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 (School-Age Program)

Report 2017-S-82

December 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 school-age special education services to children with disabilities who are between the ages of 5 and 21 years. During our audit period, NYSARC operated a full-day School-Age Special Class program (referred to as the school-age cost-based program). According to NYSARC officials, about 260 school-age students were enrolled in this program 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. For the three fiscal years ended June 30, 2015, NYSARC reported approximately $38 million in reimbursable costs for the school-age cost-based program. During the same three fiscal years, NYSARC also provided services to preschool special education students, operated non-SED programs, and provided management and administrative services to eight related entities.

Key Findings

For the three fiscal years ended June 30, 2015, we identified $513,279 in reported costs that did not comply with the RCM's requirements and recommend such costs be disallowed. These ineligible costs included $403,915 in personal service costs, $82,634 in other than personal service costs, and $26,730 in parent agency administration costs, as follows:

- $266,339 in employee bonuses that were not in compliance with the RCM's guidelines.
- $82,634 in ineligible rent expenses, including $81,976 in over-allocated agency administration facility expenses and $658 in unsupported rent for its school's instructional site.
- $72,924 in non-mandated fringe benefits contributions that were not proportionately similar to the amounts received by other classes or groups of NYSARC's employees.
- $35,066 in excess executive compensation.
- $26,730 in unsupported expenses allocated from The ARC, New York, Inc. (The ARC) – NYSARC's parent company – to the school-age cost-based program. NYSARC officials did not provide details of the actual services The ARC provided to NYSARC.
- $19,197 in non-program compensation costs. NYSARC officials allocated compensation costs associated with three program directors to the school-age cost-based program. However, NYSARC officials could not provide evidence that these costs were directly related to that program.
- $10,389 in costs applicable to 1:1 Aides program. NYSARC officials incorrectly allocated these costs to its school-age cost-based program rather than to the fixed-fee 1:1 Aides program.

We also identified $3,022,083 in agency administration costs that NYSARC charged to the school-age cost-based program. 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 $3,022,083 should have been charged to the school-age cost-based program. We did not recommend that the $3,022,083 be disallowed. Instead, we recommend that SED work with NYSARC officials to formulate a fair and reasonable allocation of these costs to NYSARC's school-age cost-based program.

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 $3,022,083 in agency administration costs should be allocated to the school-age cost-based program. 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 school-age cost-based program.

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

December 31, 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 (School-Age Program) to the State Education Department for the purposes of establishing school-age 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 4405(4)(h) of the State Education Law.

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

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

Table of Contents

State Government Accountability Contact Information:
Audit Director: Kenrick Sifontes
Phone: (212) 417-5200
Email: StateGovernmentAccountability@osc.ny.gov
Address:
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

This report is also available on our website at: www.osc.state.ny.us

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 a full-day School-Age Special Class program to children with disabilities who are between the ages of 5 and 21 years. For purposes of this report, this program is referred to as the school-age cost-based program.

According to NYSARC officials, during the school year ended June 30, 2015, NYSARC served 260 students in the school-age cost-based program. NYSARC also operated two other SED special education programs: a preschool cost-based program and a fixed-fee 1:1 Aides program. As reported by NYSARC officials, they also operated 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 service programs. 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 shared resources with some of its affiliates. These resources include its administrative building, which was 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 reimbursement eligibility of claimed 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.

Section 4405(4)(h) of the Education Law states that reimbursements are subject to adjustment and final determination upon a field audit conducted by the State Comptroller. For the three fiscal years ended June 30, 2015, NYSARC reported approximately $38 million in reimbursable costs for the school-age cost-based program. Our audit focused primarily on the fiscal year ended June 30, 2015. However, we expanded our review to include certain items claimed on the CFRs for the two fiscal years ended June 30, 2014.

Audit Findings and Recommendations

For the three fiscal years ended June 30, 2015, we identified $513,279 in reported costs that did not comply with SED's requirements for reimbursement. These ineligible costs included $403,915 in personal service costs, $82,634 in other than personal service (OTPS) costs, and $26,730 in parent agency administration costs allocated to the school-age cost-based program (see 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 $28.6 million in personal service costs for the school-age cost-based program. We identified $403,915 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 the amount of the award. Moreover, bonus awards are restricted to direct care employees (as defined by the RCM) and to those in the 100 position title code series and 505 and 605 position title codes (as defined by the CFR Manual). For the three fiscal years ended June 30, 2015, NYSARC reported $943,609 in bonus compensation for 388 employees. This includes $374,584 in payments made in the fiscal year ended June 30, 2013 to ensure that NYSARC staff would not feel the effect of a required payroll lag.

NYSARC officials disagreed with our findings and advised that the payments should not be considered bonus compensation because they were repeated in subsequent years and gave each staff a permanent salary increase in the fiscal year ended June 30, 2016. However, according to NYSARC records, the compensation was to be a one-time payment to all its employees. Moreover, we found that NYSARC approved these payments with no discussion of merit or qualification requirements. Consequently, we recommend that SED disallow $266,339 in bonus compensation payments because these costs did not comply with the requirements in the RCM.

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 within the entity. According to guidance provided to us by SED, fringe benefits are proportionately similar if the benefits-to-salaries ratio is the same/similar among all employees. Moreover, the Internal Revenue Service's website states, "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 $8,332,203 in fringe benefits on its CFRs. This amount included $78,332 in Tax Sheltered Annuity (TSA) contributions and an accompanying match for 13 select officers. NYSARC officials advised that these employees were 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 appendices, which 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 their TSA program. However, we determined that this level of contribution was not proportionately similar to the amounts received by other classes or groups of employees. As a result, we recommend that SED disallow $72,924 of the $8,332,203 in fringe benefits charged to the school-age cost-based program.

