New York State Office of the State Comptroller
Thomas P. DiNapoli

Division of State Government Accountability

Oversight of Contract Expenditures of Phoenix House New York

Office of Alcoholism and Substance Abuse Services

Report 2017-S-21

January 2019

Executive Summary

Purpose

Our audit determined whether the Office of Alcoholism and Substance Abuse Services (OASAS) is effectively monitoring its contracts with Phoenix House New York (PHNY) to ensure reimbursed claims are allowable, supported, and program related. The audit covered the period July 1, 2013 through June 30, 2016.

Background

OASAS oversees one of the nation's largest and most diverse programs for the prevention and treatment of alcohol and substance abuse. Its mission is to provide quality, accessible, and cost-effective services that strengthen communities, schools, and families through alcohol and drug prevention treatment.

In 2009, OASAS entered into a five-year, $47.6 million net deficit funding contract with PHNY, under which PHNY would provide drug and alcohol addiction treatment services. The contract was renewed in 2014 for another five-year term (July 1, 2014 through June 30, 2019) at a total cost of $51.4 million. During our audit scope, PHNY was one of six affiliates operated by the Phoenix House Foundation (Foundation), a nationally recognized and accredited behavioral health care provider that specializes in the treatment and prevention of mental health and substance use and co-occurring substance use disorders. PHNY provides outpatient, inpatient, and residential services at several facilities throughout the New York metropolitan area. According to the contracts, OASAS reimburses PHNY for its net operating expenses, up to the maximum budgeted amount, for providing the contracted services. The expenses are reported by PHNY on its annual Consolidated Fiscal Reports (CFRs) and are subject to the requirements in the Consolidated Fiscal Reporting and Claiming Manual (CFR Manual), OASAS' Administrative and Fiscal Guidelines for OASAS-Funded Providers (Guidelines), Phoenix House Personnel Policies and Procedures (Policies), and the contracts.

Key Findings

- OASAS does not adequately monitor the expenses PHNY reports on its CFRs. Consequently, PHNY was able to claim reimbursement for the higher budgeted expenses, rather than actual expenses.
- For the three years ended June 30, 2016, PHNY claimed and received reimbursement for approximately $2.9 million in unallowable and unsupported parent agency administrative expenses. This occurred because OASAS did not request, nor did PHNY disclose and document, the composition of parent agency administrative expenses.
- PHNY also claimed and received reimbursement for an additional $851,428 in personal service expenses and $169,856 in other than personal service expenses. These expenses did not meet the requirements of the CFR Manual, Guidelines, Policies, and/or contracts.

Key Recommendations

- Establish additional monitoring controls and improve oversight to ensure that PHNY only claims actual expenses and that those expenses are allowable, reasonable, supported, and consistent

with the CFR Manual, Guidelines, Policies, and contracts.
- Ensure that PHNY discloses all expenses during its budget process, specifically, the details of those expenses included in parent agency administrative costs.
- Recover $3.9 million in unallowable and/or unsupported costs from PHNY, including $2.9 million in parent agency administrative costs, $851,428 in personal service costs, and $169,856 in other than personal service costs. Take steps to ensure that PHNY only claims costs that are allowable and supported.

Other Related Audits/Reports of Interest

Office of Alcoholism and Substance Abuse Services: Contracted Programs With Puerto Rican Organization to Motivate, Enlighten, and Serve Addicts, Inc. (2015-S-24)
Office of Alcoholism and Substance Abuse Services: Drug and Alcohol Treatment Program: Provider Claiming of Depreciation Expenses (2015-S-84)

State of New York
Office of the State Comptroller

Division of State Government Accountability

January 9, 2019

Ms. Arlene González-Sánchez
Commissioner
Office of Alcoholism and Substance Abuse Services
1459 Western Avenue
Albany, NY 12203

Dear Ms. González-Sánchez:

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

Following is a report, entitled *Oversight of Contract Expenditures of Phoenix House New York*. The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

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

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

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State Government Accountability Contact Information:
Audit Director: Kenrick Sifontes
Phone: (212) 417-5200
Email: StateGovernmentAccountability@osc.ny.gov
Address:
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

This report is also available on our website at: www.osc.state.ny.us

Background

The Office of Alcoholism and Substance Abuse Services (OASAS) oversees one of the nation's largest and most diverse programs for the prevention and treatment of alcohol and substance abuse. Its mission is to provide quality, accessible, and cost-effective services that strengthen communities, schools, and families through alcohol and drug prevention and treatment.

In 2009, OASAS entered into a five-year, $47.6 million net deficit funding contract with Phoenix House New York (PHNY), under which PHNY would provide drug and alcohol addiction treatment services. The contract was renewed in 2014 for another five-year term (July 1, 2014 through June 30, 2019) at a total cost of $51.4 million. During our audit scope, PHNY was one of six affiliates operated by the Phoenix House Foundation (Foundation), a nationally recognized and accredited behavioral health care provider that specializes in the treatment and prevention of mental health and substance use and co-occurring substance use disorders. PHNY provides outpatient, inpatient, and residential services at several facilities throughout the New York metropolitan area.

According to the contracts, OASAS reimburses PHNY for its net operating expenses, up to the maximum budgeted amount (also known as net deficit funding), for providing the contracted services. The expenses are reported by PHNY on its annual Consolidated Fiscal Reports (CFRs), which are used by several State agencies, such as OASAS, to monitor and oversee service providers' financial activity and program expenses. PHNY is required to comply with the requirements in the Consolidated Fiscal Reporting and Claiming Manual (CFR Manual), the reporting requirements set forth in OASAS' Administrative and Fiscal Guidelines for OASAS-Funded Providers (Guidelines), Phoenix House Personnel Policies and Procedures (Policies), and the terms of the contracts. According to the Guidelines, OASAS monitors the fiscal activities of all OASAS-funded providers through field office budget reviews as well as through desk reviews of CFRs to determine if only allowable expenses are being claimed. OASAS utilizes a risk-based approach to select providers for periodic on-site examination of documents supporting reported and claimed expenses. Upon discovery of a contractor's non-compliance with the CFR Manual, Guidelines, Policies, or contracts, OASAS may recover expenses that were deemed to be unallowable and unsupported.

Audit Findings and Recommendations

OASAS oversees contractor services by utilizing the CFR Manual, Guidelines, and contracts to ensure that expenses are allowable and documented. For example, OASAS conducts annual budget reviews to monitor expense budgeting as well as periodic document reviews of reported actual expenses. However, these processes, as well as the Policies, are not sufficient to effectively identify unallowable and/or unsupported expenses reported and claimed by PHNY.

For the three fiscal years ended June 30, 2016, we found that PHNY claimed approximately $3.9 million in expenses that did not comply with the requirements in the CFR Manual, Guidelines, Policies, and contracts. These expenses included approximately $2.9 million in unallowable and/or unsupported parent agency administrative expenses, $851,428 in personal service expenses, and $169,856 in other than personal service (OTPS) expenses (see the Exhibit at the end of this report).

