COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF PUBLIC WELFARE
BUREAU OF FINANCIAL OPERATIONS
525 Health and Welfare Building
Harrisburg, Pennsylvania 17105-2675

KEVIN M. FRIEL
DIRECTOR

TELEPHONE NUMBER
(717) 772-2231
FAX NUMBER
(717) 705-9094

FEB 10 2009

Mr. Henry Lynch, President
Lynch Homes, Inc.
216 Cedar Avenue
Willow Grove, Pennsylvania 19090

Dear Mr. Lynch:

I am enclosing the final report of the Lynch Homes, Inc. that was recently completed by this office. Your response has been incorporated into the final report and labeled as an Appendix.

I would like to extend my appreciation to all the courtesy extended to my staff during the course of fieldwork. I understand that you were especially helpful to Barbara Miller in expediting the audit process.

The final report will be forwarded to the Department's Office of Developmental Programs (ODP) to begin the Department's resolution process concerning the report contents. The staff from the ODP may be in contact with you to follow-up on the action taken to comply with the report's recommendations.

If you have any questions concerning this matter, please contact Alexander Matolyak, Audit Resolution Section, at (717) 783-7786.

Sincerely,

Kevin M Friel

Kevin Friel

c: Mr. Kevin T. Casey
Mr. Michael Bolton
Ms. Vicki Stillman-Toomey
Mr. Joseph Church

bc: Mr. Thomas Crofcheck
Mr. Daniel Higgins
Mr. Alexander Matolyak
SEFO Audit File (S7000 – R 99)

COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF PUBLIC WELFARE
BUREAU OF FINANCIAL OPERATIONS
ROOM 525 HEALTH & WELFARE BUILDING
HARRISBURG, PA 17105-2675

KEVIN M. FRIEL
DIRECTOR

TELEPHONE NUMBER
(717) 772-2231
FAX NUMBER
(717) 705-9094

FEB 10 2009

Mr. Kevin T. Casey
Deputy Secretary for Developmental Programs
Health and Welfare Building, Room 512
Harrisburg, Pennsylvania 17120

Dear Mr. Casey:

In response to a request from the Office of Developmental Programs (ODP), the Bureau of Financial Operations (BFO) has completed an audit of Lynch Homes, Inc. (Lynch). The audit was requested to assess the appropriateness of service rates and to determine Lynch's readiness for the upcoming changes to the rate setting process.

The report is currently in final form and therefore contains Lynch's views on the reported findings, conclusions or recommendations (Attachment). The data used to prepare the report findings was discussed with Lynch management at a closing conference held on July 10, 2008.

Lynch Homes. Inc.
Executive Summary

Lynch is comprised of seven related companies: four service companies, one Management Company, and two property companies (Exhibit). Six companies are for-profit, Subchapter "S" Corporations and the principle property company is a partnership. Lynch administers two Adult Day programs, three administrative offices and 67 residential facilities, including one 60 bed private licensed facility, of which 51 are owned properties and 21 are rental properties. Pertaining to the properties owned by Lynch, 25 carry mortgages and rent is calculated based on principle, interest and real estate taxes, the remaining 26 properties are debt free and rent is based on the 8% usage allowance.

The report findings and recommendations for corrective action are summarized below:

FINDINGS	SUMMARY
Finding No. 1 – Accrued Expenses Are Booked At Year End, But Not Actually Incurred Until Several Months Later.	Lynch is accruing expenses at the end of the fiscal year; however, the actual expense is not incurred until several months later. Our audit sample of expenditures identified $36,615 in expenses that were improperly accrued at the end of the fiscal period. Deferred revenue and deferred expense should be recorded and reported until such time that the expense is incurred.

HIGHLIGHTS OF RECOMMENTATIONS	
Lynch should: • Determine whether an expense is actually incurred before booking it as an accrued expense. • Request approval from funding source to defer revenue and report as a deferred expense. • Record deferred revenues and deferred expenses until such time that the expenses are incurred.	
FINDINGS	**SUMMARY**
Finding No. 2 –*ODP and County Programs Must Ensure Timely Contracting to Limit Provider Credit Interest Expense*	Lynch incurred significant interest expense on its line of credit borrowings. Management stated that borrowing was necessary because some counties have stopped giving advance payments. However, signed contracts were not in place resulting in significant delays in the payment process.
HIGHLIGHTS OF RECOMMENDATIONS	
The county should: • Be aware of the effect of delays in the contracting and payment process. ODP should: • Not participate in interest cost if counties and/or providers do not secure contracts in a timely manner.	

