PSCH, Inc.

An Investigation into Financial Practices and Corporate Governance

New York State Commission on Quality of Care and Advocacy
for Persons with Disabilities

November 2008

Executive Summary

This report describes how Ralph Farkas, the founding executive director of PSCH, a not-for-profit agency serving people with disabilities, used his position to transfer PSCH assets to a related Foundation for his own benefit; declined to reform fiscal practices repeatedly criticized by State certifying agencies; and secured a compensation package which was out of line with those of executive directors of similar agencies. All of these actions were carried out under the eyes of a Board which did not fulfill its fiduciary responsibilities to the agency it was supposed to be overseeing.

Once the Commission on Quality of Care and Advocacy for Persons with Disabilities (CQCAPD) began its investigation at PSCH and certain findings became apparent, the Commission worked closely with the Attorney General's (AG) Office, which began its own review of the agency.

On September 22, 2008, the AG entered into an agreement with PSCH and FSD. [1] The agreement requires PSCH's Board to implement a number of reforms in governance practices, the dissolution of the Foundation for Supporters of the Disabled (FSD) and a settlement with Mr. Farkas. Key provisions relative to Mr. Farkas included the following:

- Mr. Farkas resigned from his position as president and CEO of PSCH effective January 15, 2008. PSCH will not employ Mr. Farkas in any capacity, with or without compensation, including as an officer, director, consultant, or in any other role.
- In connection with Mr. Farkas' resignation, PSCH will pay Mr. Farkas a total of $1,105,000 which reflects accrued vacation and sick leave, severance pay and the cash value of life insurance policies purchased by PSCH for Mr. Farkas.
- Mr. Farkas, in turn, agreed not to receive $657,100, reflecting the value of a deferred compensation account set aside by PSCH for Mr. Farkas, and $226,154, reflecting the value of accrued vacation time that Mr. Farkas claimed in excess of the amount that PSCH agreed (above) to pay him.
- Prior to the execution of the agreement, PSCH received payment from Mr. Farkas totaling $90,000: $15,000 for personal charges made on PSCH's corporate credit card; $25,000 for a "bonus" Mr. Farkas received in 2003 to be used for political contributions; and $50,000 which represented the net cost to a Supplemental Employee Retirement Plan.
- In addition to the amounts noted above, Mr. Farkas also paid $220,000 back to FSD, which represented more than half of the salary Mr. Farkas received from FSD.

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[1] In the Matter of PSCH, Inc. and Foundation for Supporters of the Disabled, Assurance of Discontinuance Pursuant to Executive Law §63(15), New York State Department of Law Charities Bureau, AOD No. 08-109, dated 9/22/2008.

Commission Findings

- PSCH transferred $1.4 million, in apparent violation of Mental Hygiene Law, to a related Foundation – Foundation for Supporters of the Disabled (FSD) – which was controlled by PSCH's executive director, Ralph Farkas. The purpose of FSD was to provide financial assistance to other charitable corporations. However, over an eight-year period, FSD made only three $10,000 grants to other agencies, while Mr. Farkas was paid approximately $405,000 in salary and benefits. The Commission also found that although FSD represented itself as the fundraising arm of PSCH, no funds raised by FSD ever reached PSCH.

- Over the three-year period 2003 to 2005, Mr. Farkas' total compensation was $546,221, $671,502 and $730,769 respectively. When compared to like-sized agencies providing similar services, Mr. Farkas' compensation was 250 percent higher than the mean of the other agencies.

- PSCH's largest food vendor – Trooper Foods – was charging the agency above market prices for various food items when compared to other vendors that PSCH used. Prices ranged from market price to more than 137% of what other vendors were charging PSCH. Trooper Foods was paid approximately $800,000 annually, or about one-third the total food expense incurred by PSCH. The Commission found that Trooper Foods was the largest single donor to the FSD. The wife of one of the principals of Trooper Foods was on the FSD Board, and the Trooper principal was convicted in 1999 for conspiracy related to a bid-rigging and price-fixing scheme involving another not-for-profit corporation.

- PSCH's Board of Directors violated its fiduciary duty by approving compensation for the executive director which was not comparable to that paid to executive directors of similar agencies; allowing the agency to transfer assets to FSD without proper approval from the State; and not closely monitoring the agency's activities with Trooper Foods.

Upon request from the Attorney General's Office, the Commission did not send its draft report to PSCH's Board of Directors until June 5, 2008. The Board responded to the draft report on July 10, 2008 and those responses are summarized in the report. For the most part, the Board agreed with the Commission's findings.

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Introduction/Scope of Review

The Commission's review of PSCH, Inc. began in the summer of 2006 when it received a complaint alleging the misuse of agency funds. Specifically, the complainant alleged that a related "charity or private foundation" established by the executive director and which was supposed to help people with disabilities was, in reality, being used for his personal benefit and that PSCH was paying its executive director an excessive compensation. The Commission conducted an investigation into the allegations, and a limited review of agency expenditures for the three-year period July 1, 2003 to June 30, 2006. The results of that review follow.

Background

PSCH is a provider of both mental health and developmental disabilities services and is licensed or has contracts with the NYS Office of Mental Retardation and Developmental Disabilities (OMRDD), the NYS Office of Mental Health (OMH) and the NYS Department of Health (DOH). It is headquartered at 22-44 119th Street, College Point, New York. PSCH was initially named the Professional Service Center for the Handicapped, Inc. and was incorporated as a Type B corporation pursuant to Section 201 of the Not-for-Profit Corporation Law. On June 26, 1997, the agency officially changed its name to PSCH, Inc. According to its Certificate of Incorporation, the purpose of the agency was to operate and maintain community residential facilities for people with developmental disabilities and mental illness, and to provide programs of "CARE, service, habilitation, rehabilitation, social and recreational activities, or any combination of such programs, in a homelike environment for the developmentally disabled." In addition to its main corporate purpose, PSCH also operates several affiliated corporations. Tender Transport, Inc., a wholly-owned subsidiary of PSCH, was incorporated in 1989 and performs industrial cleaning for various commercial clients, employing the graduates of PSCH, Inc. PSCH-New Jersey, incorporated in 1998, is a not-for-profit agency which operates programs for individuals with developmental disabilities in New Jersey. Astrocare, Inc. is an Article 28 diagnostic and treatment center designed to meet and coordinate the health needs of individuals with developmental disabilities. Astrocare was incorporated in 2001, but did not begin operations until January 2005. For the fiscal year ending June 30, 2005, PSCH's total revenues were about $57.5 million and expenses totaled approximately $53.2 million, reflecting a surplus of $4.3 million. As of June 30, 2005, PSCH had net assets of about $23 million. At the time of the Commission's review, PSCH's founder and president was Ralph Farkas and its Board Chairman was Hiram Rothkrug. Currently, PSCH's president is Alan Weinstock and the Chairperson of its Board is Kristina Romanzi.

