



Henry Viscardi School

Compliance with the Reimbursable Cost Manual

Report 2009-S-70



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of State Government Accountability

April 6, 2011

Dr. David Steiner
Commissioner
State Education Department
89 Washington Avenue
Albany, NY 12234

Ms. Patrice McCarthy Kuntzler
Executive Director
Henry Viscardi School
201 I U Willets Road
Albertson, New York 11507

Dear Dr. Steiner and Ms. McCarthy Kuntzler:

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

Following is a report of our audit of the Henry Viscardi School: *Compliance with the Reimbursable Cost Manual*. This audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1, of the State Constitution and Article II, Section 8, of the State Finance Law.

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

Respectfully submitted,

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

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State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

Audit Objective

Our objective was to determine whether the costs reported by the Henry Viscardi School on the consolidated financial report were properly calculated, adequately documented and allowable under the State Education Department's Reimbursable Cost Manual for the two years ended June 30, 2009.

Audit Results - Summary

The Henry Viscardi School (HVS), which is located in Albertson, Long Island, is one of eleven private schools in New York State that receive operating aid directly from the State to provide educational services to disabled students. The aid is provided on the basis of certain claimed expenses that the schools submit to the State Education Department (SED) on annual consolidated fiscal reports (CFR). To be eligible for reimbursement, the expenses must comply with the guidelines contained in SED's Reimbursable Cost Manual (Manual). For the two years ended June 30, 2009, HVS claimed a total of about \$27.8 million in reimbursable expenses.

HVS has a parent organization that provides various services for children and adults with disabilities. Under an administrative services agreement, the parent company also provides HVS with a number of administrative and support services, and HVS reimburses the parent company for those services. HVS then claims State reimbursement for this administrative overhead.

We disallowed \$835,074 of the costs included on the CFR because certain of the expenses were unnecessary, unreasonable or not allowable, and thus not eligible for State reimbursement. HVS is directed by a four-person leadership team whose combined salaries exceeded \$527,000 a year. However, HVS also claimed about \$280,000 a year in additional leadership expenses for the salary and fringe benefits of the parent company's president and secretary. Since HVS had its own leadership team in place for the audit period and we could not determine what services were provided to HVS by the President and his secretary, we disallowed the entire \$560,407 in leadership expenses allocated to HVS for the two-year period as unnecessary and unreasonable.

We also disallowed \$88,275 in executive bonuses paid by the parent organization for the 2007-08 school year. The parent company paid bonuses totaling \$165,000 to the president and chief financial officer in 2007-08 and allocated \$88,275 of the bonus to HVS. According to the

Manual, these bonuses are not reimbursable, because they were restricted to a certain class of employees. We also disallowed an additional \$186,392 in expenses claimed by HVS in the two-year period, mostly because the expenses either were not adequately documented or were not eligible for reimbursement.

In the two years covered by our audit, a portion of the salaries of about 40 parent company employees (not including the President and his secretary) was allocated to HVS as administrative overhead. However, when we interviewed 15 of these parent company employees, we found that, for 14 of the employees, the allocated portion of their salaries appeared to be excessive; because it was not commensurate with the amount of time the employees said they spent on HVS-related activities. For example, the \$36,000 allocated from the salary of one employee in one year seemed excessive, because the employee said that she spent no time on HVS-related activities that year. We identified a net total of \$488,269 in excessive allocations for the 15 employees in the two years covered by our audit. We did not disallow these costs but we question the reasonableness of the cost allocation and believe that SED should review these costs in detail.

We recommend that SED review the exceptions identified by our audit, determine necessary adjustments to tuition reimbursement rates for HVS and review the reasonableness of the methodology used to allocate costs from Abilities! to HVS. We also recommend HVS ensure that its reporting of reimbursable expenses complies with SED requirements.

This report, dated April 6, 2011, is available on our website at: <http://www.osc.state.ny.us>.
Add or update your mailing list address by contacting us at: (518) 474-3271 or
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

Introduction

Background

The Henry Viscardi School (HVS), located in Albertson, New York, is one of eleven State supported schools funded pursuant to Section 4201 of the State Education Law. HVS receives operating aid directly from the State to provide educational services to children in grades pre-kindergarten through the 12th grade, who have severe physical and medical disabilities. HVS is a subsidiary of the National Center for Disabilities that does business under the name of Abilities! Abilities! is also a nonprofit entity that provides research, training, employment opportunities, and vocational rehabilitative services for individuals with disabilities. Abilities! has several other affiliated programs and organizations in addition to HVS. These include Abilities!, Inc; Just One Break; and the National Business and Development Council.

HVS receives its State aid based upon expenses submitted on an annual consolidated fiscal report (CFR). To provide guidance on the eligibility of costs and allocation of non-direct care costs, the State Education Department (SED) issued the Reimbursable Cost Manual (Manual). All costs reported on the CFR must comply with the requirements of the Manual. During the 2008-09 school year, HVS had 203 employees, an enrollment of about 187 students and received approximately \$14 million in State aid. HVS is governed by a 12-member Board of Trustees (Board). Three of the HVS Board members, including the President, are also on the Board of Abilities!, the parent organization.

Audit Scope and Methodology

We audited the costs reported by HVS on its CFR for the two fiscal years ended June 30, 2009. The objectives of our audit were to determine whether the costs reported by HVS were properly calculated, adequately documented and allowable under SED's Manual.

To accomplish our objectives, we reviewed HVS' financial records, including audit documentation maintained by the school's independent certified public accountants. We also interviewed officials and staff of Abilities!, HVS, SED, and the certified public accountants which performed the audit of HVS. To complete our audit work, we selected a judgmental sample of costs reported by HVS for review. Our sample took into account the relative materiality and risk of the various costs reported by HVS. The scope of audit work on internal control focused on gaining an understanding of the procurement and disbursement procedures related to non-personal service expenditures and personal service expenditures. We identified certain significant control deficiencies that were significant

to the audit's objectives. These are discussed in the appropriate sections of our audit report.

We conducted our compliance 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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 and Article II, Section 8, of the State Finance Law.

Reporting Requirements

We provided a copy of this report, in draft, to SED and HVS officials for their review and comments. We have considered their comments in preparing this audit report and have included them, in their entirety, at the end of this of this report. Our responses to HVS' comments are included thereafter as State Comptroller's Comments.

SED officials agreed with the recommendations we addressed to them. They also advised us that they will make appropriate adjustments to the reported costs, as well as require HVS to conduct a study to determine the appropriate allocation of the cost of staff.

HVS officials disagreed with some of our specific interpretations and related disallowances. However, they also expressed a commitment to full compliance in the future.

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. We also request officials of Henry Viscardi School to advise the State Comptroller of actions taken to implement the recommendation addressed to them, and where such recommendation was not implemented the reasons why.

**Contributors to
the Report**

Major contributors to this report were Steven Sossei, Kenrick Sifontes, Stephen Lynch, Tania Zino, John Ames, Trina Clarke and Hugh Zhang.