OASAS Oversight

According to the Guidelines, OASAS is responsible for monitoring the fiscal activities of all OASAS-funded providers, including PHNY. Monitoring is achieved through field office budget reviews as well as desk reviews of all incoming CFR documents to determine if claimed expenses were allowable. In addition, the CFR Manual provides guidance for providers that details what expenses can and cannot be claimed for reimbursement, as well as the documentation necessary to support these expenses. These guiding principles should ensure that OASAS is responsibly monitoring the programs it funds to confirm that State resources are used only for expenses that are allowable, supported, and program appropriate. However, these guidelines and controls were insufficient to detect and/or prevent budgeted (rather than actual) expenses as well as unallowable and unsupported expenses from being claimed by PHNY.

OASAS officials "acknowledged a concern that the overall administrative costs may not have been accurately allocated to all Phoenix House programs across the country and that NYS programs may have been charged a disproportionate share." They also acknowledged that "at no time, did they (PHNY) give any indication that they had used an allocation methodology for administrative expenses that differed from the required ratio value method that may have resulted in a disproportionate share of administrative expenses being claimed against net deficit funding." They further acknowledged that "documentation detailing the claimed expenses and your (OSC's) evaluation of their allocation methodology was not uncovered until your (OSC's) on-site field work and related inquiries of PHNY." We believe that OASAS could be more proactive in its oversight and monitoring of PHNY's fiscal operations. Consequently, we concluded that OASAS is not effectively monitoring the expenses reported and claimed in its contracts with PHNY to ensure that reimbursed claims are allowable, supported, and program related, as indicated in the other sections of this report.

Parent Agency Administrative Costs

During our audit scope, the Foundation, located in New York, was the parent organization for PHNY and the five other Phoenix House affiliates located throughout the country (California, Texas, Florida, and the Mid-Atlantic and New England regions). The Foundation provides legal, human resources, IT, and other administrative services to the six affiliates.

According to Appendix X of the CFR Manual, costs included on the CFRs must be reasonable and/or necessary. Moreover, unreasonable and/or unnecessary costs are not allowable. The CFR Manual also states that expenses included as a cost of any other program in a prior, current, or subsequent fiscal period are not allowable. In addition, the CFR Manual states that parent agency administrative expenses are reimbursable if they are completely supported and are based on an allowable allocation methodology. Section 7 of the CFR Manual states that OASAS does not allow service providers to budget for or claim equipment and property depreciation expenses for Aid to Localities (State Aid) reimbursement.[1] In addition, Section 15 of the CFR Manual states, in part, that agency administrative costs do not include fundraising costs and the costs of special events. Furthermore, funds provided by OASAS pursuant to the contracts shall not be used for any partisan political activity or for activities that attempt to influence legislation.

For the three fiscal years ended June 30, 2016, the Foundation used a ratio value method, based on the annual direct care costs of each of the six affiliates, to allocate approximately $61.9 million of its administrative costs to the six affiliates. The Foundation allocated 29 percent of its administrative costs to PHNY in fiscal year 2014, 26 percent in fiscal year 2015, and 17 percent in fiscal year 2016, for a total of $7.5 million. The affiliates record these costs as parent agency administrative costs.

For the three fiscal years, we determined that approximately $2.9 million of the $7.5 million in parent agency administrative costs reported and claimed by PHNY were unallowable and/or unsupported, as follows:

- $848,836 in contributed services – According to PHNY officials, when the amount of the Foundation's administrative costs allocated to an affiliate is more than that affiliate can absorb, the costs are reallocated to the remaining affiliates as contributed services. However, the CFR Manual does not allow the costs of management services provided to another entity, in this case the other affiliates, to be claimed for reimbursement by PHNY.
- $693,178 in equipment and property depreciation expenses – According to the CFR Manual, OASAS does not allow service providers to claim depreciation expenses.
- $432,585 in expenses associated with the Office of the Foundation's President – PHNY officials told us that budgeted expenses for the President's Office included salary and fringe benefit expenses for the Foundation's Chief Executive Officer and his/her Executive Assistant, their travel expenses, and expenses for outside consultants. However, PHNY officials did not provide documentation to show that these expenses were reasonable and

[1] A June 2016 OSC audit report (2015-S-84) covering the period of January 1, 2010 through June 30, 2014 concluded that OASAS was not effectively monitoring Drug and Alcohol Treatment program contracts to ensure provider claims do not include reimbursement for depreciation expenses.

necessary and were for the operation of PHNY.

- $398,881 in fundraising expenses – According to the CFR Manual, fundraising expenses cannot be reported as agency administrative costs.
- $281,630 for the Foundation's Office of the Chief Medical Officer (OCMO) – According to PHNY officials, OCMO has overall responsibility for the clinical services provided to PHNY's patients and the patients of the other five affiliates. However, PHNY officials did not provide documentation to support the $281,630 that was allocated to PHNY.
- $164,103 related to the Foundation's Public Policy Office – According to PHNY officials, the Foundation, through its public policy work, sought to influence public opinion and policy makers on topics related to the treatment of substance use disorders and to advocate for laws and policies that promote the best interests of individuals and families struggling with addiction. PHNY officials also told us Phoenix House's founder and former president was the Foundation's primary employee carrying out Phoenix House's public policy activities during the three fiscal years. PHNY officials provided no documentation to support these costs. Moreover, costs associated with lobbying are not allowable.
- $56,155 in merit increases for the Foundation's employees – According to the Policies, merit increases are to be based on employee performance evaluations. PHNY officials were unable to provide performance evaluations to support the payment of $56,155 in merit increases.
- $12,690 in annual party expenses – According to the CFR Manual, costs that are for the entertainment of employees and that are not directly related to program/participant care are not allowable. The $12,690 in party expenses were not directly related to program/participant care.

We recommend that OASAS recover approximately $2.9 million in parent agency administrative costs because these costs did not comply with the requirements in the CFR Manual and Policies. In addition, these costs were based on the budgeted expenses of the Foundation.

Personal Service Costs

According to the contract between OASAS and PHNY, PHNY is required to maintain personal service records, including cost allocation plans. In addition, the CFR Manual states: "providers with personnel who work in more than one program should allocate their salary to the proper cost center during the normal accounting cycle based on actual time and attendance records. If this does not occur, the service provider must complete a time study for each employee who works in more than one program." The Policies state that merit increases are to be based on employee performance evaluations. For the two fiscal years ended June 30, 2016, we identified $851,428 in personal service costs that did not comply with the requirements in the CFR Manual, Policies, and/or contracts, as follows:

- For the fiscal year ended June 30, 2016, PHNY reported $493,428 in salary expenses for 28 Foundation and Phoenix House Long Island (a subsidiary of PHNY) employees. However, PHNY officials were unable to provide time studies and could not support the methodologies that were used to allocate salary expenses to PHNY. They were also unable to show that these employees provided services to PHNY.