PSCH Audit History

The following is a chronology of the State's audit history with PSCH:

- **1984:** An OMH audit cited PSCH for inappropriately claiming $80,580 in undocumented and ineligible expenses for costs incurred under two community residence program development contracts. It also cited PSCH for improperly claiming $24,873 in overtime for the executive director and supervisory staff. OMH recommended that $75,613 be refunded. Included in the audit was a finding that PSCH "has not complied with the requirement to document competitive bidding procedures..."

- **1989:** OMH cited PSCH for inappropriately paying for entertainment expenses for the Board of Directors and meal expenses for the executive director. The audit additionally stated that the agency's executive management was credited with vacation leave time which in OMH's opinion was excessive. PSCH was again cited for not following competitive bidding procedures.

- **1995:** A joint audit conducted by OMH and OMRDD cited PSCH for:

  - excessive executive salaries when compared to similarly sized not-for-profits;
  - excessive vacation and sick days for its executives;
  - reimbursing its executive director for ineligible personal expenses;
  - providing discriminatory whole and life insurance for the executive director and associate executive director and not reporting it on their W-2's;
  - not requiring its executive director to maintain personal use records of provider-owned automobiles and under-reporting the personal use amount on the executive's W-2's;
  - not disclosing all related-party transactions the agency had with certain Board members on the agency-certified financial report which is submitted to the state;
  - inappropriately transferring $158,000 in administrative costs to programs on the agency cost reports.

  PSCH responded to the joint audit stating it "refutes in the strongest terms its purported findings. The Draft Audit Report is so rife with inaccuracies, exaggerations, distortions and improper manipulation of data."

- **1996:** OMRDD conducted a limited review of the personal allowance practices and procedures for PSCH and found no major systemic problems in this area.

1996: OMH and OMRDD entered into discussion with PSCH regarding its $12 million fund balance, half of which was in cash or cash equivalents. PSCH believed the fund balance should equal four to six months of operating expenses. The state contended that one month of operating expenses is sufficient and wanted the agency to develop a long-term plan detailing the spend-down of accumulated funds to improve physical plant and quality of life issues.

- **2003:** An OMRDD limited review found the agency financially viable with close to $15 million in net assets. The review also recommended that PSCH enter into an employment contract with the executive director, as his compensation increased by 36 percent over a three-year period and there was no indication that the Board approved of his compensation.[2] Also, there was no record of Board approval of the use of a corporate credit card by the executive director, certain charges were not supported by vendor invoices and there was no indication that certain charges for meals were business-related.

- **2005:** OMRDD conducted a review of PSCH's Article 16 clinic which provided services paid for by the Medicaid program. The review found instances of missing treatment plans, insufficient documentation related to the location and/or duration of services, and instances where clinicians' time sheets did not support the hours of time spent providing services. OMRDD voided the claims in question and referred the matter to the Attorney General's Office.

Commission Findings

1. Foundation for Supporters of the Disabled (FSD)

One of the allegations which triggered the Commission's review was that PSCH's executive director, Ralph Farkas, established a related not-for-profit corporation which he then used for his personal benefit.

FSD was established on March 25, 1998 as a 501(c)(3) not-for-profit corporation. According to its Certificate of Incorporation, FSD's purpose was "to accept, hold, invest…any gifts, bequests…and property of any sort…and to use, disburse or donate the income or principle thereof for exclusively charitable purposes…to give, convey (etc)…to other organizations." Mr. Farkas told Commission staff that FSD was established as a means to provide funding for new ideas, development, and programs for agencies that provide services for individuals with disabilities. He likened FSD to the NYS Developmental Disabilities Planning Council (DDPC).[3] At the time of the

[2] After completion of the field work in this review, PSCH provided OMRDD with a copy of a board resolution which provided for a 16% increase in the executive director's salary from the previous year.

[3] The NYS DDPC is a federally funded state agency responsible for developing new ways to improve the delivery of services and supports to New Yorkers with developmental disabilities and their families. The Council focuses on community involvement, employment, recreation and housing issues faced by New Yorkers with developmental disabilities and their families. DDPC grant programs fund such activities as: demonstration programs, training for families and staff and outreach to un-served and under-served populations.

Commission’s investigation, FSD’s Board consisted of three members - - Mr. Farkas, Lewis Siegel and Claire Fauci.

The Commission’s review found that FSD was essentially the fundraising arm for PSCH, yet none of the money raised by FSD ever reached PSCH. Rather, during the eight-year period from April 1998 to March 2005, FSD made three $10,000 grants to other agencies while FSD’s president, Ralph Farkas, was paid approximately $405,000 in salary and benefits.

PSCH Response: PSCH takes issue with the Commission’s characterization of FSD as essentially the fundraising arm for PSCH. It states that this was not the fact and supports its conclusion by stating that PSCH was a substantial contributor to FSD, not a recipient of FSD funds.

CQCAPD Reply: The Commission agrees that PSCH did not benefit from FSD’s fundraising. Yet, PSCH represented that FSD was its fundraising arm. For instance, in a February 5, 2003 letter to the Cranwell Resort & Golf Club, where PSCH held its annual Board meetings, PSCH stated that “The Foundation works on behalf of disabled persons and their families to reduce the impact of disability on their lives and is the *fundraising arm of PSCH.*” *Also, in a December 1, 2004 letter to a vendor of one of the fundraising events, FSD stated that it was “the fundraising arm of PSCH.”*

a. Transfer of Agency Assets

In the April 2, 1998 Board minutes, PSCH’s budget and finance committee anticipated a $753,000 deficit for the year ending June 30, 1998. Notwithstanding the projection, two months later (on June 29, 1998), PSCH transferred approximately $1.4 million of agency securities from its Smith Barney investment account to another Smith Barney account in the name of FSD. Transferred were investments in Kodak, Ford Motor Credit, Nations Bank, American Express and U.S. Treasury Notes. The transfer was approved by PSCH’s Board, as reflected in a resolution dated June 23, 1998:

> “Resolved, that the Corporation (PSCH) be authorized and empowered to make a grant to the foundation for Supporters of the Disabled, a 501(c)(3) not for profit corporation, in an amount not to exceed $1,400,000 to be used for such purposes as deemed appropriate by the Foundation with respect to programs or services for individuals with disabilities;”

In October 1998, the PSCH Board met with Mr. Farkas and Mr. Mel Paikoff (Secretary to the FSD Board) to discuss the relationship between PSCH and FSD. According to the October 24, 1998 Board minutes, Messrs. Farkas and Paikoff explained that “FSD is now the sole fundraising source” for PSCH and that it was important for the PSCH Board to cultivate relationships with the business community so that they could offer support to other agencies. Given the substantial donation to FSD, PSCH requested and Mr. Farkas agreed to provide financial reports to PSCH on an annual basis once the Foundation was structured. This never occurred.