OBSERVATION
Property Costs Lynch calculates related party rent charges based on actual cost for mortgaged properties or based on 8% usage allowance for debt free properties. While these are acceptable methods of calculating occupancy cost, the basis used for the 8% usage charge contains costs that could be considered repair expense, which should not be included within these calculations. In addition, some counties were unaware of the cost bases for rental charges.

Background

The Lynch family has been assisting individuals with developmental disabilities since 1934. The organizational structure has evolved to include seven related corporations.

The main administrative office is located at 216 Cedar Avenue, Willow Grove Pennsylvania. Additionally, there is a program administrative office for the Montgomery and Bucks County programs in this location, and another program administrative office located at 70 Lancaster Pike, Frazer, Pennsylvania that oversees the Chester and Delaware County programs. The corporations contract with counties to provide services.

In examining Lynch's contracting process for fiscal year 2006/2007 and 2007/2008, it became apparent that the process was not being completed in a timely manner. For the fiscal periods reviewed, contracts were signed late resulting in payment delays. As discussed in Finding No. 2, Lynch incurred interest expense that appears to be excessive. One of the contributing factors to this expense was the delays in the contract execution process.

Additionally, once the ODP implements the new payment system, all payments will be made through PROMISe™. Under this new system, provider agreements must be in place at the start of the fiscal period in order to bill through PROMISe™.

Administrative costs are accumulated in the management company and allocated to the various programs based on a cost allocation plan. As such, no expenses or revenues remain in the management company at the end of the year. Also, no administrative costs are allocated to the property companies.

Within the four direct service companies there are 17 cost centers to which administrative costs are allocated. The 17 cost centers are clusters of like residences, functions or services. Expenses are allocated based on the relationship between the line item expense and the cost center. Administrative costs are then allocated to the various programs based on a ratio of total budget revenue per line item allocation to the individual cost center.

The ODP is moving to change its rate setting process to a prospective rate based on an annual cost report. Some of the findings of this report may be impacted by the changes proposed by ODP.

Objective, Scope and Methodology

The audit objectives, developed in concurrence with ODP were:

- To review Lynch Homes rate setting and budgeting process to determine appropriateness of rates charged and readiness for transition to PROMISe™ billing.
- To review Lynch Homes cost allocation plan to determine reasonableness of the allocation methodology and appropriateness of the expenditures.

In pursuing these objectives, the BFO interviewed various county staff, Lynch management staff and conducted site visits. We also reviewed accounting and financial records, budget documents, selected invoices and other pertinent data necessary to complete our objectives.
Government auditing standards require we obtain an understanding of management controls that are relevant to the audit objectives described above. The applicable controls were examined to the extent necessary to provide reasonable assurance of the

effectiveness of these controls. Based on our understanding of the controls, no material deficiencies came to our attention. Areas where we noted an opportunity for improvement in management controls are addressed in the findings of this report.

Fieldwork for this audit took place between May 28, 2008 and July 10, 2008. The report, when presented in its final form, is available for public inspection.

Results of Fieldwork

As stated above, our objectives centered on Lynch's rates and their readiness for the new ODP prospective rate setting procedures. The component parts of Lynch's current rates include, operating costs, 3% retained revenue, and rent which is either based on actual cost or 8% usage. Based on our audit, it appears that Lynch has the systems in place to be able to move into the new proposed prospective rate setting as well as the PROMISe™ billing system.

Additionally, we reviewed the cost allocation plan which has been described in detail in the background section of this report. Based on our review of the methodology used to allocate administrative costs, it appears the plan is equitable and administrative costs are allocated accordingly.

As a result of our review, the following findings and observations have been identified:

Finding No. 1 – Accrued Expenses Are Booked At Year End, But Not Actually Incurred Until Several Months Later

Lynch accrues expenses at year end which may not actually be incurred for several months after the close of the fiscal period. The audit expenditure sample identified $36,615 of expenses accrued at the end of the fiscal year that were not actually incurred for three to six months after the close of the fiscal year.

Generally Accepted Accounting Principles (GAAP) defines an accrued expense as an expense that has been incurred in the fiscal period, but has not yet been paid. The expenses in question accrued by Lynch were based on estimates for work to be completed at a later time or for items that had not yet been ordered. Therefore, these expenses have not been incurred and should not be recorded or reported as accrued expenses.

Management stated that once they make the decision to purchase something at year end, they book the expense as an accrual. They further stated that some of these items were for services such as roof repairs which may take a considerable amount of time to schedule and complete.

