Profit-Making in Not-for-Profit Corporations: A Challenge to Regulators

NYS Commission on
QUALITY
OF CARE
for the Mentally Disabled

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Profit-Making in Not-for-Profit Corporations: A Challenge to Regulators

A Review of the Financial Operations of New York Psychotherapy and Counseling Center

New York State Commission on Quality of Care for the Mentally Disabled

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Preface

Approximately $745 million was spent in New York State in 1986 for outpatient mental health programs operated by general hospitals, State psychiatric centers, and private agencies in the community.[1] As a matter of public policy, the Office of Mental Health largely relies on not-for-profit corporations to operate the majority of outpatient programs, believing that the absence of the profit motive will allow agencies to devote their full attention to quality services for the clients, and that proper decisions will be made concerning the efficient use of scarce public funds. Pursuant to law, accountability for this system is among the fiduciary responsibilities of the officers and boards of directors of these agencies, through a requirement for independent financial audits and the review of such audits by the board and State authorities, and by the State's licensing and regulatory oversight of these programs, including its determination of the licensee's "character and competence."

However, if a not-for-profit agency chooses not to police itself, and is not strongly guided from within by appropriate values, there is reason to believe that the regulatory system is an unreliable check on its performance because of the following:

- While we expect not-for-profit corporations to be efficient in directing the expenditure of public funds for client needs, there is virtually no scrutiny by State licensing and funding agencies of how money is actually spent by the not-for-profit agencies. Although annual independent audits of financial conditions are required, there is little assurance that certified public accountants are truly independent, that they apply generally accepted auditing standards, or that they ensure that all pertinent information on corporate finances, such as related-party transactions, is disclosed on their financial statements.
- While it is intended that not-for-profit corporations will make prudent judgments on the expenditure of public funds, there is little examination of the character and competence of program operators who have been known to engage in self-dealing with family-owned realty corporations, although such dealings can effectively convert a not-for-profit corporation into a profit-making enterprise.
- While there is a clear intent that not-for-profit corporations will not pay excessive salaries, there are actually no limits under the State's fee-for-service approach on salaries or perquisites for officers and employees, and little scrutiny of agencies' actual practices. A not-for-profit agency, largely supported by government subsidies, can award its top executives compensation packages far in excess of the prevailing compensation provided by comparable public and not-for-profit providers with no adverse consequence.
- While agency boards of directors are supposed to play a critical role in ensuring that a not-for-profit agency is faithful to its cor-

1 *Outpatient Mental Health Services*, NYS Commission on Quality of Care for the Mentally Disabled, July 1989.

porate charter, there is very little actual oversight to ensure that such boards comply with their fiduciary obligations. In addition, many boards have insufficient understanding of or ignore their powers and duties, or are tainted by conflicts of interest.

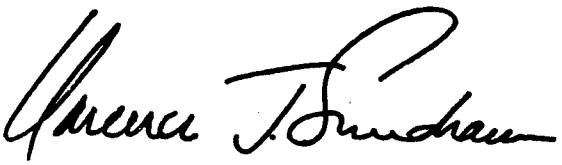
The case of New York Psychotherapy and Counseling Center (NYPCC) illustrates this pattern of conduct at a community mental health facility, which was designed to be, both by law and in fact, a not-for-profit corporation serving the mentally ill. Many of the profit-making behaviors in question appear to be at odds with the public-minded, conflict-free, unselfish motivation expected of a not-for-profit corporation.

This report looks at how an agency has taken full advantage of omission, ambiguity, and loopholes in the State's system of regulation to bring its executives income and compensation above the benefits that might reasonably be considered an appropriate use of public funds. It also illustrates how weaknesses in the regulatory structure and practice make it possible for providers to misuse the system through questionable Medicaid billing practices, and through the operation of programs without proper licensing by the State—all with impunity.

The Office of Mental Health response to the Commission's draft report, which is appended, indicates OMH will follow-up on our findings with the Attorney General regarding the violations of the Not-for-Profit Corporation Law, and with the Department of Social Services on NYPCC's Medicaid billing practices.

The Commission also afforded NYPCC the opportunity to review and comment upon an earlier draft of the report. The agency submitted an extensive response and thereafter its senior executives and outside counsel met with the Commission staff. Subsequently, NYPCC filed a supplemental response. As a result of this exchange of information, revisions were made in the draft report. Where major disputes remain, they are noted in the body of the report. The full responses of NYPCC are on file at the Commission and are available for review upon request.

This report reflects the unanimous opinion of the members of the Commission.



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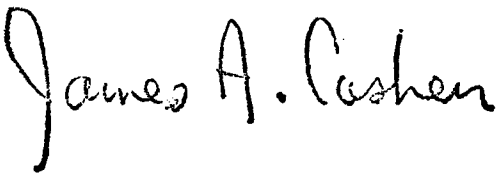

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Introduction

Basis for Commission's Review

The review of the financial operations of the New York Psychotherapy and Counseling Center (NYPCC) was conducted, pursuant to the Commission's mandate under Article 45 of the Mental Hygiene Law, to examine the efficiency, effectiveness, and economy of mental hygiene programs, and pursuant to Chapter 50 of the Laws of 1987, which appropriated funds to the Commission to perform financial reviews of facilities participating in the Medicaid program.

The Commission was aware from the State's Medicaid Management Information System (MMIS) that NYPCC was considered to be a high cost growth agency.[2] The focus of the review was to profile and understand the agency's service, billing, and expenditure practices, and to determine the adequacy of the Office of Mental Health's (OMH) regulatory rate-setting process by studying how Medicaid funds (which constituted about 95 percent of the agency's revenues) were being spent.

Scope of Commission's Review

The Commission conducted a financial review of the various books and records of NYPCC and its related real estate entities, 220-05 Jamaica Avenue Associates and 220-05 Jamaica Avenue Realty Corporation, generally for the period January 1, 1983 to December 31, 1987.

The Commission reviewed NYPCC revenue collections under the Medicaid program for services provided during 1986 and 1987 in clinic treatment programs located at several adult homes. A total of 382 claims for clinic services was randomly selected and traced to supporting documentation.

Throughout the course of this survey, the officers of NYPCC were responsive to requests for information, and readily made available for review the books and records of the agency as well as those of a limited partnership which acquired, leased, and eventually sold properties to NYPCC. The agency's board and officers also provided supplemental information on our findings to help assure the accuracy of this report.

Corporate Background

New York Psychotherapy and Counseling Center, located at 220-05 Jamaica Avenue, Queens Village, New York, was incorporated as a not-for-profit agency on January 21, 1974. The purposes of the corporation, as stated in its charter, are to provide outpatient psychiatric, psychotherapy, and counseling services to individuals who have mental or emotional disorders, and financial support for sci-

2 In 1986, NYPCC received more Medicaid revenue for OMH clinic services than any other privately operated clinic in the State.

entific, educational, and charitable purposes.

To achieve its goals, NYPCC operates psychiatric clinics and outpatient mental health programs from six locations in Queens and Brooklyn for persons residing at adult homes or in the community, as follows:

- Leben Home for Adults, 80-20 45th Avenue, Elmhurst, New York;
- Sanford Home for Adults, 140-40 Sanford Avenue, Flushing, New York;
- Surf Manor Home for Adults, 2316 Surf Avenue, Brooklyn, New York;
- Drew Street Clinic, 796H Drew Street, Brooklyn, New York;
- Continuing Treatment Program and Administrative Offices, 220-05 Jamaica Avenue, Queens Village, New York;
- East New York Continuing Treatment Program, 394 Hendrix Street, Brooklyn, New York.

The three adult homes, above, have a large concentration of mentally ill residents. In early 1987, 562 beds, or 80 percent, of the total 701 beds in these homes were occupied by mentally ill residents.

The president of the board of directors informed the Commission that the board passes on all of the major decisions concerning the overall operation of NYPCC. It sets salary levels of the senior executive staff and makes decisions on whether to rent or purchase property. The Commission was told that the board had not delegated its authority to the agency's senior executives. To the extent that the decisions of the board were not recorded, the president admitted that the board was guilty of keeping sparse minutes.

The executive director of NYPCC is Rabbi Isidore Klein. Rabbi Klein's son, Elliott Klein, serves as NYPCC's assistant executive director. Its two medical co-directors are Jack Schnee, M.D., and Harold Finn, M.D.

Leases and Transactions with Related Parties

NYPCC leases space in the three adult homes to provide program services at these sites. The agreements provide for rental amounts, which are to be increased in the same percentage amount as any increase in the Medicaid rate for individual psychotherapy. The rents paid in 1987 to the Leben, Sanford, and Surf Manor Adult Homes were $22,200, $14,874, and $12,320, respectively. The Drew Street Clinic was leased in 1987 for $21,600 from the Baptist Medical Center of New York, and the rent was to increase thereafter at a 7 percent annual rate. Most recently, over 75 percent of NYPCC's Medicaid income was generated by these clinics.