The Commission believes that the transfer of PSCH assets to FSD violated the provisions of Mental Hygiene Law §16.32 and §31.31, "No provider of services shall make any charitable contribution of any state moneys, medical assistance payments or social security or supplemental security income or any interest or any other income earned thereon, except as authorized by the commissioner." PSCH had no such authority from the commissioner of either OMH or OMRDD to transfer its funds.

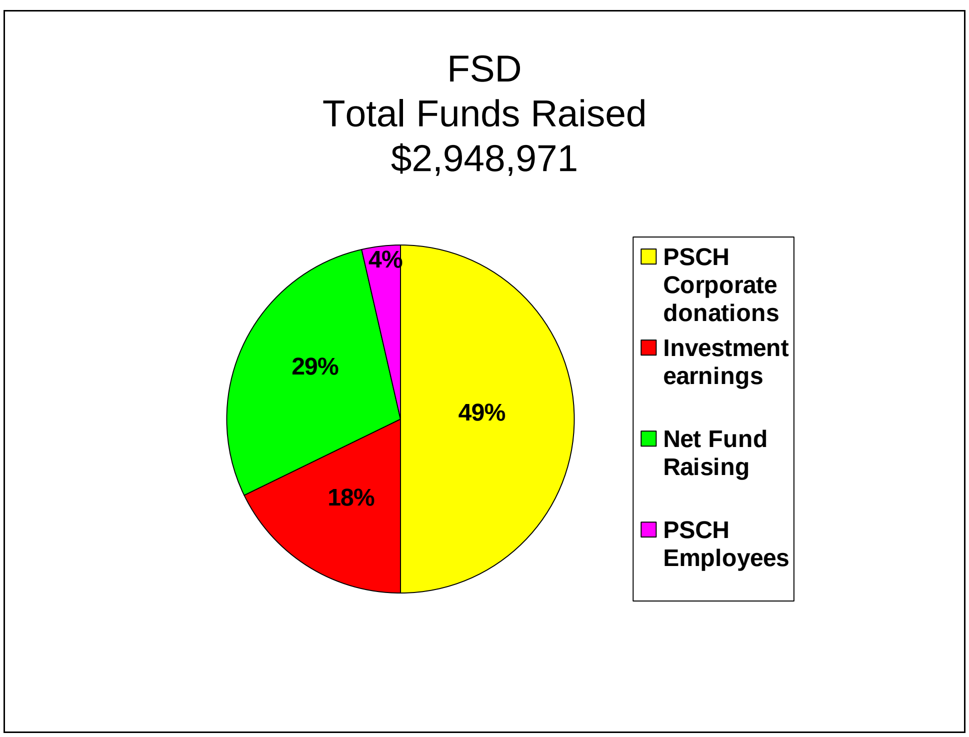
PSCH Response: PSCH does not agree that the transfer was illegal, stating "PSCH conducted its own fundraising prior to the establishment of FSD. In order to comply with the Mental Hygiene Law, PSCH's CFO and PSCH's outside auditors sought to ensure that the amounts contributed to FSD excluded any "state moneys".

CQCAPD Reply: The Commission has not been provided with any report or analysis produced by PSCH which could "ensure" that non-state moneys were exclusively used for the transfer of assets to FSD. Given that more than 90 percent of PSCH's revenues are from government funds, in the absence of such documentation, the Commission does not accept PSCH's assertion that no government funds were part of the transfer to FSD.

b. Corporate Revenue and Expenses

The following chart reflects the sources of funds received by FSD over the eight-year period 1998 to 2005:

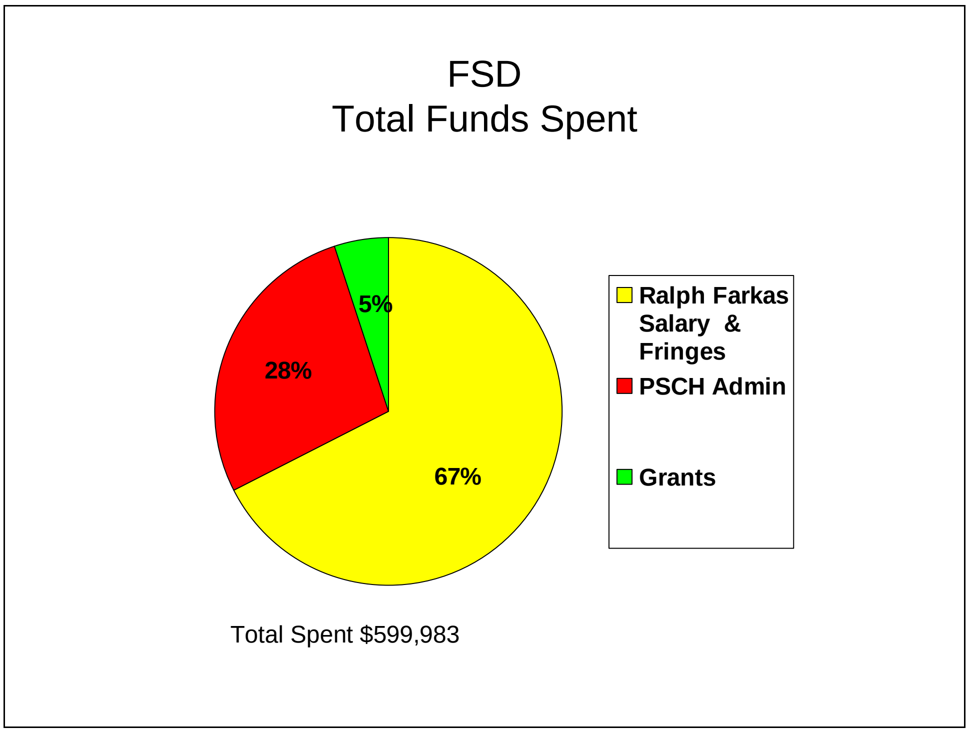
Chart 1.