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 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: two Executive Directors, seven Assistant Executive Directors, and one Chief Financial Officer. 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 $35,066, the portion of the excessive compensation allocated to the school-age cost-based program. SED, pursuant to a desk review, previously disallowed some of these costs.

Incorrectly Allocated 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 $29,857 was allocated to the school-age cost-based program. However, according to NYSARC's records (e.g., employee files and job descriptions), these employees did not provide services that were directly related to the school-age cost-based program. 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 $19,197 in costs that were incorrectly allocated to the school-age cost-based program.

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 or unit 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 more than once. Further, salaries of employees who perform tasks for more than one program must be allocated among all programs for which they work. Moreover, 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 ending dates of service.

For the three fiscal years ended June 30, 2015, NYSARC reported $11,726,856 ($8,459,827 in salaries and $3,267,029 in fringe benefits) in compensation costs for 183 full-time and part-time employees. It allocated $9,881,589 of these costs for 143 employees to the school-age cost-based program. NYSARC officials asserted that the 143 employees provided "substitute" and 1:1 Aides services to NYSARC's school-age cost-based program. 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 a judgmental sample of 17 of the 143 employees. However, NYSARC officials could not provide records to support $10,389 ($7,306 in salaries + $3,083 in fringe benefits) in compensation costs for 4 of the 17 employees. As a result, we recommend that SED disallow the $10,389 in compensation costs because these costs were insufficiently documented to support that they should have been charged to the school-age cost-based program.

Other Than Personal Service Costs

For the three fiscal years ended June 30, 2015, NYSARC reported $9.3 million in OTPS expenses for the school-age cost-based program. We identified $82,634 of these expenses that did not comply with SED's reimbursement requirements, as outlined below.

Unsupported and Over-Allocated 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 and maintenance, depreciation, and leases 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 $82,634 in reported expenses did not comply with the guidelines in RCM and the CFR Manual, as follows:

- $81,976 in rent, utilities, repairs, and maintenance costs that should have been allocated to the other NYSARC programs that shared the same location.
- $658 in unsupported rent expenses applicable to NYSARC's school instructional site. According to NYSARC's lease agreement, the school's rent expense was $1,395,567 for the three fiscal years ended June 30, 2015. This was $658 less than the $1,396,225 NYSARC officials reported on the CFRs. NYSARC officials did not provide support for the $658 in additional rent expense.

Consequently, we recommend that SED disallow $82,634 ($81,976 + $658) in property-related costs.

Parent Agency Administration Allocation

According to the RCM, charges to programs receiving administrative services, insurance, supplies, technical consultants, or other services from a parent or related organization are reimbursable provided they are not duplicative in nature, provide a direct benefit to the subsidiary charged, are based on actual direct and indirect costs, are allocated to all programs on a consistent basis, and are defined as reimbursable in the Regulations of the Commissioner of Education, the CFR Manual, or the RCM. Costs must be reasonable, necessary, directly related to the special education program, and sufficiently documented. We identified $26,730 in parent agency expenses that did not comply with the reimbursement requirements.

During the three fiscal years ended June 30, 2015, NYSARC officials reported $472,758 in parent agency administration costs on their CFR. According to NYSARC officials, The ARC, New York, Inc. (The ARC, NYSARC's parent company), which currently oversees over 50 affiliated chapters, allocated these fees to NYSARC during the three fiscal years ended June 30, 2015. This includes $309,616 that NYSARC officials reported using CFR-3 Line 38 (the designated CFR line for reporting parent agency allocations) as well as $163,142 that NYSARC officials reported under the CFR-3 Line 17 (a CFR line for reporting miscellaneous agency administrative OTPS costs). NYSARC officials allocated $26,730 ($17,813 on CFR-3 Line 38 and $8,917 on CFR-3 Line 17) of the $472,758 in costs to the school-age cost-based program. However, NYSARC officials did not provide support for the services The ARC provided to NYSARC. As a result, we recommend that SED disallow the $26,730 in unsupported parent agency expenses.

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 recordkeeping, 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 agency 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 are the preferred statistical basis upon which to allocate salaries and fringe benefits for shared staff who work on multiple programs. Entities must maintain appropriate documentation reflecting the hours used in this allocation. Acceptable documentation may include payroll records or time studies. 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 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] entities (affiliates). NYSARC officials told us that the $4,278,274 in costs associated with providing these services 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, $3,022,083 ($2,063,325 in personal service costs and $958,758 in OTPS costs) was allocated to the school-age cost-based program.

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 and administrative services to the 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 NYSARC 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 the affiliates, which totaled $4,278,274 over the three-year audit period. However, absent support for the actual costs NYSARC incurred in providing these services, we have no assurance that the cost of providing management and administrative services was limited to $4,278,274. In fact, the following are some of the reasons that lead us to conclude that the $4,278,274 is understated:

- During the three fiscal years ended June 30, 2015, NYSARC's staff processed grant awards and payments for one affiliate; however, NYSARC did not maintain records identifying the cost incurred to provide such services. These costs should have been charged as a direct cost to the affiliate rather than in NYSARC's 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 bylaws of its affiliates. However, NYSARC officials did not include this cost as part of the management and administrative service fee. Instead, NYSARC officials included this cost as part of their total management and administrative cost. As a result, the school-age cost-based program was incorrectly allocated a portion of this cost.

[1] According to the CFR Manual, a related entity is, to a significant extent, associated or affiliated with, or has control of, or is controlled by, the organization/individual furnishing the services, facilities, or supplies. In addition, the CFR Manual defines Closely Allied Entities relationships 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.

Although NYSARC officials maintained documentation to support the direct costs and program administration costs of their education programs, they failed to maintain similar documentation that would assist in identifying the costs of the services provided to their affiliates.