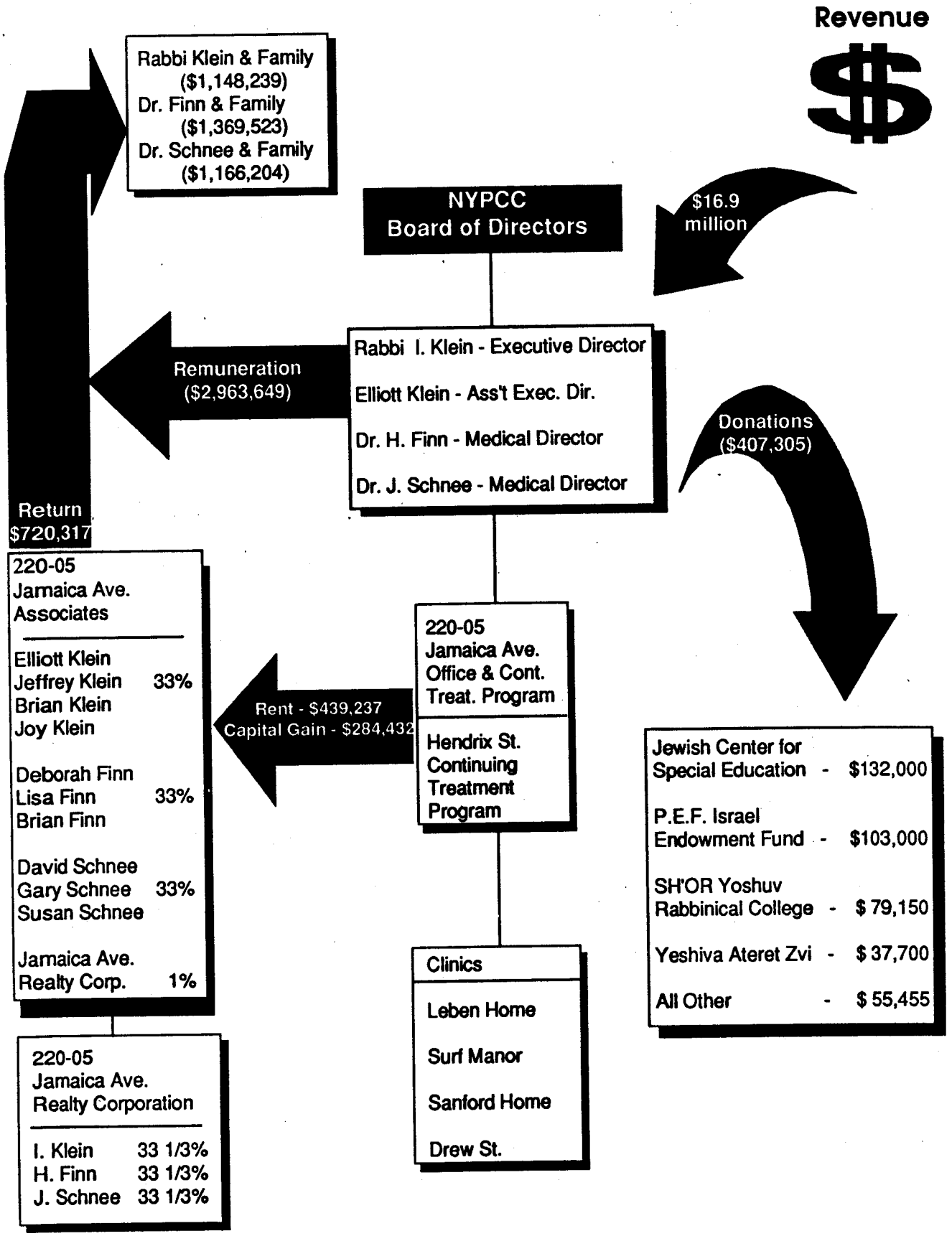
The properties at Hendrix Street and Jamaica Avenue were purchased by NYPCC in 1987, for $1,065,000, from a limited partnership which is comprised of Rabbi Klein (NYPCC's executive director), Drs. Schnee and Finn (NYPCC's medical co-directors), and their children. Prior to purchasing the buildings in late 1987, NYPCC leased these properties

from this limited partnership. The latest annualized rent due for the two buildings was $230,757.[3]

In addition to the income from these related-party real estate transactions, the senior executives and their families have also received substantial remuneration from NYPCC, while donating NYPCC's own funds to religious and charitable organizations. Chart I illustrates the interrelationships, cash flow, individuals, and entities involved in these transactions for the years 1983 through 1987.

3 Actual rent paid was somewhat less because NYPCC did not occupy the buildings for full calendar year periods.

Chart I
NYPCC Transaction Flow
1983 to 1987



Financial Findings

The State's regulatory and reimbursement framework for community-based OMH outpatient programs relies for its integrity on not-for-profit agencies and a premise of provider self-regulation, based upon the Commissioner's initial judgment of the character and competence of the operators, independent financial reviews by CPAs who are legally and ethically bound to be honest and accurate, and, ultimately, by law, particularly the New York Not-For-Profit Corporation Law [hereinafter N-PCL].

Under the N-PCL, and as a condition for being granted an operating certificate, it is envisioned that boards of directors and officers of these corporations will have the requisite independence, as well as the appropriate character and competence, to assure that the corporation will be operated in the public interest, and that proper care and treatment will be given to its clients. The State Attorney General has extensive powers to enforce the N-PCL.

It is important at the onset to define the State's fee-for-service approach, which is the primary government funding mechanism for outpatient psychiatric services. It is a set fee paid by the State for a particular service for care or treatment (e.g., $53 for a 30-minute clinic visit); it is not established based on the actual cost of providing the service. The fee might be higher or lower than actual cost, and permits maximum latitude on how funds may be spent as long as expenditures are authorized under the corporate charter and operating certificate. The principle, inherent in not-for-profit corporations, is that directors and officers of a corporation will discharge their duties in good faith to the corporation and its mentally disabled clients by adhering to the terms of the operating certificate.

The N-PCL requires an independently functioning board of directors to review and approve the agency's programs and finances. Board members are required specifically, by statute, to direct the purchase, sale, and lease of real property, to authorize the investment and disposition of corporate assets, and to use any agency profits to maintain or expand services. They are prohibited from making loans to officers or directors, or distributing agency assets or profits *in any manner whatsoever* among the members or officers of the corporation.[4] In short, such individuals must at all times put the interests of the not-for-profit corporation ahead of any conflicting or inconsistent

4 §508 of the N-PCL provides that "A corporation whose lawful activities involve among other things the charging of fees or prices for its services or products shall have the right to receive such income and, in so doing, may make an incidental profit. All such incidental profits shall be applied to the maintenance, expansion or operation of the lawful activities of the corporation, and in no case shall be divided or distributed in any manner whatsoever among the members, directors, or officers of the corporation."

self-interest. In discharging their duties, the members and officers may seek and rely upon financial reports by independent accountants, but board approval and financial disclosure is required on all important fiscal issues.

However, as explained below, at NYPCC this system of controls (i.e., board oversight, independent audits, and prohibitions on self-serving acts) has failed because the NYPCC was only nominally a not-for-profit corporation. In reality, it functioned as a profit-making corporation for its key officers rather than solely for a public purpose.

To accomplish this, the NYPCC officials inappropriately maximized Medicaid billings to produce excess revenues of over $1.4 million, established for-profit realty entities that diverted a large proportion of this income to themselves and their families, and established a practice of tying executive compensation to the "financial success" of the corporation.

The relevant statutes require that the compensation of corporate officers of not-for-profit corporations be "reasonable." There are no clear guidelines to establish what is reasonable and what is unreasonable compensation. However, when such compensation is significantly out of line with prevailing practices at comparable agencies, substantial questions are raised about whether the compensation is reasonable and whether the corporation is being operated in a manner consistent with its not-for-profit status.

The following summarizes the payments to NYPCC officers and to realty corporations controlled by the officers and their families that appear to represent an unwarranted distribution of income beyond what might be considered reasonable compensation.

Inordinate Remuneration to Corporate Officers

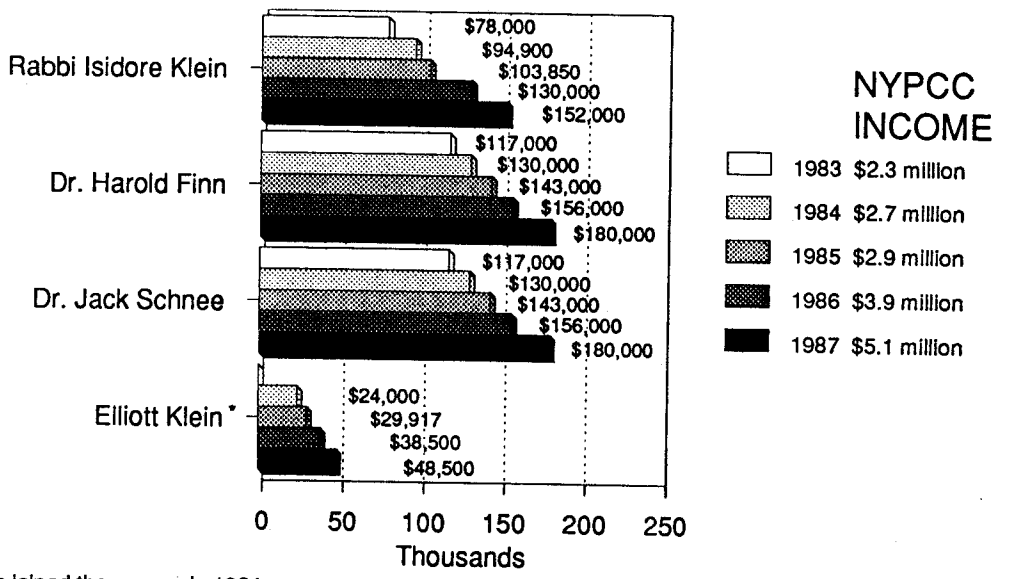
Salary

The N-PCL (§§202 and 717) requires executive salaries to be reasonable. The Commission, in its review of management salaries, found the compensation levels of NYPCC's three top executives to be grossly in excess of the norm of similar public-funded agencies. Over the past five years, the wages paid to the agency's three top executives and to the assistant executive director totaled $2.15 million. Chart II summarizes executive salaries over the last five years.

