance, provided following the Draft Audit Report's issuance, revealed a calculation error. In preparing the supporting schedule, OSC included DASNY Bonding interest, DASNY Bond issuance costs and building improvement depreciation as expenses in the OSC's CFR-1 spreadsheet. However, these expenses and allocations were inadvertently omitted from OSC's CFR-3 spreadsheet. AHRC NYC corrected this omission, and revised OSC's spreadsheet CFR-3 to capture the same expenses included on CFR- 1. This resulted in a disallowance of $158,971, compared to $284,930. Due to this error, the calculated disallowance of the questioned facility expenses is overstated by $133,078. Enclosed with this letter as Exhibit F is a copy of the draft schedule provided by OSC. Additionally, enclosed with this letter as Exhibit G is a copy of the schedule revised by AHRC NYC and updated by OSC for the final report to include the omitted expenses discussed above, indicating the discrepancy.

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Comment 18

Beyond the calculation error, AHRC disagrees with the substance of OSC's proposed disallowance. To restate our understanding, OSC contends that AHRC NYC failed to allocate these expenses to other programs located at 83 Maiden Lane. We further understand, based on prior correspondence. OSC contends that the space measurements used by AHRC NYC did not match AutoCAD measurements taken by AHRC NYC's Assistant Director of Real Properties. Additionally, OSC contends that the estimated useful life of 25 years used by AHRC to charge depreciation expenses, does not conform to the recommended 40-year useful life included in the American Hospital Association's "Estimated Useful Lives of Depreciable Hospital Assets" handbook ("AHA Guidelines").[6] As discussed more fully below, the space measurements used

the onus on JGB to retain and produce such documentation if and when the documentation is requested by AHRC NYC. Notably, JGB's retention obligation does not expressly survive the expiration of the lease, such that JGB is not contractually bound to provide this documentation after the lease ended. As such, neither AHRC NYC nor JGB was required to retain the documentation being sought by OSC.

[6] We understand that OSC ultimately applied a 30-year useful life depreciation period in its calculations for the Draft Audit Report.

by AHRC NYC were reasonable, and the utilization of a useful life of 25 years complies with CFR reporting guidelines.

Appendix O of the CFR Manual states that AHA Guidelines "must be used in the calculation of depreciation expense *unless the service provider can justify that an alternative useful life is more appropriate*" (emphasis added). AHRC NYC has determined and justified that a different useful life methodology is more appropriate than the AHA guidelines or the 30-year useful life applied by OSC. The methodology used by AHRC NYC to calculate its depreciation expense is based on a full understanding of the asset and its remaining life, along with AHA published guidelines. This methodology accounts for the many factors that should be included in estimating a building's life, including, but not limited to, the expected wear and tear based on the frequency of usage, and the number and type of occupants using the building. Additionally, the useful life calculations in the AHA Guidelines cited by OSC relate only to the "Building" portion of the purchase price and do not include other costs of the facility. The AHA Guidelines are broken down into various components of a building to be depreciated—the timeframe suggested by OSC relates to the building shell, exterior walls, interior framing, walls, floors and ceilings. However, AHRC NYC's purchase price includes parts of the building that are classified separately by the AHA Guidelines as "Building Components," "Fixed Equipment," and "Building Services Equipment," all of which have useful lives significantly lower than 30 years. Based on the AHA Guidelines, we note the following with regard to these components:

* Comment 19

- Building Components are defined by the AHA Guidelines as part of the building shell or interior construction, and include carpentry work, ceiling finishes, doors and frames, floor finishes, and wall coverings. According to the AHA Guidelines, the cost of Building Components should be depreciated over 5 to 15 years depending on the asset.
- Fixed Equipment includes assets that are permanently affixed to the building structure and have a shorter useful life than that of the building. These assets include cabinets, counters, shelving, and sinks that should be depreciated over 10 or 15 years.
- Building Services Equipment are mechanical components or systems, including air-conditioning, electrical, elevators, heating, lighting, plumbing, sprinklers, and ventilation systems. The AHA Guidelines recommend a 10 to 20 year useful life for Building Services Equipment.