Non-Compliance With the RCM and CFR Manual

Management service costs are distinct from agency administration costs. According to the CFR Manual, the cost of providing management services must be reported in a separate cost center on Schedule CFR-2.

NYSARC officials disagree. They assert that they did not provide the management services as a separate business activity. They further assert they allocated NYSARC's shared administrative costs among its related companies and affiliates. Therefore, these costs did not need to be shown separately in Schedule CFR-2. We disagree, and note that, according to NYSARC's contracts with its various related affiliates, NYSARC was retained as an independent contractor to provide these affiliates with management and administrative services. In addition, NYSARC officials requested that we use the ratio value of each entity's operating expense to the total operating expense 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. The ratio value methodology of allocation in this instance would not result in an accurate or reasonable allocation because the entity would be combining two separate cost centers – one of which was not a shared cost. Management services should be the actual cost of providing contracted services to an affiliate. Rather than reporting actual costs, NYSARC arbitrarily charged management service fees to its affiliates. This has an impact on its rates, as some of the expenses of affiliates related to these contracted services appear to have been reported as shared costs and allocated to the SED school-age program. As the ratio value results in an individual affiliate's costs being shared among NYSARC and all other affiliates, this method of allocation is 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 school-age cost-based program. 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 school-age cost-based program.[2]

[2] 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," "Incorrectly Allocated Staff Compensation," and "Unsupported and Over-Allocated 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 $3,022,083 in agency administration costs should be allocated to the school-age cost-based program. 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 school-age cost-based program.

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 reasonable, necessary, directly related to the special education program, and sufficiently documented pursuant to SED guidelines. 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's 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. We also evaluated the internal controls over the costs claimed on, and the schedules prepared in support of, the CFRs submitted to SED.

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 4405(4)(h) 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 responses to certain NYSARC comments are embedded within NYSARC's response. 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 of the final release of this report, as required by Section 170 of the Executive Law, the Commissioner of Education shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and if the recommendations were not implemented, the reasons why.

Contributors to This Report

Kenrick Sifontes, Audit Director
Stephen Lynch, Audit Manager
Aida Solomon, Audit Supervisor
Adefemi Akingbade, Examiner-in-Charge
Jiaying Li, Senior Examiner
Faisal Nadeem, Senior Examiner
Wayne Scully, Senior Examiner
Baomei Ma, Intern

Division of State Government Accountability

Andrew A. SanFilippo, Executive Deputy Comptroller
518-474-4593, asanfilippo@osc.ny.gov

Tina Kim, Deputy Comptroller
518-473-3596, tkim@osc.ny.gov

Ken Shulman, Assistant Comptroller
518-473-0324, kshulman@osc.ny.gov

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 (School-Age Program)
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 Services				
Direct Care	$26,572,993	$284,687	$26,288,306	A-B,D-G,J-M, O-T
Agency Administration	2,063,324	119,228*	1,944,096	
Total Personal Services	**$28,636,317**	**$403,915***	**$28,232,402**	
Other Than Personal Services				
Direct Care	$8,374,165	$58,614	$8,315,551	A-B,H-I,K,N,P,S, T,V-W
Agency Administration	949,841	24,020	925,821	
Total Other Than Personal Services	**$9,324,006**	**$82,634**	**$9,241,372**	
Parent Agency Administration Allocation	**$26,730**	**$26,730**	**$0**	B-C,K,P,T,U,X
Total Program Costs	**$37,987,053**	**$513,279***	**$37,473,774**	

*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 I.9 - Agency administration is 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 recordkeeping, budget, and fiscal management; costs for public relations (non-fundraising); and costs for parent agency expenditures.
B. RCM Section II - Generally, costs will be considered for reimbursement provided such costs are reasonable, necessary, directly related to the special education program, and sufficiently documented.
C. RCM Section II.10 - Charges to programs receiving administrative services, insurance, supplies, technical consultants, etc., from a parent or related organization are reimbursable provided they are not duplicative in nature, provide a direct benefit to the subsidiary charged, are based on actual direct and indirect costs, are allocated to all programs on a consistent basis, and are defined as reimbursable in the Regulations of the Commissioner of Education, the CFR Manual, or this Manual.
D. RCM Section II.13.A.(4)(a) - Compensation (i.e., salaries plus fringe benefits) for an entity's staff whose function is that of Executive Director, Assistant Executive Director, or Chief Financial Officer will be directly compared to the regional median compensation for comparable administration job titles of public school districts. Reimbursement of employee compensation for these job titles shall not exceed the median compensation paid to comparable personnel in public schools for similar work and hours of employment in the region in which the entity is located. Compensation for an "Executive Director" providing services to an Article 81- and/or Article 89-funded program will be compared to the median "Superintendent-Independent" compensation for the region in which the entity is located. Compensation for an Assistant Executive Director and Chief Financial Officer will be compared to the median compensation for an "Assistant Superintendent."
E. 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, which is not directly related to hours worked. Bonus compensation is restricted to direct care titles/employees.
F. RCM Section II.13.A.(10) (July 2013 Edition and July 2014 Edition) - A merit award (or bonus compensation) shall mean a non-recurring and non-accumulating (i.e., not included in base salary of subsequent years) lump sum payment in excess of regularly scheduled salary, which is not directly related to hours worked. A merit award may be reimbursed if it is based on merit as measured and supported by employee performance evaluations. In 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.

G. RCM Section II.13.B.(2)(c) - Benefits, including pensions, life insurance, and Tax Sheltered Annuities (TSAs) for individual employees or officers/directors are proportionately similar to those received by other classes or groups of employees.
H. 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.
I. 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.
J. 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.
K. RCM Section III.1 - Costs will not be reimbursable on field audit without appropriate written documentation of costs.
L. 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.
M. 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.
N. RCM Section III.1.D - All purchases must be supported with canceled checks and invoices listing items purchased and indicating date of purchase and date of payment. Costs must be charged directly to specific programs whenever possible. The particular program(s) must be identified on invoices or associated documents.
O. 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.
P. 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.
Q. 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.
R. 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).