To determine the reasonableness of the wages paid by NYPCC to its executive director and two medical co-directors, Commission staff compared their 1987 salaries to those of the managers of 67 other OMH-licensed agencies in the New York City area. On the basis of this analysis, the Commission believes the salaries being paid to NYPCC's three top executives to be unreasonable because:

- The salary of the NYPCC executive director was 132 percent above the average salary ($152,000 versus $65,536)

Chart II
Salaries of Executives
1983 to 1987



* E. Klein joined the agency in 1984

of the other 67 agencies' executive directors. These agency executives were responsible for administering agencies whose revenues are, on average, about the same as those of NYPCC. (The next highest paid executive directors earned salaries of $136,771 and $131,710 and ran agencies about five and eight times larger, respectively, than NYPCC.)[5]

- NYPCC's two medical co-directors were each paid 162 percent more ($180,000 versus $68,582) than the average of their counterparts at other agencies. During the Commission's review, Medical Co-Director Finn was the prime contact person on administrative and financial matters, and seemed in many respects to be acting in a role normally associated with that of an executive director.

Tax-Deferred Compensation

The Commission also found that the officers had been awarded deferred com-

5 NYPCC claims it is aware of two facilities providing similar services in the New York City area which are not included on this list of 67 facilities. One reportedly had a gross income for 1986 of approximately $861,000 and paid its medical director approximately $145,000. The other had a 1986 gross income of approximately $6,000,000, and paid its medical director approximately $140,000 and its executive director approximately $123,000.

NYPCC also asserts that, based upon an examination of "reputable" journals, NYPCC's salaries are "within the normal boundaries paid to comparable staff members in other facilities." The health care executives presented as performing "comparable" duties include, however, senior executives of hospitals, chief executive officers of corporate and private foundations, and senior faculty of New York State medical schools.

pensation for services reportedly provided in 1978. The compensation totaled $204,000, and was paid in 1984 and 1985 to a custodian to be held in trust until the officers resign or retire from the agency. The following reflects the amount of deferred compensation for each officer.

Tax-Deferred Compensation

	1984	1985	Total
Rabbi Klein	$24,000	$36,000	$60,000
Dr. Harold Finn	36,000	36,000	72,000
Dr. Jack Schnee	36,000	36,000	72,000
Total	$96,000	$108,000	$204,000

Tax-Sheltered Annuities

In addition to salaries, the agency contributed $360,392 from 1983 to 1986 to tax-sheltered annuities for its officers. The payments listed below represent the maximum annual contributions ($30,000, or 25 percent of salary) allowed by the Internal Revenue Service for a tax-exempt employer to such pension plans. Because of changes in the federal tax code, the agency, in 1987, substituted life insurance for these annuities.

Life Insurance

	Total Coverage	1987 Premiums		
	(Millions)	Term	Split-Dollar	Total
Rabbi Klein	$2.20	$6,200	$30,000	$36,200
Dr. Harold Finn	2.20	8,757	30,000	38,757
Dr. Jack Schnee	2.20	9,494	30,000	39,494
Elliott Klein	1.21	88	10,000	10,088
Total		$24,539	$100,000	$124,539

Life Insurance

In 1987, NYPCC paid $124,539 in life insurance premiums for its top executives, while expending $3,938 on 45 other employees. The executive director and the two medical co-directors are insured for $2.2 million each; the assistant executive director for $1.21 million; and 43 other employees for $10,000 each. Two former employees are insured for $25,000 and $5,000 each. The beneficiaries of the three executives' policies are their children; the executive director is the beneficiary of his son's policy. Listed below is a breakdown of the officers' 1987 premiums and coverage.

Included therein are split-dollar life insurance policies of $1.0-$1.2 million on each officer, which were substituted in 1987 for previously provided, tax-deferred annuities when employer contributions became taxable to individuals under the Tax Reform Act of 1986. A split-dollar plan is an alternative type of insurance similar to a whole-life policy. The annual $100,000 premium on these policies will be refunded, without interest to the agency, upon cancellation of the policies or death of the insurees. Even though the 1987 annuity payments for the officers are reduced by this amount, the agency

Tax-Sheltered Annuities

	1983	1984	1985	1986	Total
Rabbi Klein	$19,500	$23,725	$26,188	$30,000	$99,413
Dr. Harold Finn	29,250	30,000	30,000	30,000	119,250
Dr. Jack Schnee	29,250	30,000	30,000	30,000	119,250
Elliott Klein	—	6,000	7,479	9,000	22,479
Total	$78,000	$89,725	$93,667	$99,000	$360,392

loses the opportunity to earn interest on this outlay, or to use it to reduce the agency's then $500,000 mortgage debt at 11.3 percent.

Luxury Automobiles

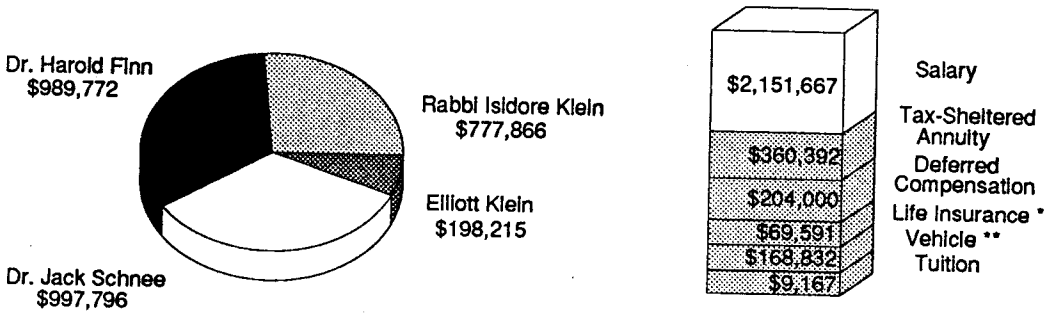
A costly perquisite that NYPCC provides to its three top executives is the use of luxury automobiles, currently three late model Lincoln Mark VI and Town Cars. Over the past five years, the Commission estimates that it has cost the agency over $168,000 to purchase and operate these vehicles. Included in the total is a $1,000 annual stipend to each executive for "out-of-pocket expenses," even though all vehicle operating expenses are paid by the agency.

The two medical co-directors and the executive director have been provided with the new Lincolns, which cost the agency $75,000; the assistant executive director has the use of a new $12,000 Mercury Cougar. The ostensible purpose of these large outlays is to provide the executives with transportation to the agency's program sites, but the cars are also for personal usage. The Commission believes that the number and types of vehicles assigned to perform these functions are unreasonable.

Total Executive Remuneration

The total remuneration paid by the agency to its three top executives and the assistant executive director from 1983 to 1987 totals about $3 million, and is summarized in Chart III. This compensation was 20 percent of the agency's total expense for this period. The nature and

Chart III
Executive Compensation
1983 to 1987



Total Compensation: $ 3 Million

* 1987 Split-dollar compensation benefit calculated at opportunity cost of $11,500.

** Includes business and personal usage.

level of these expenditures, in contrast to other similar agencies, appear to the Commission to be inconsistent with the N-PCL's requirement of "reasonable" compensation.

Less-Than-Arm's-Length Property Transactions

Another way that the assets of NYPCC have been transferred to its corporate officers was through a series of less-than-arm's-length property transactions with proprietary entities owned and controlled by the officers and their families. The officers of NYPCC jointly controlled both their for-profit realty businesses and the not-for-profit NYPCC, allowing a $720,317 return to the officers and their families over an approximate three-year period, even though it is questionable whether NYPCC needed their financial assistance in acquiring or leasing agency properties.

Purchases of Properties by Executives and Their Children

220-05 Jamaica Avenue Associates is a limited partnership formed in April 1984. Dr. Finn stated that the sole purpose of this partnership was to acquire and lease properties to NYPCC because the agency lacked the resources to do so on its own. The partnership is comprised of the NYPCC executives' children and a general partner (owned by NYPCC officers), and their investments and shares of ownership are listed in the table which follows.

220-05 Jamaica Avenue Realty Corporation (the general partner) manages the day-to-day operations of the partnership.

220-05 Jamaica Avenue Associates			
Partner	Type of Partner	Equity	Percent of Ownership
Elliott Klein	Limited	$825	
Jeffrey Klein	Limited	825	33
Brian Klein	Limited	825	
Joy Klein	Limited	825	
Deborah Finn	Limited	1,100	
Lisa Finn	Limited	1,100	33
Brian Finn	Limited	1,100	
David Schnee	Limited	1,100	
Gary Schnee	Limited	1,100	33
Susan Schnee	Limited	1,100	
Jamaica Ave. Realty Corp.	General	100	1
Total		$10,000	100

It is owned by NYPCC prinicpals, as follows:

220-05 Jamaica Avenue Realty Corporation		
Shareholder	Equity	Percent of Ownership
Rabbi Klein	$4,000	$33\frac{1}{3}$
Dr. Harold Finn	4,000	$33\frac{1}{3}$
Dr. Jack Schnee	4,000	$33\frac{1}{3}$
Total	$12,000	100

On October 9, 1984 and on July 29, 1986, 220-05 Jamaica Avenue Associates became the landlord of NYPCC by purchasing, improving, and leasing the respective properties, known as 220-05 Jamaica Avenue and 394 Hendrix Street, to NYPCC. The cost of acquiring and renovating these properties was about three-quarters of a million dollars, as follows:

	220-05 Jamaica Avenue	394 Hendrix Street	Total
Acquisition	$145,891	$351,334	$497,225
Renovations	216,485	62,582	279,067
Total	$362,376	$413,916	$776,292