- For the same fiscal year, PHNY officials could not provide documentation to support an additional $296,911 in allocated salary expenses.
- For the two fiscal years ended June 30, 2016, PHNY paid $190,650 in merit increases to 94 employees. However, we found that $61,089 in merit increases paid to 38 of the 94 employees did not comply with the Policies, as they were not supported by employee performance evaluations.

Other Than Personal Service Costs

The CFR Manual states that OASAS does not allow service providers to claim equipment and property depreciation expenses. Furthermore, costs incurred primarily for lobbying services are not allowable. The Guidelines require providers to maintain detailed vehicle travel logs (i.e., dates and times of travel, destination, starting and ending mileage, and operator name) when vehicles are used. In addition, the Guidelines require providers to maintain written documentation of work performed by and amounts paid to each consultant. Such documentation must include the nature of the work performed, dates and/or time frame that the work was conducted, and if/when the work was completed by the consultant. Moreover, service providers must ensure that a fully executed written contract/agreement is maintained for each vendor.

For the three fiscal years ended June 30, 2016, we identified $169,856 in OTPS expenses that did not comply with the CFR Manual and/or Guidelines, as follows:

- $102,682 in equipment and property depreciation expenses for the two fiscal years ended June 30, 2015 – According to the CFR Manual, equipment and property depreciation is not a reimbursable expense for OASAS providers.
- $54,200 in consulting fees – According to PHNY officials, the consulting firm was retained to provide advice on legislative matters. However, funds provided under PHNY's contracts with OASAS cannot be used to influence legislation.
- $12,065 in vehicle expenses for fiscal year ended June 30, 2016 – We have no assurance that the vehicles were used for program purposes, as PHNY officials could not provide vehicle logs, as required.
- $909 in travel expenses to a consultant – The contract prohibited the payment of the consultant's travel expenses unless preapproved; these travel expenses were not preapproved.

Recommendations

1. Establish additional monitoring controls and improve oversight to ensure that PHNY only claims actual expenses and that those expenses are allowable, reasonable, supported, and consistent with the CFR Manual, Guidelines, Policies, and contracts.

2. Ensure that PHNY discloses all expenses during its budget process; specifically, the details of those expenses included in parent agency administrative costs.

3. Assess the appropriateness of the methodology used by the Foundation to allocate administrative costs to PHNY.

4. Recover $3.9 million in unallowable and/or unsupported costs from PHNY, including $2.9 million in parent agency administrative costs, $851,428 in personal service costs, and $169,856 in OTPS costs. Take steps to ensure that PHNY only claims costs that are allowable and supported.

Audit Scope, Objective, and Methodology

Our audit determined whether OASAS is effectively monitoring its contract with PHNY to ensure reimbursed claims are allowable, supported, and program related. The audit covered the period July 1, 2013 through June 30, 2016.

To accomplish our objective and evaluate internal controls, we reviewed relevant laws and regulations that identify OASAS' oversight responsibilities to its contracted providers, as well as the CFR Manual, Guidelines, Policies, and contracts to gain an understanding of the appropriate reporting and claiming of expenses, and assessed OASAS' and PHNY's related internal controls over the reporting of said expenses. We interviewed officials and staff of OASAS and PHNY to obtain an understanding of their services, policies, and procedures. We also reviewed PHNY's financial records and supporting schedules for expenses. Furthermore, we selected judgmental samples of reported personal service and OTPS costs to determine whether they were allowable, supported, and program related. We selected our judgmental samples based on costs that were considered high risk based on prior audit report findings, and included parent agency expenses, salary costs, depreciation, and personal service and OTPS expenses.

We conducted our performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions, and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

Authority

The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

Reporting Requirements

We provided a draft copy of this report to OASAS and PHNY officials for their review and formal comment. Their comments were considered in preparing this final report. Both OASAS and PHNY's responses are attached in their entirety at the end of this report. In their response, OASAS officials generally agreed with our recommendations and noted actions that have already been or will be taken to implement them. Specifically, OASAS stated that it will conduct a follow-up financial analysis to confirm the findings in our report and then take appropriate remedial action, including recovering all dollars that may have been inappropriately paid to PHNY. PHNY's response, which was addressed to OASAS, reiterated its positions regarding the allowability of the costs it had claimed. We defer to OASAS to determine the amount inappropriately paid to PHNY and to recover said amount. In PHNY's response, they disagreed with many of our conclusions. Our responses to their disagreements are embedded within PHNY's response.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the Office of Alcoholism and Substance Abuse Services shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and if the recommendations were not implemented, the reasons why.

Contributors to This Report

Kenrick Sifontes, Audit Director
Michael Solomon, Audit Manager
Judy Grehl, CFE Audit Supervisor
Natalie Sherman, Examiner-In-Charge
Latishea White, Senior Examiner
Artan Fejza, Staff Examiner
Kevin Fung, Senior Editor

Division of State Government Accountability

Andrew A. SanFilippo, Executive Deputy Comptroller
518-474-4593, asanfilippo@osc.ny.gov

Tina Kim, Deputy Comptroller
518-473-3596, tkim@osc.ny.gov

Ken Shulman, Assistant Comptroller
518-473-0324, kshulman@osc.ny.gov

Vision

A team of accountability experts respected for providing information that decision makers value.

Mission

To improve government operations by conducting independent audits, reviews, and evaluations of New York State and New York City taxpayer-financed programs.

Exhibit

Office of Alcoholism and Substance Abuse Services
Oversight of Contract Expenditures Phoenix House New York
Recommended Cost Recoveries
Three Fiscal Years July 1, 2013 Through June 30, 2016

Recommended Cost Recoveries	2015-16	2014-15	2013-14	Totals
Parent Agency Administrative Costs	$797,402	$1,014,562	$1,076,094	$2,888,058
Personal Service Costs	844,028	7,400	0	851,428
Other Than Personal Service Costs	67,174	40,397	62,285	169,856
Total Recommended Cost Recoveries	**$1,708,604**	**$1,062,359**	**$1,138,379**	**$3,909,342**

Agency Comments - Office of Alcoholism and Substance Abuse Services

NEW YORK STATE | Office of Alcoholism and Substance Abuse Services

ANDREW M. CUOMO
Governor

ARLENE GONZÁLEZ-SÁNCHEZ, M.S., L.M.S.W.
Commissioner

August 28, 2018

Mr. Kenrick Sifontes
Audit Director
Office of the state Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

Re: Response to audit draft report
2017-S-21

Dear Mr. Sifontes:

Thank you for the opportunity to respond to the draft audit report of the Office of the State Comptroller's (OSC) audit conducted of Oversight of Contract Expenditures of Phoenix House of New York (PHNY) report number 2017-S-21. As is our practice, upon receipt of the OSC's final audit report, OASAS will conduct a follow up financial analysis to confirm the findings and take appropriate remedial action including recovering all dollars that may have been inappropriately paid to PHNY.

Background

Under the section on Background, in the next to last sentence, OSC references aspects of OASAS' oversight noting that we "conduct desk reviews of CFRs to determine if only allowable expenses are being claimed." That is an accurate representation of the current process, but it is important to point out in the context of this audit that the CFR Review Unit that conducts such analysis only came in to being in mid-2016 which is after the audit period end date and therefore would not apply to the review of prior PHNY's CFRs.