S. 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.

T. CFR Manual, page 15.1 - Agency administrative costs do not include fundraising costs, special events costs, costs of management services provided to another entity through an ongoing contract, and Local Governmental Unit (LGU) Administration. Fundraising, special events, and management services contract costs and their related revenues are reported on Schedule CFR-2 in Column 7, “Other Programs.”

U. CFR Manual, page 15.6 - Supporting documentation for the parent agency administration allocation should be sent with the certification pages to each funding/certifying State agency. Supporting documentation must include: total parent organization cost, total allocated cost to all subordinate agencies of the parent organization, and the basis used to allocate the cost to its subordinate agencies. If all necessary documentation is not submitted, the cost will be excluded from allowable cost.

V. 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.

W. CFR Manual, page 43.3 - When programs share the same geographic location or more than one State agency is served at the same geographic location, property and related costs must be allocated between the programs/State agencies benefiting from those resources. These costs include expenses such as utilities, repairs and maintenance, depreciation, leases, or mortgage interest.

X. CFR Manual, page 57.1 - Dues or portions of dues paid to any professional association or parent agency whose primary function is of a political or lobbying nature and whose intent is to influence legislation or appropriation actions pending before local, State, or federal bodies.

Agency Comments - State Education Department

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

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

December 20, 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-82, 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 $3,022,083 in agency administration costs should be allocated to the school-age cost-based program. 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 school-age cost-based program.

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 school-age cost-based program.

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: Karla Ravida
Christopher Suriano
Suzanne Bolling
Harold Matott
James Kampf

Agency Comments - NYSARC, Inc. – NYC Chapter and State Comptroller's Comments

AHRC
new york city

83 Maiden Lane, New York City, NY 10038
ph: 212.780.2500
TTY: Dial 711 and ask for 212.780.2500
www.ahrcnyc.org

Sharyn Van Reepinghen, *President*
Marco R. Damiani, *Chief Executive Officer*

December 18, 2018

BY FEDEX AND E-MAIL

Mr. Kenrick Sifontes
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236
StateGovernmentAccountability@osc.ny.gov

Re: **NYSARC, Inc., New York City Chapter ("AHRC NYC")**
Response to Office of the New York State Comptroller ("OSC")
Audit No. 2017-S-82: 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-82 issued by OSC on November 20, 2018 (the "Draft Audit Report"), which examined costs claimed by AHRC NYC for its school-age 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 them in its final audit report.

I. Background

As indicated in the Draft Audit Report, AHRC NYC is accurately described as a New York City-based not-for-profit corporation that has been approved by SED to operate a school-age special education program for children and adolescents with disabilities between the ages of five to twenty-one. The New York City Department of Education ("DOE") refers special education students to AHRC NYC based on completed clinical evaluations and reimburses AHRC NYC for its services using rates established by SED. As noted by the Draft Audit Report, during the Audit Period, these services included the operation of full-day School-Age Special Class programs. Additionally, AHRC NYC operated other SED-approved programs: the

Arc New York | New York City Chapter

1:1 Aides program, full-day and half-day special preschool education classes, and a full-day Integrated Special Class. AHRC NYC also operated non-SED services, and provided management and administrative services to its eight related entities during the Audit Period. During the 2014-15 school year, AHRC NYC served approximately 260 school-age students in the programs being audited by OSC.

The Background portion of the Draft Audit Report makes modest reference to, but fails to acknowledge fully that AHRC NYC operates far more than its SED-approved, school-based programs.

State Comptroller's Comment - Page 5, paragraph 2 of our audit report makes adequate reference to NYSARC's (AHRC NYC) non-SED 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:

- **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; and
- **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 DOE-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 DOE-funded programs that were subject to this audit, AHRC NYC operates 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 for Person-Centered Excellence 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 many other audits of SED-funded providers of school programs.

State Comptroller's Comment - We acknowledge that NYSARC is a complex organization. However, its processes and operations are no more complex than any of the other large preschool and school-age special education providers we audited that have both SED and non-SED programs. Difficulties encountered during the audit resulted from the insufficiency of, and delays in, obtaining information from NYSARC officials and staff.

Response Letter to OSC Audit 2017-S-82 December 18, 2018

- 3 -

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"); however, as with its prior audit of AHRC NYC's pre-school programs, the final audit report for which was issued by OSC on November 21, 2018 (the "Pre-School Audit"), we believe that many of the incorrect findings contained in the Draft Audit Report are a function of OSC not recognizing 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.

II. Preliminary Procedural Matters and Overview of Response

Before providing our responses to OSC's findings, and consistent with the Pre-School Audit, AHRC NYC wants to commend the OSC auditors for their professionalism and attention to detail while completing the audit. 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 set forth in the Draft Audit Report):

	Section	Finding and Description[1]
1.	Personal Service Costs	**Ineligible Bonuses:** $266,339 in employee bonuses that were not in compliance with the RCM's guidelines.
2.		**Excess Executive Compensation:** $35,066 in non-program compensation costs for three program directors that were incorrectly allocated to the SED cost-based programs.
3.		**One-to-one (1:1) Aide's Costs:** $10,389 in compensation costs for employees serving as 1:1 aides that were insufficiently documented.
4.	Other than Personal Services	**Unsupported and Over-Allocated Facility Expense:** $658 in unsupported rent expenses.
5.	Parent Agency Administration Allocation	**Parent Agency Administration Allocation:** $26,730 in unsupported expenses, which reflect amounts paid to The ARC, New York, Inc.
6.	Indeterminable Allocation of Agency Administration Costs	**Cost of Providing Management and Administrative Services:** Although OSC is not recommending its disallowance of $3,022,083 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.