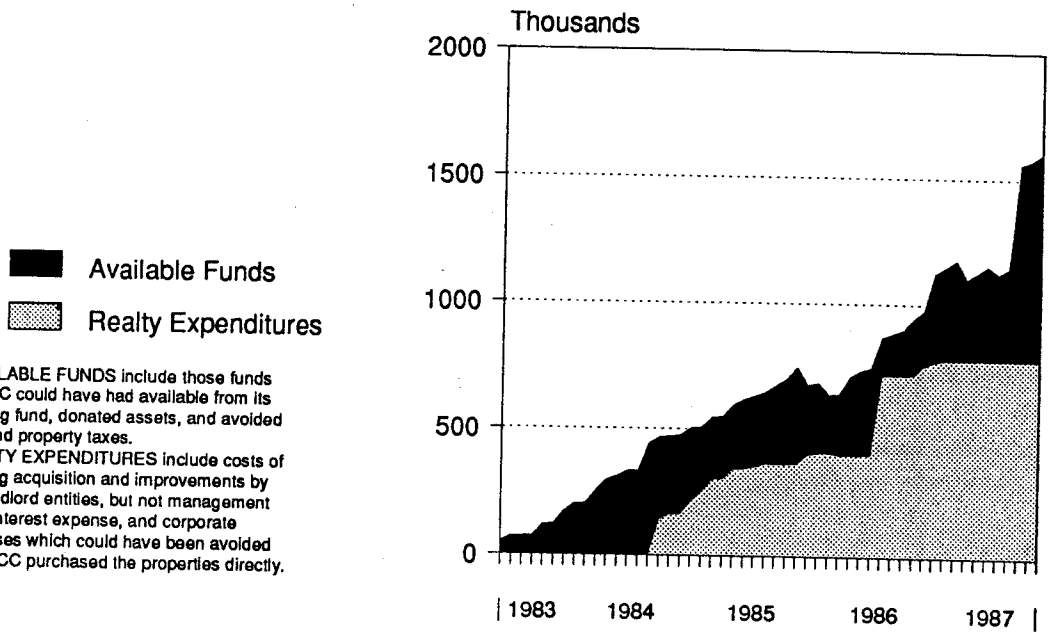
In order to purchase and improve the properties, in addition to the partners' minimal equity capital, money was loaned to the partnership from Dr. Finn's personal retirement fund, "Harold Finn, M.D., P.C. Retirement Trust."

NYPCC Was Financially Able to Acquire Properties at Time of Original Purchase

Dr. Finn asserted that the partnership was formed because NYPCC could not afford to acquire the properties directly. The board president told the Commission that the Jamaica Avenue property was purchased by the limited partnership only after NYPCC's attempt to obtain a mortgage and building loan was rejected by Chase Manhattan Bank, and after informal inquiry of several other banks led to the conclusion that NYPCC itself could not obtain a mortgage. The reasons given were NYPCC's lack of a financial track record and the depressed areas of the Jamaica Avenue and the Hendrix Street properties.

The plausibility of these assertions, however, is undercut by very questionable management decisions that were made, which either gave away or invested in long-term securities much of NYPCC's available assets. It appears,

Chart IV
Available Funds vs. Realty Expenditures*



*AVAILABLE FUNDS include those funds NYPCC could have had available from its building fund, donated assets, and avoided rent and property taxes.
REALTY EXPENDITURES include costs of building acquisition and improvements by the landlord entities, but not management fees, interest expense, and corporate expenses which could have been avoided if NYPCC purchased the properties directly.

therefore, that it was not the lack of resources, *per se*, which prevented NYPCC from purchasing the properties it was forced to rent, but rather a management choice, which allowed the principals and their children to reap substantial profits as its landlord. As summarized in Chart IV, the Commission found that, had funds ($407,305) not been given away to charitable organizations, NYPCC would have had sufficient monies to acquire and improve the properties from this source, an agency building fund, and by doing so would have avoided paying rent ($439,237) and property taxes ($27,453).[6]

Operating Capital

NYPCC further contends that, when the Jamaica Avenue property was purchased in 1984, its consultants advised it would cost between $450,000 and $500,000 to purchase and refurbish this property; it actually cost a total of $360,000. NYPCC, with "cash-on-hand" of $566,000, claimed it would have been left with insufficient operating capital had it purchased the property.[7]

However, the agency neither prepared any formal cash flow analysis to predict its actual cash needs, nor established a cash requirements budget. In fact, the agency acted in a manner contrary to achieving its cash management objective. For example, proximate to the purchase and renovation period, the agency had discretionary outlays of $207,000 for donations and $96,000 for senior executives' deferred compensation. These expenditures alone, if not made, and when added to the $206,000 working capital, would have resulted in a potential $509,000, or about 70 days' cash

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6 The contributions total is for the period 1983-1987. *See, infra,* Discussion at pp. 17-18.

Agency officials said that donations were made only at a time when there was no intent on buying property, or they were aware they could not obtain a mortgage. Yet, in August 1983, the agency established a building fund to purchase property. A week later, the agency began making donations ($20,000). By October 1983, the agency entered into a contract to purchase the 220-05 property. Again, about two weeks later, another contribution ($30,000) was made. In total, from the time the first donation was made to the time of the purchase of 220-05 Jamaica Avenue (in October 1984), NYPCC made $140,000 in donations. Clearly, this was at a time when agency officials claimed they were searching for a mortgage for the property.

7 With annual expenditures in 1984 of approximately $2.7 million, the remaining $206,000 in operating capital would have represented about one month's operating capital. NYPCC reports that its current independent accounting firm of Loeb & Troper — engaged for the first time in 1988 — recommends keeping on hand at least 90 days' operating capital (at that time $700,000). The Commission's analysis of this apparent *ex post facto* justification indicates that three months' operating capital is an overly conservative safety margin for a heavily Medicaid-funded clinic with a steady non-cyclical flow of revenues and virtually no bad debt expectations.

reserve after purchase and rehabilitation outlays.

Advance of Monies to Real Estate Entities

While NYPCC claimed to lack funds to purchase its own building, ironically the Commission also found instances where NYPCC loaned agency funds to the for-profit partnership of the three senior executives and their children to acquire or improve the Hendrix Street property. These loans appear to violate the N-PCL.[8]

The first advance occurred on November 25, 1985, when NYPCC prepaid $30,000 in rent on the Jamaica Avenue properties to the partnership. The rent funds were then used by the partnership as a down payment to purchase the Hendrix Street building at a time when the partnership lacked the funds required to make the down payment. Dr. Finn confirmed that the money was used as a down payment, and that the prepaid rent was "for the convenience of the real estate corporation because they didn't have the money, while the agency had plenty of cash."

Other advances occurred during a three-month period from August to October 1986. NYPCC made $25,000 in payments to Future Mechanical Corp., which was hired by the partnership to renovate the Hendrix Street property. Dr. Finn said the assistant executive director (also a member of the realty partnership) paid the bills by "mistake," and, in November 1986, when the agency's accountant found the error, NYPCC was reimbursed.

Rental of Properties to NYPCC

The officers of NYPCC have been leasing property from their own real estate partnership to NYPCC. And, because of this interlocking association, the not-for-profit corporation actually functioned as a source of profit-making for the operators and their families.

220-05 Jamaica Avenue Property

The 220-05 Jamaica Avenue property is a two-story building which houses NYPCC's administrative offices and a continuing treatment program. The building has an estimated gross office area of 6,000 square feet and a 2,000 square foot basement used by NYPCC for storage.

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8 §716 of the N-PCL prohibits loans to be made by a corporation "to its directors or officers, or to any other corporation, firm, association or other entity in which one or more of its directors or officers are directors or officers or hold a substantial financial interest."

NYPCC entered into a ten-year lease with the landlord corporation (controlled by the families of NYPCC executives) on March 15, 1985. The provisions of the lease called for the building to be rented at an annual cost of $120,000, with increases tied to the annual increase in the Consumer Price Index. The "net net" lease required NYPCC to pay for all landlord expenses, including property taxes.[9]

The Commission finds that the rent paid by NYPCC for this property in this non-arm's-length transaction, where both ends were controlled by the same parties,[10] was grossly inflated for two reasons:

- NYPCC was paying prime rent for the property even though, as discussed earlier (pp. 11-12), NYPCC said banks would not provide a mortgage on the property, in part because it was in a "depressed area." Yet, NYPCC's board president states, in a reply to the Commission, that "at Jamaica Avenue the upper floor (very prime office space) was rented at $18.50 per square foot, the street level (very good quality clinical space) at $15.00 per square foot, and the basement at $6.00 per square foot."

- In 1987, when NYPCC purchased the premises from the landlord, it had an appraisal done to determine the market value of the building. The appraisal reflected that, when expenses NYPCC was paying related to the premises are deducted (e.g., taxes, utilities, maintenance), the market rent should be only one-half what NYPCC was paying in 1987.

Hendrix Street Property

The Hendrix Street property is a two-story, school-type structure which houses NYPCC's East New York continuing treatment program. The building contains 7,595 square feet of space above ground and a finished basement of approximately 3,798 square feet, which has been approved for use in the continuing treatment program.

NYPCC entered into a ten-year lease with the limited partnership on August 1, 1986. This "net net" lease provided for an

9 Property taxes paid for the 29 months the building was leased totaled $23,501. If NYPCC purchased this building directly, these taxes would not have been required because of its tax-exempt status. Thus again, NYPCC, a not-for-profit corporation, was used as an instrument to profit by enabling the officers' business to avoid the payment of taxes, while saddling the not-for-profit corporation with an unnecessary expense.