As illustrated in chart 1, FSD raised slightly under $3.0 million over the eight-year period. The majority of its revenue (49%) was from PSCH itself in the form of the initial transfer of securities in 1998 of $1.4 million and another $75,000 in cash donations over the period. The remaining funds came from FSD's two annual fund-raising events -- a golf outing and a holiday dinner – which are attended primarily by PSCH employees and PSCH vendors. FSD netted about $843,000 or 29% from the two fund-raising events.[4] The remaining funds came from investment earnings ($522,000 or 18%) and donations from PSCH employees ($109,354 or 4% of the total).

Of the close to $3.0 million it has raised since its inception, FSD had only spent about $600,000 or 20% of the total funds available. The remaining $2.4 million remained in an FSD investment account with Smith Barney.[5] The following chart reflects how the $600,000 was spent:

Chart 2.



As illustrated in chart 2, the majority of the funds (67% or $404,863) were spent on Mr. Farkas' salary and benefits. The remaining funds (28% or $165,121) were spent on reimbursing PSCH for administrative costs associated with operating FSD, and only

[4] The top five donors to the fund raising events were: Trooper Foods - $42,100; Pension Actuaries - $41,275; Basit Tariq Ambulance - $31,000; Loeb & Troper CPA's - $28,140; and Levy & Stopol PSCH attorneys - $24,490.

[5] The Smith Barney account is managed by an FSD board member – Lewis Seigel.

5% or $30,000 was spent on the corporate purpose for which FSD was formed – providing grants to other not-for-profit agencies.[6]

The grants were provided as follows:

1. Two grants of $10,000 each were provided on November 15, 2002. The first, to the New York City Outward Bound Center, was to pay for 90 special education students to participate in the Outward Bound adventure activities. Outward Bound's executive director is related to Larry Stopol, PSCH's attorney. The second was provided to the Achilles Track Club, which encourages people with all types of disabilities to participate in distance running.
2. On August 2, 2004, FSD gave one grant of $10,000 to Community Mainstreaming Associates. The funds reportedly enabled the agency to start a Social Enterprise Development Project to get individuals working rather than participating in day programs.

Although FSD was initially incorporated in 1998, it was not until four and one-half years later that its first grants were made. At the time, FSD had net assets of close to $2.0 million (mainly due to the $1.4 million transfer of PSCH assets) and had paid its president, Mr. Farkas, $215,000 in salary and benefits.

In a July 1999 letter soliciting donors for the annual golf and tennis outing, Mr. Farkas stated that FSD was an organization that works with PSCH "to enhance our efforts and expand our services on behalf of people with disabilities." The letter concluded by stating "Remember that while you enjoy a very special day, you have the satisfaction of partnering with PSCH to aid the Foundation's vital work." In another letter to NYS Assembly Speaker Sheldon Silver after the September 11, 2001 World Trade Center tragedy, Mr. Farkas stated that FSD was a "not-for-profit corporation which provides support for people with developmental disabilities and mental illness." Mr. Farkas said that FSD was prepared to issue grants in the amount of $5,000 to $10,000 to organizations offering counseling services to those impacted by the tragedy. At the time of the letter, no grants had ever been made to any organization and no grants were issued as a result of this letter.

c. FSD's Corporate Structure and Board of Directors

Although Mr. Farkas told Commission staff that FSD was a separate corporation and not related to PSCH, the Commission's review has concluded that FSD was closely related and controlled by PSCH based on the following factors:

- When FSD was incorporated in March 1998, two of the three initial directors - Ralph Farkas and David Lurie - were also PSCH Board members.[7]

[6] Subsequent to the Commission's on-site reviews of PSCH's books and records, FSD made three additional grants of $10,000 each to other not-for-profit agencies.

- FSD was controlled by its president, Ralph Farkas, who was the executive director of PSCH.
- FSD was initially funded by PSCH.
- FSD had no offices or staff. Rather, it operated out of PSCH's corporate headquarters and all administrative functions were performed by PSCH staff.
- FSD's "independent" accountant – Ben Milchman – was PSCH's internal auditor and its attorney – Larry Stopol – was PSCH's attorney.
- PSCH had represented that FSD was the "fundraising arm" of PSCH.
- PSCH had a "due to / due from" account on both their respective books, reflecting that they were closely related.

The Commission also found others evidence that FSD was controlled by PSCH and that the Board failed to oversee the corporation:

- FSD only spent five percent of the funds available to it over the past eight years for its corporate purpose. More than two-thirds of the corporation's expenses were for Mr. Farkas' salary and benefits.
- While Mr. Farkas received an annual salary of $55,000 from FSD, it is questionable whether this was ever approved by the FSD Board. The Commission requested all Board minutes related to FSD. The minutes that were initially provided by PSCH officials contained no documentation related to any approval of Mr. Farkas' compensation. When questioned about this, FSD's independent accountant, Ben Milchman, provided the Commission with Board minutes dated May 3, 2000, which reflected the approval of Mr. Farkas' salary at $55,000 per year. The minutes were reportedly found on his personal computer. However, the minutes provided by Mr. Milchman differed from those initially provided by PSCH. Specifically, the minutes provided by Mr. Milchman included an additional sentence that discussed the salary approval. The Milchman minutes were never signed by the Board Secretary, Mel Paikoff, while the minutes provided by PSCH were signed by Mr. Paikoff.
- In 2006, Mr. Farkas' salary temporarily increased from $55,000 to $75,000. When questioned about any Board approval for the increase, Mr. Milchman told Commission staff that the payment was an error that had been corrected.[8] FSD had only one employee – Mr. Farkas – and he was paid only once during the year. Further, it appears that either Mr. Milchman or Mr. Farkas would have prepared the check.
- Two different versions of Board minutes were provided for the February 21, 2001 Board meeting. At this meeting, Board member Claire Fauci was nominated and elected to the Board. One version of the minutes reflected that Ms. Fauci was present at the meeting. The second version indicates that she was not present.

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[7] David Lurie resigned from the PSCH Board on the same day (6/23/1998) that the FSD Board met for the first time.