While we recognize the degree of uncertainty regarding long-term planning and scheduling of projects of this nature, an expense must be reported within the appropriate fiscal period when it is incurred per the matching principle. Therefore, management must inform the appropriate county that provided the funding and request approval to report a deferred expense and record a deferred revenue liability. This will ensure all revenues and expenses are properly accounted for within appropriate fiscal periods.[1]

Recommendations

The BFO recommends that in the future, Lynch properly record accrued expenses per GAAP.

The BFO further recommends that Lynch record deferred expenses and revenues as defined by GAAP, and also provide notification to appropriate counties providing the funding.

Finding No. 2 – ODP and County Programs Must Ensure Timely Contracting To Limit Provider Credit Interest Expense

Lynch incurred line of credit interest totaling $262,360 related to all four service companies during fiscal year ended June 30, 2007. The line of credit interest was related to borrowings made to supplement cash flow. While interest of this nature is an allowable expense under the 4300 Regulations, the amount of interest incurred by Lynch could have been better used to provide services.

Management recounted that some counties no longer give advance payments at the beginning of the fiscal period resulting in the need to borrow funds to cover expenses. However, in reviewing the Lynch contracts with County Programs, it was noted that many of their contracts were not signed in a timely manner. Because contracts were not signed, timely payments could not be made, with some services unfunded through a signed contract for the entire fiscal period. Management presented several reasons why the contracts were not signed timely, the main reason being disputes with counties over financial and/or service issues.

Delays in executing finalized contracts result in increased borrowing and interest expense to cover costs during the periods in question and deny the opportunity to better utilize these funds for provision of services. Because line of credit interest is an allowable expense, there is no incentive to move to resolve contracting issues.

Recommendations

The BFO recommends ODP not participate in interest cost if contracts are not secured in a timely manner. Both counties and providers need to negotiate in a good faith effort that alleviates any requirement for excessive borrowing.

[1] Payments were made for all questioned accrued expenses in the next fiscal year (2007/2008).

Observation
Property Costs

Lynch owns 51 of the 72 sites they operate. There are 26 properties that are debt free and 25 properties with mortgages. The properties that have mortgages are expensed based on principle, interest and taxes; for debt free properties, Lynch charges rent, between the related companies, based on 8% usage calculated on the acquisition cost plus renovations and improvements. While these methods are in accordance with the 4300 Regulations, costs related to items usually classified as repairs were included within the usage calculation. While property repair expense is an allowable expense, it is ineligible as a component of the usage calculation. Lynch does not have a written policy that delineates what would be considered a renovation, an improvement or a repair.

In some cases, county staff reviewing rates and participating in contract negotiations were unaware of how providers are calculating the related party rental charges. In one case county personnel were unaware that the 4300 Regulations allowed an 8% usage charge for debt free property.

When ODP promulgates the new prospective rate methodology governing these programs, the usage allowance calculation will be based on an amount that may not exceed an amount equal to the continuing participation allowance percentage that the provider claimed in fiscal year 2007/2008. If repair expenses continue to be included within the fiscal year 2007/2008 continuing participation allowance calculation, the expensed amounts will be overstated.

Exit Conference/Summation

An exit conference was held on November 21, 2008. At the conference Lynch presented distinct concerns about selected wording used in the report. Upon consideration and review, BFO agreed to revise certain statements to better reflect their intended meaning.

The BFO also recognizes that the description of prospective rate methodology, as outlined in the Observation Section of the Draft Report, has changed as the developing methodology continues to be developed and finalized. However, regardless of the final methodology, our concerns related to the inclusion of expensed items within a calculation of usage allowance, still stands as a reasonable one.

In addition, Lynch presented data concerning its line of credit interest. The data indicates that for the year under audit, interest expense was greater than other comparable periods. While the BFO acknowledges this, no changes to the finding were made as the amount of interest charged in the year under audit was accurate.

Pertaining to Lynch's written response that concludes with the assertion that the audit report should be issued without the findings, recommendation and observation, the BFO respectfully disagrees. The BFO is of the opinion that the findings, recommendations and observation are fairly stated, and that the inclusion of the Lynch written response ensures a fair, complete and objective report.

In accordance with the BFO established procedures, please provide a response within 60 days to the Audit Resolution Section concerning actions to be taken to ensure the report recommendations are implemented.

Please contact Alex Matolyak, Audit Resolution Section at (717) 783-7786 if you have any questions concerning this audit or if we can be of any further assistance in this matter.