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

Response Letter to OSC Audit 2017-S-82 December 18, 2018

- 4 -

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 merit awards issued in compliance with RCM requirements and appropriately supported by performance evaluation.

AHRC NYC respectfully disagrees with the proposed disallowance of $266,339 in perceived merit-based bonus compensation charged to the SED School-Age program during the Audit Period. To restate our understanding of OSC's position, the Draft Audit Report findings contend that AHRC NYC failed to establish that the bonus compensation was based on "merit" and "supported by employee performance evaluations" and, therefore, failed to comply with the RCM's requirements for reimbursable bonus compensation.[2] In support of its findings, OSC stated that AHRC NYC paid these bonus amounts with no discussion of "merit" or "qualification" requirements that were found in policies and procedures that were adopted by AHRC NYC.

In response, AHRC NYC asserts that these bonuses paid to direct care employees during the Audit Period (the "Merit Awards") were in full compliance with the requirements of the RCM.

State Comptroller's Comment - The RCM requires merit (bonus) awards to be based on employee performance; however, these payments were not based on merit. As noted in a November 19, 2013 memo to staff, "a one-time payment of $750 to each of you [NYSARC's employees] in the December 20 payroll disbursement," NYSARC officials directed the payment of bonuses to all staff, regardless of their performance evaluations. Further, in a January 12, 2015 memorandum to staff, NYSARC's Executive Director implemented "a one-time payment of $800 to all staff in the January 16th payroll disbursement." This memorandum also included additional instruction to pro-rate this payment to staff hired after June 30, 2014.

Specifically, the RCM requires that-in order to demonstrate that a Merit Award is based on appropriate criteria-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 A),** which was revised as of September 1, 2013, AHRC NYC requires annual performance evaluations to be conducted for all staff. Each newly hired

[2] The RCM states: "A merit award may be reimbursed if it is based on merit as measured and supported by employee performance evaluations." The RCM applicable to FY 2013 (the July 2012 edition) contains language on the topic of Merit Awards that is different from the language found in the RCMs applicable to FY 2014 (the July 2013 edition) and FY 2015 (July 2014 edition), but all three RCMs contain this requirement, in § II.13.A.(10).

[3] RCM § II.13.A.(10), p. 21 (July 2013 edition).

staff member meets with his or her supervisor after three months to discuss performance and to develop a professional plan by setting goals to guide improvement efforts. The first performance review is conducted on the anniversary date of the staff member's hire, and occurs annually thereafter. AHRC NYC has established rubrics for Standards of Teaching and Leadership Standards and Performance Review templates for each position.

The principal of each school has an ongoing schedule of supervision and evaluation of classroom effectiveness and staff performance. Each school's principal, assistant principal and/or program coordinator advise and provide support to the classroom teachers, regularly visit classrooms for both scheduled and impromptu observations, share resources and information, and assist in the development and review of lesson plans. Formal and informal classroom observations, team meetings and conferences are the core of the evaluation process for teachers and behavior trainers. Specifically, AHRC NYC performs a minimum of two formal classroom observations within the school year. The initial classroom observation occurs within the first three months of employment and is the focal point of the three-month goal setting process, as well as the framework for guiding improvement efforts. Before the anniversary date of hire, AHRC NYC performs a second formal classroom observation. After the first year of teaching, the two formal classroom observations can be scheduled at the discretion of the principal, but must occur within the annual review period. Formal classroom observations must be accompanied by pre and post conferences, during which AHRC NYC offers teachers and other direct care workers feedback directly related to the standards and elements on the rubrics and criteria that are the framework for the annual performance review.

Specifically, staff performance is measured using the Standards of Teaching Rubric and Performance Review Checklist. The Standards of Teaching Rubric and Performance Review Checklist are divided into eight domains largely based on Charlotte Danielson's *Enhancing Professional Practice: A Framework for Teaching*. Each domain is further subdivided into elements that provide a framework for professional practice in AHRC NYC schools. There are four levels of performance: (1) ineffective, (2) developing, (3) effective and (4) highly effective. This framework is intended to promote self-reflection, professional discussion and continuous improvement during the formal evaluation and supervision process for both probationary and tenured teachers. Staff, whose overall performance levels are ineffective with little or no improvement, will not pass their probationary period. There is an expectation that staff whose practice is in the developing stages will make progress over the next review period and will achieve the goals and expectations set at the previous review period. As Section 6.1.4 states, only staff with consistently effective and highly effective ratings (90% +) will be considered for merit-based bonuses and salary increases.

OSC cites that AHRC NYC approved these payments "with no discussions of merit or qualification requirements," despite the rigorous and SED-compliant staff review process and policy noted above.

State Comptroller's Comment - According to the RCM's guidelines for reporting reimbursable bonus awards, evaluations used in the merit award process should include an overall rating. However, none of the evaluations NYSARC provided included the overall rating of the staff's performance. For example, we received staff evaluations that commented on the staff's performance; however, there was no rating or scale delineating how NYSARC officials translated these comments to align with their performance bonus rating scale.

To demonstrate that these payments were, in fact, merit based bonuses derivative from the performance evaluation process, AHRC NYC has located evaluations for all but seven of the 388 employees receiving bonus compensation that OSC seeks to disallow. As AHRC NYC was unable to locate the remaining evaluations (despite its belief that such evaluations were performed), a revised schedule of these evaluations, adjusting the reimbursable merit-based bonus compensation to exclude bonuses granted to these seven employees, is enclosed with this letter as **Exhibit B.** The existence of these performance evaluations, which align with the merit-based bonuses paid to the vast majority of direct service professionals and other eligible staff members, reflects that AHRC NYC did in fact pay these bonuses with consideration given to performance of these individuals.