Audit Findings and Recommendations

OASAS stated in its responses to the numerous OSC preliminary findings that the overwhelming majority of the noted non-allowable or questionable expenses claimed by PHNY were contained in a single line item on their CFRs, specifically line 38 "Parent Agency Administration Allocation" found on schedule CFR-3. While OASAS does not dispute that the types of expenses identified by the OSC would likely be considered non-allowable, we believe it is important to continue to point out that PHNY was not required to provide any detail or supplemental information as to the makeup of that single line item entry at the time of its CFR submission. Furthermore, documentation detailing the nature of these non-disclosed expenses was only uncovered by the OSC as part of its on-site field work and related inquiries of PHNY. These were not obvious questionable expenses on their face; rather they were expenses that were difficult to detect absent a robust review such as that undertaken by OSC.

1450 Western Avenue | Albany, New York 12203-3526 | oasas.ny.gov | 518-473-3460

To further put PHNY's non-disclosure of these expenses into perspective, it is significant to note that this draft report identified $693,178 of depreciation expense that was inappropriately claimed by PHNY for the period July 1, 2013 through June 30, 2016. However, in a prior OSC audit of several OASAS providers who inappropriately claimed depreciation expense (report 2015-S-84) from 2010 through 2014, PHNY was not cited for claiming any depreciation expenses; This further demonstrates PHNY's efforts to conceal the true nature of the line 38 entry.

In addition to depreciation expense, other questionable expenses lumped into that single line item included interest expense, an annual party, fundraising, and "Personal Service - merit increases." There was also a category called Contributed Services to Affiliates where it was determined that the PH Foundation may have allocated to PHNY more than its fair share of administrative expenses. PHNY's reported rationale was that when one of their other affiliates was unable to absorb their proportionate share of the Foundation's administrative costs, dollars were reallocated to other affiliates who could afford to do so. If confirmed, this action would not comply with the required ratio value allocation methodology and therefore would need to be corrected and excess funds recovered. Another questionable expense included in the line 38 entry was a category identified as associated with the "Office of the Foundation's President." PHNY advised these expenses were related to the Foundation's Chief Executive Officer and his/her Executive Assistant, their travel expenses and expenses for outside consultants.

Aside from the contents of line item 38 on schedule CFR-3, the OSC noted, and proposed to disallow, a variety of expenses that PHNY failed to provide sufficient supporting documentation for or were claimed contrary to the CFR manual. These expenses included, but were not limited to, salary expense, consulting fees, vehicle expense and travel.

In processing incoming CFR's, where annual revenues and expenses are reconciled against the funding advances provided during the year, the OASAS State Aid unit ensures that the provider did not claim more than the allowable percentage of administrative costs. When the analysis was done of PHNY's submissions, they were found to be at or under the required limitation. Similarly, when the PHNY budgets were approved, the approved administrative expenses also did not exceed the allowable percentage. In retrospect, while PHNY did not provide details of their line 38 entry on schedule CFR-3, OASAS did not ask for specific details about the administrative expenses since the noted amount was within the allowable percentage.

it is important to understand that OASAS-funded providers are required to enter all revenue and expenses on the CFR core schedules (CFR-1 for direct expenses and CFR-3 for administrative expenses), regardless of whether those entries are on line items for a specific type of expense or one where the nature of the expense is not disclosed, like line item 38 of the CFR-3. Per the CFR manual, these entries must match the information contained in the provider's independently prepared audited financial statements. That means that both non-allowable or questionable expenses must be included on these schedules.

While PHNY entered the information on the core schedules, they failed to adjust out non-allowable expenses, as required, on either the appropriate lines on the core schedules, or on line 12 of claiming schedule DMH-2. By not removing these expenses, they inappropriately inflated the reconciled amount of net deficit funding received from OASAS.

Steps Taken by OASAS Relating to the Preliminary Findings

Once the issue came to light about PHNY's non-disclosed entry on line 38 of schedule CFR-3, OASAS took the following action.

We undertook an examination of CFR line 38 entries for all funded providers. Our CFR review unit, who is tasked with reviewing the propriety of each CFR submission, extracted information from our internal systems that detailed that only 19 OASAS providers had any entries on line 38 of schedule CFR-3 from 2010 through 2016. Of those 19 providers, PHNY comprised nearly half of the total dollars involved. A plan has been put in place to contact those 19 providers, other than PHNY, and request details of what comprised that entry. If any inappropriate expenses are found during this process, the provider will first be directed to reclassify such expenses to available line items on schedule CFR-3 that more appropriately identifies the expense. They will then be required to adjust out any non-allowable expenses, submit a corrected CFR, and OASAS will recover any identified overpayments.

The next round of budget submissions will take place in the fall of 2018 for calendar year providers looking to create their 2019 budgets. The OASAS Regional Office staff, in evaluating provider submissions, will proactively question the providers in more detail on various aspects of their proposed budget to ensure that it does not contain any non-allowable expenses. This step will not only strengthen the process and result in more accurate budgets, it will also result in more accurate annual CFR claim submissions that will them be far less susceptible to disallowances.

Steps taken to Improve OASAS' Oversight and Monitoring of Funded Providers

Insofar as OASAS's oversight and monitoring of its providers, we previously explained to the OSC the vastly expanded controls and processes implemented by OASAS the last 2-4 years that have successfully held our providers more accountable. These include, but are not limited to, the following:

- an enhanced risk assessment used by the OASAS Fiscal Review and Audit (FARU) staff to ensure that we correctly prioritize the providers who require more immediate analysis;
- the creation of a CFR Review Unit tasked with analyzing every submitted CFR looking to identify non-allowable claimed expenses, and to ensure that other financial information presented on the annual submission is supported by appropriate provider documentation;
- the revision of the FARU review instrument to contain specific steps to identify non-allowable or inappropriately claimed expenses when on site at a provider;
- creating an additional attestation (PAS-124) required to be submitted by the provider along with the annual CFR specifically stating that, amongst several stipulations, there filing did not contain non-allowable expenses, that their Medicaid revenue was accurately stated, and that they were up to date with all required Federal and State tax filings;

- enhancing statewide CFR training given to providers to facilitate the completion of more accurate annual submissions.

- creating an additional attestation (PAS-125) that somewhat mirrors the questions contained in the above referenced PAS-124. This document is required to be submitted along with the providers Consolidated Budget Report (CBR) that attests, amongst several stipulations, that their budget did not contain non-allowable expenses, that their Medicaid revenue was accurately stated, and that they were up to date with all required Federal and State tax filings;

Once again, thank you for the opportunity to respond to the draft report and we look forward to receipt of the final document.

