

CARRIER FOUNDATION-EAST MOUNTAIN	:	
SCHOOL, SOMERSET COUNTY,	:	
	:	
PETITIONER,	:	
	:	
V.	:	COMMISSIONER OF EDUCATION
	:	
NEW JERSEY STATE DEPARTMENT OF	:	DECISION
EDUCATION, OFFICE OF COMPLIANCE,	:	
	:	
RESPONDENT.	:	
	:	

SYNOPSIS

Petitioning Carrier Foundation (Foundation), a private, statewide, behavioral healthcare system providing inpatient, outpatient and residential services, challenged the results of the respondent Department’s audit of Carrier’s East Mountain School program (East Mountain) for fiscal year 1998. The Foundation filed a motion for summary decision and the Department filed a cross-motion for summary decision.

The ALJ concluded that summary decision be granted on the cross-petition and denied on the petition. Moreover, the ALJ concluded that 1) the Foundation’s investment expenses were per se non-allowable costs under *N.J.A.C. 6:20-4.4(a)16* in the calculation of the certified annual cost per pupil; 2) severance expenses paid by the Foundation were non-allowable costs under *N.J.A.C. 6:20-4.4(a)5* because they were fringe benefits paid to staff members for time not expended and/or services not performed (severance expenses are also non-allowable costs under *N.J.A.C. 6:20-4.4(a)5* because they are costs not listed in the *Chart of Accounts for Private Schools for the Handicapped* issued by the Department); 3) the Department properly disallowed \$132,375 in General and Administrative (G & A) expenses under *N.J.A.C. 6:20-4.1(c)*. Medicare reporting principles are not applicable to the tuition reimbursement procedures promulgated by the State Board of Education. The Foundation attempted to “double charge” the Department when it allocated the same expenses as “direct expenses” under its “Medicare step-down methodology” and as “indirect expenses” under the State Board’s methodology; 4) \$84,518 should be excluded from G & A expenses under *N.J.A.C. 6:20-4.1(l)*, *N.J.A.C. 6:20-4.4(a)8* and *N.J.A.C. 6:20-4.4(a)10* as excess salary paid to the Foundation’s CEO.

The Commissioner adopted findings and determination in the Initial Decision as his own.

April 12, 2001

OAL DKT. NO. EDU 508-00
AGENCY DKT. NO. 380-12/99

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The record and Initial Decision issued by the Office of Administrative Law (OAL) have been reviewed. Petitioner’s exceptions and respondent’s reply thereto were submitted in accordance with *N.J.A.C.* 1:1-18.4, and were duly considered by the Commissioner in reaching his determination herein.

In its exceptions, petitioner essentially relies on and restates the arguments expressed before the Administrative Law Judge (ALJ). With respect to the disallowance of petitioner’s claim of \$103,427 in investment expense, petitioner reasserts that, since the East Mountain School was established solely to provide educational services to handicapped students, everything done for the school is directly related to the education of students and should be deemed allowable in terms of costs. Thus, a portion of the investment expenses incurred by the Carrier Foundation (Foundation), which partially finances the East Mountain School by providing working capital,¹ should be considered an allowable cost. Moreover, petitioner

¹ Petitioner maintains that working capital provided through investments is necessary to supply operating cash flow to the school because the working capital fund limitation of 15% permitted by Department of Education regulations is insufficient to provide the necessary funds to support the school’s operations while awaiting receipt of under-charges from sending districts, which are due two years following an audit. (Petitioner’s Reply Brief at 3)

contends that the ALJ erred in holding that the Foundation's investment expenses are per se non-allowable expenses under *N.J.A.C. 6:20 4.4(a)16*, maintaining that its investment expenses are allowable because the statute provides that expenses incurred for the education of handicapped children, which its investment expenses are, "are per se *allowable*." (emphasis in text) (Petitioner's Exceptions at 2)