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Audit Findings and Recommendations

Allocation of Parent Organization Costs

HVS is a subsidiary of Abilities! and HVS includes a significant portion of the operating costs for Abilities! as administrative cost on its CFR. We reviewed these costs and have disallowed a total of \$720,921 of the amounts included on the HVS CFR report for the two years audited. This includes \$412,693 for fiscal year 2007-08 and \$308,228 for fiscal year 2008-09. These costs were disallowed because the costs duplicated those already incurred by HVS, did not relate to the operation of HVS and/or were specifically prohibited by certain sections of the Manual.

Allocation of Abilities! President's Office Costs

The Manual states that costs must be both reasonable and necessary in order to be allowable. HVS is directed by a four-member leadership team consisting of an Executive Director with an annual salary of \$156,832, an Acting Principal at a salary of \$135,200, an Assistant Director with a salary of \$95,000, and an Executive Associate for Trans Pupil Personnel Services with a salary of \$140,608. The total cost of this leadership team is included on the CFR.

In addition to the costs incurred by HVS for leading the school's operations, HVS also included an additional \$560,407 in leadership expenses on the CFRs for the cost of Abilities! President's office. HVS included on its CFR a portion of the salary, fringe benefits, and other miscellaneous expenses for the President of Abilities! and his secretary. Abilities! President's office incurred a total expense of \$851,303 in 2007-08 and \$808,443 in 2008-09. Of these amounts, \$281,279 was allocated to HVS for fiscal year 2007-08, while \$279,128 to HVS for fiscal year 2008-09.

According to the Manual, costs must be reasonable and necessary for the school's operation to be allowable. We have disallowed the costs of the President's office because it duplicates the leadership costs already incurred by HVS and thus is unnecessary. Furthermore, the positions of the Executive Director and Principal are comparable to the leadership positions normally funded in other 4201 schools. In addition, we were unable to ascertain what services the President and his secretary provided to the school and what benefit this expense provides to HVS.

Executive Bonuses of Abilities! President and Chief Financial Officer

The Manual states that bonus compensation restricted to certain classes or types of employees are not reimbursable. During fiscal year 2007-08,

we found that bonus compensation was awarded to only certain members of Abilities! executive staff - the President and the Chief Financial Officer (CFO). The President received a bonus of \$135,000 and the CFO received \$30,000 - a total of \$165,000. Abilities! allocated \$88,275 or 53.5 percent of the total bonuses to the HVS. We disallowed all of the \$88,275 bonus expense allocated to HVS because it was restricted to a certain class of employees. No bonuses were given in 2008-09.

Abilities! officials disagree with this disallowance. They maintain that the information in the Manual applies to bonuses for administrative staff of HVS and not to employees of related entities, such as Abilities!. We disagree; Abilities! is the “parent organization” to HVS. Therefore, the standards set in the Manual apply to any overhead that Abilities! allocates to HVS.

Legal Services

The Manual states that costs must be both reasonable and necessary. HVS included on its CFRs \$69,600 of the legal expenses incurred by Abilities!. We disallowed a portion of these costs because they were not related to the operation of HVS. For 2007-08, only \$21,950 of Abilities! legal expenses were related to HVS’s operations. Only \$27,055 of Abilities! legal expenses for the 2008-09 were related to HVS’s operations. Therefore, we disallowed the difference of \$20,595.

Abilities! officials advised that their attorneys work on a flat fee retainer basis. They added that several of the issues handled by these attorneys impact HVS; thus, allocating a portion of this overhead expense to HVS is appropriate. We agree that legal fees for issues related to HVS should be allocated to HVS and we have only disallowed those expenses that did not relate to HVS’s operations.

Leased Vehicles

According to the Manual, the cost associated with the personal use of a company vehicle assigned to an employee is not reimbursable. Further, the Manual requires that the usage of such vehicles must be documented with vehicle logs that include the date, time of travel, destinations, mileage, the purpose of travel and name of the traveler. HVS included on the CFRs a portion of the vehicle costs for two vehicles assigned to the President and the Building Operations Director of Abilities!. Abilities! provided their Building Operations Director with a 2007 Honda Odyssey and the President with a 2008 Lexus automobile. Officials informed us that the Lexus was provided to the President of Abilities! in accordance with his employment contract and the Honda Odyssey is used to transport

construction supplies. They also stated that the Building Operations Director is allowed to take the vehicle home in the case of an emergency. The lease payments, gas, insurance, and maintenance costs for the two vehicles totaled \$32,622 for fiscal years 2007-08 and 2008-09 of which \$18,276 was allocated to HVS.

While the Buildings Operations Director estimated that he used the Honda Odyssey 42 percent of the time for personal use, he did not maintain the required vehicle log or any other documentation to substantiate his personal and business use of the vehicle. Similarly, the President did not maintain a vehicle log or other records to substantiate his business and personal use of the Lexus automobile. Therefore, we are disallowing the \$18,276 of leased vehicle costs.

Abilities! and HVS officials advised that they will ensure that vehicle logs are maintained for any personal use of vehicles leased by or on behalf of the entities. Abilities! officials further advised that the Honda Odyssey is occasionally used to transport staff and visitors, and for weekend business related activities. They also stated that the President's vehicle is included in the President's compensation package thus a vehicle log does not need to be maintained. Since the costs of these vehicles are being allocated for reimbursement, the basis for that allocation should be supported by a usage log.

Income from State Fund

The Manual states that income earned from the investment of public funds must be used to reduce the costs of the programs for which the funds were provided. Abilities! maintains an investment account to receive and hold HVS's State aid funds until needed. We reviewed the monthly statements from this account and found that it earned \$65,004 in investment income during the two fiscal years. However, HVS applied just \$38,977 of the \$65,004 in earnings towards a reduction of program costs. The remaining \$26,027 of investment earning was not applied for cost reduction purposes. Therefore we have adjusted the allowed amount to reflect this additional amount. HVS officials agreed with this determination and advised that they will apply all investment earnings generated from State fund accounts immediately.

Other Miscellaneous Allocated Expenses of Abilities!

According to the Manual, expenses of a personal nature, such as for a residence, personal travel expenses, laundry and beverage charges, gift certificates to staff and vendors, flowers and staff parties are not reimbursable.

We reviewed a judgmental sample of 223 expenses incurred by Abilities! and allocated to HVS for the two fiscal years ended on June 30, 2009. The expenses had a total value of \$310,822. We found that expenses totaling \$12,252, as identified below, did not comply with the Manual:

- 39 invoices totaling \$4,650 for utilities related to four residences located on the campus.
- Two invoices with expenditures totaling \$3,200 for expenses paid to an attorney to determine the President's Supplemental Executive Retirement Plan (SERP) lump sum benefits. SERP is a non-qualified retirement plan that provides benefits above and beyond those covered in other retirement plans such as IRA, or 401(k).
- One invoice totaling \$3,532 related to the rental of a catering hall to hold a retirement party.
- Two invoices totaling \$450 for ambulatory services for an individual not related to the HVS. The services were provided from this person's home to a local hospital. HVS officials told us that this individual was a participant in another program run by Abilities!.
- One invoice totaling \$420 for flowers purchased for Administrative Professional day.

Our actual disallowance for these \$12,252 of non compliant expenses was limited to \$7,341 that was included on the CFR.