[8] The correction which was made was not in the amount of pay actually provided to Mr. Farkas, but rather, the quarterly income tax filings were adjusted to reflect the $55,000 salary.

- Other than Mr. Farkas, FSD's Board consisted of two other individuals – Claire Fauci and Lewis Siegel. Ms. Fauci is the spouse of Frank Fauci, who is a vice-president of Trooper Foods, which is the largest food vendor for PSCH and Lewis Siegel is a manager at Smith Barney, which manages both PSCH and FSD investments. There is no record that either Ms. Fauci or Mr. Siegel had signed any conflict-of-interest statement although both work either directly or indirectly for FSD and/or PSCH.

PSCH Response: PSCH disagrees that they controlled FSD, but rather states that the Commission's findings support the conclusion that FSD was controlled by Mr. Farkas and not PSCH.

CQCAPD Reply: The Commission agrees that Mr. Farkas was the controlling force behind both PSCH and FSD, supporting its conclusion that the respective Boards failed in their fiduciary duty to the corporation.[9]

d. FSD's "Independent" Auditor

FSD's independent auditor was Mr. Ben Milchman, CPA. Mr. Milchman was a contract employee who also served as the "internal auditor" for PSCH.

In an interview with the Commission, Mr. Milchman described himself as the independent auditor for FSD. His services to FSD include preparation of financial statements and tax returns, review of investment accounts, and posting all transactions to the general ledger. When questioned about his audit procedures, Mr. Milchman replied that he used no audit programs, nor did he get any representations from FSD management. He stated that he did not believe such documentation was necessary because he did all of the bookkeeping for the Foundation. The Commission believes that Mr. Milchman has violated numerous Auditing Standards by signing an audit opinion on the FSD financial statements, when it appears he neither met the definition of independence, nor obtained or utilized required documents:

- Current American Institute of Certified Public Accountants (AICPA) independence rules as taken from the **AICPA Plain English Guide to Independence** "prohibit members from acting as client management in all circumstances. Accordingly, a member may provide bookkeeping services provided the client oversees the services and, among other things, performs all management functions and makes all management decisions in connection with the services." Based on the Commission's review of FSD's books and records and our conversation with Mr. Milchman, it appears that Mr. Milchman was acting as FSD management with regard to decisions about posting of transactions and classifications of revenue and expenses. In fact, Mr. Milchman believed he had adequate knowledge of account balances to render an audit opinion because of the accounting services that he provided throughout the year. The Commission

[9] The AG investigation concluded that "FSD's Board existed in name only and provided no oversight of FSD." In the Matter of PSCH, Inc. and Foundation for Supporters of the Disabled, p. 4.

believes that Mr. Milchman had forfeited his independence and should not have provided audit services to the agency.

- As stated above, Mr. Milchman admitted to having no audit programs or representation letters, but did maintain files with analysis and other items relating to his work as a bookkeeper for the agency. This lack of an audit file violates Generally Accepted Auditing Standards (GAAS), particularly Standard of Fieldwork No. 3 which requires sufficient evidential matter to afford a basis for an audit opinion. In addition, the lack of audit programs is a clear violation of Standard of Fieldwork No.1, which requires that in order to adequately plan an engagement, the auditor should prepare a set of written audit programs containing reasonably detailed procedures for the steps to be performed.

- In addition to his role at FSD, Mr. Milchman described himself as the "internal auditor" for PSCH and described his duties as preparing audit workpapers and reconciliations for PSCH's outside auditors, Loeb & Troper. This was confirmed by Loeb & Troper. The Commission believes that the nature of Mr. Milchman's involvement is further evidence that PSCH and FSD were controlled by the same small group of people, including Mr. Milchman, thus disqualifying him from being independent in order to perform any audit services for FSD.

PSCH Response: PSCH has terminated its engagement with Mr. Milchman effective August 1, 2008.

2. Executive Compensation

The second allegation received by the Commission was that compensation for PSCH's president, Ralph Farkas was excessive. As noted in the audit history of PSCH, allegations regarding excessive or inappropriate compensation have recurred over the past twenty years. A 1983 audit found improperly claimed overtime and ineligible fringe benefits for the executive director; the 1989 audit found that PSCH's executive management were credited with excessive vacation leave; the joint OMH/OMRDD audit in 1995 found the executive director had received excessive compensation; and, the 2003 OMRDD audit found that there was no evidence that the executive director's compensation was reviewed or approved by the Board. It was during the 2003 audit that OMRDD recommended that PSCH enter into an employment contract with its executive director, but the Board never entered into such a contract with Mr. Farkas. At the time of the 2003 audit, OMRDD found that Mr. Farkas' salary had increased by 36 percent over the four-year period 1999 to 2002, from $253,899 to $346,003.

Consistent with past findings, the Commission also found that Mr. Farkas' compensation exceeds that paid to executive directors by similar organizations. The Commission's review included an examination of Mr. Farkas' compensation over the three-year period 2003 to 2005, a review of the Board's oversight and approval of his compensation package and a comparison of the compensation to similar-sized agencies in the New York City area. The review found the following:

- Mr. Farkas' total compensation (including both PSCH and FSD) for 2003, 2004 and 2005 was $546,221, $671,502 and $730,769 respectively. This represents a 34 percent increase over the three-year period.

- When compared to the compensation paid to executive directors of similar-sized agencies (see Table 1) Mr. Farkas' 2005 compensation, at $730,769, was by far the highest and more than 250 percent higher than the mean of the other agencies. In fact, Mr. Farkas' compensation was about 150 percent of the next highest compensation amount.