10 The March 15, 1985 lease was signed by Harold Finn as landlord and Isidore Klein as tenant. A building purchase rider attached to this lease was signed for the landlord by Jack Schnee. Officials reply that "the rental levels were based upon negotiations conducted between the board and 220-05 Jamaica Avenue Associates on the basis of considerable information available concerning rental values." However, board minutes do not mention any review or approval by the board of the property lease or purchase option.

annual rent of $108,000, to be increased yearly based on increases in the Consumer Price Index.[11] NYPCC leased this property from August 1986 to November 1987 at a total cost of $139,162.[12]

The Commission believes that the rent charged to NYPCC was unfair for the following reasons:

- In June 1986, the previous owners of the building had an appraisal to determine its market value. This appraisal estimated that the net income expected from the property would only be $36,161 annually. The partnership, controlled by the officers of NYPCC and their families, received over three times this amount.

- In September 1987, as a precondition to NYPCC purchasing the building from the partnership, NYPCC's appraiser estimated the property yielding a net income of $46,153, or about one-half the amount which the agency was paying.

The Commission estimates, based on the agency's own property appraisals, that the partnership overcharged NYPCC between $125,000 to $165,000 in rent on the two properties.

Sale of Properties to NYPCC

On August 13, 1987 and on November 11, 1987, 220-05 Jamaica Avenue Associates sold to NYPCC the properties the agency had been leasing at 220-05 Jamaica Avenue and 394 Hendrix Street. Aside from the $439,237 in rental return received by the landlord entities from leasing these properties, the landlord, in just over three years, realized a $284,432[13] capital gain on the sale of these properties, as shown in the table on the following page.

Rental Profits, Capital Gain, and Return to the Landlord

The partners' return on their $10,000 combined investment in 220-05 Jamaica Avenue Associates was $491,692,[14] or 4,917 percent, over a period of three years and two months. Ninety-nine (99) percent ($486,775) of these profits were distributed to the officers' children, while the remaining 1 percent ($4,917) was returned to the general partner.

Not included above are returns, through interest payments of $212,763, to two NYPCC officials from loans made to the limited partnership.

From October 4, 1984 to August 13, 1987, Dr. Harold Finn loaned Jamaica Avenue Associates varying amounts ranging from $160,000 to $640,000. Dr. Finn said he obtained the money for this loan from his personal retirement trust account. Monthly, the partnership paid interest on the balance at annual rates of 15

11 The lease was signed by Harold Finn as landlord and Isidore Klein as tenant. A building purchase rider was signed for the landlord by Jack Schnee. Board minutes do not mention any review or approval by the board of the lease or purchase option.

12 In addition, NYPCC paid real estate taxes on this building totaling $3,952 for the 15 months leased.

13 The book gain to the partnership is actually $361,825, because depreciation expenses of $77,393 reduces the cost basis of the properties to the landlord.

14 The Commission estimates that a personal tax credit amounting to $17,319 was obtained in addition to this return.

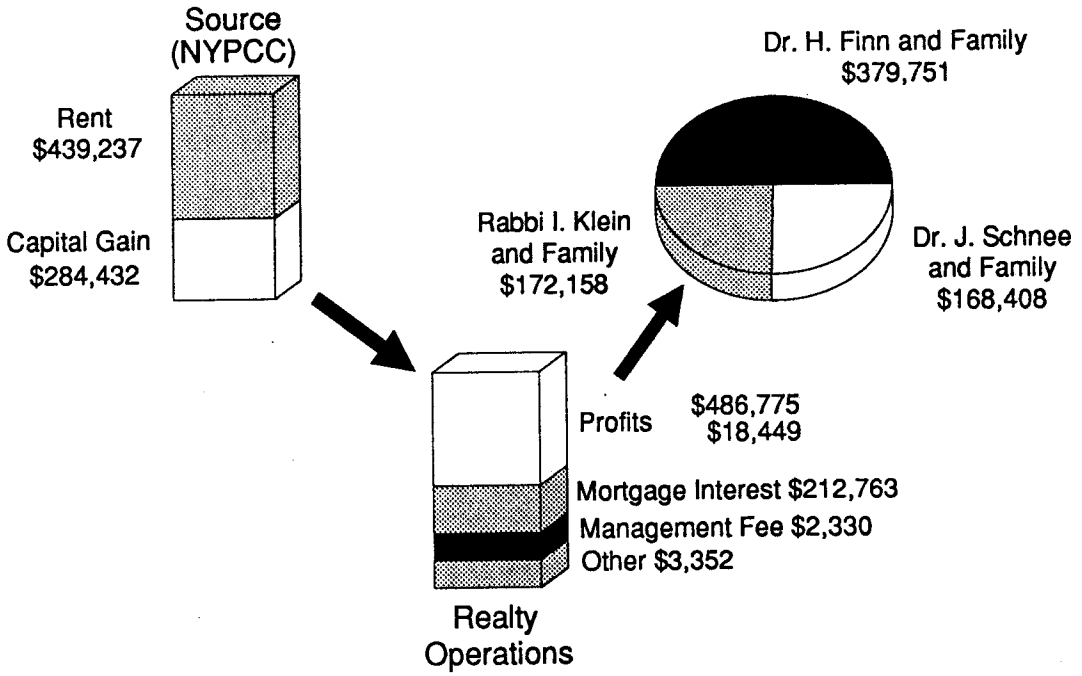
	Jamaica Avenue	Hendrix Street	Total
Proceeds from sales	$682,244	$378,480	$1,060,724*
Acquisition costs	145,891	351,334	497,225**
Renovations	216,485	62,582	279,067
Cost Basis	$362,376	$413,916	$776,292
Cash Capital Gain (Loss)	$319,868	($35,436)	$284,432

* The sale prices were based on market value appraisals of these two properties by Ray Brower Associates. The net proceeds reflect a reduction of $4,276 for title search costs paid by the limited partnership.

** The acquisition costs do not include $70,176 for costs the tenant was responsible for under the "net net" lease. These include the architect's fee ($8,000), new roofing ($5,660), plumbing ($19,518), carpeting ($19,749), and other ($17,249).

percent through 1986, and an average of 13.5 percent for 1987. The mortgage agreement between Dr. Finn and the Jamaica Avenue Associates called for interest payments at a rate of 2.5 points above prime. Dr. Finn received a total of $209,013 in interest income from his loan to Jamaica Avenue Associates. However, we estimate that Dr. Finn received interest at a rate as high as 7.5 percent above prime. Rental funds from NYPCC, which paid for expenses of the landlord, did not change with variations in the prime rate. It appears, therefore, that Dr. Finn received an advantage from de-

Chart V
Real Estate Return



clining interest rates at the expense of the partnership.

Elliott Klein also loaned the partnership $30,000 from November 3, 1986 to November 16, 1987, and was paid interest at a 12 percent annual rate amounting to $3,750.

The shareholders in 220-05 Jamaica Avenue Realty Corporation earned $18,449, or 154 percent, on their $12,000 investment. These profits do not include a $2,330 management fee expense paid in 1986 to Judith Finn, wife of Dr. Finn.

The return to NYPCC principals and their families from the lease and sale of properties, through related real estate entities, is summarized in Chart V.

Given the lack of evidence of board oversight and approval of the property lease and purchase option, and questionable need for the executives' financial assistance in purchasing these properties which permitted profits of $439,237 from rental payments and $284,432 in capital gain derived from executives' self-dealings, these transactions appear to represent a wrongful conversion of NYPCC's assets into personal assets, and might be voidable and recoverable under the N-PCL.

Donation of Agency Assets

For the years 1983 to 1987, NYPCC donated a total of $407,305 to 40 mostly religious and charitable organizations. The majority of these funds (86 percent), however, were donated to four agencies: the Jewish Center for Special Education ($132,000), the P.E.F. Israel Endowment Fund ($103,000), the Sh'or Yoshuv Rabbinical College ($79,150), and the Yeshiva Ateret Zvi ($37,700).

The Commission finds the following with respect to these donations:

- The corporate charter permits charitable donations as does the N-PCL. However, the law requires that such decisions require the clear authorization by the board of directors.
- There appears to have been no real independent board of directors' oversight of where funds were donated, or how much was donated.
- Donations were made at a time when the agency was seeking to obtain a mortgage to purchase real estate and claimed it was unable to do so because of lack of funds.
- $103,000 has been donated to the P.E.F. Israel Endowment Fund, which exclusively benefits organizations in the state of Israel. This raises questions of whether this was within the powers expressed in NYPCC's corporate charter, or faithful to its spirit and intent to operate outpatient clinics, and, if so, whether such practices should be limited by the operating certificate itself pursuant to Section 31.05 of the Mental Hygiene Law.
- Organizations with which Rabbi Klein is involved are recipients: the Jewish Center for Special Education, the Sh'or Yoshuv Rabbinical College, and the Yeshiva Ateret Zvi. A 1985 publication of Sh'or Yoshuv, which honored Rabbi Klein, stated that he was actively involved in the Jewish Center and the Yeshiva and that his children were then attending Sh'or Yoshuv. Also, a 1987 publication by Sh'or

Yoshuv lists Rabbi Klein as a director of the Rabbinical College.

- $7,250 of agency funds were donated to Congregation Shaaray Tefila, where Rabbi Klein is a director.

Executive Director Klein stated that the agency has an "informal" donation committee that decides where funds will be contributed. He said the committee was comprised of himself, the board president, and a board member. He also said that, because the committee was informal, no minutes of meetings were kept. This committee appears illegal under §712 of the N-PCL, since committee creation requires a recorded majority vote by the board, a specific delegation of powers to it, and the appointment of at least three board members to the committee to act on behalf of the board.[15]

The agency attempts also to decouple the connection between such donations and its Medicaid receipts by noting that it had sufficient non-Medicaid income from private patients and investment income (largely the result of surpluses from Medicaid operations) to cover the donation outlays.