Personal Service Costs for HVS

Personal service costs must be reported on the CFR as either direct care costs - such as teachers' salaries, or non-direct care costs - such as administrators' salaries. According to the Manual, costs will be considered for reimbursement provided such costs are sufficiently documented, reasonable, necessary, and related directly to the education program. In addition, accrued vacation and sick leave expenses are not reimbursable until actually paid.

We reviewed the personal service costs reported by HVS for 20 teachers and found that HVS included as personal service costs the accrued vacation leave of these 20 teachers. As a result, we disallowed a total of \$17,887 in personal service costs for fiscal years 2007-08 and 2008-09.

Furthermore, in fiscal year 2007-08, two teachers' aides and a teaching assistant were paid a total of \$1,430 for reportedly performing additional services, such as extra period coverage and substituting for absent teachers. However, the documentary support for the additional services performed by these three individuals was inconclusive. Thus, there is inadequate assurance that the employees actually performed the extra services for

which they were paid. In addition, we found a \$291 overpayment to an HVS employee that was the result of a clerical error. These amounts are included in the total personal service costs disallowance of \$17,887.

**Other Than
Personal Service
Costs for HVS**

According to the Manual, reported costs should be reasonable, necessary, program-related, and properly-documented. Moreover, payments for consultants must be supported by itemized invoices, which must indicate the names of the students who were served, the actual dates of service, and the number of hours of service received by the student. Furthermore, vehicle usage must be documented with individual vehicle logs that include, at a minimum, the date, time of travel, destinations, mileage, purposes of travel, and name of traveler. Costs associated with retainers for legal, accounting, or consulting services are not reimbursable unless the fee represents payment for actual services. We disallowed a total of \$96,266 in other-than-personal service costs reported by the school for fiscal years 2007-08 and 2008-09, as follows:

- \$68,850 in payments to a medical doctor who is contracted at \$135 per hour to provide students with medical care. We found that the invoices submitted by the doctor did not include the individual names of students or the actual number of hours of service each student received, as required. When we brought this to the attention of officials at Abilities!, they created a chart to show that the doctor had provided 208 units of service to 169 students during the two-year period that ended on June 30, 2009. However, this chart did not include the actual number of hours of service provided to each student. We subsequently reviewed the students' files to determine whether the doctor, in his notes, had recorded the services he provided, as well as the duration of each service. We found no evidence that the stated services were provided in 102 of the 208 instances. In another 76 instances, we found that the school nurse had recorded the dates, names, and services received. However, this information does not comply with the Manual's requirements because we are unable to determine how many hours the doctor had spent with each student.
- \$18,913 of gas expenses pertaining to three yellow school buses owned by HVS and used to transport students to and from the school and on field trips. We found that neither Abilities! nor HVS staff maintains logs for the use of these vehicles, as required by the Manual. Daily inspection reports were maintained, but they do not satisfy the requirements of the Manual. In the absence of the vehicle logs, we were unable to determine whether the costs that were charged pertained only to official purposes.
- \$6,750 in legal expenses that were documented inadequately and/or were ineligible. In fiscal year 2007-08, HVS paid \$24,000 in retainer

fees for legal services. However, actual legal expenses amounted to just \$23,680; resulting in \$320 in undocumented legal expenses. In fiscal year 2008-09, the legal retainer fee was \$24,000; however, actual legal expenses amounted to just \$19,505, which resulted in \$4,495 in undocumented legal expenses. In addition, we found \$1,890 in fundraising related legal expenses and \$45 in other ineligible legal expenses.

- \$1,753 in indirect cost classified as “other”. Other than an unsupported general journal entry for fiscal year 2007-08, School officials could not provide support for this expenditure.

**Questioned
Allocation
Methodology
for Other Parent
Organization Costs**

The Manual allows administrative and other costs to be allocated to programs based upon the ratio value method. Using this method, HVS included a significant portion of the salary and fringe benefits costs of the remaining staff of Abilities! as administrative costs on the CFRs. For the 2007-08 year, HVS included 53.5 percent of the total compensation for the remaining 42 employees of Abilities! on the CFR. For the 2008-09 year, HVS included 62.5 percent of the compensation of the remaining 39 Abilities! employees on the CFR. These allocations totaled \$434,233 and \$510,051, respectively. We did not disallow these costs, but we question the reasonableness of the costs and believe SED should review the costs in detail.

We selected and interviewed a judgmental sample of 15 Abilities! employees to determine if the allocation methodology was equitable. We selected those Abilities! employees whose job-functions did not appear to be directly related to the administration of HVS. We determined that 14 of the 15 staff worked a much lower percentage of their time on HVS business than the amount that was allocated to HVS. These 14 staff worked between 0 to 25 percent of their time on HVS business. For example, a financial analyst stated that she did not perform any work for HVS even though almost \$36,000 of her compensation was included on the CFR for fiscal year 2007-08. Another staff member informed us that he worked just 15 percent of his time on HVS related activities even though almost \$29,000 of his salary was allocated to the school in fiscal year 2008-09. Based on the testimonial evidence obtained during our interviews of the 15 employees, we question the reasonableness of using the ratio value method as applied by HVS. The ratio value method should be used when costs cannot be assigned to a specific program, such as a common human resource office function that serves multiple programs. Further, the method must be reflective of the true efforts made for the various programs. We believe that many of the costs of Abilities! can be assigned to a specific program. Based upon our small sample, we estimated that at least \$488,269 in administrative costs may have been allocated to HVS unnecessarily over the two year period.

HVS and Abilities! officials disagree with our conclusion. They stated that the methodology - the ratio value method - that is used to determine the amount of overhead to allocate to the school is an equitable alternative to utilizing actual hours. They added that this methodology conforms to generally accepted accounting principles and the CFR. They advised that it would be very difficult to determine the actual time that Abilities! employees spend performing support tasks for HVS. They added that some duties are not so easy to allocate when those duties benefit all of the entities. Furthermore, they stated that duties attributable to particular entities might fluctuate significantly from week to week. They argued that time studies would depend principally on estimates of the amount of time that an employee spends on a task, rather than on objective evidence.

We do not dispute that some Abilities! employees spend a portion of their time on HVS related activities, however the amount allocated must be fair and equitable. The ratio value method is an appropriate method for allocating costs when all of the costs being allocated have a direct relationship to the operation of HVS. This is not the case as some of Abilities! costs' do not directly relate to the operation of HVS. These costs should be removed from the cost pool before the costs are allocated. However, without time studies or other supporting documentation, SED is not able to reasonably rely upon the amounts allocated.

Recommendations *To SED*

1. Review the adjustments resulting from our audit, and make the appropriate adjustments to the costs reported on the CFR and reduce future payments to HVS.
2. Review the methods used by HVS for allocating the costs of Abilities! to the programs to determine if the ratio value method is an appropriate method.