State Comptroller's Comment - We disagree that these performance evaluations align with the bonuses, as evaluations were not provided to support the bonuses paid to certain individuals. For example, NYSARC officials could not provide us with performance evaluations for $44,690 of the $98,218 in bonus payments summarized in their Exhibit B. This included the $26,700 in bonuses that NYSARC funded using State grants, $13,125 in bonuses that NYSARC excluded from reimbursable cost reporting, and $4,865 in bonuses for which NYSARC officials could not locate performance evaluations.

OSC further contends that AHRC NYC failed to comply with the RCM's requirements by distributing Merit Awards of "equal size" to the staff members who earned them. Under the RCM, employee performance evaluation policies should indicate how an employee's rating "directly" correlates to the merit bonus awarded.[4] Consistent with the RCM, AHRC NYC's policy clearly states that staff reaching a set threshold performance rating (90%+) are eligible to receive a Merit Award; as such, there exists a *direct* correlation between reaching the established rating threshold and the receipt of a Merit Award. Critically, and contrary to OSC's reading of the RCM, the RCM does not state specifically that Merit Awards must be *proportionally* correlated to performance ratings, such that the specific dollar amount of the bonus has to be comparatively and relatively assigned to each staff member who earned a bonus. Rather, the RCM requirements are satisfied so long as the staff member's evaluation performance has direct relationship whether that staff member earns a bonus, which was true for these payments. Moreover, given that these staff members have different base salaries, even performance bonuses of an equal amount constitute a different percentage of each staff member's total compensation in the year it was paid.

State Comptroller's Comment - We disagree. The RCM specifically states, "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." NYSARC's policy did not include such a correlation. Moreover, NYSARC did not provide performance evaluations for staff whose bonus compensation NYSARC officials deemed non-reimbursable.

[4] "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." RCM § II.13.A.(10), p. 21 (July 2013 edition). Though the RCM applicable to FY 2013 (the July 2012 edition), does not contain this language, it is less restrictive regarding merit-based awards.

Response Letter to OSC Audit 2017-S-82 December 18, 2018

- 7 -

In addition to the assertion that the Merit Awards were not clearly based on performance OSC communicated its disapproval that letters sent to AHRC NYC staff regarding the one-time bonus did not stipulate the bonus was contingent upon performance.

State Comptroller's Comment - NYSARC management addressed these memoranda to all NYSARC staff and specified that "each" employee would receive the bonus awards (November 19, 2013 and January 12, 2015). The memoranda clearly indicated that all staff were going to receive a bonus. These memoranda did not include language that the bonuses were going to be based on performance evaluations.

However, AHRC NYC notes that the RCM contains no express or implied requirement that specific communications with employees specify that a bonus is merit based. For a merit award to be reimbursable, the RCM requires only that it be based on merit, and supported by evaluations. Furthermore, that an award is merit based and supported by evaluations may be evidenced by "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."[5] Nowhere does the RCM indicate that for a Merit Award to be reimbursable, there must also be express, written communications with staff that the Merit Awards were based on performance. Here, the process was straightforward and clear: performance evaluations were conducted and Merit Awards were paid to staff based on the scores contained in those evaluations. Nothing more is required by the RCM and OSC cannot disallow these claims for any failures by AHRC NYC to follow these specified processes.

Based on the foregoing explanation, we respectfully request that OSC reconsider its recommended disallowance of $266,339 in bonus compensation, and instead seek a lower disallowance of $182,276, corresponding to the portion of those payments that were paid for staff members for whom AHRC NYC could not locate evaluations, even though AHRC NYC believes that such evaluations were completed.

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 respectfully disagree with the Draft Audit Report Findings basis for proposing disallowance of $35,066 of executive compensation charged to the SED School-Age Cost-based

[5] RCM § II.13.A.(10), p. 21 (July 2013 edition). The RCM applicable to FY 2013 (the July 2012 edition), does not contain this language, however, as it provides less guidance regarding required support for merit awards, AHRC NYC's assertion is still supported.

program.[6] As cited in the Draft Audit Report Findings, 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."[7] 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, rather than at the reported amounts.

State Comptroller's Comment - 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.

Neither the RCM, CFR Manual nor SED instructs AHRC NYC, as a school-age program provider, to make this adjustment when completing the CFR. 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, OSC has not furnished a sufficient basis for we of the reason for this finding and believe that it should be excluded from the Draft Audit Report Findings entirely. 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. Because the median salary levels are not established by SED until after the CFRs are filed, there would be no way for AHRC NYC to calculate with any accuracy or degree of certainty the adjustment to the median salary level when reporting on the CFR. As such, programs are entitled to rely on the post hoc calculated reimbursement adjustment by SED after they review AHRC NYC's CFR to ensure compliance with the RCM.

State Comptroller's Comment - 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."

Without prejudice to the jurisdictional argument above, and similar to the preschool audit conducted previously by OSC, we also note that the amounts calculated by OSC as the "Total Compensation Reported" on the CFR subject to the median salary limitation are overstated, due to an OSC error. 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. Additionally, given that fringes as a percentage of salary for the top three positions are considerably lower than the overall agency

[6] The Draft Audit Report Findings note that SED, pursuant to a desk review, previously disallowed some of these costs.
[7] RCM § II.13.A.(4).a, p. 19 (July 2014 edition).

Response Letter to OSC Audit 2017-S-82 December 18, 2018

- 9 -

administration staff fringe benefit percentage, this relationship 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.