As evidenced by the foregoing discussion, the estimated useful life being used by the auditors relates only to one of many components of the building's depreciation. Other building components have useful lives significantly lower than the 30 years suggested by OSC, and furthermore have useful lives lower than the 25 years used by AHRC NYC. Accordingly, AHRC NYC's use of a 25-year useful life is a justifiable and reasonable estimation of the useful life of the building as a whole, taking all of its components into account. AHRC NYC asserts the preceding explanation supports its calculation of the depreciation expense using an estimated 25-year useful life. We respectfully request that the finding regarding the overallocation of agency administrative facility expenses be excluded from the audit report.

* Comment 19

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B. Finding 5: Indeterminable Allocation of Agency Administration Costs

Summary of Response: The allocation of Agency Administration costs was designed to approximate the "Ratio Value" method, which is a long-recognized approach to allocating agency costs under both the CFR Manual and RCM. This allocation methodology in and of itself constitutes sufficient documentation of how Agency Administrative costs were charged among AHRC NYC and its Related Entities.

Although not contained in the Draft Audit Report's recommended disallowances to SED, OSC nonetheless made recommendations to SED regarding the prior methodology by which AHRC NYC allocated its agency administration costs to SED cost-based programs. Specifically, OSC recommended that SED formulate a methodology that meets the requirements of the RCM and will result in a fair and reasonable allocation of AHRC NYC's agency administration costs to SED cost-based programs. Although AHRC NYC appreciates that OSC is not recommending a disallowance based on its allocation methodology during the Audit Period, it nonetheless reasserts its prior responses to OSC regarding the appropriateness of its historical allocation methodology in order to formalize this position as part of its response to the Draft Audit Report and to ensure SED is aware of why this prior method is both fair and reasonable.

As described to OSC in a letter from Brian O'Reilly of BKD CPAs & Advisors LLP (formerly Loeb & Troper LLP) dated April 2, 2018, AHRC NYC used an allocation methodology for agency administration costs based on the long-recognized "Ratio Value" approach. In the Draft Audit Report, OSC cites the RCM's statement that costs will be considered for reimbursement provided such costs are "reasonable, necessary, directly related to the special education program and are sufficiently documented."[7] OSC contends that (1) administrative costs are insufficiently documented, and (2) allocation methods are inconsistent. The issue underlying both these contentions is the basis AHRC NYC used to distribute its Agency Administrative services among itself (including its affiliates who are consolidated on its CFR) and its five non-CFR related entities (the "Related Entities") with which it has management service agreements.

With the exception of one Related Entity, for which a slightly different but related methodology was used, the management service agreements between AHRC NYC and the Related Entities were based on a flat rate equal to 10% of the Related Entity's expenses. This 10% rate was established by using AHRC NYC's historical Ratio Value allocation of its administrative costs and results, as a practical matter, in a Ratio Value allocation among AHRC and the Related Entities.[8] Notwithstanding the use of the recognized Ratio Value methodology that is based on costs and its compliance with applicable legal rules for Related Entities, OSC has raised two questions in its audit with regard to the calculation and application of the

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[7] RCM § II, p. 13 (July 2014 edition). The July 2014 edition "defines Reimbursable Costs for the July 2014 to June 2015 period." Given that the audit scope is the three fiscal years ended June 30, 2015, citations to the RCM in this letter are to the July 2014 edition, which applies to the final year of the audit period.

[8] As described in the Response Letter, the differential between this 10% of expenses methodology and straight Ratio Value methodology is only 0.26%, which demonstrates that the methodology is based on Ratio Value.

management fee as a basis for an Agency Administration allocation: (1) is the Ratio Value-derived methodology being used by AHRC NYC to perform this allocation appropriate, allowable and in conformity with the CFR and RCM guidelines; and (2) are the costs being used in the allocation base correctly calculated?

