# Office of Addiction Services and Supports

## Oversight of Contract Expenditures of Palladia, Inc.

Report 2020-S-5 | August 2021

OFFICE OF THE NEW YORK STATE COMPTROLLER
Thomas P. DiNapoli, State Comptroller
Division of State Government Accountability

# Audit Highlights

## Objective

To determine whether the Office of Addiction Services and Supports (OASAS) is effectively monitoring its contract with Palladia, Inc. (Palladia) to ensure reimbursed claims are allowable, supported, and program related. The audit covered the period from July 1, 2015 through June 30, 2018.

## About the Program

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 2014, OASAS entered into a five-year $45.6 million contract with Palladia, under which Palladia would provide drug and addiction treatment services. During fiscal year 2017-18, Palladia operated 31 distinct programs, 10 of which were contracted with OASAS. These 10 programs served 603 individuals in the fields of residential treatment, outpatient treatment, and scattered-site housing. In December 2014, Palladia merged with and began operating under Services for the Underserved (SUS), an organization that offers housing, employment, skills-building, treatment, and rehabilitation services. In 2017, Palladia and SUS entered into a management agreement whereby SUS would provide Palladia with administrative services. According to the contract, OASAS reimburses Palladia for its net operating expenses, up to the maximum budgeted amount for providing the contracted services. The expenses are reported by Palladia on its annual Consolidated Fiscal Reports 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), and the contract.

## Key Findings

OASAS is not effectively monitoring the expenses reported by Palladia to ensure that reimbursed claims are allowable, supported, and program related. For the three fiscal years ended June 30, 2018, we identified $2,508,682 in costs that did not comply with the requirements in the CFR Manual, the Guidelines, and the contract, as follows:

- $1,679,913 in personal service costs, including:
  - $878,747 in costs that were not sufficiently documented or not allowable; and
  - $801,166 in salaries allocated to OASAS that were already covered under a management fee agreement.
- $779,458 in other than personal service (OTPS) costs, including:
  - $635,115 for which Palladia could not provide basic general ledger detail to support reported expenses; and
  - $144,343 in costs that were either not sufficiently documented, not program related, or ineligible.
- $49,311 in non-allowable parent agency administration costs.

## Key Recommendations

- Recover $2,508,682 in unallowable and/or unsupported costs from Palladia, including $1,679,913 in personal service costs, $779,458 in OTPS costs, and $49,311 in parent agency administration costs.
- Establish additional monitoring controls and improve oversight to ensure that Palladia claims only actual expenses and that those expenses are allowable, reasonable, supported, and consistent with the CFR Manual, the Guidelines, and the contract.
- Ensure Palladia discloses all expenses and allocation methodologies during its budget process, specifically salary expenses shared between OASAS and non-OASAS programs and the details of those expenses included in parent agency administration costs.

**Office of the New York State Comptroller**
**Division of State Government Accountability**

August 18, 2021

Arlene González-Sánchez
Commissioner
Office of Addiction Services and Supports
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. By so doing, it provides accountability for the 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 of our audit entitled *Oversight of Contract Expenditures of Palladia, Inc*. This 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 report, please feel free to contact us.

Respectfully submitted,

*Division of State Government Accountability*

# Contents

# Glossary of Terms

| Term | Description | Identifier |
|---|---|---|
| CFR | Consolidated Fiscal Report | *Key Term* |
| CFR Manual | Consolidated Fiscal Reporting and Claiming Manual | *Policy* |
| Guidelines | OASAS' Administrative and Fiscal Guidelines for OASAS-Funded Providers | *Policy* |
| OASAS | Office of Addiction Services and Supports | *Auditee* |
| OTPS | Other than personal service | *Key Term* |
| Palladia | Palladia, Inc. | *Service Provider* |
| SUS | Services for the Underserved | *Service Provider* |

# Background

The Office of Addiction Services and Supports (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 2014, OASAS entered into a five-year (July 1, 2014 through June 30, 2019) $45.6 million contract with Palladia, Inc. (Palladia), under which Palladia would provide drug and alcohol addiction treatment services. During fiscal year 2017-18, Palladia operated 31 distinct programs, 10 of which are contracted with OASAS. These 10 programs served 603 individuals in the fields of residential treatment, outpatient treatment, and scattered-site housing. According to the contract, OASAS reimburses Palladia for its net operating expenses, up to the maximum budgeted amount, for providing the contracted services. The expenses are reported by Palladia 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), and the contract.