State Comptroller's Comment - During the audit, NYSARC officials advised us to use the average fringe benefit rate(s); however, in their response to the draft report, they now want us to use the actual fringe benefit rate(s) as reported on the CFR. However, NYSARC officials did not provide us with documentation to support the actual fringe benefit rate(s).

Enclosed with this letter as **Exhibit C** is a schedule recalculating the salaries subject to the median salary adjustment. However, AHRC NYC asserts that the finding should be removed in its entirety because it reported the compensation correctly on the CFR and was *not* reimbursed for these costs, consistent with the RCM.

C. Finding 3: One-to-one (1:1) Aide's Costs

Summary of Response: As AHRC NYC has sufficient documentation for costs associated with two of the four aides in question, the disallowed costs are in part reimbursable.

AHRC NYC respectfully disagrees with the proposed disallowance of $10,389 in compensation costs charged to SED. To restate our understanding of OSC's position, the Draft Audit Report Findings contend that compensation costs applicable to four employees who were reported as providing services as substitutes and 1:1 aides were insufficiently documented. AHRC NYC respectfully disagrees with the Draft Audit Report Finding for two of the four aides. AHRC NYC has sufficient documentation, in the form of timesheets (one of the categories cited by OSC in the Draft Audit Report as documentation that would evidence where a staff member worked), for two of the employees in question. The timesheets reflect that these employees served as substitutes and 1:1 aides to the school-age program, and fully support—in the form of signed and dated documents—the number of hours spent providing services as 1:1 aides for the employees in question.

State Comptroller's Comment - We disagree. 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 providers' CFRs under the fixed-fee 1:1 Aides program. NYSARC officials could not provide documentation to show that these employees were no longer part of the 1:1 Aides program; therefore, their compensation should not have been charged to the school-age cost-based program.

Attached to this letter as **Exhibit D** are copies of these personnel records. Based on the foregoing explanation, we respectfully request that OSC reconsider its recommended disallowance of 1:1 aides' costs for these two aides, and reduce the proposed disallowance from $10,389 to $4,095.

IV. <u>Response to Disallowances Related to Other Than Personal Service Cost</u>

Response Letter to OSC Audit 2017-S-82 December 18, 2018

- 10 -

A. **Finding 4: Unsupported and Overallocated Facility Expenses - Unsupported Rent Expense**

Summary of Response: As AHRC NYC requested reimbursement for rent expenses based on the actual documented rental charges, in compliance with the RCM, the disallowed costs are fully reimbursable.

AHRC NYC respectfully disagrees with the proposed disallowance of $658 in rent expenses as unsupported. To reiterate our understanding of OSC's finding, the OSC found that the rent expense specified in AHRC NYC's lease agreement for the space in question, is $658 less than the rent expense reported by AHRC NYC. However, the $1,396,225 reported by AHRC NYC is the actual amount spent on rent expenses for the three fiscal years ended June 30, 2015, as supported by AHRC NYC general ledger and other accounting records, enclosed with this letter as **Exhibit E.**

State Comptroller's Comment - NYSARC officials should not have paid more than they were contractually obligated to pay in their lease agreements without obtaining an explanation for the increased cost. It remains management's responsibility to determine if the costs reported for reimbursement were necessary, reasonable, program related, and sufficiently documented.

As the RCM bases reimbursement on actual documented rental charges, not on the amount stated in the relevant lease,[8] AHRC NYC feels that the additional rent charge was sufficiently documented, and as such, these additional rent costs should be deemed fully allowable.

V. **Parent Agency Administration Allocation**

Summary of Response: NYSARC, Inc.—referred to in the Draft Audit Report as ARC, New York, Inc. ("ARC") —separately submits and justifies the costs it incurs on behalf of its chapters, including AHRC NYC, to OPWDD and other state agencies. As such, AHRC NYC has appropriately instructed OSC to obtain this supporting documentation from ARC or OPWDD, rather than AHRC NYC, which does not receive this information.

OSC respectfully disagrees with the proposed disallowance of $26,730, which corresponds to amounts paid by AHRC NYC to ARC, as its parent corporation. In citing the RCM, OSC seeks to disallow this allocation to the school-age program because AHRC NYC could not provide OSC adequate documentation that these costs were reasonable, necessary and directly related to the school-age program. Given the corporate relationship between ARC and each of its chapters, including AHRC NYC, and the amounts charged by ARC to its chapters, ARC separately submits its justification of these charges to the state. This process allows one entity—ARC—rather than more than 50 of its chapters to provide a single set of documentation to the state to justify its costs and charges, which is a streamlined and efficient process.
Moreover, based on the prominence of ARC in New York State—especially with regard to the services furnished to people with intellectual and developmental disabilities—the CFR Manual specifically references that ARC may justify its costs to the state directly.

[8] RCM § II.4l.B(2), p. 37 (July 2015 edition)

> **38. Parent Agency Administration Allocation:** The allocation of administration expense of a parent organization incurred in providing support and/or direction to its separately incorporated subsidiary agencies. Supporting documentation for the parent agency administration allocation should be sent with the certification pages to each funding/certifying State Agency. Supporting documentation must include: total parent organization cost, total allocated cost to all subordinate agencies of the parent organization, and the basis used to allocate the cost to its subordinate agencies. If all necessary documentation is not submitted, the cost will be excluded from allowable cost.
>
> ***OPWDD:*** *Providers that are chapter members of the New York State Association for Retarded Children, Inc. are not required to submit parent agency expense documentation since this parent agency submits this information to OPWDD on their behalf* (emphasis added).[9]

As reflected above the CFR Manual and OPWDD specifically note that ARC submits documentation regarding its agency administration allocation on "behalf" of its chapters, including AHRC NYC, and that AHRC NYC is not "required to" retain or submit this documentation to justify its CFR submission. Given this arrangement, it is appropriate for AHRC NYC to instruct OSC (as it has done) to seek this supporting documentation from ARC or from OPWDD (to which it submits this information), as each individual chapter is not expected to retain this documentation for reporting purposes.