Very truly yours,

Steven J. Shrager
Director, Office of Audit Services

Cc:
Vittoria Parry
Robert A. Kent
Trisha Schell-Guy

Agency Comments - Phoenix House and State Comptroller's Comments

50 Jay Street
Brooklyn, NY 12201

T 631 306 5833
F 631 787 2630
www.phoenixhouse.org

Phoenix House
Rising Above Addiction

August 29, 2018

Mr. Steven J. Shrager
Director, Office of Audit Services and Internal Audit
NYS OASAS
1450 Western Avenue
Albany, NY 12203

Re: New York State Office of the State Comptroller
Draft Report – Oversight of Contract Expenditures of Phoenix House New York

Dear Mr. Shrager:

We are writing in response to the draft report, entitled "Oversight of Contract Expenditures of Phoenix House New York" (the "Draft Report"), prepared by the New York State Office of the State Comptroller (the "State Comptroller" or "OSC") in connection with the State Comptroller's audit of the New York State Office of Alcoholism and Substance Abuse Services ("OASAS") contract with Phoenix Houses of New York, Inc. ("PHNY") for fiscal years beginning July 1, 2013 through June 30, 2016. PHNY is eager to be responsive to the audit findings, ensure that monies are properly accounted for, and address each concern raised by the State Comptroller's Office in its Draft Report.

As you know, PHNY responded to the State Comptroller's six preliminary audit reports by letters dated November 27, 2017, April 16, 2018, April 30, 2018 and May 22, 2018 (the "Response Letters"). In those letters, PHNY addressed certain incorrect conclusions reached by OSC in its preliminary reports and, in certain cases, provided additional information and/or documentation to support its position. Certain conclusions reached in OSC's preliminary reports have been excluded from or modified in the Draft Report, presumably in light of the additional information and documentation provided by PHNY. However, many of the incorrect conclusions set forth in OSC's six preliminary audit reports are repeated in its Draft Report. PHNY maintains and reiterates its position, articulated in its Response Letters, with respect to each of the incorrect conclusions. For clarity, however, PHNY restates below in brief its position with respect to each of the incorrect conclusions appearing in the Draft Report.

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(A) Parent Agency Administrative Costs

1. **$848,836 in Contributed Services.** In its Draft Report, the State Comptroller concludes that PHNY's inclusion of $848,836 in Contributed Services expense in its Parent Agency Administration Allocation on its CFR-3 schedules for the three fiscal years beginning July 1, 2013 and ending June 30, 2016 is not permitted under the CFR Manual. **PHNY disagrees with OSC's finding regarding Contributed Services and plans to address that finding directly with OASAS.**

State Comptroller's Comment - The CFR Manual does not allow the costs of management services provided to another entity to be claimed for reimbursement by PHNY.

2. **$693,178 in Equipment and Property Depreciation Expenses.** In its Draft Report, the State Comptroller asserts that PHNY's inclusion of $693,178 in equipment and property depreciation expenses in its Parent Agency Administration Allocation reported on its CFR-3 schedules for the three fiscal years beginning July I, 2013 and ending June 30, 2016 is not permitted under the CFR Manual.

OSC's finding that PHNY received over $693,178 in improper reimbursements for equipment and property depreciation charges for the three fiscal years ending June 30, 2016 is without merit. No improper parent agency depreciation expenses were claimed by PHNY and no reimbursement is due to OASAS.

As you know, transactions with, including all payments to, related organizations are reported on the CFR-5 schedule. Phoenix House Foundation, Inc. (the "Foundation" or "Parent Agency") is a related organization of PHNY. During the three fiscal years in question, the Foundation provided administrative services to PHNY and five other affiliates. The CFR Manual instructions specifically note, in providing an example of allowable related organization costs, that "the related organization's actual cost in operating the building used by the service provider may include depreciation, amortization, mortgage interest, property taxes, insurance, utilities and repairs and maintenance." *(See* CFR Manual, Section 18.0, Page 18.3.) **OSC's position regarding these Parent Agency depreciation costs is not in accord with the CFR Manual.**

State Comptroller's Comment - According to the CFR Manual, OASAS does not allow service providers to claim depreciation expenses.

3. **$432,585 in Expenses Associated with the Office of the Foundation's President.** OSC asserts that PHNY did not provide documentation to show that the $432,585 in expenses associated with the Office of the Foundation's President claimed by PHNY were reasonable and necessary and were for the operation of PHNY.

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OSC's finding is incorrect. The work carried out by the Office of the President was work that was reasonable and necessary for the operation of PHNY. The expenses associated with the Office of the President are documented in the Foundation's General Ledger for each of the fiscal years in question and supporting documentation for the General Ledger entries is maintained and was available for OSC's review. No unallowable expenses associated with the Office of the Foundation's President were claimed by PHNY and no reimbursement is due to OASAS.

State Comptroller's Comment - According to OASAS Guidelines, the expenses of OASAS-funded providers must be documented. Throughout the response addressed to OASAS, Phoenix House asserts that its expenses are documented in the general ledger, which was available to the auditors. Though a general ledger is a record of an organization's transactions, it does not contain source and other documentation to support those transactions. Moreover, PHNY's general ledger does not document the methodology for allocating these expenses to PHNY. In addition, these amounts were based on budgeted expenses, not actual.

Appendix X (Section 57.0) of the CFR Manual provides that "[a) cost must be reasonable and/or necessary for providing services in both its nature and amount" and further provides that in determining the reasonableness of a given cost, "consideration will be given to whether the cost is generally recognized as ordinary and necessary for the operation of the organization and the restraints or requirements imposed by Federal and State laws and regulations."

Appendix I of the Manual provides that agency administration costs include all the administrative costs that are not directly related to specific programs/sites but are attributable to the overall operation of the agency such as: (i) costs for the overall direction of the organization; (ii) costs for general record keeping, budget and fiscal management; (iii) costs for governing board activities; (iv) costs for public relations; and (v) **costs for parent agency expenses** *(emphasis added).* Appendix I specifically notes that such costs may include, but are not limited to, personal service costs of agency administrative staff, *i.e.,* Executive Director, Comptroller, Personnel Director, etc. and leave accruals and fringe benefits corresponding to such personal services, other than personal services costs associated with agency administration activities *(i.e.,* telephone, repairs and maintenance, utilities), agency-wide auditing costs for independent licenses or certified public accountants, and depreciation and/or lease costs associated with vehicles and equipment used by agency administration staff.

Pursuant to the By-Laws of the Foundation and PHNY in effect during the fiscal years ending June 30, 2014 through June 30, 2016, the President & CEO of the Foundation served *ex officio* as the President of PHNY and five other affiliates. The individual serving in this office, therefore, was charged with supervising the operations and affairs of PHNY including its clinical treatment programs, financial and business operations and development activities, as well as the work of PHNY's Executive Director. The individual serving in this office also was responsible for ensuring compliance with the laws and regulations governing PHNY and the entire Phoenix House organization, promoting good governance and providing support to the boards of directors

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of PHNY and the other affiliates, setting policy for PHNY and the other affiliates, and ensuring proper stewardship of assets in furtherance of the charitable mission shared by PHNY, the Foundation and the other affiliates. Clearly, the work carried out by the President and his or her support staff was work that is ordinary and necessary for the operation of PHNY, and was necessary for the provision of services by PHNY and related to program/site participant care and treatment. Accordingly, this expense should not be disallowed.