1. *The Ratio Value Methodology Conforms to the CFR Manual and RCM*

The concept for utilizing an allocation methodology, as opposed to specific assignment of individual costs, is that maintaining records for the time spent by each individual staff in Agency Administration is cost-prohibitive and impracticable. AHRC NYC meets the conditions that necessitate use of an allocation basis, rather than the assignment of individual costs. AHRC NYC has over one hundred staff working in its Agency Administration departments in addition to individual items of OTPS costs numbering in the tens of thousands. Requiring such a significant number of staff members to maintain contemporaneous time records and then collecting and analyzing those records to develop allocations and sub-allocations would require the hiring of numerous additional staff to perform these functions, creating additional unnecessary Agency Administration costs and therefore additional administrative allocated costs to the SED program.

* Comment 20

In addition, many of the staff members who are included in an administrative pool have jobs and functions that are not identifiable with a specific program. For example, the Controller may have responsibility for overseeing the general ledger, payroll, and disbursements processes. Tracking this individual's time would provide information on time spent not on programs or divisions, but on functions that benefit all programs and divisions. Therefore, contemporaneous time records for this individual would not provide a basis for allocating his/her cost; this is true of numerous staff positions and OTPS costs in Agency Administration. This principle, in addition the fact that burden of tracking and maintaining contemporaneous time records would necessitate the hiring of additional staff, is why calculating allocations of Agency Administration costs based on a percentage of direct costs is a universally accepted accounting practice.

* Comment 21

To that end, CFR reporting agencies commonly utilize a Ratio Value allocation (or modified Ratio Value) methodology as opposed to the more costly practice of hiring additional staff to track contemporaneous time records. With lower Agency Administration costs, agencies have more resources to devote to the programmatic services that further their respective charitable missions. Consistent with state policy, recipients of state funds, such as AHRC NYC, should be looking to maximize the amounts invested in programmatic services, rather than centralized administrative expenses, and using Ratio Value—rather than contemporaneous time records—to calculate allocation of Agency Administration costs permits these organizations to achieve this goal. Stated simply, requiring time studies and direct cost allocation would result in higher administrative expenses and less available budget to spend on programmatic activities.

* Comment 22

Ratio Value has been the accepted basis for allocating Agency Administration costs reported on the CFR since its inception. The RCM states that "[a]ny expenditures that cannot be charged directly to a specific program must be allocated across all programs and/or entities benefited by the expenditure"[9] and that "[f]or CFR filers (except Office of Children and Family Services Residential Facilities), agency administration costs shall be allocated to all programs operated by the entity based on the *Ratio Value Method of allocation*" (emphasis added).[10] The use of Ratio Value by the four State agencies using the CFR (including SED) recognizes the fact that Agency Administration benefits all programs to varying degrees and maintaining records to document the time of all staff and expense in Agency Administration is, as stated earlier, both cost-prohibitive and impracticable. Additionally, the CFR Manual and the RCM specifically define Agency Administration costs (inclusive of parent agency expenses) to be costs that are not assignable to specific programs/sites, but are attributable to the overall operation of an agency.[11] Accordingly, by its own definition, SED identifies administrative costs as not directly assignable to programs, which makes the maintenance of contemporaneous time records for Agency Administration not meaningful for an accurate allocation of costs to various programs.

* Comment 23

The four State agencies (including SED) using the CFR are not the only governmental agencies that accept this methodology for allocating administrative costs. The New York State Department of Health utilizes what it calls "Accumulated Costs" to allocate Agency Administration expenses between programs and services. The Federal Office of Management and Budget ("OMB") Uniform Guidance (formally Circular A-122) requires the use of Modified Total Direct Costs ("MTDC"[12]) for the allocation of general administration and general expenses. In fact, OSC itself has used Ratio Value as the basis for calculating disallowance in numerous of its audit reports on preschool providers, including allocations between companies. Based on the foregoing, it is evident that utilization of Ratio Value as a basis for allocating Agency Administration costs among programs and entities is overwhelmingly accepted by governmental agencies, including OSC and SED.

* Comment 22

2. *The Allocations Were Correctly Calculated by AHRC NYC*

In asking whether the allocation was correctly calculated, OSC has questions on how AHRC NYC has determined what "direct" costs should be included in the base for calculating Ratio Value. Consistent with the principles underlying Ratio Value, the base for the allocation should include those costs that drive the use of administration. For example, AHRC NYC has appropriately excluded the "grants made to individuals and organizations" from the direct costs used in the allocation base because these costs do not utilize administrative personnel or resources. However, the staff determining the grants and the staff processing the payments do utilize administration and those costs were still included in the base used for the calculation. The grants made to individuals are different than the grant expenses incurred for the Sections 611 and 619 funding[13], which are actual staff and expenses of AHRC that do utilize administration.