State Comptroller's Comment - Although it is not OSC's responsibility, we contacted ARC officials and they could not provide the required documents. Further, ARC officials advised us that they have not provided the parent agency allocation documentation to any of the State agencies (e.g., OPWDD, SED). Therefore, NYSARC does not have support for these costs reported on their CFRs.

Based on the foregoing explanation, we respectfully request that OSC refrain from imposing any disallowance based on the costs charged to AHRC NYC by ARC, until and unless OSC seeks such information from ARC. As previously discussed with OSC, AHRC NYC would cooperative with and support OSC in seeking such information from ARC.

VI. Indeterminable Allocation of Agency Administration Costs

A. Finding 5: Cost of Providing Management and Administrative Services

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

[9] CFR Manual, CFR-3 - Agency Administration, § 15.0, page 15.6 (Issued Aug. 20, 2018).

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."[10] 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.[11] 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 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

[10] 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.

[11] 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.

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.

State Comptroller's Comment - We disagree. It remains management's responsibility to assess the risk and cost of their functions 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.

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.

State Comptroller's Comment - The CFR Manual and its appendices clearly instruct providers not to include the cost of their management service contracts as agency administration costs. However, NYSARC officials reported these costs as agency administration costs. Further, NYSARC officials failed to keep track of the actual cost of their 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 their staff.

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.

State Comptroller's Comment - 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.

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"[12] 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).[13] 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.[14] 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.

State Comptroller's Comment - We disagree. The cost of providing services to NYSARC's 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. The CFR Manual and its appendices clearly instruct providers not to include the cost of management service contracts as agency administration costs.

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" [15]) 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.

State Comptroller's Comment - 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.

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

---

[12] RCM § III.l.M.(l), p. 52 (July 2014 edition).
[13] RCM § III.l.M.(3), p. 52 (July 2014 edition).
[14] RCM § I.9, p. 11 (July 2014 edition).
[15] 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)

Response Letter to OSC Audit 2017-S-82 December 18, 2018

- 15 -

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[16], which are actual staff and expenses of AHRC that do utilize administration.

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.[17] 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,[18] 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.

State Comptroller's Comment - 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.

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.

---

[16] Federal Allocations for Special Education (Individuals with Disabilities Education Act, Sections 611 and 619).

[17] 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).

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

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.

State Comptroller's Comment - 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 $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.

B. Finding 6: Non-Compliance with the RCM and CFR Manual

Summary of Response: AHRC NYC does not furnish administrative services as a "separate business line" to its programs and affiliates. Rather, AHRC NYC is consistently allocating its administrative expenses across its programs and affiliates.

We respectfully disagree with OSC's assessment that AHRC NYC's treatment of its management and administrative services costs does not comply with the CFR Manual's guidance on how to report the cost of providing management services. To restate our understanding of OSC's position, OSC contends that such costs should have been reported in a separate cost center on Schedule CFR-2 and would thereby have received an allocation of agency administrative expenses through Ratio Value. However, the section of the manual cited by OSC is not applicable in this situation and thus this finding is misplaced.

Specifically, OSC cites the FAQ section of the CFR Manual, found on Page 8.14 of the July 2015 – June 2016 manual, which states:

Question: How should the expenses and revenues for management services provided to another entity be reported on the CFR?

Answer: When a CFR agency provides management services to another entity as a *separate business activity* (emphasis added) 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.

AHRC NYC is not providing management services as a separate business activity; rather, it is simply allocating its shared administrative costs amongst its related companies and affiliates. As the management services are not a separate business activity, this section of the CFR Manual

Response Letter to OSC Audit 2017-S-82 December 18, 2018

- 17 -

is not applicable. The rationale behind this CFR reporting rule is that a Management Service Organization ("MSO") performs its administrative and management services, much like another agency would operate a "program." As with any program operated by a CFR-filing provider, the MSO should receive an allocation of agency administration. However, AHRC NYC is not operating an MSO and is not providing services as a separate business activity. Instead, OSC is treating AHRC NYC's agency administration services expenses, which are pooled and then allocated to each affiliated company or program benefitting from them, as a separate business line when the programs or operations themselves are the business. Unlike an organization running an MSO as a separate business activity, AHRC NYC does not provide management services to any outside entities-rather, the recipients are its own programs and affiliates. Accordingly, AHRC NYC disputes the OSC's assertion that the treatment of management and administrative services costs does not comply with the CFR Manual, as the provision of the CFR Manual upon which the OSC based its finding is not applicable.

State Comptroller's Comment - We disagree. According to SED officials, management services contract costs and their related revenues should be reported on Schedule CFR-2 under column 7 – Other Programs Totals, unless NYSARC obtained written approval from SED allowing it to deviate from the CFR Manual instructions. However, NYSARC did not obtain such approval from SED.

* * * * *

Response Letter to OSC Audit 2017-S-82 December 18, 2018

- 18 -

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: Stephen Lynch, Audit Manager, OSC
Aida Solomon, Audit Supervisor, OSC
Adefemi Akingbade, Examiner-in-Charge, OSC
Arny West, Chief Financial Officer, AHRC NYC
Elizabeth Lynam, Chief Program Officer, AHRC NYC
Alden Kaplan, Senior Policy Advisor, AHRC NYC
Kathy Broderick, Senior Program Advisor, AHRC NYC
Christine Muccioli, Vice President, Education Services, AHRC NYC
Louise Marchini, Assistant Director of Education, AHRC NYC
Brian O'Reilly, BKD CPAs & Advisors LLP
Brett R. Friedman, Ropes & Gray LLP