Sincerely,

Kevin M Friel

Kevin M. Friel

Attachments

c:	Mr. Henry Lynch	Mr. Eric Goldstein	Mr. Phillip M. Fenster
	Mr. Michael Bolton	Ms. Dorothy Klein	
	Ms. Vicki Stillman-Toomey	Mr. Gary Entrekin	
	Mr. Joseph Church	Mr. Michael Cavone	

bc: Mr. Thomas Crofcheck
Mr. Daniel Higgins
Mr. Alexander Matolyak
SEFO Audit File (S7000-R99)

Lynch Homes, Inc.'s
Response to the Draft Report

November 12, 2008

Mr. Kevin Friel
Director
Bureau of Financial Operations
Third Floor, Bertolino Bldg.
1401 N. 7th St.
PO Box 2675
Harrisburg, PA 17110-2675

RE: Draft Performance Audit Report
Lynch Homes, Inc.

Dear Mr. Friel:

I am writing to you on behalf of my client, Lynch Homes, Inc., in response to a "Draft" Performance Audit Report ("Report") prepared by the Bureau of Financial Operations ("BFO"), Department of Public Welfare ("Department").

The Report contains a draft letter to the Deputy Secretary for the Office of Developmental Programs ("ODP") which states, in part, that the audit was conducted in response to a request from ODP for the purpose of assessing "the appropriateness of service rates and to determine Lynch's readiness for the upcoming changes to the rate setting process."[1] The Report itself, at p. 4, actually defines the "audit objectives" more broadly, as follows:

- To review Lynch Homes rate setting and budgeting process to determine appropriateness of rates charged and readiness for transition to PROMISE™ billing.
- To review Lynch Homes cost allocation plan to determine reasonableness of the allocation methodology and appropriateness of the expenditures.

According to the Report, the auditors examined the Lynch Homes' "management controls that are relevant to the audit objectives" and found "no material deficiencies" based on their review. Report at p.4. The auditors also determined "that Lynch has the

[1] It is presumed that the "rate setting process" referred to is the Prospective Payment System ("PPS") still in development under the Department's Consolidated and Person/Family Directed Support Waivers.

systems in place to be able to move into the new proposed prospective rate setting as well as the PROMISE™ billing system. Id. Additionally, the auditors reviewed the Lynch Homes' cost allocation plan and found the plan to be "equitable and administrative costs allocated accordingly." Report at p. 5.

Lynch Homes welcomes the favorable Findings of the auditors concerning the rate setting and budgeting processes, including the cost allocation process. The auditors, however, propose two Findings and one Observation that we believe are neither supported by the facts nor by Generally Accepted Accounting Principles. This response sets forth our objections to the proposed Findings and to the Observation.

Finding No. 1 **Accrued Expenses Are Booked At Year End, But Not Actually Incurred Until Several Months Later.**

Lynch Homes' Response:

BFO faults Lynch Homes for accruing "expenses at year end which may not actually be incurred for several months after the close of the fiscal period." Report at p. 5. The total amount of such expenses relating to the July 1, 2006 – June 30, 2007 was $36,615.00, of which amount $33,000.00 was attributable to building repairs and maintenance. According to BFO, "Generally Accepted Accounting Principles ("GAAP") defines an accrued expense as an expense that has been incurred in the fiscal period, but has not yet been paid." Id. Lynch Homes advised the auditors that when it makes a commitment (as opposed to merely a decision) to purchase service/supplies, the funding for which depend substantially on the availability of funding from the County MH/MR Programs, it accrues the expenses.

GAAP recognizes that accruals often consist of estimates of amounts that are expected to be required to cover expenditures within the year for known obligations such as: (a) where the specific person(s) to whom payment will be made is (are) not known (e.g., accrued liability for a product or service) or (b) when the amount can be determined only approximately (e.g., accrued audit fees). GAAP recognizes that accruals are commitments made by an entity of assets (cash) for property or services ordered prior to the end of the accounting period, but not paid for until subsequent accounting periods. Accruals can be estimated based on management's historical experience, research and expectations and often are anticipated during the budgeting process so that entities can avoid overspending a budget and to predict cash outflow.