Apparent Medicaid Abuse

Group Visits

The Commission's investigation has found that the agency, through its outpatient clinic programs co-located with adult homes, has been improperly billing the Medicaid program by failing to distinguish group therapy visits from 30-minute individualized clinic visits. The former service gets a much lower Medicaid reimbursement rate. The improper claims resulted when the agency aggregated two or more group therapy sessions and claimed them as 30-minute individual sessions.[16] The Commission estimates that, from January 1, 1986 to August 31, 1987, the agency improperly

15 NYPCC's board president told the Commission that, based on the Commission's findings, the board formed a properly constituted donations committee consisting of two other board members and himself. According to the June 22, 1988 board minutes, the committee would render reports to the full board on a quarterly basis. Rabbi Klein will act as a consultant to this committee.

16 NYPCC contends it can aggregate group sessions and bill them as regular clinic visits since OMH approved this practice for the Post Graduate Center for Mental Health; and, on June 10, 1987, when NYPCC met with OMH officials on this billing approach, OMH never disapproved (nor approved) this practice. Accordingly, NYPCC continued the questionable billing practice, and claims it notified OMH that it was doing so in a June 1, 1987 letter to OMH. There are, however, three substantial discrepancies which seem to contradict this position, as follows:

- NYPCC began its group billing practice on February 1, 1986, some sixteen months before writing to OMH for approval.
- OMH acknowledges that it did meet with NYPCC officials on June 10, 1987 on this billing issue, but apparently kept no notes of the meeting, did not have in its files a copy of the June 1, 1987 letter from NYPCC, and was never pressed for a formal response on the issues by NYPCC officials subsequent to the letter and meeting.
- OMH documents point out that it is unlikely that it would have given NYPCC officials approval to bill group visits as full clinic visits since the 1984 Post Graduate determination was based on a unique situation and it was never intended as a systemwide billing policy.

charged the Medicaid program almost $1.0 million by this practice. (This estimate rises to $1.2 million when annualized for the remainder of 1987.)

The OMH regulatory requirement in 14 NYCRR 579 specifically states that, except for crisis services, only one visit for an outpatient program for the mentally ill is reimbursable per patient, per day, regardless of the number of services provided or the number of outpatient programs in which the patient participates.

The rate of reimbursement for a regular clinic visit is substantially higher than the rate for a group visit, and must involve only one patient and one or more clinical staff. A group therapy session is billed at $18.55 for each patient in attendance at a group for at least 50 minutes. A regular clinic visit is billed at $53.00 per patient and shall be at least 30 minutes.

The Commission reviewed a statistically valid sample of 382 Medicaid-reimbursed regular visit claims submitted by NYPCC's three adult home clinics during the 20-month period. The sample included 267 different adult home residents who received clinic services. The total amount claimed for the three clinics during this period was $4,138,565. The sample resulted in the following:

- Of the 382 regular clinic visits reimbursed, in 135 instances there were no regular clinic visits at all, merely group sessions which were misreported as individual sessions.
- Two of the claims could not be supported because there was no documentation that any service was provided.

Based on this sample, we estimate that NYPCC inappropriately claimed $971,664 in excess reimbursement during the 20-month period. This equates to 23.5 percent of the total amount paid to NYPCC for regular visits at the adult home clinics.[17]

Unlicensed Clinic Site

From 1980 to 1985, NYPCC operated a clinic program, which was never licensed by OMH, at the New Homestead Home for Adults .

The program began in August 1980 as an outreach service of the Leben Adult Home clinic. According to a letter from Dr. Schnee to OMH, the program was to provide services to "approximately twenty of the home's one hundred-sixty residents" and operate "two days a week." Prior to its opening, Dr. Schnee contacted Mr. William Yates, OMH's Regional Director of Certification,[18] to determine whether NYPCC was required to obtain a separate operating certificate for this program. In separate letters dated June 2, 1980 and July 2, 1980, Mr. Yates informed Dr. Schnee that "Outreach services may be offered as requested under your existing facility operating certificate. A new application need not be filed for a limited outreach service. However, since this is a PPHA you may not exceed a maximum of 25 patients without filing

17 Since a group session is reimbursable, the amount inappropriately claimed is the difference between the $53.00 regular clinic rate and $18.55 group rate.

18 Mr. Yates is no longer with OMH. In 1986 and 1987, he provided consulting services to NYPCC.

an Application for [new program] Establishment/Construction under Part 51 of the Commissioner's Regulations," and "prior approval must be granted by the Office of Mental Health before the service becomes operational." Subsequent to these letters, the Commission was unable to find any documentation by OMH approving the program.

In April 1983, the Leben Home clinic was recertified. This certification approved of NYPCC operating satellite locations at the Leben Home and at the Sanford Home. No approval was given, nor was there any mention of any program at the New Homestead Home.[19] The Commission could not locate any further documentation concerning the New Homestead program until September of 1984, when OMH was notified by the Department of Social Services that an anonymous complainant called its Medicaid Fraud and Abuse Hotline claiming that services were being provided at the New Homestead Home without OMH's knowledge or approval. Based on this referral and a review of the situation, OMH concluded, in October 1984, that the "Homestead Home for Adults in Kew Garden Hills is not authorized as a location by the Office of Mental Health." In May 1985, NYPCC discontinued its clinic operation at the New Homestead Home. According to a letter from Dr. Finn to OMH's Regional Office, the "satellite treatment program" was discontinued because the owner asked the clinic to leave due to the "presence of psychiatric patients in the Home interferes with his ability to attract non-psychiatric patients in his Home."

According to OMH regulation (14 NYCRR 585.5 (g)(6)), "A satellite location that provides the full range of services . . . or operates more than 25 hours per week, or operates more than two days per week on a full-time basis, shall constitute a separate outpatient program which must receive a separate operating certificate." The Commission learned from the administrator of the New Homestead Home that NYPCC had provided group therapy and individual counseling services to clients at the New Homestead Home. Although NYPCC officials claimed that they were unable to locate all documentation supporting billings to the Medicaid program, we were able to identify from the MMIS system that, from 1983 to 1985, 113 clients at the New Homestead Home received services from NYPCC that were billed to the Medicaid program. Additionally, the Home's administrator confirmed that NYPCC's clinic was open five days a week, with services being provided each day and sometimes during the evening. He also confirmed that one social worker was assigned to the program at least 40 hours a week, and that a psychiatrist saw clients one day a week.

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19 OMH said that approval of this clinic as a satellite location was prior to new OMH Part 585/579 regulations. When these new regulations were established, effective April 1, 1983, the NYPCC programs were reviewed and the New Homestead satellite location was not part of the OMH license to NYPCC. OMH concludes that it seems clear that, between April 1, 1983 and May 17, 1985, when the satellite location was terminated, the New Homestead site operated without OMH approval. NYPCC's board president said OMH never communicated this position to NYPCC.

The total amount inappropriately billed to Medicaid for services provided at this unlicensed site by NYPCC was $252,933.

Abdication by the Board of its Fiduciary Responsibilities

Under Article 7 of the N-PCL, directors of a not-for-profit agency stand in a fiduciary relationship to the corporation, and are obliged to exercise good faith in dealing with the corporation's fiscal affairs.

At NYPCC, the board acted improperly by its appointment of the corporation's auditor as a director and, later, as president of the board. The board also failed to exercise ordinary care and judgment in overseeing agency finances, in fixing compensation for its corporate officers, through failing to appoint a treasurer while allowing agency Medical Co-Director Dr. Finn to personally invest agency funds, by not carefully scrutinizing dealings in real estate by agency officers, and by failing to have appropriate control over funds donated to charitable organizations.[20]

Appointment of Accountant to Board

The board acted improperly by appointing its licensed public accountant as a director while at the same time retaining the accountant as auditor of the corporation's financial statements. State regulations (8 NYCRR 29.10 and 14 NYCRR 585.6) require that an independent accountant not be or have been a director or be a member of a governing board.

- At its March 11, 1984 meeting, the board appointed Mr. Norman Eiger, the corporation's outside public accountant, as a director. At its September 23, 1984 meeting, the board elected Mr. Eiger as its president, while continuing to retain him as the corporation's outside auditor. The board relied on Mr. Eiger's audit opinions during and after his departure from the board on March 26, 1986, although he was not independent of the corporation and was prohibited by State regulation from issuing opinions on the corporation's financial condition.[21]

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20 NYPCC's board president said it is the board that passes on all of the major decisions concerning the overall operation of NYPCC. The authority of the senior executives does not exceed that of the board, nor do they control the board's decisions. It is the board which sets salary levels of the senior executive staff and makes decisions on whether to rent or purchase property. To the extent that board minutes do not reflect the decisions of the board, he said the board was guilty of sparse record keeping.

21 *See, infra,* Discussion at pp. 23-24.

Failure to Oversee Agency Finances

During the Commission's review period, the board never had an independent audit of its finances. OMH regulation (14 NYCRR 585.7) specifically states that the agency must have an annual audit by an independent certified public accountant.[22] Consequently, the board could not have been fully informed concerning the corporation's financial condition. Also, the board did not exercise reasonable care to fix and adjust the compensation paid to the corporate officers.

- The actual compensation paid to the NYPCC officers was significantly out of line with similar individuals in comparable agencies.
- The salaries of the executives for 1988 were frozen by the board in December 1987, but provision was made for year-end bonuses based on the "financial success of the agency and the performance of the executives."

No Board Treasurer

The board has not had a treasurer since September 26, 1985 to oversee the corporation's finances and to assist in the preparation of the annual financial statements. Prior to this time, the treasurer was the wife of Medical Co-Director Jack Schnee.