In December 2014, Palladia merged with and began operating under Services for the Underserved (SUS), an organization that offers housing, employment, skills-building, treatment, and rehabilitation services. For the purposes of this report, Palladia and SUS officials are collectively referred to as Palladia officials. In 2017, Palladia entered into a management agreement with SUS whereby SUS would provide Palladia with administrative services, including organizational strategy and financial services and other services requested by SUS' Board of Directors. Palladia charged the management fee, which is calculated as a percentage (7.3%) of Palladia's total direct allowable cost, on the CFR. The management fee for fiscal year 2017-18 was approximately $1.8 million.

# 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 are not sufficient to effectively identify unallowable and/or unsupported expenses reported and claimed by Palladia.

For the three fiscal years ended June 30, 2018, we found that Palladia claimed $2,508,682 in expenses that did not comply with the requirements in the CFR Manual, the Guidelines, and the contract. These expenses included $1,679,913 in personal service expenses, $779,458 in other than personal service (OTPS) expenses, and $49,311 in unallowable and/or unsupported parent agency administration expenses.

## OASAS Oversight

According to OASAS' Guidelines, OASAS is responsible for monitoring the fiscal activities of all OASAS-funded providers, including Palladia. The CFR Manual offers guidance for providers that details what expenses can and cannot be claimed for reimbursement, as well as the documentation necessary to support these expenses. Palladia's contract requires Palladia to establish and maintain complete and accurate books, records, documents, and other evidence directly pertinent to its performance under the contract. OASAS performs desk reviews of incoming CFR documents to determine whether claimed expenses are allowable. OASAS officials advised us that they also perform field office budget reviews to ensure that the reported CFR information is within Palladia's approved budget. Upon discovery of a provider's non-compliance with the CFR Manual, the Guidelines, or the contract, OASAS may recover expenses deemed to be unallowable and unsupported. 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.

We determined that OASAS did not adequately monitor Palladia's fiscal activities. For example, OASAS did not ensure that Palladia maintained adequate records. We found that Palladia could not provide general ledger detail to support $635,115 in reported OTPS expenses. We also determined that an additional $1,873,567 was not in compliance with the CFR Manual, the Guidelines, and the contract. OASAS had earlier indications that Palladia was out of compliance with requirements for claiming reimbursements based on deficiencies that were previously identified, as follows:

- A 2010 OSC audit report determined that Palladia could not support over $8 million in reported expenses, primarily due to the absence of an appropriate allocation methodology for costs shared between OASAS and non-OASAS programs; and
- A 2016 OASAS fiscal review determined that the personal service allocation for Palladia employees shared between OASAS- and non-OASAS-funded programs was not in compliance the CFR Manual. We found these same

allocation issues were still occurring in fiscal year 2017-18 and account for $801,166 in disallowances identified during this audit.

We also determined the Guidelines and controls used by OASAS were not sufficient to detect or prevent unallowable and unsupported expenses from being claimed by Palladia. While the CFR Manual requires providers, such as Palladia, to report actual expenses on their CFRs, OASAS did not verify that Palladia maintained an allocation methodology to support shared expenses; instead, OASAS relied on budgeted costs to determine whether the amounts claimed on the CFR were reasonable. Moreover, OASAS may view annual costs as appropriate as long as the total program costs are below the provider's approved budget, which incentivizes providers to report budgeted rather than actual expenses on their CFRs.

In response to our findings, OASAS officials acknowledged concerns regarding how Palladia apparently calculated and claimed its personal service and fringe benefits expenses and how administrative expenses were lumped together on a single line item "Parent Administrative Expenses." They further acknowledged that Palladia had a contractual obligation to maintain appropriate documentation to support claimed expenses for the required number of years.

## Personal Service Costs

Personal service costs, which include all salaries and fringe benefits paid or accrued to employees, must be reported on the CFR as either direct care costs (e.g., case workers' salaries) or non-direct care costs (e.g., administrators' salaries). For the three fiscal years ended June 30, 2018, Palladia reported approximately $24.6 million in personal service costs related to the OASAS programs. We identified $1,679,913 in personal service costs that did not comply with the CFR Manual, the Guidelines, and the contract's requirements for reimbursement.

### Services Covered Under the Management Agreement

During the two fiscal years ended June 30, 2017, Palladia reported its agency administration personal service costs under the personal service line item on its Schedule CFR-3 (non-direct care costs). On July 1, 2017, Palladia entered into a management fee agreement with SUS whereby SUS would provide Palladia with administrative and management services, including organizational strategy and financial services or other services requested by SUS' Board of Directors. As such, all agency administrative costs, including personal service costs, were being incurred by SUS and should have been reported under the parent agency administration allocation on Palladia's CFR. According to Appendix L of the CFR Manual, 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. Further, the contract requires that Palladia maintain personal service records, including cost allocation plans.