With respect to OSC's contention that documentation of the expenses of the President's Office was not provided, PHNY provided OSC with access to the Foundation's General Ledger for the fiscal year ended June 30, 2016, which was the only General Ledger requested by OSC.

The expenses of the President's Office as reflected in the Foundation's General Ledger include expenses that are specifically identified in Appendix I as permissible costs. In PHNY's May 22, 2018 Response Letter, PHNY indicated that it would be pleased to provide access to the General Ledger for fiscal years ending June 30, 2014 and 2015, as well as backup documentation for any journal entries selected by OSC. OSC did not request to see those General Ledgers or select any specific journal entries for review.

4. **$398,881 in Fundraising Expenses.** The State Comptroller asserts that, according to the CFR Manual, fundraising expenses cannot be reported as agency administrative costs.

The State Comptroller's position is not supported by the guidance regarding Parent Agency costs set forth in the CFR Manual and, accordingly, its finding that PHNY should repay $398,881 in improper reimbursements for fundraising charges for the three fiscal years ending June 30, 2016 is without merit.

State Comptroller's Comment - According to the CFR Manual, fundraising expenses cannot be reported as agency administrative costs.

Pursuant to the CFR Manual, the total allowable cost of a transaction with a related organization, such as a transaction between PHNY and the Foundation, is "the lower of the related organization's/individual's actual cost or the fair market value of providing the service or supply." *(See* CFR Manual, Section 18.0, Page 18.3.) The instructions do not specify any actual costs of the related organization that must be excluded from this calculation. Appendix X (Adjustments to Reported Costs) of the CFR Manual provides that costs applicable to services, facilities and supplies furnished to the provider by a related organization are excluded from the allowable cost of the provider "if they exceed the cost to the related organization." *(See* CFR Manual, Section 57.0, Page 57.1, item 6.) This provision does not identify any specific actual cost of the related organization, such as fundraising costs, that must be excluded *per se.* Appendix X is comprised of a list of provider expenses that are considered non-allowable. Fundraising expenses are not included on that list. The CFR Manual does not support OSC's contention that fundraising expenses cannot be reported as agency administrative costs.

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5. **$281,630 for the Foundation's Office of the Chief Medical Officer ("OCMO") Expenses.** The State Comptroller contends that PHNY did not provide documentation to support the $281,630 in Foundation OCMO expenses allocated to PHNY.

The expenses associated with the Foundation's OCMO are documented in the Foundation's General Ledger for each of the fiscal years in question and supporting documentation for the General Ledger entries is maintained and was available for OSC's review. No unallowable expenses associated with the Foundation's OCMO were claimed by PHNY and no reimbursement is due to OASAS.

State Comptroller's Comment - According to OASAS Guidelines, the expenses of OASAS-funded providers must be documented. Throughout the response addressed to OASAS, Phoenix House asserts that its expenses are documented in the general ledger, which was available to the auditors. Though a general ledger is a record of an organization's transactions, it does not contain source and other documentation to support those transactions. Moreover, PHNY's general ledger does not document the methodology for allocating these expenses to PHNY. In addition, these amounts were based on budgeted expenses, not actual.

As PHNY noted in its May 22, 2018 Response Letter, the work carried out by the Foundation's OCMO during the three fiscal years ending on June 30, 2016 was work that was ordinary and necessary for the operation of PHNY, and was necessary for the provision of services by PHNY and related to program/site participant care or treatment. The Foundation's OCMO has overall responsibility for the clinical services provided to PHNY's patients and all Phoenix House patients, and establishes and oversees procedures to ensure that treatment services comply with all applicable regulatory schemes, meet quality standards and adhere to best practices. In addition, the OCMO develops and oversees the implementation of protocols for the delivery of quality medical and substance use disorder treatment services to all Phoenix House patients including PHNY patients, has supervisory authority over all clinical staff and overseas credentialing and the development and implementation of ongoing training programs for clinical staff.

With respect to OSC's assertion that the expenses of the Foundation's OCMO charged to PHNY are unsupported, PHNY provided OSC with access to the Foundation's General Ledger for the fiscal year ended June 30, 2016, which was the only General Ledger requested by OSC. The expenses of the OCMO as reflected in the Foundation's General Ledger include expenses that are specifically identified in Appendix I of the CFR Manual as permissible costs. In PHNY's May 22, 2018 Response Letter, PHNY indicated that it would be pleased to provide access to the General Ledger for fiscal years ending June 30, 2014 and 2015, as well as backup documentation for any journal entries selected by OSC. OSC did not request to see those General Ledgers or select any specific journal entries for review.

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6. **$164,103 Related to the Foundation's Public Policy Office.** The State Comptroller asserts that PHNY provided no documentation to support the $164,103 in expenses related to the Foundation's Public Policy Office that were allocated to PHNY and that costs associated with lobbying are not allowable.

The expenses associated with the Foundation's Public Policy Office are documented in the Foundation's General Ledger for each of the fiscal years in question and supporting documentation for the General Ledger entries is maintained and was available for OSC's review. The $164,103 in expenses related to the Foundation's Public Policy Office does not represent lobbying costs or unallowable expenses and no reimbursement is due to OASAS.

State Comptroller's Comment - According to OASAS Guidelines, the expenses of OASAS-funded providers must be documented. Throughout the response addressed to OASAS, Phoenix House asserts that its expenses are documented in the general ledger, which was available to the auditors. Though a general ledger is a record of an organization's transactions, it does not contain source and other documentation to support those transactions. Moreover, PHNY's general ledger does not document the methodology for allocating these expenses to PHNY. In addition, these amounts were based on budgeted expenses, not actual.

The public policy activities carried out by the Foundation on behalf of PHNY during the three fiscal years ending Jun 30, 2016 was work that was ordinary and necessary for the operation of PHNY, and was necessary for the provision of services by PHNY. As explained in PHNY's May 22, 2018 Response Letter, Phoenix House's founder and former President, Dr. Mitchell Rosenthal, was the Foundation's primary employee carrying out Phoenix House's public policy activities during that period. He did so primarily in his role as Executive Director of a then Foundation program known as the Rosenthal Center for Clinical and Policy Studies.

This program supported the activities and mission of PHNY and the other affiliates by identifying and analyzing public policies, research directions and treatment innovations related to substance use disorder treatment and by working with policy makers, funders, educational institutions and treatment providers to improve training and credentialing of persons entering the substance use disorder treatment field. Dr. Rosenthal did not lobby on PHNY's behalf and these costs are not lobbying costs.

With respect to OSC's contention that these expenses are unsupported, PHNY provided OSC with access to the Foundation's General Ledger for the fiscal year ended June 30, 2016, which was the only General Ledger requested by OSC. The expenses of the Public Policy Department as reflected in the Foundation's General Ledger include expenses that are specifically identified in Appendix I of the CFR Manual as permissible costs. In PHNY's May

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22, 2018 Response Letter, PHNY indicated that it would be pleased to provide access to the Foundation's General Ledger for fiscal years ending June 30, 2014 and 2015, as well as backup documentation for any journal entries selected by OSC. OSC did not request to see those General Ledgers or select any specific journal entries for review.