- The bylaws state that the treasurer is responsible for the general care and custody of all the corporation's funds. The Medical Co-Director, Dr. Finn, had sole custody to invest over one-half million dollars of agency funds. He did this while seeking a mortgage for the agency and, subsequently, while acting as prime financier for the limited partnership that acquired, leased, and sold properties to the agency.[23]

Lack of Careful Scrutiny of Officers' Self-Dealing in Real Estate

Section 509 of the N-PCL requires a two-thirds vote of the entire board for the purchase, lease, or sale of its property. The Commission finds no evidence or board minutes that the board of directors properly reviewed or approved realty leases, or was fully aware of senior executive involvement in the acquisition and eventual sale of properties to the corporation.

- The minutes do not mention any inquiry by the board concerning the agency's ability to initially purchase rather than lease the 220-05 Jamaica Avenue property, or approval of the $30,000 advance to the limited partnership for the down payment on the

22 In response to the Commission's inquiry concerning this requirement, NYPCC engaged the CPA firm of Loeb & Troper to audit its 1987 financial statements. *See, infra,* Discussion at p. 24.

23 While examining the building fund's monthly statements from E.F. Hutton & Co., made out to NYPCC c/o Harold Finn, it was noted that, on July 6, 1984, bond certificates, valued at approximately $186,000, were withdrawn from the account and not returned until September 21, 1984. Dr. Finn said that during this time he had the bonds in his personal possession and was attempting to use them as collateral to obtain a mortgage for NYPCC's purchase of the 220-05 Jamaica Avenue property.

Hendrix Street property. The board had previously established a fund to purchase buildings, and the corporation could have had sufficient funds from this and other sources to purchase the properties at that time.[24]

- The minutes do not mention any review or approval by the board of the property leases. Such review would have disclosed to the board the signatures of Harold Finn or Isidore Klein, as representatives of the lesser organization, and the interests of the corporate officers to the transactions, compelling it to act on such a conflict of interest in their fiduciary capacity.

- The minutes do not document any inquiry by the board regarding the related-party interests of the corporate officers in the 220-05 Jamaica Avenue property, or the $319,868 profit the corporate officers realized from the sale of this building to the corporation.

Wrongful Dissipation of Agency Assets

The board failed in its fiduciary responsibility to protect the funds of the corporation. Large sums were donated to charitable organizations, without board authorization, at a time when the agency also claimed it did not have sufficient funds to acquire property needed to support its programs. Other donations were made to an organization in the state of Israel, despite the intent of the board to allocate contributions to "local charitable causes."

- Since 1983, the corporation donated $407,305 to mostly religious-affiliated organizations. Although contribution expenses were reported on the NYPCC financial statements, the minutes do not document any inquiry or discussion by the board relating to these expenditures.

- Donations were decided by an informal committee of three, which included the board president, one other director, and the executive director. The board did not require the committee to report to it concerning the donations made. Moreover, Article 7 of the N-PCL requires at least three board members to serve on such committees.

Professional Misconduct by NYPCC Accountants

The agency's licensed Public Accountant, Norman Eiger, appears to have violated numerous regulatory provisions (8 NYCRR 29.10) regarding the practice of public accountancy. Violations in the areas of independence, fieldwork, and reporting were noted. Mr. Eiger impaired his independence when he served on the board from March 11, 1984 until March 26, 1986. During this time, he issued audit opinions on the agency's 1983 and 1984 financial statements. After resigning from the board, he issued an audit opinion on the 1986 financial statements. Mr. Eiger also impaired his independence by being involved in agency management decisions. For example, he chose the insurance company to handle the deferred compensation package paid to the executive director and the medical co-directors.

24 *See, supra,* Discussion at pp. 11-13.

New York State regulation (8 NYCRR 29.10) requires that licensees comply with generally accepted auditing standards (GAAS) while conducting an audit. Mr. Eiger violated GAAS fieldwork standards by: (1) not documenting, reviewing, and evaluating the agency's internal accounting control system, and (2) failing to obtain sufficient, competent evidential matter through inspection, observation, inquiries and confirmations to provide a reasonable basis for an opinion on the financial statements. His "audit" working papers were essentially nonexistent. The work he did was equivalent to that normally done by a bookkeeper, accountant, or controller, but not of an auditor.

Mr. Eiger violated several GAAS reporting standards by: (1) not expressing in his audit opinions whether or not the NYPCC financial statements conform to generally accepted accounting principles (in fact, they did not conform), (2) not stating whether the current reporting principles are consistent with those of the preceding period, and (3) not providing adequate disclosures in the financial statements. For example, the financial statements prepared by Mr. Eiger contain no footnotes to report or qualify essential facts. As a result, relevant accounting information relating to the agency's operations was not disclosed, such as the related-party leases involving realty entities owned by the NYPCC principals and their families.

In 1988, NYPCC engaged the CPA firm of Loeb & Troper to audit its 1987 financial statements. Although the CPA firm issued an unqualified opinion, the statements omitted information which should have been disclosed. The omissions relating to the rental and purchase of properties from related parties appear to violate State regulation (8 NYCRR 29.10) and professional standards requiring such disclosure.

Under the N-PCL (§717), members of a board of directors may rely upon the financial statements of a corporation represented to them by an independent public or certified public accountant. With this disclosure, unknowing board members can become aware of related-party transactions and other financial matters they are responsible for overseeing. In this regard, a question still remains as to whether all of NYPCC's board members were ever fully aware of what was occurring at this agency.

Summary of Fiscal Impact

The preceding sections trace the flow of transactions concerned with safeguarding the assets of this not-for-profit provider, consistent with practices that are reasonable, necessary, and related to client care. Also reviewed are the integrity of provider practices in billing for Medicaid services, the role of the board of directors that has a fiduciary obligation to the corporation, and the preparation of financial reports consistent with professional standards and State regulations.

It is a conclusion of the Commission that the agency has been operating, in large part, for the private interests of agency officers and their families, to the detriment of the not-for-profit corporation itself. This occurred because the agency's board of directors failed in its fiduciary role to protect the assets of the corporation, and the agency's accountants failed to live up to the standards of their profession.

To place into perspective the annual executives' compensation, real estate gains, donations, questionable revenue collected from improper Medicaid billings, and revenue excesses generated by the State's fee-for-service schedule, see Appendix I.

Regulation and Enforcement

Regulation

The Office of Mental Health plays multiple roles in the delivery of mental health services. It is the largest direct provider of mental health services, operating State institutions, community residential programs, and a variety of outpatient programs and services. It is also responsible for the statewide planning process and for the development of services. It administers much of the funding provided by the State to non-State-operated mental health programs. Finally, it is responsible for issuing operating certificates to non-State-operated programs, for promulgating regulatory standards, and for monitoring provider compliance with the terms of their operating certificates.

Historically, the Office of Mental Health's provider role has overshadowed its other responsibilities. In particular, regulation has been weak. OMH has had difficulty in regularly complying with statutory requirements to visit certified programs at least twice a year. In many instances, programs have continued to operate with expired operating certificates.[25] Beyond this, there are no guidelines to ensure that provider costs are reasonable, necessary, and related to patient care.

Funding for outpatient programs, like mental health clinics, day treatment and continuing treatment programs, is not cost-based, and relies heavily on fixed fees for services provided. There is therefore a perception that examining the manner in which the funds provided are actually spent is not essential, as the level of reimbursement to a provider would neither increase nor decrease under such a fixed fee system. Thus, the State does not usually conduct financial reviews of such programs, nor does it closely scrutinize the audit reports which are required to be prepared by independent certified public accountants.[26]

It needs to be kept in mind, however, that, in a system that relies heavily on not-for-profit corporations to provide services, one of the essential checks is the determination by the Commissioner of Mental Health that an applicant for an operating certificate possesses the requisite character and competence to be granted the privilege to provide services for people who are mentally ill. If provider behavior is not monitored adequately, this initial determination of

25 OMH has been making a concerted effort to reduce its backlog of programs with expired operating certificates. As of July 1989, 84 percent of the State's 951 outpatient programs had current operating certificates, although in New York City only 66 percent were current. Two years previously only 40 percent of 943 programs had current certificates, and, in New York City, only 3 percent were current.

26 In reality, the validity of establishing proper fees rests on knowing the actual expense of quality care. Unless costs are properly analyzed through accurate reporting and audits, there can be no confidence that the fees set are reasonably related to efficiently delivered services.

character and competence becomes a static one, impervious to change no matter how inconsistent with such a determination the provider's subsequent behavior might prove to be.

In this case, closer monitoring of this program's finances might have revealed the substantial profit-making, self-dealing and Medicaid billing irregularities that this report documents, as well as the failure of the agency's board of directors to properly exercise their fiduciary obligations to protect the assets of the corporation. Knowledge of these behaviors, which are more typical of a proprietary corporation than a not-for-profit, may well have provoked a reassessment of the initial determination of "character and competence," even if some of the practices were found not to violate any clear regulatory standard.

The Commission is pleased to note that, as a result of this investigation and its own assessment of the need for strengthened regulation and oversight, the Office of Mental Health is planning to make a number of changes in its monitoring and regulation of programs it certifies:

- Adopting a fiscal audit approach similar to the Commission's, which applies reasonableness tests to provider program costs and give greater scrutiny to related-party transactions.

- Performing audits of several predominately Medicaid-funded providers to see how prevalent, within the outpatient system, are the fiscal problems which the Commission identified at NYPCC.

- Implementing by mid-1991 a new Consolidated Fiscal Reporting (CFR) system to replace the inadequate Year End Expenditure Report (YEER), which providers currently utilize to report their outpatient program expenditures to OMH. The primary objective of the CFR will be to provide a standard methodology for the accurate and uniform reporting of all provider cost and service unit statistics. Unlike the YEER, this report will be certified and required for all outpatient programs, even non-contract funded agencies such as NYPCC.

- Once OMH has collected the CFR data for all providers, it will perform various analyses to measure the cost-effectiveness of its outpatient programs and to determine the best Medicaid rate-setting methodology to use for them.