To HVS

3. Comply with the Manual's requirements for eligibility and documentation of all reported program costs.

Exhibit A

Henry Viscardi School
Schedule of Submitted and Allowed Program Costs
State Supported Educational Program (4201)
For the Fiscal Year July 1, 2007 through June 30, 2008

| | Amount Per CFR | Disallowed (Allowed) | Amount Allowed Per Audit | Notes to Exhibit |
|------------------------------------|---------------------|-------------------------|--------------------------------|-------------------|
| Personal Services | \$7,375,391 | \$3,992 | \$7,371,399 | A,D,I |
| Fringe Benefits | \$2,367,794 | \$0 | \$2,367,794 | |
| Other than Personal Service | \$548,667 | \$50,079 | \$498,588 | K |
| Equipment | \$191,543 | \$0 | \$191,543 | |
| Property | \$121,059 | \$0 | \$121,059 | |
| Administrative Costs | \$3,064,186 | \$422,985 | \$2,433,138 | A,B,C,E,F,G,H,I,J |
| Total Program Costs | <u>\$13,668,640</u> | <u>\$477,056</u> | <u>\$12,983,521</u> | |

Henry Viscardi School
Schedule of Submitted and Allowed Program Costs
State Supported Educational Program (4201)
For the Fiscal Year July 1, 2008 through June 30, 2009

| | Amount Per CFR | Disallowed (Allowed) | Amount Allowed Per Audit | Notes to Exhibit |
|---|-------------------|-------------------------|--------------------------------|-------------------|
| Total Personal Service | \$7,886,850 | \$6,284 | \$7,880,566 | A,D,I |
| Total Fringe Benefits | \$2,403,188 | \$0 | \$2,403,188 | |
| Total OTPS | \$424,200 | \$37,684 | \$386,516 | K |
| Total Equipment | \$164,313 | \$0 | \$164,313 | |
| Total Property | \$99,558 | \$0 | \$99,558 | |
| Agency Administration Allocation | \$3,196,594 | \$314,050 | \$2,882,544 | A,B,C,E,F,G,H,I,J |
| Total Program Costs | \$14,174,703 | \$358,018 | \$13,816,685 | |

Notes to Exhibits

The Notes shown below refer to specific sections of the Reimbursable Cost Manual upon which we have based our adjustment. We have summarized the applicable section to explain the basis for the disallowance. Details of the transactions in question were provided to SED and HVS officials during the course of our audit.

- A. Section I - Costs must be reasonable, necessary, program related and sufficiently documented.
- B. Section I.9 - Charges to programs receiving administrative services, insurance, supplies, technical consultants, etc. from a parent or related organization are reimbursable provided they are based on actual direct and indirect costs, allocated to all programs on a consistent basis, and defined as reimbursable in the Regulations of the Commissioner of Education, CFR Manual or this Manual.
- C. Section I.12 A - Opportunities for bonus compensation may not be restricted to certain classes or types of employees.
- D. Section I.12 B - Vacation and sick leave are reimbursable in the year actually paid and reported as a salary expense. Accrued vacation and sick leave expenses are not reimbursable until actually paid.
- E. Section I.16 A - If assets are shared by more than one program and/or entity, the share of depreciation expense allocated to programs funded pursuant to Article 85 shall be based on documented and reasonable criteria.
- F. Section I.18 B - All personal expenses, such as personal travel expenses, laundry charges, beverage charges, gift certificates to staff and vendors, flowers or parties for staff, holiday parties, repairs on a personal vehicle, rental expenses for personal apartments, etc., are not reimbursable unless specified otherwise in this Manual.
- G. Section I.41 A - Any income earned from investment of public funds (e.g. certificates of approval) resulting from the operations of approved programs will be considered applied income to reduce the costs of the program(s).
- H. Section I.54 D - Costs of personal use of a program-owned or leased automobile are not reimbursable. The costs of vehicles used by program officials, employees or Board members to commute to and from their homes are not reimbursable.
- I. Section II.A - Costs will not be reimbursable without appropriate written documentation.
- J. Section II A (3) - All payments to contractors must be supported by itemized invoices which indicate the specific services actually provided; and for each service, the date(s), number of hours provided, the fee per hour; and the total amount charged. In addition,

when direct care services are provided, the documentation must indicate the names of students served, the actual dates of service, and the number of hours of service to each child on each date.

- K. Section II.A (10) - Vehicle use must be documented with individual vehicle logs that include at a minimum: the date, time of travel, to and from destinations, mileage between each, purpose of travel and name of traveler. If the vehicle was assigned to an employee, also list the name of the employee to whom it was assigned.

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Agency Comments



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

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January 3, 2011

David R. Hancox, CIA, CGFM
Director of State Audits
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Dear Mr. Hancox:

I am responding to your letter of November 12, 2010 addressed to Commissioner Steiner to the recommendations contained in the Office of the State Comptroller's draft audit report (2009-S-70) on the Henry Viscardi School's (HVS's) compliance with the Reimbursable Cost Manual (RCM) in 2007-08 and 2008-09.

Recommendation 1:

Review the adjustments resulting from our audit, and make the appropriate adjustments to the costs reported on the CFR and reduce future payments to HVS.

We agree with this recommendation and will make the appropriate adjustments to the costs reported on the 2007-08 and 2008-09 Consolidated Fiscal Reports (CFRs) as identified in the audit. We will also review subsequent CFRs to identify similar adjustments. Future payments to HVS will be reduced to capture the over payments resulting from the over statement of costs. In addition, we will reduce the operating budget of HVS as appropriate starting with the 2010-11 school year.

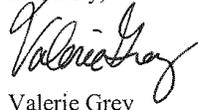
Recommendation 2:

Review the methods used by HVS for allocating the costs of Abilities! to the programs to determine if the ratio value method is an appropriate method.

We agree with this recommendation. SED is requiring HVS to conduct a time study for all Abilities! staff who perform work for HVS to determine the appropriate allocation of the cost of these staff to HVS. In addition, SED has informed HVS that a detailed accounting of all expenses allocated to HVS by Abilities! is required starting with the 2009-10 Consolidated Fiscal Report.

If you have any questions, please contact April Wojtkiewicz, Bureau Chief of the Rate Setting Unit, at (518) 402-5668.

Sincerely,

A handwritten signature in black ink that reads "Valerie Grey". The signature is written in a cursive style with a large, stylized initial "V".

Valerie Grey

c: A. Wojtkiewicz
M. Kogelmann
J. Conway

Patrice M. Kuntzler
Executive Director



pkuntzler@hvs.k12.ny.us
www.hvs.k12.ny.us

Via Email and Overnight Mail

December 23, 2010

David R. Hancox, CIA, CGFM
Director of State Audits
Office of the New York State Comptroller
110 State Street, 11th Floor
Albany, New York 12236

Re: Henry Viscardi School (Audit Report 2009-S-70)

Dear Mr. Hancox:

We have reviewed the draft Audit Report on “Compliance with the Reimbursable Cost Manual” issued by the Office of the New York State Comptroller (“OSC”). The OSC extended the time to submit a response to the draft Audit Report to December 27, 2010. Our response is provided below.

As more fully discussed below, Henry Viscardi School appreciates the OSC’s recommendations during the audit process. While the School agrees that a small number of expenses should not have been included in its prior requests for reimbursement, it disagrees that a disallowance of \$835,074 is warranted. The Reimbursable Cost Manual (the “Manual”) specifically endorses the purchase of administrative services and the Ratio Value Method of allocating such costs utilized by the School. The inclusion of certain costs questioned by the OSC in the ratio value calculation is justified given the nature and extent of administrative services purchased by the School.