7. **$56,155 in Merit Increases for the Foundation's Employees.** The State Comptroller contends that because Phoenix House's policies require merit increases to be based on employee performance evaluations and PHNY was unable to provide performance evaluations to support the payment of $56,155 in merit increases to Foundation employees during the three fiscal years ending June 30, 2016, this expense should be disallowed.

The Foundation merit increases charged to PHNY are both supported and authorized and should not be disallowed.

As stated in PHNY's May 22, 2018 Response Letter, the Foundation followed its policies and procedures with respect to awarding merit increases to specific employees. In that regard, it has been the Foundation's practice to conduct annual employee performance evaluations in the Spring of each year, with merit increases, if any, awarded in July or so, at the beginning of the Foundation's fiscal year, to employees who met or exceeded job expectations. This annual merit increase practice did not preclude the Foundation from awarding individual employees a merit increase at any time throughout the year if such increase was requested by the employee's supervisor and authorized by the Foundation's President & CEO on the recommendation of the Foundation's Director of Human Resources. The Foundation followed these practices in awarding the $56,155 in merit increases.

State Comptroller's Comment - PHNY failed to provide performance evaluations, as required by its policies and procedures, to support the awarding and payment of merit increases.

(B) Personal Service Costs

1. **$493,428 in Salary Expenses for 28 Foundation and Phoenix Houses of Long Island Employees (for fiscal year ending June 30, 2016).**

2. **Additional $296,911 in Allocated Salary Expenses for which PHNY Officials Could Not Provide Documentation (for fiscal year ending June 30, 2016).**

The State Comptroller contends that the amounts in allocated salary expenses noted above, which total $790,339, should be recovered by OASAS because PHNY was not able to provide time studies, could not support the methodologies used to allocate salary expenses to PHNY and was unable to show that these employees provided services to PHNY.

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It is PHNY's position that the State Comptroller's finding that PHNY over claimed salary expenses by $790,339 for the fiscal year ending June 30, 2016 is without merit. PHNY has a procedure in place for determining salary allocations and maintains sufficient evidence to support the salary allocations. No improper salary expenses were claimed by PHNY and no reimbursement for salary expenses is due to OASAS.

State Comptroller's Comment - PHNY officials were unable to show that the employees in question provided services to PHNY. Additionally, officials were unable to provide time studies, nor could they support the methodology used to allocate salary expenses, as required.

As explained to the OSC auditors, salary allocations are determined as part of the annual budget process. PHNY's Executive Director meets with the PHNY Director of Human Resources, Finance Department and various PHNY program directors to construct an appropriate staffing budget that meets the needs of the respective program, satisfies OASAS requirements regarding staffing ratios and credentials, and is fiscally sound. The staffing budget is incorporated into PHNY's prospective budget submission sent to OASAS for approval. Salary allocations are then tracked and documented in PHNY's Resource Navigation, a position control system used by PHNY to record salary expenses. Adjustments are reflected in the General Ledger and PHNY maintains documentation to support all such journal entries.

PHNY provided OSC with access to the Foundation's General Ledger for the fiscal year ended June 30, 2016, when OSC requested such access. In PHNY's April 30, 2018 Response Letter, PHNY indicated that it would be pleased to provide access to backup documentation for any sampling of journal entries selected by OSC. OSC did not select any specific journal entries for review.

3. **$61,089 in Merit Increases Paid to 38 Employees During the Two Fiscal Years Ending June 30, 2016.** The State Comptroller asserts that $61,089 in merit increases paid to employees during the two fiscal years ending June 30, 2016 did not comply with PHNY's personnel policies, as they were not supported by employee performance reviews, and should be recovered by OASAS.

It is PHNY's position that these findings are incorrect. As explained in detail in PHNY's April 16, 2018 Response Letter, PHNY complied with its practices and policies in awarding these merit increases.

State Comptroller's Comment - PHNY failed to provide performance evaluations, as required by its policies and procedures, to support the awarding and payment of merit increases.

In its Preliminary Audit Report #6, the State Comptroller identified $68,158 in merit increases awarded to 44 employees that it contends did not comply with PHNY's policies because they were not supported by employee performance reviews. Based on additional information received from PHNY in its April 30, 2018 Response Letter, OSC reduced the

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amount of unsupported merit increases to $61,089 awarded to 38 employees. However, it is PHNY's position that PHNY complied with its policies and practices in awarding these salary increases and only $17,485, at most, of the $61,089 that OSC identifies as constituting unsupported merit increases could be viewed as unsupported merit increases.

It has been PHNY's policy and practice to conduct annual employee performance evaluations in the Spring of each year, with merit increases, if any, awarded in July or so, at the beginning of PHNY's fiscal year, to employees who met or exceeded job expectations. This practice did not preclude PHNY from awarding an individual employee a merit increase at any time throughout the year if such increase was requested by the employee's program director and authorized by PHNY's Executive Director and PHNY's Director of Human Resources, subject to oversight by Phoenix House's National Director of Payroll and National Director of Human Resources. As PHNY explained in its April 30, 2018 Response Letter, a number of the merit increases that OSC identified as unsupported merit increases did not constitute merit increases. In some cases, an employee's salary was increased to ensure his or her salary met the minimum salary for that employee's pay grade. In others, the employee received a pay increase because he or she had not received a raise in two or three years. In both of these circumstances, the salary increases were not tied to performance evaluations and a performance review was not necessary under PHNY policy in order to award the salary increase. PHNY identified the employees falling into these categories in a chart that PHNY provided to OSC with its April 30, 2018 Response Letter.

As PHNY also explained in its April 30, 2018 Response Letter, PHNY was undergoing a significant restructuring at the time of the Spring 2015 annual employee performance evaluations. The restructuring involved the closure of several programs and facilities, the transfer of employees, including program managers and supervisors, from one program or facility to another, and a significant change in leadership at program and senior management levels. These changes made the Spring 2015 performance review process, the review process for the merit increases awarded in the fiscal year ending June 30, 2016, more difficult to complete than in prior years. Given these unique circumstances, the PHNY Director of Human Resources, with the authorization of the Phoenix House National Director of Human Resources, allowed for more flexibility in completing the performance review process. This meant that, in certain circumstances, the absence of a written performance review did not preclude the award of a merit increase if the employee's program director, after conferring with the PHNY Director of Human Resources, confirmed that the employee's job performance met or exceeded expectations. A number of the employees that OSC identifies as receiving unsupported merit increases fall into this category.

As noted in PHNY' s April 30, 2018 Response Letter, PHNY could not locate performance reviews for 12 of the 38 employees identified by OSC who PHNY also has identified as receiving merit increases in the fiscal year ending June 30, 2016. The amount in merit increases awarded to these 12 employees is $17,485. As noted above, the lack of a performance review does not mean that these merit increases were awarded in violation of PHNY's policies and practices. It is PHNY's position that these merit increases were awarded based on either a written performance review supporting the award or a conference between the PHNY Director of Human Resources and the employee's program director confirming the

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employee's job performance met or exceeded expectations. However, PHNY currently is unable to provide documentation supporting that position.