Table 1

2005 Salary Comparison
CEO - MH/MR Services Agency - New York City Area
(Data Obtained from IRS Form 990)

Agency #	**Fiscal Year Ended**	**Agency Revenues**	**CEO Compensation**	**Benefits / Def. Comp**	**Expense Acct.**	**Total**
1	June 30, 2005	63,817,381	393,899	35,942	8,750	438,591
2	December 31, 2005	50,513,479	303,405	82,165	4,508	390,078
3	December 31, 2005	56,677,648	309,720	86,757		396,477
4	September 30, 2005	91,619,616	301,447	37,319		338,766
5	December 31, 2005	52,186,847	282,916	55,398		338,314
6	December 31, 2005	49,920,160	283,161	57,836	27,136	368,133
8	June 30, 2005	79,923,069	234,055	18,032		252,087
9	December 31, 2005	74,175,388	234,423	27,934		262,357
10	June 30, 2005	67,089,076	210,437	21,964		232,401
11	December 31, 2005	42,969,434	160,419	37,475		197,894
12	June 30, 2005	47,657,643	161,289	25,160		186,449
13	June 30, 2005	83,608,683	173,690	8,685		182,375
14	June 30, 2005	48,975,690	129,814	19,472		149,286
Mean		62,241,086				287,170
Median		56,677,648				262,357
75th Percentile		74,175,388				368,133
Ralph Farkas (Includes FSD Salary)		**57,540,275**	**480,000**	**228,250**[10]	**22,519**	**730,769**

- In addition to his salary, Mr. Farkas received several benefits, such as, contributions to a profit sharing plan, deferred compensation and various insurance plans. The deferred compensation plan, which had a balance of about $500,000 as of September 2006, raised several questions:

  - First, although PSCH contributed a total of $436,500 to the deferred compensation account[11], the Commission could only find Board approval

[10] Of this amount, $127,000 is in dispute as to whether it belongs to Mr. Farkas, because it was recorded in a PSCH account entitled "PSCH for RDF." See discussion infra at p.12.
[11] The deferred compensation account was maintained in two separate Smith Barney accounts that totaled $500,060.60 as of 9/6/2006. The account total was comprised of PSCH contributions of $436,000 and earnings on these contributions of $63,560.60.

for about one-half of the total or $221,500. Therefore, it is questionable whether the Board ever approved or was aware of the remaining $215,000 that had been deposited into the account. For example, in fiscal year 2004/2005, three separate contributions were made totaling $127,000. Yet, according to Board minutes provided by PSCH, there was only one time during the year - - November 2004 - - when the Board approved a $35,000 contribution to the account.

- Second, although there is Board approval to contribute to a deferred compensation account for Mr. Farkas, no separate account was ever established solely in his name. Rather, the deferred compensation account was titled "PSCH for RDF" and was recorded as part of PSCH's assets. As a result, there was confusion as to who had the legal right to these funds. For instance, PSCH's independent auditors – Loeb & Troper – did not consider the funds to belong to Mr. Farkas, but rather to PSCH.
- Third, the confusion as to the legal right to ownership of these funds raised numerous questions about the appropriateness of deferring the funds and the tax consequences to Mr. Farkas if he claimed that they belong to him.

- As noted in two prior audits of PSCH, Mr. Farkas received excessive vacation and sick leave benefits in addition to his salary. For instance, as of June 30, 2006, Mr. Farkas had accrued 351 days of vacation leave and 400 days of sick leave. Upon separation the accrued vacation leave would be equivalent to a payment of $672,965.[12] The number of accrued days violated PSCH's own personnel manual which capped the number of vacation and sick leave days at 260 days for each category.

- Another area criticized in past audits was the use of a corporate credit card by PSCH's executive director. Although problems have been noted in the past, PSCH had made no effort to control the use of the card. Mr. Farkas has the use of a corporate credit card which was mainly used for entertainment and travel expenses, including restaurant charges, gas purchases, and the purchase of wine and liquor.[13] For the three-year periods ending June 30, 2003, 2004 and 2005, Mr. Farkas charged $15,088, $19,370 and $22,519 respectively, on the card. Several problems were noted with the use of the credit card. First, although the Board purportedly approved of the purchases, it had no idea of what was actually purchased. Purchases were categorized in various general account titles, such as "Board expense," "staff travel" and "conference" before being presented to the Board for their approval. Thus, the Board was unaware of the nature of the actual expense. For example, purchases of wine were classified as "board expense" on numerous occasions. Second, in many instances, there was no indication on the actual receipt whether the expense was business-related. For instance, restaurant receipts were routinely submitted without any explanation as to who was at the

[12] According to Board minutes dated March 12,1996, in response to the joint OMH/OMRDD audit, the PSCH Board resolved to "amend the personnel policy to cap the vacation of Ralph Farkas…at 25 days (from 46 days) and to terminate the vacation buyback policy solely with respect to Ralph Farkas…".
[13] For the three-year period reviewed, slightly over $9,000 was charged to the credit card for liquor purchases. The purchase of alcoholic beverages is a non-reimbursable cost.

dinner or the business purpose of the dinner. Third, in some instances, there was no documentation to support the charge.

- Finally, the Commission found that PSCH was improperly underestimating the value of Mr. Farkas' personal use of a company car. Mr. Farkas had the use of a 2000 Lexus SUV. For 2003, 2004 and 2005, PSCH's controller calculated Mr. Farkas' personal use of the car and reported on his W-2 $3,112, $4,007 and $4,007 respectively. The controller told Commission staff that she estimated Mr. Farkas personally used the car 20% of the time. She also said that the amounts reported on his W-2 were also estimates, but she could not explain how they were derived. The Commission believes the amounts to be low for several reasons. First, PSCH maintained no records regarding the personal use of the car. However, Mr. Farkas resides approximately 45 miles from PSCH's headquarters; he commutes to work approximately 455 miles per week. If he were using the vehicle only 20% of the time for personal use, he would be driving approximately 113,000 miles per year. Second, because PSCH does not maintain any records of the personal use of Mr. Farkas' vehicle, it should have used IRS guidelines, which value the personal use of the vehicle at $8,250, $6,100 and $6,100 for 2003, 2004 and 2005 respectively, plus another 5.5 cents per mile for fuel. Therefore, the Commission estimates that the amounts that should have been reported on Mr. Farkas' W-2 should have been closer to $7,500 per year rather than the $4,000 that was reported.

PSCH Response: The Commission's conclusion that Mr. Farkas' compensation was excessive is contrary to a recent examination by the IRS of PSCH's tax filings for the year ended June 30, 2005. The IRS examination reviewed every aspect of PSCH's operations, including Mr. Farkas' compensation. After completing its examination, the IRS concluded that PSCH continues to qualify for exemption from Federal income tax and accepted the organization's Form 990 as filed. Additionally, PSCH contracted with an outside consulting firm – Sibson Consulting – to review Mr. Farkas' compensation and found that "the total compensation for the CEO (Mr. Farkas) is near the top of the peer group defined by similar missions around a similar current revenue base as PSCH."