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[9] RCM § III.1.M.(1), p. 52 (July 2014 edition).
[10] RCM § III.1.M.(3), p. 52 (July 2014 edition).
[11] RCM § I.9, p. 11 (July 2014 edition).
[12] MTDC is defined in the OMB Uniform Guidance (formally Circular A-122) as all salaries and wages, fringes benefits, materials and supplies, services, travel and excludes equipment and capital expenditures (2 C.F.R. §200.68)
[13] Federal Allocations for Special Education (Individuals with Disabilities Education Act, Sections 611 and 619).

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When preparing the CFR, these costs are included in the allocation of Agency Administration costs between State agencies in the first step of Ratio Value.[14] Therefore, their inclusion in the base cost used by AHRC NYC in the allocation of Agency Administration among AHRC NYC and Related Entities is consistent with CFR reporting and reflects the fact that they are actual staff and OTPS that utilize Agency Administration costs. However, as stated in the RCM, because of the specific funding limitations of the Sections 611 and 619 Grants, [15] SED allows for the grant to be excluded from receiving an allocation of Ratio Value in the second step of Ratio Value. However, this does not change the appropriateness for using these costs in the base for allocating administrative costs between AHRC NYC and its Related Entities as is done in the first step of ratio value.

* Comment 24

Additionally, OSC challenged the inclusion in administrative costs of five Real Property staff, alleging that their functions were specific to the operations of real estate companies and therefore should not have been reported as Agency Administration expenses. AHRC NYC's position regarding these five employees, namely that the real estate companies in question were established to maintain properties that are used for AHRC NYC programs, and that the staff's responsibilities are administrative in nature and the tasks they perform cannot feasibly be charged to individual properties or programs.

* Comment 25

Based on the foregoing, AHRC NYC used a reasonable and recognized Ratio Value allocation methodology that in and of itself constitutes sufficient documentation of how its Agency Administrative costs were charged among AHRC NYC and its Related Entities, such that the costs expensed to SED programs were entirely defensible, fair and appropriate.

* * * * *

[14] Ratio Value is a two-step process with all costs (including the 611/619 grant expenses) included in the allocation between State agencies in the first step (line 52 on CFR-3) and then certain costs being specifically excluded by State agency rules in the second step of the allocation to individual programs. This is the reason each State agency has different Ratio Value allocation percentages (line 65 to 69 on CFR-3).

[15] RCM § II.26.C, p. 31 (July 2014 edition).

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We thank you for your consideration of this response to the Draft Audit Report. AHRC NYC hopes and trusts that OSC will carefully review and consider the points above and the supporting documentation provided before issuing its final audit report.

Very truly yours,

Marco Damiani
Chief Executive Officer

Enclosures

cc: By E-mail without Enclosures
Stephen Lynch, Audit Manager, OSC
Aida Solomon, Audit Supervisor, OSC
Adefemi Akingbade, Examiner-in-Charge, OSC
Amy West, Chief Financial Officer, AHRC NYC
Alden Kaplan, Senior Policy Advisor, AHRC NYC
Kathy Broderick, Senior Program Advisor, AHRC NYC
Christine Muccioli, Director of Education, AHRC NYC
Louise Marchini, Assistant Director of Education, AHRC NYC
Brian O'Reilly, BKD CPAs & Advisors LLP
Brett R. Friedman, Ropes & Gray LLP