Petitioner also disagrees with the ALJ's finding regarding severance expenses. The ALJ found that since the Chart of Accounts does not list severance expenses as an allowable expense and since severance expenses are fringe benefits and not part of an employee's salary as petitioner claims, the \$399,541 in severance costs claimed by petitioner is not an allowable expense. Petitioner acknowledges that the Chart of Accounts does not list severance expenses as an allowable expense, but citing *Botany Mills, Inc. v. Textile Workers Union*, 50 *N.J. Super.* 18, 20 (App. Div. 1958), petitioner continues to maintain that "severance expenses are a part of an employee's *salary earned during the course of his employment*, but disbursed at a later date." (emphasis in text) (Petitioner's Exceptions at 2) Thus, petitioner reasons, by virtue of the fact that salaries are included in the Chart of Accounts, severance expenses are an allowable expense. (*Id.* at 2-3)

With respect to the ALJ's disallowance of \$132,375 in General and Administrative (G & A) expenses, petitioner reiterates its argument that *N.J.A.C. 6:20-4.1(d)* is a proper method to allocate G & A cost. Petitioner also expresses its disagreement with the ALJ's conclusion that *N.J.A.C. 6:20-4.1(d)* does not apply because the Foundation does not qualify as a facility as defined in the education statutes. Petitioner asserts that the ALJ improperly focused on the word "facility" and that her interpretation of the word facility does nothing to properly determine whether subsection (d) applies. (*Id.* at 3) Petitioner maintains that

N.J.A.C. 6:20-4.1(c) and *N.J.A.C. 6:20-4.1(d)* do not distinguish between indirect costs and facility costs and that subsection (d) could apply because the Foundation is not in the business of educating students. Therefore, petitioner submits, the seven Cost Centers at issue must be allocated to the East Mountain School since the school receives a benefit from the G & A expenditures. (*Ibid.*) Noting that respondent failed to recognize costs in excess of \$7 million from various Cost Centers, petitioner posits that if subsection (c) is accepted as the method to allocate G & A costs, as found by the ALJ, then “*all appropriate G & A expenses must be apportioned equitably.*” (emphasis in text) (*Id.* at 4)

Petitioner vigorously objects to any implication that it is attempting to double charge respondent by labeling certain G & A costs as direct expenses for Medicare purposes and then relabeling the same costs as indirect expenses. Petitioner explains that it originally asserted that the Medicare method was the proper reporting method, but when it became apparent that respondent was applying *N.J.A.C. 6:20-4.1*, it asserted that, if this code section were to be applied, then all Cost Centers must be accounted for. (*Ibid.*) Petitioner asserts that there is no valid reason for respondent to accept costs from Cost Centers, such as data processing and communications, and not allow costs from the other seven Cost Centers at issue because each department provides services or benefits to the East Mountain School. Therefore, petitioner proffers, there must be some allocation of these indirect G & A services. (*Ibid.*)

Finally, petitioner excepts to the ALJ’s holding that \$84,518 should be excluded from G & A expenses, pursuant to *N.J.A.C. 6:20-4.4(a)(8)*, as excess salary paid to the Foundation’s Chief Executive Officer (CEO). (*Ibid.*) In so doing, petitioner reasserts its argument that the salary limits in *N.J.A.C. 6:20-4.4(a)(8)* refer to the salary of an Executive Director, not to the CEO of a Foundation, nor is it proper to compare the CEO to a

superintendent of schools as the ALJ concluded. (*Id.* at 5) Since the Foundation's CEO is charged with the running of a vast hospital, which includes a school for the handicapped, petitioner contends that the salary of the CEO of the Foundation should be fully included in G & A expenses as it is not subject to the "cap" provisions. (*Ibid.*)

In its reply, respondent disputes petitioner's characterization of the ALJ's decision as disallowing investment expenses incurred for the education of handicapped children. In point of fact, petitioner submits, the ALJ determined that investment expenses associated with the education of handicapped children, such as the type set forth in the Initial Decision, are allowable under the provisions of *N.J.A.C. 6:20-4.4(a)16*. (Respondent's Reply at 2) Respondent asserts, however, that petitioner did not demonstrate the necessity of, nor the direct utilization of its investments for the education of handicapped children, but merely stated that "everything done for the school is directly related to the education of the students." (*Id.* at 3, quoting Petitioner's Exceptions at 2) Moreover, in contrast to petitioner's contention that the Foundation provides the necessary working capital for the East Mountain School, respondent avers that the June 30, 1998 audit report indicates that the Foundation owed money to the school, thus demonstrating that the school provided working capital to the Foundation, not the reverse. (*Id.* at 3) Additionally, respondent suggests that if the Foundation actually needed to fund East Mountain School through investments as petitioner claims, then a portion of the \$1,423,671 in investment income should also have been allocated to the school. (*Ibid.*)