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With respect to certain expenses for which logs or other documentation were not separately maintained, the required information was contained in other documents that were compiled, summarized, and made available to the OSC. Notably, to comply with the Manual’s general provisions regarding consultants when requesting reimbursement for the School Physician likely conflicts with patient/student confidentiality obligations under federal and state law. In any event, given that information justifying the expenses exists, but perhaps not in the form preferred by the OSC, the School accepts any recommendation to improve its documentation, but does not believe that a disallowance is warranted under the circumstances.

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201 I.U. Willets Road, Albertson, NY 11507-1599 T 516 465 1675 F 516 465 3726 TTY 516 747 5355

* See State Comptroller’s Comments, page 39.

BACKGROUND INFORMATION

Henry Viscardi School (the “School”) is a not-for-profit educational corporation organized and existing under the laws of the State of New York. The School provides tuition-free education for approximately 200 children with disabilities through its early childhood, elementary and secondary educational programs. Although it is a private school, pursuant to Article 85 of the New York Education Law (Education Law § 4201, *et seq.*), the School receives State funds to provide educational services to children in pre-Kindergarten through 12th grade who have severe disabilities. The School submits requests for reimbursement of covered expenses (“4201 Expenses”) to the New York State Education Department.

The School is located on the campus of The National Center for Disability Services, Inc. (d/b/a Abilities!).¹ Abilities! is a non-profit agency dedicated to empowering people with disabilities to be active, independent, and self-sufficient participants in society. Abilities, Inc., a subsidiary of Abilities!, provides comprehensive services to help individuals with disabilities reach their employment goals by providing employment evaluations, training, and placement services. It also provides support services and technical assistance to employers who hire persons with disabilities. Another subsidiary of Abilities! is Just One Break, Inc., a not-for-profit organization that is dedicated to supporting and increasing the employment of people with disabilities.

Abilities! provides certain administrative services to the School, including accounting, financial reporting, human resources, payroll, information technology, and maintenance. These administrative services are provided pursuant to an Administrative Services Agreement (the “Agreement”) negotiated by the School and Abilities!, which provides that “all charges for the Services shall include the allocable portion of any office overhead relating thereto.”

To determine the allocable portion of office overhead attributable to services performed by Abilities! employees for the School, the total non-overhead expenses for the School (including non-4201 Expenses) are divided by the total expenses attributable to the School, Abilities!, Abilities, Inc., and Just One Break. This percentage was 53.5% in 2007-2008 and 62.5% in 2008-2009. The percentage is then applied to the overhead costs to determine the amount to charge the School for administrative services. A similar calculation is performed for certain building services overhead based on the overall percentage of campus square footage (approx. 70%) utilized by the School. This Ratio Value Method of allocation has not been questioned by the New York State Department of Education. Additionally, KPMG LLP, the independent auditors for Abilities! and the School, have certified annually that certain schedules (as required and identified in their report) included in the Consolidated Fiscal Report of the School have been presented, in all material respects, in conformity with the instructions contained in the Consolidated Fiscal Reporting and Claiming Manual.

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¹ Throughout its report, the OSC refers to Abilities! as a “parent organization” to the School and states that the School is a “subsidiary” of Abilities! Neither assertion is correct. The administrative services provided are the result of a negotiated agreement between the two entities. In any event, as discussed herein, the methodology utilized to determine the cost of the administrative services provided is proper even if Abilities! is considered a “parent organization” of the School.

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* See State Comptroller’s Comments, page 39.

ALLOCATION OF "PARENT ORGANIZATION" COSTS

President's Office

The OSC criticized the inclusion of the compensation of Abilities! President and his office staff in the overhead figure from which the cost of the administrative services was calculated. As an initial matter, the OSC's calculation of the expenses charged to the School over two years relating to this item of overhead includes \$72,225 relating to the allocated portion of the Abilities! President's bonus, which is addressed later in the OSC's report. Thus, OSC erroneously disallowed this amount twice.

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With respect to the allocation of the President's Office overhead for purposes of the Agreement, approximately forty (40) Abilities! employees perform services for the School under the Agreement. The employment of these employees is managed day-to-day, supervised and evaluated by Abilities! leadership, not the School's leadership. Indeed, as a separate entity, the School has no authority over the employees of Abilities! If a problem arises with the performance of any of the Abilities! employees of the administrative services, it is reported by the School to Abilities!, where it is then addressed accordingly by Abilities! leadership. The President's Office thus provides the management and coordination of the administrative services that the School purchases from Abilities! Thus, inclusion of the President's Office expenses in the overhead number is therefore appropriate and non-duplicative.²

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Additionally, pursuant to the Agreement, the administrative services provided include "overall management services, representation of organization by the School, leadership and oversight." In addition to the oversight and coordination of all administrative services, the President's Office provides several essential administrative functions, including the development, implementation and monitoring of long-range strategic planning; assistance to the Board in development of policies; public relations and development at a private, corporate and foundation level; leadership and technical support in the development of plans and programs in special education; and fiscal management. The Executive Director and Principal of the School do not duplicate these functions, precisely because these and other administrative services are contracted out via the Agreement. Under the Agreement, the President's Office undertakes to perform these functions, which supports the inclusion of the President's Office overhead expenses in the calculation of the amount charged to the School. If these administrative services and related management functions were not performed pursuant to the Agreement, the School would not only have to hire many additional employees to perform these duties, but would likely need additional administrators (e.g., an Assistant Superintendent, a CFO, an HR Manager, a Facilities Manager, etc.), all of which are reimbursable under the Manual. Thus, the OSC's conclusion that HVS leadership duplicates Abilities! leadership is demonstrably untrue, as is the related conclusion that the costs allocated from the President's Office are unnecessary and/or unreasonable.

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² An analogous situation would be hiring temporary workers to perform certain functions. The cost to the company contracting for the services is more than that earned by the individuals performing the work because the supplying company charges an additional amount above and beyond the wage of the persons performing the work to cover its overhead, including the cost of employee benefits, payroll taxes, and supervision/management.

* See State Comptroller's Comments, page 39.

Based on the foregoing, the School does not agree that a disallowance is warranted and maintains that its application of the Ratio Value Method of determining administrative costs was proper and reasonable.

Executive Bonuses

OSC disallowed bonuses paid to Abilities! executives in 2007-2008, citing Section I(12)(A)(4) of the Manual for the proposition that bonuses may not be restricted to a particular class or type of employee. However, that portion of the Manual applies to bonuses for administrative staff of the School, not to employees of entities with whom the School contracts for administrative services. Such bonuses are part of the overhead for Abilities! and includable in the overhead calculation for allocation of expenses to the School for the 2007-2008 fiscal year.