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Exhibits To Response

Exhibits A
Categorization of Lump Sum Payments Made in FY 2014

Exhibit B

Education Department Policies & Procedures Manual – Excerpt

Exhibit C

Median Salary Calculations

Exhibit D

Corrected Calculations of Administrative Costs for FY 2013, FY 2014, and FY 2015

Exhibit E

Jewish Guild for the Blind - Additional Monthly Rent Charges

Exhibit F

OSC Draft Schedule for Disallowed Agency Administrative Facility Expenses

Exhibit G

Revised Schedule for Disallowed Agency Administrative Facility Expenses

State Comptroller's Comments

1. Page 5, paragraph 2 of our draft audit report acknowledged NYSARC's (AHRC NYC) non-school-based programs.
2. We acknowledge that NYSARC is a complex organization. However, its processes and operations were no more complex than any of the other large preschool special education providers we audited. Difficulties encountered during the audit resulted from the insufficiency of, and delays in, obtaining information from NYSARC officials and staff.
3. The audit is not complete until the final audit report is issued to NYSARC and SED. As was indicated to NYSARC at the opening conference and throughout the audit, it is our process and practice to regularly discuss preliminary audit findings with, and request feedback from, the auditee throughout the audit engagement. The "Preliminary Audit Findings" were fact-finding documents issued to NYSARC. In response, NYSARC officials provided additional information and documentation to support the amounts claimed on its CFRs. We subsequently requested additional documentation in an attempt to resolve outstanding issues.
4. We strongly disagree and maintain that we did not deviate from the standard audit process. NYSARC was not deprived of opportunities to address the issues in the report. In fact, NYSARC officials had ample opportunities to address the issues raised in the preliminary findings and draft audit reports. Moreover, we carefully considered all relevant evidence or information provided by NYSARC officials.
5. NYSARC, like all other preschool special education providers, is required to maintain sufficient documentation to support the expenses reported on the CFRs submitted to SED. Therefore, asking for supporting documentation for the additional rent expenses is not a deviation from what NYSARC should reasonably be expected to produce as part of an audit. Moreover, as per the lease agreement, NYSARC officials had the right and an obligation to request the necessary documentation from the landlord in order to verify the amount of additional rent.
6. NYSARC's comments are misleading. At NYSARC's requests, we provided copies of our schedules to support the OTPS disallowances. Refer to Comment No. 3.
7. Throughout the audit, NYSARC had considerable difficulty producing the required supporting documentation for the costs claimed on its CFRs. We informed NYSARC officials that we would review any documentation they provide prior to preparing and issuing the draft and final audit reports. After we issued the draft report, NYSARC requested copies of our schedules in support of the OTPS disallowances. We provided the requested schedules.
8. The RCM requires merit (bonus) awards to be based on employee performance; however, these payments were not, as NYSARC officials could not provide performance evaluations for all of the employees who received bonuses. As noted in a November 19, 2013 memo to staff, "a one-time payment of $750 to each of you [employee] in the December 20 payroll disbursement," NYSARC officials directed the payment of bonuses to all staff, regardless of their performance evaluation.
9. NYSARC's comments are not accurate. These payments were announced as a one-time payment and were not subsequently built into the base salary. In fact, these payments

were paid under a different payroll compensation code. Refer to Comment No. 8.