With respect to the disputed severance expenses, respondent asserts that petitioner erroneously relies on *Botany Mills, supra*, in support of its contention that severance expenses are part of an employee's salary earned during the course of employment. Pointing out that *Botany Mills* concerned an interpretation of contract provisions under a collective bargaining

agreement related to an employee's entitlement to vacation pay upon lay off, respondent underscores that the ALJ considered petitioner's reliance on *Botany Mills* and distinguished the holding in that case by noting that severance pay is more accurately defined as "terminal compensation measured by the service given during the period covered by (a) collective bargaining agreement." *Morris Sch. Dist. Bd. of Ed. v. Education Ass'n of Morris*, 310 N.J. Super. 332, 344 (App. Div. 1998). (*Id.* at 4-5) Averring that the ALJ established that severance pay is a fringe benefit, not salary, respondent concludes that the ALJ properly determined that severance payments are disallowed expenses under N.J.A.C. 6:20-4.4(a)5 and (51). (*Ibid.*)

In determining whether indirect costs should be calculated in accordance with N.J.A.C. 6:20-4.1(c) or (d), respondent points to the regulation in question, N.J.A.C. 6:20-4.1(d), which it submits, clearly denotes the meaning of "facility" as referring to the building and/or property of a school for the handicapped. Since the Foundation is the parent company, not the physical building or facility where classes are held, respondent asserts that petitioner's argument that subsection (d) can apply to indirect costs, other than for facilities, would render N.J.A.C. 6:20-4.1(c) superfluous. Respondent further maintains that there is no evidence to support that the State Board of Education contemplated that indirect costs, other than facility costs, would be calculated under N.J.A.C. 6:20-4.1(d). (*Id.* at 6) Respondent proffers that N.J.A.C. 6:20-4.1(c) is, therefore, the appropriate procedure for determining indirect costs attributed to the Foundation. Respondent maintains that it correctly disallowed certain costs from the indirect cost calculation because they were costs already accounted for as direct expenses. Moreover, respondent posits, in determining the ratio of private school direct expenses to total Foundation expenses, there is nothing in the regulations that permits the Foundation to exclude the amount of overhead covered by Medicare. Thus, respondent argues,

the Foundation's total overhead must include the Medicare reimbursement for purposes of determining the total G & A expense that can be charged to respondent. (*Id.* at 6) Respondent notes that the ALJ found that the Foundation must use the calculation set forth in *N.J.A.C. 6:20-4.1(c)1* because it is a parent corporation, not a school, and is prohibited under the provisions of *N.J.A.C. 6:20-4.1(c)1* from charging an indirect cost based on a direct cost already accounted for under any methodology, including the "step-down" method used for Medicare cost reimbursement purposes. (*Id.* at 7) Moreover, respondent submits, the allocation of the costs in the overhead categories of Depreciation-Buildings/Fixed, Depreciation-Moveable, Employee Benefits, Maintenance and Repairs, Plant, Housekeeping, and Cafeteria are shown separately on East Mountain School's financial statements. Therefore, respondent contends, to also include these Cost Center expenses in indirect expenses as petitioner suggests would be double counting for these expenses. (*Ibid.*)

Finally, respondent maintains that \$84,518 was properly disallowed as excess salary paid to a director of a private school pursuant to *N.J.A.C. 6:20-4.4(a)8* and *N.J.A.C. 6:20-4.1(l)*. Respondent points to petitioner's own admission that the Foundation's CEO does not devote his entire time to running East Mountain School. Therefore, respondent argues, the East Mountain School should only be charged a portion of the CEO's salary "commensurate with a director or superintendent running a school, not with an executive running a 'vast hospital.'" (*Id.* at 8)

Upon careful and independent review of the record, the Initial Decision, the exceptions and the reply thereto filed in this matter, the Commissioner determines to affirm the Initial Decision.

Initially, the Commissioner notes the parties' stipulations that there are no issues of material fact in this matter, and, therefore, agrees that summary decision is appropriate in this instance for reasons expressed by the ALJ in the Initial Decision.