BFO's review disclosed that the Lynch Homes matches costs (which were budgeted with the expectation that they would be spent provided the revenue was collected on a timely basis) with revenues collected. It is common practice under the MH/MR County Program funding model that revenues are sometimes not known, or collected at such a late date that certain projects cannot be completed before the year end (though those projects were intended to be expended against the provided revenues). When county agencies fund Lynch Homes, that funding is noted on the county's budgets which are monitored by DPW. Practically speaking, if Lynch defers revenue on its books, it becomes out of sync with the funding sources that have reflected expenses on their books for the funding provided to Lynch. Thus, the accrual of the commitments at year end properly matches the expense against the collected revenue. The matching concept provides for the recording of costs associated with the revenues of a period. Expenses are matched to revenue; revenues are not matched to expenses.[2]

BFO auditors duly recognize "the degree of uncertainty regarding long-term planning and scheduling of projects" such as those they identified for audit purposes. Nonetheless, the auditors recommend that Lynch Homes accrue expenses when actually "incurred" as opposed to when a commitment is made. Aside from our understanding, as explained above, that the practice of Lynch Homes is entirely consistent with GAAP, under the logical extension of BFO's interpretation, an agency that contracts with a County MH/MR program could never be certain that funds would actually be available from a particular county to fund an expense for a necessary project or service. This uncertainty arises because if a provider and a county do not book a cost for a necessary expenditure in the year that revenues are available, there is no assurance that the revenue will be available in the subsequent fiscal year. How, for example, can Lynch be assured that it will actually receive funds from a county to pay for repairs to a roof committed to in June but not completed until August? Under BFO's methods, there is no assurance that the funds which were available to pay for the roof repair in one fiscal year will be available in the next fiscal year for that purpose. What BFO proposes as a mandatory accrual method is inconsistent with GAAP and simply does not match the realities of how counties and providers must manage their respective budgets consistent with DPW's funding practices and policies.

Because the facts demonstrate that Lynch Homes properly documented and matched payment commitments made prior to the end of the fiscal year with payments made in the subsequent fiscal year consistent with and in accordance with GAAP, Finding No. 1 should be withdrawn.[3]

<u>Finding No. 2</u> **Lynch Incurred $260,360 In Line of Credit Interest Expense**

<u>Lynch Homes' Response:</u>

This Finding is both unfairly stated and wrongfully noted. As stated, the Finding connotes a sense of improper practice by Lynch Homes when, to the contrary and as

---

[2] As noted by the auditors, "payments were made for all questioned accrued expenses in the next fiscal year (2007/2008)". Report at p. 5.

[3] Why and how this Finding is even relevant as part of a determination of Lynch Homes' "readiness" to participate in the anticipated Prospective Payment System is not explained in the Report. As of July 1, 2009, DPW, not the County MH/MR Programs, will pay Lynch Homes for services and payments will be based on cost reports submitted by providers as adjusted to reflect applicable trend factors and changes in services and utilization.

conceded by the auditors, the interest expense was legitimately incurred and allowable under applicable regulations. Report at p. 6. The plain fact that Lynch Homes incurred interest expense is not an appropriate "Finding." A Finding typically connotes non-compliance with a regulation and is written so as to convey that conclusion. Here, of course, no such Finding or conclusion is possible because there was no violation by Lynch Homes of applicable regulations.[4]

The explanation for the Finding states that the "amount of interest incurred by Lynch could have been better used to provide services" and chastises Lynch that because the "line of credit interest is an allowable expense, there is no incentive for providers to move to resolve contracting issues." Report at p.6.

This "incentive" theory espoused by the auditors is fundamentally flawed in its erroneous presumption that a provider typically causes the delay in resolving "contracting issues." It is the counties that have the funds and can dictate whether a provider obtains or retains a contract. The notion that a provider seeking to contract with a County MH/MR Program will otherwise delay contract resolution because interest on its finite line of credit is allowable is, frankly, silly.

Turning from the Report's inappropriate and unsupported incentive theory and gross speculation about incurring line of credit interest expense, actual facts demonstrate the prudence of Lynch Homes in borrowing, including the cause for the borrowing in 2006-2007. Unmentioned by the auditors but a reality for Lynch Homes in 2006-2007 are the following facts:

1. Contract advances from county programs amounting to $1.4 Million were discontinued in 2006-2007.

2. In 2006-2007 ODP introduced electronic submission of budgets which required a "per site" payment in place of prior years' blended budget rates. ODP added to the complexity by requiring budget neutrality. The new system required extended rate setting discussions between counties and providers to maintain budget neutrality.

3. Unavoidable circumstances necessitated relocating nine consumers, involving six sites. The relocations, of necessity, required intense attention to the needs of fragile consumers. Further, the relocations required approval of various County MH/MR Programs and implementation within the multi-county framework of budget neutrality.