10. Our audit is independent of SED's desk reviews and we may be aware of information that was unavailable to SED. As noted on page 8 of the report, we acknowledge that SED had previously disallowed a portion of this cost during its desk review.
11. We agree that the CFR Manual does not restrict the reporting of full compensation. However, the CFR Manual also instructs providers to report the non-reimbursable portion of any reported cost. In fact, we noted that NYSARC officials identified a portion of these costs as non-reimbursable on their CFRs. Although median salary levels may not be established until CFRs are filed, the RCM states, "All approved programs shall be subject to a fiscal audit pursuant to Section 200.18 of the Commissioner's Regulations. Tuition rates may be adjusted accordingly based on the results of the final audit."
12. We disagree. We took the necessary adjustments into account and used the reduced compensation in our analysis.
13. On several occasions, we requested schedules to support the actual fringe benefit rate for each of the employees subject to the median salary limitation. However, NYSARC officials did not provide us with the requested schedules. Moreover, NYSARC officials advised us to use the average fringe benefit rate.
14. We disagree. The after-school day care program is part of NYSARC's education department. NYSARC's education department staff provided administrative services to all programs in the education department – including the after-school day care program. As such, these costs should be allocated accordingly. These administrative services included overseeing programs' staff and resources and reviewing purchase requests and staff time sheets. The education department staff was responsible for reviewing staff time sheets, including lobby monitors, nurses who were available to all the students at each location, and school principals who ensured that all students were provided a safe environment. As the students in the after-school day care program benefited from these services, it should have been allocated a share of the expenses of the program administrative staff salaries.
15. Our report does not state that the after-school day care service included an educational component that required oversight by the administrative staff. Refer to Comment No. 14.
16. We disagree. NYSARC officials did not provide appropriate supporting documentation for the additional rent reported for reimbursement. Instead, NYSARC officials provided us with a single-page summary of the expense categories included in the rate increase calculation. NYSARC did not provide us the details of the summarized costs or records that could be used to verify the amounts reported and determine whether the reported costs were related to NYSARC's preschool programs. Refer to Comments No. 5 and No. 17.
17. According to the lease agreements, NYSARC officials had the right to request documentation to verify the additional rent expenses. However, NYSARC officials did not request this documentation. On its CFR, NYSARC's then Chief Executive Officer attested that NYSARC has custody of records and allocation worksheets to support the costs reported for reimbursement. The invoices provided to us did not show the basis for the additional rent charges. Moreover, we question NYSARC's due diligence as it did not verify the costs of its lease agreements. The invoices provided to us by NYSARC and JGB only indicate the amount of rent requested by JGB. Refer to Comments No. 5 and No. 16.
18. We revised our report to reduce the recommended disallowance by $133,078.
19. We disagree. Although the CFR Manual allows providers to depreciate an asset using

management estimates, NYSARC officials did not provide records of the analysis (despite our requests) used to determine that 25 years was reasonable for treating this cost as a single asset and for its corresponding depreciation. NYSARC officials also did not record this cost separately as building component costs or building improvement costs. Instead, NYSARC officials combined these costs and depreciated it as a single asset.

20. We disagree. It remains management's responsibility to assess the risk and cost of its function and operations when determining compliance with applicable laws, regulations, and requirements (e.g., RCM). It is sound business practice to understand the requirements of an operation prior to reporting the costs for reimbursement.
21. The CFR Manual and its appendices clearly instruct providers not to include the cost of its management service contracts as an agency administration cost. However, NYSARC officials reported these costs as agency administration costs. Further, NYSARC officials failed to keep track of the actual cost of its management and administrative services. We disagree that the services provided by the staff who also provided management services would be indiscernible from their agency administrative functions. Moreover, it remains management's function to design clear and appropriate job functions and responsibilities for its staff.
22. We agree that ratio value can be used to allocate agency administrative costs. However, the CFR Manual states that management services cannot be a part of agency administration costs.
23. We disagree. The cost of providing services to its affiliates is assignable to the benefiting entities/programs. Moreover, NYSARC tracks the direct cost of services to its education department. This includes costs that one of the affiliates charged directly to the education department as well as additional costs allocated to the education department from the same affiliate. Refer to Comment No. 22.
24. NYSARC officials are mistaken. We agree that the total operating expenses to be used in developing a ratio value would include all operating expenses. We also agree that NYSARC's operating expenses would include expenses funded through supplemental government grants when calculating NYSARC's ratio value. However, we disagree with NYSARC's methodology to exclude grants from its affiliates' operating expenses when calculating its ratio values. For example, one of NYSARC's affiliates (AHRC New York City Foundation) issues grants to people with intellectual and developmental disabilities. Therefore, grant expenses are the majority of its operating expenses. Excluding these expenses understates the amount of administrative cost allocated with this affiliate and overstates the amount of administrative expense allocated to the SED cost-based programs.
25. We disagree; the five employees were not agency administration staff. As noted in NYSARC's response, the RCM defines agency administration costs as expenses not directly related to a specific program but attributable to the overall operation of the agency. However, ACCESS, also known as AHRC HealthCare, is a separate entity with its own programs. Further, NYSARC could have identified the entities that directly benefited from these five employees' services. For example, according to NYSARC's own agreement with ACCESS, NYSARC would invoice and charge ACCESS at $85 per hour for services provided by the Real Property department. As a result, NYSARC officials should have maintained records on the actual services these staff members provided to NYSARC's programs and only reported those expenses as reimbursable costs.