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Comment 7

Even if the OSC is correct that Abilities! is a parent organization of the School, such bonuses do not conflict with the Manual's provisions. In 2007-2008, the year in which the questioned bonuses were paid, approximately 135 Union employees at the School in a variety of job titles received a one-time bonus as part of collective bargaining. Accordingly, bonuses paid in 2007-2008 were not restricted to a particular class or type of employee and therefore the OSC's basis for disallowing the Executive Bonuses is unsupported by the information provided to the OSC.

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Legal Services

The OSC questions legal expenses charged to the School pursuant to the Agreement. Such legal expenses, however, are part of the overhead expenses associated with providing the administrative services. The attorneys engaged by Abilities! perform work on a flat fee retainer basis, including contract drafting, review, and negotiation, as well as advice concerning employees and operations. Several of the contracts reviewed by this law firm affect the School, including the landscaping contract, food service contract, cleaning contract, clinical agreements, and certain student-related documents/contracts. Such contracts necessarily relate to the operation of the School, which occupies 70% of the space on the Abilities! campus. Thus, allocating a portion of this overhead expense to the School pursuant to the Agreement is appropriate, as it is part of the cost to Abilities! to provide the administrative services.

The OSC purports to have been able to determine the actual legal expenses related to the operation of the School, but fails to specify how such a determination was made. Indeed, the School asked in response to a preliminary audit report for that information to enable it to address this issue, but the OSC never specified how it determined whether legal services were related to the operation of the School. Given that much of the legal work in question relates to the physical plant, of which approximately 70% is occupied by the School, the allocation of 53.5% and 62.5% of the legal expenses in the years at issue pursuant to the Ratio Value Method was reasonable and appropriate.

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* See State Comptroller's Comments, pages 39-40.

Leased Vehicles

The OSC is correct that the Building Operations Director did not maintain a log for use of the Honda Odyssey vehicle, which included some personal use. That vehicle is taken home by the Building Operations Director in part, however, because he is on call 24 hours per day in case of fire or burglary alarms and/or to oversee the cleaning vendor. The vehicle is also used to travel to offsite offices, to transport staff/visitors as necessary, and to supervise weekend contractors, outside vendors or weekend events. The OSC recommends disallowing the entire amount charged with respect to this vehicle, even while estimating personal use at only 42%. The School and Abilities! understand the need for a vehicle log, and will require one in the future, but the lack of a log does not necessarily justify the complete disallowance of the expenditure when an estimate of personal use is provided (and a log could possibly be generated for the applicable fiscal year).

The President of Abilities! received an automobile as part of his compensation package in 2007-2008. The annual cost of this lease was approximately \$6,600. Since this vehicle was part of a compensation package, it was included in the overhead expense and a vehicle log was not required. (Historically, the Manual treated vehicles provided as fringe benefits as compensation and not subject to the vehicle log requirements.) Moreover, the OSC estimated personal usage of this car at 33%, so recommending total disallowance is not appropriate, as discussed above. After 2007-2008, the President of Abilities! assumed personal responsibility for the cost of his vehicle.

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Income from State Fund

The OSC states that interest earned on SED funds transferred to the School was not fully credited to the School for cost reduction. While further investigation is warranted, particularly as to the amount at issue, it appears that the interest income may have been allocated pursuant to the same percentage used to allocate expenses. The School and Abilities! agree that the full amount of interest should be credited to the School for cost reduction.

Miscellaneous Invoices

The OSC went through a judgmental sample of 223 invoices and determined that certain expenditures associated with 45 invoices should not have been charged to the School. The School and Abilities! agree that \$7,341 should not have been charged to the School nor included in the CFR.

* See State Comptroller's Comments, page 40.

PERSONAL SERVICE COSTS

The draft audit report faults the School for reporting accrued, but not paid, vacation expenses on the Consolidated Fiscal Reports applicable to the 2007-2008 and 2008-2009 School Years. The School acknowledges that it recorded vacation accrual every year on its general ledger in accordance with generally accepted accounting principles. This expense was increased as the vacation liability increased (*i.e.*, employees accrued more vacation), and decreased as vacation liability decreased (*i.e.*, employees used their accrued vacation). Therefore, the total amount charged to New York State pursuant to this accrual method would be identical to the amount charged under a cash basis method, although the timing of the reimbursement would be different. However, the School has transitioned to a cash basis method of reporting vacation expenses, as required by the Reimbursable Cost Manual.

Three Teacher Aides/Assistants accepted substitute teaching assignments, for which the applicable collective bargaining agreement requires additional compensation. To support payment of this additional compensation, a daily log indicates which period a Teacher Aide/Assistant performs duties as a substitute teacher, and a memorandum is generated for purposes of ensuring proper payment for this extra work. The Executive Director approves the memorandum on a bi-weekly basis for payroll purposes. Teacher Aides/Assistants also sign in and out on their timesheets, which serve as verification and approval of their hours and assignments. Thus, ample documentation (which was provided to the OSC) exists for the payment of the required extra compensation for these substitute teaching services.

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The small amount discovered as an overpayment was the result of a clerical error of which the School was unaware until the audit. The error has not been repeated.

OTHER THAN PERSONAL SERVICE COSTS

School Physician

The School denies that it lacks documentation of the School Physician's services for the students judgmentally sampled during the audit. The School compensates the School Physician only for services actually provided.

The School Physician's primary responsibility is to evaluate students' medical condition for either placement or reevaluation purposes. The School Physician performs a comprehensive evaluation to ascertain each student's medical stability as well as the School's ability to medically support the candidate. Both screening evaluations and reevaluations entail at least an hour of family/student interviews, a comprehensive review of a student's medical records and care history, and a thorough medical examination. All of this information is ultimately synthesized into an evaluation report.

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* See State Comptroller's Comments, page 40.

In addition to his evaluation duties, the School Physician also trains School staff to provide adequate support for its medically fragile students; consults with Administration and School staff regarding appropriate health related policies and procedures; evaluates and clears students for participation in the Independent Living Program; and acts as a medical liaison between the School, parents, and the students' private physicians. The specific services scheduled to be provided by the School's Physician are set forth on the billing calendars provided to the OSC.

The School notes the tension between the Manual's general provisions regarding documentation of consultant services and statutory confidentiality obligations when such provisions are applied to a medical professional. Requiring the School Physician to submit invoices in the form recommended in the audit report would reveal private health information, including which students were examined and evaluated, the specific medical services that were provided to each student, and how long they received services. It would not be appropriate to disclose this confidential information to employees of Abilities! who provide support through an administrative services contract with the School. Consequently, the inclusion of this information on the School Physician's invoices conflicts with the School's obligations to maintain the confidentiality of student records under the Individuals with Disabilities Education Act and the New York State Education Law. *See* 34 C.F.R. § 300.623, 8 N.Y.C.R.R. § 200.2(b)(6), 8 N.Y.C.R.R. § 5(e)(2), 8 N.Y.C.R.R. § 200.7(b)(2).

We acknowledge that some student information may be disclosed to school officials, including contractors performing outsourced services, if the individual to whom information is disclosed has a legitimate educational interest. 34 C.F.R. § 99.31. Here, the clerical employees who process payments have no educational interest in students' confidential medical information, and it is unlikely that SED officials processing reimbursement have the requisite interest. The private nature of student information, particularly confidential student medical information, need not and should not be disclosed as part of the reimbursement process, as the Manual cannot create the requisite educational interest. While we understand the need to ensure that contractual services are actually provided, where, as here, the School is able to verify that services were provided through other means, we do not believe that this interest overrides the need to protect students' confidential medical information.