Moreover, the Commissioner agrees that petitioner's investment expenses in the amount of \$103,427 are non-allowable costs. Under *N.J.A.C. 6:20-4.4(a)16*, investment expenses associated with the purchase/sale of stock, securities, other investment instruments or other investments not associated with the education of handicapped children are not allowable in the calculation of the certified actual cost per pupil. As the ALJ properly observed, the State Board acknowledged in the Economic Impact Statement published upon promulgation of *N.J.A.C. 6:20-4.4*, that although addition of non-allowable cost items at *N.J.A.C. 6:20-4.4* might reduce the allowable tuition charges to public schools by the private schools for the handicapped, it was promulgating the rule to "ensure that private school operators utilize public funds for bona fide special education expenses to improve or supplement special education programs." 22 *N.J.R. 2634* (Sept. 4, 1990). (Initial Decision at 16-17) The Commissioner, therefore, finds that petitioner's statement that "everything done for the school is directly related to the education of the students, and thus, should be considered an allowable cost" (Petitioner's Exceptions at 2) is insufficient to demonstrate that the investment expenses at issue were associated with or directly utilized in the education of handicapped children at the East Mountain School as required by *N.J.A.C. 6:20-4.4(a)16*. Additionally, petitioner's argument that investment expenses were incurred as a result of the need to provide working capital to the East Mountain School above the 15% capital fund cap imposed by regulation is rejected. Such financial arrangements for the maintenance of the *economic viability* of the East Mountain School are not directly related to

*improving or supplementing special education programs.*² Accordingly, the Commissioner concurs that the \$103,427 claimed by petitioner as investment expense was properly disallowed.

The Commissioner also concurs that severance expenses totaling \$399,541 claimed by petitioner are not an allowable expense. It is undisputed that severance expenses are not listed in the Chart of Accounts and that *N.J.A.C. 6:20-4.4(a)51* specifically excludes costs charged to account categories other than those reflected in the Chart of Accounts in the calculation of the certified actual cost per pupil. Moreover, the Commissioner finds that petitioner's reliance on *Botany, supra*, in support of its argument that severance pay is an employee's deferred "salary earned during the course of his employment, but disbursed at a later date," and thus, an allowable expense under the salary category in the Chart of Accounts, is misplaced. As noted by the ALJ, the *Botany Mills* case *did not hold* that severance pay is payment for services rendered by a worker, and "the mere fact that severance pay is guaranteed to a worker within a collective bargaining agreement does not change its nature." (Initial Decision at 19) Unlike pension contributions and Social Security payments, severance pay is not compensation deducted by petitioner from an administrator's paycheck to be returned at a later date, but is a fringe benefit paid to an administrator at the end of his career based on the total time worked for petitioner. *See Morris, supra*, at 344 (quoting *Owens v. Press Publ'g Co.*, 20 *N.J.* 537, 547 (1956)); *Noorily v. Thomas & Betts Corp.*, 188 *F.3d* 153, 158 (3d. Cir. 1999) (interpreting the Employee Retirement Insurance Security Act, 29 *U.S.C.A.* §1104, and implicitly acknowledging that severance pay is a fringe benefit for ERISA purposes), *cert. denied*, ___ *U.S.* ___, 120 *S.Ct.* 1555, 146 *L.Ed.2d* 460 (2000); and *E.E.O.C. v. Westinghouse Elec. Corp.*,

² The Commissioner notes that the parties disagree with respect to whether funds in excess of the 15% capital cap were necessary to maintain the economic viability of the East Mountain School. Although petitioner submits that additional funds were required to provide adequate cash flow for the East Mountain School (Petitioner's Exceptions at 2), respondent asserts that the East Mountain School provided working capital to the Foundation, not the reverse. (Respondent's Reply Exceptions at 3)

869 F.2d 696, 710 (3d. Cir. 1989) (holding that severance pay was a fringe benefit and not part of “an integrated benefits scheme designed to provide post-employment benefit to the greatest number of employees”). (Initial Decision at 18) Accordingly, for the reasons expressed by the ALJ, the Commissioner finds petitioner’s claim for \$399,541 in severance expenses was properly disallowed.³