OMH officials have also formed a work group to address the significant weaknesses in the agency's existing standards and mechanisms for overseeing the programmatic performance of its outpatient programs. This work group will be responsible for:

- Evaluating the adequacy of present certification standards and recommending needed changes.

- Assessing the appropriateness of using performance contracts to increase program accountability.

- Identifying the staffing, training, and protocol issues which OMH must address to improve the effectiveness of its program monitoring activities.

Enforcement

In addition to these structural changes, which are necessarily more long-term efforts, the Commission perceives a need for a stronger commitment to more vigorous enforcement of the regulatory standards which exist. As this case illustrates, even with knowledge of provider practices which violate regulatory standards, there has been a reluctance to invoke enforcement procedures.

As documented in this report, there is reason to believe that the agency submitted improper Medicaid billings in excess of $1 million by billing group visits as individual sessions.[27] In addition, it improperly billed Medicaid for approximately a quarter of a million dollars for services provided at an unlicensed clinic.[28] Although these and other irregularities in the agency's operations were called to the attention of senior OMH officials in October 1988, no enforcement action has been taken by OMH either directly or by referrals to other appropriate State agencies, despite their commitment to do so, and despite repeated inquiries from the Commission in subsequent months.

Without effective enforcement in the face of knowledge of likely regulatory violations, particularly when the money involved has been diverted away from patient care, it will be difficult to engender provider respect for the regulatory system. In the absence of such respect, the regulatory system will remain ineffective.

27 *See, supra,* Discussion at pp. 18-19.
28 *See, supra,* Discussion at pp. 19-21.

Recommendations

1. In the course of this review, the Commission found instances where the not-for-profit agency, because of an allegedly weak financial position, entered into transactions for the leasing and acquisition of facilities which resulted in large profits to the operators and their families. The profits, which totaled $720,317 over about three years, disadvantaged the not-for-profit agency because it was questionable whether NYPCC needed their financial assistance in acquiring or leasing agency properties, or whether the NYPCC board properly approved these transactions. To prevent these questionable types of abuses, the following changes are recommended:

- §41.46 of the Mental Hygiene Law should be amended to require officers and employees, in addition to board members as is now required, to disclose in writing to the board of directors and to the appropriate mental hygiene commissioner any interest in the purchase, lease, rehabilitation, or improvement of real property used or to be used by the licensed mental hygiene agency.

- Upon notice to the mental hygiene commissioner, prior approval of public funding related to the property should be made contingent on a requirement that, within available appropriations, all such mental hygiene facilities be acquired or improved by the not-for-profit agency through tax-exempt bonds and notes issued by the New York Medical Care Facilities Finance Agency (MCFFA). This requirement would advantage the licensed agency by allowing low cost financing for direct ownership thereby eliminating the types of profit-making abuses surfaced in this report.

2. The Commissioner of Mental Health should propose changes in law and regulation to clearly establish the privity relationship between a licensed mental hygiene agency's certified public accountant and the State licensing and funding agencies. This would remove any doubt as to the accountant's liability for negligence stemming from the accuracy of the accountant's audit work and reports, and the State agency which relied on that work product.

3. The Commissioners of Mental Health and Social Services should seek to recoup the Medicaid funds improperly received by NYPCC through the operation of an unlicensed clinic and billing of aggregated group therapy sessions as 30-minute individual therapy sessions.

4. The Commissioner of Mental Health should request the State Attorney General to examine the N-PCL violations and determine appropriate remedies.

Appendix I

New York Psychotherapy and Counseling Center
Five-Year Revenue, Expense, Profit,
Executive Remuneration, and Donations Summary

New York Psychotherapy and Counseling Center
Five-Year Revenue, Expense, Profit, Executive Remuneration, and Donations Summary

	1983	1984	1985	1986	1987	Total
Actual revenue	$2,300,856	$2,733,739	$2,951,143	$3,901,195	$5,092,920	$16,979,853
Actual expenses	2,006,649	2,470,465	2,880,733	3,576,315	4,136,378	15,070,540
Actual net profit	294,207	263,274	70,410	324,880	956,542	1,909,313
Accounting adjustment*				380,958		380,958
Adjusted profit	294,207	263,274	70,410	705,838	956,542	2,290,271
Questionable revenue						
New Homestead clinic	83,262	109,356	60,315			252,933
Group billings				562,017	650,066	1,212,083
Net adjusted profit	$210,945	$153,918	$10,095	$143,821	$306,476	$825,255
Executive compensation and benefits**	$416,122	$599,751	$671,269	$644,835	$631,672	$2,963,649
Real estate gains			140,000	119,500	460,817	720,317
Donations	57,500	85,100	108,755	67,100	88,850	407,305
Total	$473,622	$684,851	$920,024	$831,435	$1,181,339	$4,091,271

* Fund balance increase of $380,958 related to a change from the cash basis to the accrual basis of accounting on December 31, 1986.

** 1987 split-dollar life insurance benefit calculated at an opportunity cost of $11,500; automobile expense includes business and personal usage.

Appendix II

Letters:

1) Draft Report Transmittal Letter to the Office of Mental Health
2) Response from the Office of Mental Health

STATE OF NEW YORK
COMMISSION ON QUALITY OF CARE
FOR THE MENTALLY DISABLED
99 WASHINGTON AVENUE, SUITE 1002
ALBANY, NEW YORK 12210
(518) 473-4090
(TDD) 473-7871

CLARENCE J. SUNDRAM
CHAIRMAN

JAMES A. CASHEN
IRENE L. PLATT
COMMISSIONERS

October 25, 1989

Dr. Richard C. Surles
Commissioner
Office of Mental Health
44 Holland Avenue
Albany, NY 12229

Dear Dr. Surles:

Approximately one year ago, the Commission met with your senior staff to apprise them on the findings of our review of the New York Psychotherapy and Counseling Center (NYPCC). At that time, we provided your office with a preliminary draft of our investigative findings.

The Office of Mental Health indicated at that time that certification reviews would be conducted and that issues pertaining to compliance with the Not-For-Profit Corporation Law and improper Medicaid billing practices would be referred to the Attorney General's Office. The Commission is aware that certification reviews have been conducted but, to the best our knowledge, there has been no follow-up on the expressed intent to refer other matters to the Attorney General's attention.

In the interim, Commission staff have met with representatives of NYPCC to discuss their responses to our draft report. Copies of agency responses dated January 20, 1989 and May 10, 1989 were forwarded to your office by the Commission and by the agency itself.

I enclose for your review and comment a draft of the Commission's final report in this matter. The Commission is particularly interested in knowing what actions OMH intends to

take regarding the irregularities in Medicaid billings of approximately $1.4 million, as well as regarding the pending applications for expansion of the outpatient programs operated by NYPCC.

The Commission would appreciate a response from the Office of Mental Health by November 15.

Sincerely,

Clarence J. Sundram
Chairman

Enclosure

NEW YORK STATE
OFFICE OF MENTAL HEALTH
44 Holland Avenue, Albany, New York 12229

RICHARD C. SURLES, Ph.D., Commissioner

December 7, 1989

Clarence J. Sundram
Chairman
New York State Commission on Quality of
Care for the Mentally Disabled
99 Washington Avenue, Suite 1002
Albany, NY 12210

Dear Mr. Sundram:

Thank you for the opportunity to review the draft of the Commission's final report regarding New York Psychotherapy and Counseling Center (NYPCC).

Our analysis of the Commission's findings and the responses from the agency indicate that there is little disagreement concerning the facts depicted in the report. Disputed issues relate to interpretation of law and regulations or to agency motives. However, the following actions appear warranted at this time:

1. The allegations, as documented in the report are serious enough in relation to NYPCC's behavior as a Not-For-Profit corporation for the OMH to refer your report to the attorney General's Office. Although we had formerly discussed doing this on a joint basis, we will initiate the process.

2. We are requesting the Department of Social Services' participation with OMH in a joint review of the agency's billing and general financial practices. We note however, that DSS audited the Medicaid bills submitted by NYPCC from 1983-1986, and that the agency sustained inconsequential audit recoupments. We believe that clarification from OMH concerning billing guidelines will justify further joint efforts.

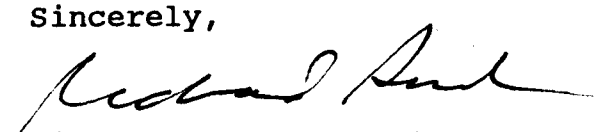
3. In order for OMH to perform an in-depth analysis we request an opportunity for our staff to review notes and baseline information collected during CQC's investigation. Accordingly, Mr. Larry Chase, OMH's Director of Inspection and Certification, will contact your staff shortly to discuss suitable arrangements.

We appreciate acknowledgement in the draft report of several OMH initiatives we consider to be critical. These include the development of a fiscal reporting system (the consolidated fiscal report) which will be key in rate setting and monitoring activities. Likewise, a new audit capability within the Quality Assurance Division will undertake in-depth agency reviews of clinical, financial, and program performance issues.

Also, the OMH certification system is essentially "current" for the first time ever. As of November 10, 1989, 96% of all certified inpatient, outpatient, and community residence programs either possessed current operating certificates or had been recently inspected, received deficiency reports, and were not recertified because of the level of type of deficiencies such as non-compliance with 9.39 requirements.

While we are taking actions based upon the draft materials received to date, in the future any required regulatory or other types of actions could be expedited by receiving final materials earlier in the process. We would appreciate receiving a copy of the final report when it is issued, and we will keep you informed on the status of the steps identified above.

Sincerely,



Richard C. Surles, Ph.D.
Commissioner

cc: Sandra L. Forquer, Ph.D.