The School notes that all the information required by the Manual, except for the amount of time spent evaluating each student, is contained in students' evaluation reports. The School proposes that the School Physician also include the amount of time spent with each student in his evaluation reports and that such information be provided in the School Physician's invoices without providing patient/student identifying information, and such invoices will also include the dates of service and the hourly rate. The physician's daily calendar will also be attached, which will include the number of hours of service provided to individual students.

The School accepts OSC's recommendation for contracted services other than medical services provided to its students by the School Physician. Services that are not specific to a particular student, such as staff training, will be clearly identified as to type and amount of time on each invoice.

Gas Expenses

The School is a teaching community of students, parents, teachers, staff, and volunteers dedicated to empowering students with physical disabilities and health impairments to enable them to be active, independent, self sufficient participants in society. The ability of students to participate in supportive and challenging learning environments and integrated community-based services is vital to this goal. Without the specialized transportation provided by the School for preschool students and for many students in the after school programs, many students would be unable to fully participate in these programs. It is essential to provide directly for transportation services not provided by school districts, not only because it is more cost effective, but also because the School's trained staff has experience with the needs of our medically fragile students.

The School currently owns three vehicles to transport students and employs two drivers. Daily transportation to and from the School is provided for pre-kindergarten students. A log based upon documentation of the pre-kindergarten runs for the 2007 – 2008 and 2008 – 2009 school years was provided to the OSC. In addition to these daily runs, many students who participate in the Independent Living Overnight Program and the Friday Night Recreational Program must be transported home from school following the programs. Logs based upon School records reflecting these transportation services were also provided to the OSC.

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The draft audit report mentions daily vehicle inspection reports maintained by the School. These reports are used to document vehicle mileage accumulated during student transport and log the total daily mileage of each vehicle. The School acknowledges that the inspection reports alone do not meet the requirements of the Manual. Nonetheless, the School maintained sufficient documentation in the form of student attendance and participation records to include the information required by the Manual in the above-referenced logs for the Pre-kindergarten Program, the Independent Living Overnight Program, and the Friday Night Recreational Program. The OSC was offered the opportunity to review this source material months ago.

Based on the foregoing, the disallowance of gas expenses is unwarranted. The School will create and maintain the vehicle logs required by the Manual going forward, but as noted above, it compiled and provided the required information to the OSC to justify these expenses for the school years in question.

Legal Expenses

The draft audit report appears to misinterpret the School's contract with its attorneys. The School denies that it failed to comply with the Manual for reimbursement of legal services. The School's retainer agreement provides that all legal services subject to the annual retainer are provided for a flat annual fee of \$24,000, paid at a rate of \$2,000 per month. Such an arrangement is beneficial to the School because, among other things, it allows the School to budget for general legal services; reduces the likelihood that School officials will be hesitant to seek legal advice for fear of large legal bills; and reduces unanticipated spikes in fees.

* See State Comptroller's Comments, page 40.

During the 2007 – 2008 school year, the School’s attorneys provided over 104 hours of legal services and during the 2008 – 2009 school year they provided over 91 hours of legal services to the School. Thus, the annual retainer fee clearly represents payment for actual documented reimbursable services. Furthermore, the cost of legal services under the retainer agreement is also well within the regional prevailing rates and substantially less than the law firm’s standard billing rates of \$495 per hour for partners and \$375 per hour for associates. The average billing rate calculated using only total attorney hours for the 2007 – 2008 school year is \$242.27 and the average billing rate for total attorney hours for the 2008 – 2009 school year is \$214.59. The Manual expressly allows for reimbursement of costs associated with retainer agreements as long as such services are documented and provided at a cost within the regional prevailing rates. The School will continue to monitor its use of legal services to ensure that its retainer agreement stays within the parameters required by the Manual.

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ALLOCATION METHODOLOGY

Based on a judgmental sample of Abilities! employees, the OSC concluded that the Ratio Value Method described above does not accurately reflect the amount of time such employees spend on School business. Notably, the sample of employees was not only judgmental, but the questions posed by OSC on this issue likely skewed the results. For example, the OSC apparently listed the four entities who share the Abilities! Campus and then asked the judgmentally selected employees (who typically perform services for all four entities) if they performed any work for the School. Upon receiving an affirmative response, the OSC apparently assumed that the percentage of time spent on work for the School was 25%, simply because the School is one of four entities. The 0% for a financial analyst fails to take into account the other person holding that job title (not judgmentally selected by the OSC), who spends 100% of his time on School business and is more highly compensated, warranting an allocation to the School of greater than 50% of the expenses attributable to these two employees, which is exactly what occurs under the Ratio Value Method.

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The Manual provides that reimbursable administrative costs include “administrative purchase of services.” Manual, § I(2). While the Manual states that “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,” the same section of the Manual also states: “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.” Manual, § II(A)(2).

The OSC’s statement that the Ratio Value Method should only be used when costs cannot be assigned to a specific program is not supported by the language of the Manual cited above. Here, the OSC states its belief that the work of Abilities! employees can be neatly parsed into separate silos for each entity. However, it would be very difficult to calculate actual hours of service for the administrative services provided to each individual entity. While in some cases duties might clearly be related to only one of the four entities involved, many duties are not so easily allocated when those duties benefit all entities. Additionally, the duties attributable to particular entities might fluctuate significantly from week to week, depending on entity-specific

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* See State Comptroller’s Comments, page 40.

issues that might predominate in any particular week, which would thus skew any time study conducted over a short period of time. Finally, such time studies would principally depend in this context on the estimation of the employees involved, rather than on objective evidence.³

Abilities! and the School allocate a percentage of overhead based on total expenses for the entire year attributable to the School as compared to the overall expenses for all four entities. This Ratio Value Method is an equitable alternative to utilizing actual hours and comports with generally accepted accounting principles. Using total expenses for the year accounts for the short-term variations in time spent on duties for one particular entity. Importantly, the Manual itself endorses this approach to allocating agency administrative costs across programs. Manual, § II(A)(13(c); *see also* New York State Consolidated Fiscal Reporting and Claiming Manual, App. AA (“The CFR instructions require the use of the ‘ratio-value’ method for allocating agency administrative expenses and for allocating program administrative expenses in those situations where time records or other documentation are not available to support another basis.”); App. I (“To ensure equity of distribution and to provide uniformity in allocation of agency administration, ... SED require[s] the ratio value (R/V) method of allocation....”).

For the two years covered by the audit, Abilities! allocated 53.5% and 62.5% of overhead expenses to the School under the Agreement. In those years, the School accounted for approximately 59% of the total number of employees for all four entities, but an even greater proportion of administrative time is taken up by those employees given the more complex payroll and benefit structure for the School’s employees. Moreover, the School uses 70% of the space on the Abilities! campus. Accordingly, the methodology employed to allocate overhead expenses under the Agreement based on the proportion of non-overhead expenses attributable to the School is an equitable and acceptable method of allocating overhead costs.