With respect to whether respondent properly disallowed \$132,375 in G & A expenses under *N.J.A.C. 6:20-4.1(c)*, the Commissioner concurs that *N.J.A.C. 6:20-4.1(c)*, not *N.J.A.C. 6:20-4.1(d)*, is the appropriate regulation to be applied in determining the tuition petitioner may charge for the educating of handicapped students. The Commissioner emphasizes that the expenses being challenged herein are *general indirect costs*, not facility costs. As found by the ALJ, *N.J.A.C. 6:20-4.1(d)* applies to the allocation of costs within *the facility that a private school uses* for both activities related and unrelated to the education of handicapped children. Under *N.J.A.C. 6:20-4.1(d)* all the facility costs cannot be allocated to the private school if some of the costs were generated by activities and enterprises which do not have a common purpose of educating pupils. (Initial Decision at 22) *N.J.A.C. 6:20-4.1(c)*, however, provides for the calculation of indirect costs “***which are incurred for a common or joint purpose and not readily assignable to an approved private school *facility****.” (emphasis supplied) The Foundation is the parent company of the East Mountain School, and not the physical location or facility where classes for the handicapped students are held, and thus,

³ On April 4, 2001, the State Board of Education adopted amended regulations pertaining to Finance and Business Services proposed at *N.J.A.C. 6:20 et seq.*, for recodification at *N.J.A.C. 6A:23 et seq.* with an effective date of July 1, 2001. Although previously excluded, these amended and recodified regulations permit the cost of severance pay, not to exceed four weeks salary, to be included in the calculation of the certified actual cost per student. See *N.J.A.C. 6A:23-4.5(a)58* and *N.J.A.C. 6A:23-4.5(a)7*.

N.J.A.C. 6:20-4.1(d) is inapplicable. Accordingly, *N.J.A.C.* 6:20-4.1(c) is the appropriate regulation to be applied in calculating petitioner's G & A expenses.

The Commissioner similarly concludes that respondent correctly applied *N.J.A.C.* 6:20-4.1(c) in excluding non-allowable indirect costs in seven Cost Centers because costs for these overhead categories are allocated separately on the East Mountain School's financial statements. Moreover, petitioner seeks the exclusion of Medicare reimbursement from its overhead expenses which would permit a higher allocation of total G & A expenses. *N.J.A.C.* 6:20-4.1(c)1, however, prohibits the exclusion of \$5,699,698 in overhead expenses, covered in Medicare reimbursements, from its total overhead. As noted by the ALJ, "N.J.A.C. 6:20-4.1(c)1 expressly prohibits [the Foundation] from charging an indirect cost based on a direct cost already accounted for under any methodology, including the Medicare methodology." (Initial Decision at 24) Accordingly, respondent correctly disallowed \$132,375 in G & A expenses.

Finally, the Commissioner concurs with the ALJ's conclusion that \$84,581 was properly excluded from G & A expenses under *N.J.A.C.* 6:20-4.4(a)8 as excess salary for petitioner's CEO. Notwithstanding petitioner's assertions that the CEO is not subject to the salary "cap" provisions because he is not the director, but rather an administrator charged with the running of a vast hospital, which includes "ten private schools" (Petitioner's Exceptions at 5), salaries of chief administrators for private schools which receive public monies for the education of children with special needs are limited in the public interest by *N.J.A.C.* 6:20-4.4(a)8, *N.J.A.C.* 6:20-4.4(a)10 and *N.J.A.C.* 6:20-4.1(l) so that these administrators are paid commiserate with their public school counterparts. Moreover, \$128,544 is the highest allowable salary for the highest paid executive for the fiscal year monitored. (First Level Appeal Decision at 3)

Accordingly, the Commissioner determines that \$84, 518 of the CEO's salary of \$213,062 was properly excluded from G & A expenses as excess salary.

The Initial Decision of the OAL is, therefore, affirmed for the reasons expressed therein.

IT IS SO ORDERED.⁴

COMMISSIONER OF EDUCATION

Date of Decision: April 12, 2001

Date of Mailing: April 12, 2001

⁴ This decision, as the Commissioner's final determination, may be appealed to the State Board of Education pursuant to *N.J.S.A. 18A:6-27 et seq.* and *N.J.A.C. 6A:4-1.1 et seq.*, within 30 days of its filing. Commissioner decisions are deemed filed three days after the date of mailing to the parties.