CQCAPD Reply: The AG investigation concluded that "Farkas' total compensation package approved by the PSCH Board – salary as well as retirement and other benefits – was out of line with compensation paid to chief executive officers at comparable organizations." The AG further found that "Farkas increased his compensation by awarding himself additional benefits worth nearly $500,000 by the end of 2007…without the knowledge or approval of PSCH's Board." Additionally, the AG noted that "although PSCH's Board attempted to meet its fiduciary obligations in approving Farkas' salary, it failed to develop reasonable procedures for evaluating his total compensation. In the absence of such procedures, the Board approved excessive levels of compensation for Farkas. And, "The Board's failure to review the entire package when it reviewed Farkas' annual requests for increases in his compensation, and to act accordingly, was a violation of its fiduciary duties."

3. Trooper Foods

PSCH had a well-documented history of questionable and/or inappropriate purchasing practices. Audits by OMH beginning in 1983 noted that "PSCH has not complied with the requirement to document competitive bidding procedures for purchases of equipment and furnishings expected to cost $500 or more." In November 1989 an OMH Audit Report again noted "Competitive bidding required by contract is not followed" and "Competitive bidding was not followed on purchases of equipment and furniture from businesses owned by members of PSCH's Board of Directors." Again in 1995, the joint OMH/OMRDD audit stated that there were "Irregularities in competitive bidding practices and procedures that resulted in business transactions with Board members without obtaining the lowest prices for goods." There is "Potential that the competitive bidding process was not done fairly and openly. [It] Also appears that PSCH has had altered or improper invoices against which payments were made but goods [were] not yet received."

There was also evidence that these issues were not due to mistakes or merely an oversight by the management of PSCH. The 1995 audit states that a "board member provided OMH with a signed statement which implicated that PSCH knowingly participated in and condoned these practices."[14]

PSCH management disagreed with the audit findings and stated that they had proper policies and procedures for purchasing in place.

Notwithstanding PSCH's assertion, the Commission also found questionable purchasing practices by PSCH. Our review concentrated on those PSCH vendors who also made large and/or multiple donations to FSD.

The Commission found that the largest single donor to FSD was a food service company named Trooper Foods. One of the principals of Trooper Foods is Frank Fauci, whose wife, Claire, is a Board member of FSD. Mr. Fauci's past includes a 1999 conviction for bid-rigging and a price-fixing conspiracy at Odyssey House, a not-for-profit residential substance abuse treatment organization located in Manhattan. These crimes were not related to PSCH or FSD, but caused the Commission to question why PSCH would do business with Mr. Fauci. Trooper Foods was ultimately selected to be one of the vendors included in our review.

During the period July 1, 2001 through June 30, 2003 the total food and household costs reported by PSCH on its Federal Form 990 was $2,486,161. Of that amount, approximately one-third, or $809,164, was purchased from Trooper Foods.

To determine whether Trooper Foods was charging PSCH market prices for food items, the Commission performed an extensive price comparison. Invoices were collected for a three-year period from the four major food vendors servicing PSCH programs. Prices were compared for approximately twenty five specific food items over

[14] The Board member who provided the statement to OMH was subsequently removed from the Board.

this period. To ensure the validity of the comparison, the date of purchase, package size, and brand name were considered, when possible.

The results of the comparison follow. Although in some cases the prices were comparable, the vast majority of items reviewed were more expensive when purchased from Trooper Foods. The following chart displays some examples of price differentials.

Purchase Date	Quantity	Item	Trooper Foods	Company A	Company B	Company C	Price Difference
10/03	48 8oz. Bottles	Poland Spring Water	$22.50		$14.50		56.5%
10/03	15 32oz Bottles	Hellman's Mayonaise	$98.75		$62.69		57.5%
11/03	1 lb.	Frozen Mixed Vegetables	$1.78		$0.93	$0.75	137.3%
02/04	48 6oz. Bottles	Pineapple Juice Concentrate	$26.18		$17.50		49.6%
04/04	24 12oz. Cans	Pepsi Soft Drinks	$19.75	$10.00			97.5%
07/04	24 4oz. Assorted	Dannon Yogurt	$18.24		$11.99		52.1%
10/04	24 12oz. Cans	Pepsi Soft Drinks	$19.75	$9.69			103.8%
05/05	48 8oz. Bottles	Poland Spring Water	$23.59		$14.50	$13.35	76.7%
11/05	144 count	Aunt Jemima Pancakes	$25.94			$15.18	70.9%
12/05	96 count	Swiss Miss Hot Cocoa	$37.65			$21.24	77.3%
06/06	48 6oz. Bottles	Pineapple Juice Concentrate	$24.31			$16.64	46.1%

PSCH could have saved many thousands of dollars simply by purchasing food items from vendors other than Trooper but chose not to do so. In addition, in an interview with Commission staff, the sales manager of one of Trooper's competitors said that he offered to sell food items to PSCH at the state contract price, which would not only save PSCH even more money, but would also satisfy any bidding requirements for government contracts. The Commission was told by this person that PSCH told him that they were not interested.

In response to questions by the Board regarding this issue, PSCH management developed a comparison which showed that those programs that purchased food supplied by Trooper spent approximately the same per day as those serviced by other vendors. There were no details accompanying the comparison, such as the types of programs being compared or number of meals provided. Given the price differences found in our comparison, the Commission could not reconcile PSCH's findings with the Commission's analysis.

PSCH Response: In February 2008, PSCH hired a new purchasing manager and has revised its Purchasing Policy and Procedure Manual. The new policies describe the process by which vendors are selected with preference given to those identified by the NYS Office of General Services.

4. Corporate Governance

Under NYS Not-for-Profit Corporation Law (§202(a)(12)), one of the purposes and powers of a corporation is to "elect or appoint officers, employees and other agents of the corporation, define their duties, **fix their reasonable compensation and the reasonable compensation of directors** (emphasis added), and to indemnify corporate personnel. Such compensation shall be commensurate with services performed." The duty to set the executive director's compensation rests solely with the Board of directors. The Commission found that the PSCH Board failed in its duty to set a reasonable compensation for Mr. Farkas.

A review of the Board minutes found that only the "Audit & Finance Committee" of the Board voted on Mr. Farkas' compensation and that there was no evidence that the entire Board was ever aware of or approved of his compensation.[15] Questions remain as to whether the Audit & Finance Committee was aware of exactly what Mr. Farkas was being paid. For instance, in 2004 and 2005, the Audit & Finance Committee approved a salary of $430,000 and $445,000 respectively. Yet, for those two years, Mr. Farkas was actually paid $450,000 and $425,000. PSCH officials told us that there was an error in how much Mr. Farkas made in 2004, so it was corrected the following year.