CONCLUSION

The School appreciates the OSC’s recommendations throughout the audit process, many of which have been implemented already. The School agrees that its documentation of expenses must improve, and it agrees that certain expenses should not have been included on its previous CFR’s for reimbursement. However, the School continues to contend that the Ratio Value Method it employs to allocate overhead expenses is valid and in compliance with the Manual, and that its inclusion of certain leadership, vehicle, and legal expenses in that calculation is also appropriate.

³ Notably, even seemingly objective evidence would not provide an accurate calculation of the time involved spent by an employee on School activities. For example, if a payroll administrator regularly processes payroll for 100 employees, 50 of whom were School employees, one might conclude that 50% of his/her time was allocable to the School. However, if the payroll for the School employees were more difficult to process (e.g., multiple pay rates, overtime issues, special stipends for teachers, retroactive pay pursuant to collective bargaining, etc.) and resulted in more follow up and corrections, then the actual percentage of time spent on School business would be greater than 50%. Indeed, the School accounts for a majority portion of the overall expenses precisely because it has more complex administrative issues for a variety of reasons, including but not limited to the unionized workforce (which requires collective bargaining support), additional stipends payable to some School employees, more employee turnover (requiring additional recruiting), additional benefit plans not applicable to the other entities, and three times as many accident reports and workers’ compensation claims because of the unique nature of the students served.

December 17, 2010

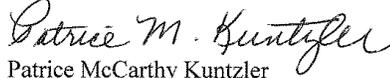
Page 11

Notably, Abilities! and the School's internal controls have been evaluated by KPMG, which found no "significant deficiencies" and further "did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses...."). In fact, KPMG LLP, has performed an audit in accordance with Government Audit Standards for the last several years and has issued an unqualified opinion in their Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*. Moreover, Abilities! engaged a Sarbanes-Oxley expert as part of a proactive approach to strengthening internal controls. That process led to revised policies and procedures, including but not limited to an authorization matrix for purchases by expense category and dollar amount, a streamlined process for receipt of payments, and a formal document retention policy.

Accordingly, the School will continue to evaluate and improve its internal controls and accepts the OSC recommendation to comply with the Manual's requirements for documentation of reported costs. However, a need to improve documentation does not necessarily support disallowance of requested expenses, particularly where the propriety and reasonableness of those expenses has been demonstrated to the OSC. The School will work with SED officials to resolve these issues in a manner that is not detrimental to the severely disabled students served by the School.

If you have any questions or require additional documentation, please contact me at any time.

Very truly yours,



Patrice McCarthy Kuntzler
Executive Director

cc: Dr. David Steiner, SED Commissioner
Thomas Lukacs, Division of the Budget

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State Comptroller's Comments

1. The Manual states that the actual hours of service should be the preferred statistical basis on which to allocate salaries and fringe benefits for shared staff who work on multiple programs. It also states that if the hours of service cannot be calculated, or if a time study cannot be completed, then alternative methods may be utilized. Although the Ratio Value Method is an equitable alternative, there is no indication that either HVS or Abilities! attempted to determine the actual hours of service or ever completed a time study before implementing this alternative methodology. In addition, our position is affirmed by SED officials. In their response to the draft report, SED officials stated that they are requiring HVS to conduct a time study for all Abilities! staff who perform work for HVS to determine the appropriate allocation of the cost of these staff to HVS.
2. We do not agree that the audit disallowances are unwarranted or that the documents and information that were provided always satisfied the requirements of the Manual. For example, personal use of a vehicle was estimated by the Building Operations Director of Abilities! However, such an estimate is not acceptable. The Manual states that for costs to be considered for reimbursement, a vehicle log must be maintained. Also, the documentation provided by HVS officials to support extra service compensation paid to employees who accepted substitute teaching assignments was neither reasonable nor adequate to support all of the payments that were made. In addition, we acknowledge the importance of maintaining confidentiality over student information, but note that our disallowance was based on the inability of HVS to provide us with reasonable and adequate documentation such as the hours of service provided.
3. See note number 1.
4. The financial statements of Abilities! refer to HVS as a subsidiary of Abilities!. Therefore, it is accurate to characterize Abilities! as the parent of HVS. The presence of an administrative agreement between Abilities! and HVS does not change this. As indicated in note number 1, we do not agree that there has been a proper determination of the cost of administration provided by Abilities! to HVS.
5. We did not disallow the President's bonus twice. The disallowance amount was not included in the calculation for the President's Office disallowance. Rather, it was included only for the determination of the Executive Bonus disallowance.
6. We allowed reasonable expenses associated with day-to-day management of Abilities!, including those costs which pertain to the Chief Financial Officer, accountants and financial analysts.
7. We maintain our position that the costs of the President's Office are not allowable. We were unable to establish what specific services were provided to HVS by the President and his secretary. We found that HVS already had a team of leadership personnel which was comparable to other 4201 schools. In addition, certain bonus costs were not permitted according to the Manual.

8. According to the financial statements of Abilities!, the relationship between Abilities! and HVS is that of parent and subsidiary. Therefore, we believe the provisions of the Manual stating that bonuses cannot be awarded to only certain classes of employees does apply to Abilities!
9. While bonuses may have also been paid to a number of union employees, the bonuses paid for management were restricted to only certain Abilities! Staff.
10. In this instance, the Abilities! Chief Financial Officer identified to us the specific legal costs related to HVS.
11. We did not estimate the percent of personal usage of the Honda Odyssey. Rather, as our report states, the Buildings Operations Director told us that his estimate was 42 percent for personal usage. In the absence of the required log or any other documentation to substantiate personal and business use of the vehicle, we have disallowed the cost. We further maintain that a vehicle use log or other like documentation should have been kept to support the business and personal use of the President's car even if the leased cost was part of executive compensation. This would be necessary so that the cost associated with the personal use of the leased vehicle could be subtracted from the costs that are going to be allocated as overhead to HVS.
12. We took the documentation into consideration during the audit field work. As a result, our preliminary disallowance was reduced. However, \$1,430 of the payments remained inadequately documented.
13. The disallowance resulted primarily because we could not establish the number of hours of service provided in support of the charges. We acknowledge the concerns presented about confidential information. We are pleased to note the School's proposal that the School Physician also include the amount of time spent with each student in his evaluation reports and that such information be provided in the School Physician's invoices without providing identifying patient/student information and that invoices will also include the dates of services and the hourly rate.
14. Contrary to the School's response, we were not provided with logs that were based upon school records adequately supporting that transportation services were provided. We are pleased to note that the School does plan to create and maintain vehicle logs required by the Manual going forward.
15. The Manual is clear that costs associated with retainer agreements are reimbursable only to extent that the fees represent payments for actual services. Furthermore, all costs must be reasonable, necessary and program-related. As noted in our report, the actual expenses charged against the retainer fee resulted in \$1,935 of ineligible costs and \$4,815 in retainer fees not covered by documented expenses.
16. We believe our report provides adequate information to illustrate our concern about the reasonableness of the cost allocations and to support our recommendation to SED to examine these costs in detail.
17. See note number 1.