Essentially, the line of credit interest expense experienced by Lynch Homes in 2006-2007 was an outlier in what otherwise has been a most prudent history of borrowing by Lynch Homes. The prudence in borrowing that characterizes Lynch Homes and that

[4] Frankly, this Finding and the accompanying narrative is particularly inappropriate given that the Department has knowingly adopted "prudent pay" policies that deliberately delay payments owed to providers (e.g., ICF/MR Providers, managed care organizations) and that compels the providers to incur interest costs to assure "cash flow."

easily dispels the unwarranted and unfounded criticism by the auditors is evidenced by the following borrowing history:

2008: $73,383
2007: $260,692
2006: $64,471
2005: $52, 646
2004: $28,124
2003: $35,165
2002: $30,645

This Finding is based on borrowing experience that is not reflective of the agency's established borrowing history, fails to fairly set forth the facts that necessitated the borrowing in 2006-2007 and reflects an unfortunate misapprehension regarding the operational and business realities providers constantly confront.

The first and third Recommendations themselves too are wholly inappropriate and, as written, unintentionally reflect an unfortunate bias toward providers. Initially, even ignoring that the current county-based payment system is scheduled to terminate effective June 30, 2009, and so essentially makes this Recommendation moot, ODP must abide by current regulations which expressly allow interest expense. Second, given the complex consumer relocations, why should a provider suffer the consequences of delayed contracts? In addition, the action proposed in Recommendation No. 3 that a county decide when contract action is "delayed due to provider actions" is certainly outside the scope of applicable regulations. Finally, how is the County in such a situation not in an inherent conflict having been a party to the contract negotiation BFO recommends the County should ascribe fault in?

The Finding and the related Recommendations are ill conceived and not supported in law, are notably and wrongfully punitive towards providers and, accordingly, must be withdrawn.

BFO Observation: Property Costs

Lynch Homes' Response:

The Observation is outside of and beyond the objective and scope of the audit and for those reasons alone it must be withdrawn. It also is inappropriate because it discusses an aspect of the PPS, the continuing participation allowance, that, similar to many aspects of the PPS, will be subject to review and likely modification. Indeed, the discussion in the Observation has been superceded by decisions that occurred shortly after release of the Report. Regardless, it is unacceptable for BFO to make an Observation about policies and procedures that are not finalized.

BFO relates anecdotes about county staff in the Observation as to which Lynch Homes has no knowledge. Such Observations are neither relevant nor appropriate to this Report regarding this provider's performance.

Conclusion

Lynch Homes has attained a stellar reputation throughout Pennsylvania for the quality of the services it provides and the skills, professionalism, dedication and commitment of its employees. Since 1934, far before the enactment of the Mental Health and Mental Retardation Act of 1966, Lynch Homes was in the vanguard of service providers that developed community-based alternatives to persons with intellectual and physical disabilities who otherwise would have been placed into large institutions. The auditors, with the concurrence of ODP, developed audit objectives, reviewed Lynch Homes against those objectives, and found Lynch Homes fully compliant with applicable standards. Nonetheless, and inexplicably, the Report proposes two Findings and an Observation that, for the reasons explained above, are inherently flawed. The Report should be issued without the Findings, the Recommendations and the Observation. In the event BFO disagrees with the position of Lynch Homes regarding the issuance of a Final Report, we ask for a meeting to discuss the Report with you.

Respectfully submitted,

JOHN A. KANE

EXHIBIT

Lynch Homes, Inc
Chart of Corporations and Functions

Corporation	Function	Principle Assets
Lynch Community Homes, Inc.	Provides residential services and day programs	18 related party rental properties Nine (9) unrelated rental properties
Lynch of Montgomery County, Inc.	Provides residential services	Nine (9) related party rental properties One (1) unrelated rental property
Lynch of Delaware County, Inc.	Provides residential services	Two (2) related party rental propeties Six (6) unrelated rental properties
Lynch of Chester County, inc.	Provides residential services and day programs	22 related party rental properties Five (5) unrelated rental properties
Lynch Homes Properties, Inc	Holds title to propeties used by all service companies	Owns 46 properties
Lynch Management Serviecs, Inc.	Provides management services to all other service companies	
Lynch Home for the Handicapped, Inc.	Holds title to propeties used by service companies	Owns four (4) properties

** One property is own personally by the President
*** There are 21 propeties that are leased through an arms length transactions

Exhibit A