At the opening conference with PSCH's executive director and deputy executive director, Commission staff asked to review all Board minutes for the past ten years. After an initial review which revealed that there was no documentation that the Board either reviewed or approved of Mr. Farkas' compensation, PSCH officials produced additional minutes documenting Board approval. In each instance, the minutes that were

[15] According to the IRS guidelines, when reviewing executive compensation, exempt organizations should look to four key governance areas: legal protection, reporting and disclosure, avoiding excess benefit transactions and transparency. The Commission found that the Board did not comply with these guidelines. For instance, the guideline for avoiding excess benefit transactions states that every form of compensation needs to be reported timely as compensation. As discussed previously, this did not occur with regard to Mr. Farkas' deferred compensation. Not only was the amount not reported timely, there is a question as to whether the amount legally belonged to Mr. Farkas. Regarding transparency, the IRS guidelines state that the Board has the ultimate responsibility over compensation and, to the extent appropriate, executive compensation must be disclosed to the full Board.

produced recited the precise information the Commission was seeking. For instance, when the Commission sought minutes approving of Mr. Farkas' use of the corporate credit card, minutes were produced that discussed only the corporate credit card.

As a result, the Commission questioned the veracity of the minutes produced. For example, two versions of Board minutes for a June 17, 2003 meeting were provided to State officials. One set was provided to the Commission during its review, the other set was provided to OMRDD during its 2003 limited fiscal review. As noted in the graphics below, the minutes provided to the Commission are virtually the same as those produced for OMRDD, except for additional language which adds a resolution by the Audit/Compensation Committee regarding Mr. Farkas' compensation.

Board Minutes Produced for OMRDD

The following resolutions were presented to the board:

RESOLUTION: To adopt the PSCH Budget for fiscal year July 1, 2003 through June 30, 2004, as presented to PSCH's Finance and Audit Committee on June 11, 2003

Leo Laventhal motioned to accept the budget for fiscal year 7/1/03 through 6/30/04, Ann Mittasch seconded with all voting in favor.

RESOLUTION: To accept as presented and make a Pension Contribution for Fiscal Year ending June 30, 2004 of approximately 8.15% which is equivalent to contributions made over the past several years.

Herman Weiner motioned to accept the resolution to make a Pension Contribution for fiscal year ending June 30, 2004 of 8.15%. Ann Mittasch seconded with all voting in favor.

Ben discussed the payroll and equipment audit scheduled to commence July 31 and explained that it is part of an ongoing audit and review of PSCH internal controls. Ben recapped the work performed and audits conducted by his firm during the current fiscal year. A copy of his presentation is attached and considered part of these minutes.

Ralph Farkas excused himself from the meeting. The board then discussed his proposed compensation for fiscal year 2003/2004. Larry Stopol and Ben Milchman excused themselves from the meeting. Upon their return, the board unanimously approved the resolutions as presented. Ralph Farkas was then asked back to the board meeting.

Herman Weiner motioned to close the meeting, Leo Laventhal seconded, with all voting in favor.

Respectfully submitted,

Helen M. Schaefer

Helen M. Schaefer
Secretary to the BOD

BOD
August 12, 2003

Board Minutes Produced for CQC

The following RESOLUTION presented by David Lurie to the full Board of Directors and is considered part of these minutes.

RESOLUTION: To adopt the PSCH Budget for fiscal year July 1, 2003 through June 30, 2004, as presented to PSCH's Finance and Audit Committee on June 11, 2003

Leo Laventhal motioned to accept the budget for fiscal year 7/1/03 through 6/30/04, Ann Mittasch seconded with all voting in favor.

RESOLUTION: To accept as presented and make a Pension Contribution for Fiscal Year ending June 30, 2004 of approximately 8.15% which is equivalent to contributions made over the past several years.

Herman Weiner motioned to accept the resolution to make a Pension Contribution for fiscal year ending June 30, 2004 of 8.15%. Ann Mittasch seconded with all voting in favor.

Ben discussed the payroll and equipment audit scheduled to commence July 31 and explained that it is part of an ongoing audit and review of PSCH internal controls. Ben recapped the work performed and audits conducted by his firm during the current fiscal year. A copy of his presentation is attached and considered part of these minutes.

Ralph Farkas excused himself from the meeting. Larry Stopol and Ben Milchman excused themselves from the meeting. The chairman of the Audit/Compensation Committee presented to the full Board of Directors, the request for the salary increase for Ralph D. Farkas (President) as approved by the Committee. Upon review of the Executive Compensation of similar agencies, survey of levels of compensation such as Ernst & Young Survey of NY Metropolitan NFP organizations; Towers & Perrin Management Compensation Report for NFP organizations; Guidestar NFP compensation report and performance of the organization, services provided, program certification, new development and fiscal viability, the following resolution was presented.

RESOLUTION: To accept as presented by the Audit/Compensation Committee a salary increase for Ralph D. Farkas (President) for the fiscal year ending June 30, 2004. Annual compensation from $ ______ will increase to $ ______.

Leo Laventhal motioned to accept the resolution as presented, Lou Weinberg seconded and the resolution was carried unanimously.
Ralph Farkas, Larry Stopol and Ben Milchman were then asked back to the meeting.

Herman Weiner motioned to close the meeting, Leo Laventhal seconded, with all voting in favor.

Respectfully submitted,

David Lurie
Chairperson, Audit/Finance Committee

BOD
August 12, 2003

PSCH Response: PSCH has made fundamental changes in its senior management and governing Board. PSCH is in the process of revising its policies and procedures , including Conflicts of Interest Policy, Code of Ethics, and Whistleblower policies. In addition, PSCH is currently revising its employee handbook to address various employee benefits, including vacation accrual, sick day accrual and severance. Furthermore, PSCH will implement a revised travel and expense reimbursement policy with procedures for expense reports, mileage reimbursement, personal use of company vehicles, reimbursement for entertainment and business meetings and non-reimburseable expenses.

CQCAPD Reply: As part of the settlement with the AG, PSCH agreed to make substantial changes to Board governance including: amending its by-laws to allow for Board members terms to be staggered every three years, additional training of Board members, the formation of a Finance Committee and Audit and Compliance Committee, and implementing and employing procedures to ensure that executive compensation is "reasonable" and "commensurate" with services performed, including, retaining an independent compensation consultant by no later than January 2010 to prepare a survey of compensation of agencies comparable to PSCH.