(C) Other Than Personal Service Costs

1. **$102,682 in Equipment and Property Depreciation Expenses for the Two Fiscal Years Ending June 30, 2015.** The State Comptroller contends that PHNY claimed $102,682 in equipment and building depreciation expenses on its CFR-3 for the two fiscal years ending June 30, 2015 and that this expense should be recovered from PHNY.

No depreciation expenses were claimed on PHNY's schedule DMH-2 for the two fiscal years beginning on July 1, 2013 and ending June 30, 2015. OASAS did not reimburse PHNY for $102,682 in equipment and building depreciation expenses as claimed by the State Comptroller and, accordingly, such amount is not owed to OASAS by PNHY.

The CFR-3 schedule is a reporting schedule, not a claiming schedule. In accordance with the instructions set forth in the CFR Manual, Section 15.0, PHNY used its fiscal year ending June 30, 2014 and fiscal year ending June 30, 2015 CFR-3 schedules to report administrative costs not directly related to specific programs or sites. **However, PHNY did not claim these depreciation expenses on its schedule DMH-2, the claiming schedule, for either fiscal year.** As OASAS did not reimburse PHNY for these depreciation expenses, no repayment is due to OASAS.

State Comptroller's Comment - According to the CFR Manual, OASAS does not allow service providers to claim depreciation expenses.

2. **$12,065 in Vehicle Expenses for Fiscal Year Ending June 30, 2016.** The State Comptroller asserts that it has no assurance that $12,065 in vehicle expenses for the fiscal year ended June 30, 2016 were used for program purposes as PHNY officials could not provide vehicle logs as required, and recommends that OASAS recover that amount from PHNY.

PHNY's records reflect that the vehicles in question were used for PHNY program purposes and the $12,065 in vehicle expenses identified by OSC should not be disallowed.

In its Preliminary Audit Report #5, the State Comptroller identified $25,896 in undocumented vehicle lease payments based on its sampling of 15 vehicles to determine if the usage of the vehicle was program related. Based on additional information received from PHNY in its April 16, 2018 Response Letter, OSC reduced the amount of undocumented lease payments to $12,065, representing costs related to four vehicles. Two of the four vehicles were service vehicles, one of which was used for PHNY's Yorktown facility maintenance purposes and the other for deliveries and pick-ups of mail, packages, correspondence or documents among PHNY program facilities. Because these vehicles were service vehicles, daily travel logs were not maintained. However, PHNY facilities staff tracked how and where each of these vehicles was being used on a vehicle data summary report regularly maintained by the facilities staff.

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Accordingly, PHNY does maintain documentation demonstrating that these vehicles were used for PHNY program purposes.

With respect to the remaining two vehicles, one (Vehicle 81) was used by a PHNY employee from July 1, 2015 through approximately September 15, 2015, when this individual's employment with PHNY ended. PHNY provided the employee's vehicle business use logs for the entire period the vehicle was used by this employee (from July through mid-September 2015). After this employee left, Vehicle 81 was not reassigned to a new PHNY staff member and the costs related to Vehicle 81 from October 2015 through the end of the lease term in April 2016 were not charged to PHNY and were not claimed on PHNY's DMH-2 schedule for the fiscal year ending June 30, 2016. **Accordingly, no costs related to Vehicle 81 should be recovered by OASAS.**

The fourth vehicle (Vehicle 78) was used by a PHNY employee from July 1, 2015 through the end of her employment in mid-November 2015. After this employee left, Vehicle 78 was not reassigned to a new PHNY staff member and the costs related to Vehicle 78 from December 2015 through the end of the lease term in February 2016 were not charged to PHNY and were not claimed on PHNY's DMH-2 schedule for the fiscal year ending June 30, 2016. PHNY provided OSC with copies of the employee's vehicle business use logs for July and August 2015 but could not locate copies of her logs for September, October and the portion of November during which she was employed. OSC asserts that $1,747 should be disallowed based on the absence of logs for the September through mid-November 2015 period. However, if this expense is to be disallowed because logs could not be located, the expense associated with the two and one-half months for which logs could not be located is $1,248, not $1,747.

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As the State Comptroller notes in the Executive Summary of the Draft Report, PHNY's contracts with OASAS included a five-year, $47.6 million net deficit funding contract entered into in 2009 and a renewal of that contract, for another five-year term (July 1, 2014 through June 30, 2019), at a total cost of $51.4 million. Under those contracts, OASAS was to reimburse PHNY for its net operating expenses, up to the maximum budgeted amount, for providing the contracted services, which include outpatient, inpatient and residential services, at most, but not all, of PHNY's facilities in New York State.

As you may be aware, OASAS did not reimburse PHNY for all of its net operating costs for fiscal year ending June 30, 2015 or fiscal year ending June 30, 2016. In that regard, PHNY's net operating costs for fiscal year ending June 30, 2015 were $10,866,124. OASAS funded only $9,005,265 of the PHNY's net operating expenses that fiscal year. OASAS did not reimburse PHNY for $1,860,859 in net operating expenses. In fiscal year ending June 30, 2016, PHNY's net operating costs were $9,801,102. OASAS reimbursed $9,689,664 of that amount, leaving PHNY with $111,348 in unreimbursed net operating expenses. This fact also should be taken into consideration when considering OSC's recommendations with respect to amounts that should be recovered by OASAS.

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PHNY also would note that during each fiscal year in question, PHNY did not claim on its DMH-2 schedule all of the Net Agency Administration costs allocable to OASAS per PHNY's CFR-2 schedule for that fiscal year. For fiscal year ending June 30, 2014, PHNY did not claim on its DMH-2 schedule over $243,000 of Net Agency Administration costs that were allocable to OASAS. For fiscal year ending June 30, 2014, over $800,000 of Net Agency Administration Costs that were allocable to OASAS were not claimed on PHNY's DMH-2 for that fiscal year. For the fiscal year ending June 30, 2016, over $1.8 million of Net Agency Administration costs that were allocable to OASAS were not claimed on PHNY's DMH-2 schedule for that fiscal year. Accordingly, over the three fiscal years in question, PHNY did not seek or receive from OASAS $2,843,000 in costs that were allocable to and could have been reimbursed by OASAS. In addition, OASAS did not fund all of PHNY's programs licensed by OASAS. Net Agency Administration cost totals for each fiscal year included costs associated with those programs but such costs were not claimed by PHNY and OASAS did not reimburse PHNY for such costs. These facts also must be taken into consideration when considering the OSC's recommendations regarding amounts that should berecovered from PHNY.

Please let us know if you have any questions or require any additional information.

Very truly yours,

Anthony Marotta
Regional Controller

cc: Judy Grehl, SGA-OSC
Natalie Sherman, SGA-OSC
Michael Solomon, SGA-OSC

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