During our review of Palladia's fiscal year 2017-18 direct care costs (Schedule CFR-1), we found that $7,089,511 in personal service costs were allocated to Palladia's OASAS programs. These allocated personal service expenses represented 340 employees. Upon further examination, we identified 120 employees who performed work for multiple entities/programs, including both Palladia and SUS. When asked, Palladia officials could not support the actual allocation methodologies used, nor could they provide time studies to support the compensation allocated to the OASAS programs. As a result, we interviewed six employees and asked those working in administrative functions about their process for tracking time worked for multiple programs. Each claimed that they do not track their time spent among the multiple programs and work is done per program on an "as needed" basis. We concluded that their estimation of time worked for OASAS programs cannot be verified. Moreover, we determined that these 120 employees, whose compensation totaled $801,166, had job titles that were administrative in nature (e.g., tech support analyst, accounts payable specialist, chief operating officer) and should not have been reported as direct care costs on Palladia's CFR. Instead, these job functions are related to the parent agency administration costs and should have been already accounted for separately on the CFR as parent agency administration costs, for which Palladia already pays SUS a management fee.

Palladia officials disagreed, and stated that the amounts reported on the CFR are within the OASAS-approved budgeted amounts and, therefore, should not be disallowed. However, we found that compliance with overall budget does not support the actual program use for many of the aforementioned administrative positions. For example, Palladia budgeted two full-time positions (superintendent and tutor) totaling $58,000 for one of its OASAS-funded programs. However, when we reviewed Palladia's actual costs, we found they did not support any employees in these two roles. Alternatively, portions of 54 employees' salaries totaling $49,500 were allocated to the OASAS-funded program.

We recommend OASAS recover $801,166 in personal service costs that were incorrectly allocated to the OASAS programs.

## Undocumented and Unallowable Expenses

According to the Guidelines, providers who desire to make changes in employee compensation in the form of salary or bonuses must submit a detailed request to the OASAS Regional Office for approval. The Guidelines also require providers to maintain complete and up-to-date employee personnel records, which, at a minimum, contain each employee's hiring contract, job description, salary action forms, and time records. Additionally, the CFR Manual states that a cost must be reasonable and/or necessary in both nature and amount for providing services. We identified $878,747 in personal service expenses that did not comply with the CFR Manual and the Guidelines.

To determine whether personal service costs were adequately supported, we reviewed Palladia's personnel records and payroll registers for a sample of 105 employees (which includes some individuals whose records covered more than one year). For 51 of these employees, Palladia officials could not provide adequate documentation supporting $796,700 in salary and other compensation charged to the OASAS programs, as follows:

- $534,835 for 17 employees for whom there was no documentation to support they worked for the OASAS programs during our audit period, including:
  - $215,743 for eight employees for whom Palladia could not provide any employment information, such as hiring letters, salary action forms, job descriptions, or proof of which program they worked for;
  - $166,688 for six employees whose personnel records and time records did not support that they worked for the OASAS programs;
  - $116,494 for two employees who worked for non-OASAS programs; and
  - $35,910 for one employee whose salary was allocated to fiscal year 2016-17, but who was not hired until fiscal year 2017-18.
- $194,239 in salary for 26 employees that was overstated on the CFR, compared with the contracted salaries documented in Palladia's records.
- $64,063 for two employees whose salaries were allocated to the OASAS programs but who were not listed on Palladia's payroll register.
- $3,563 in non-allowable bonuses for six employees. (Four of these employees were among the 26 mentioned above whose salaries were overstated.)

Separate from our sample above, we found an additional $82,047 in personal service expenses that did not comply with the CFR Manual and the Guidelines, including:

- $44,383 in one-time salary payments to seven employees, in excess of their contracted annual salary, that were not approved by OASAS. Palladia officials explained that these one-time payments stemmed from a reclassification of expenses; however, they could not provide documentation to support this.
- $37,664 in compensation paid to 31 employees in October 2017, which was allocated to a residential treatment program that closed in July 2017. Palladia officials could not provide any support for work done by these employees after the program closed.

We recommend OASAS recover $878,747 in personal service costs that were undocumented and/or not allowable.

## Other Than Personal Service Costs

OTPS costs, including equipment and rent, must be reported on the CFR as either direct care costs (e.g., directly related to the OASAS program) or non-direct care costs (e.g., administrative). For the three fiscal years ended 2017-18, Palladia reported approximately $15.9 million in OTPS costs for the OASAS programs. We identified $779,458 in OTPS expenses that did not comply with the CFR Manual requirements and/or the Guidelines for reimbursement.

## Supporting Records Not Available

According to the contract and the Guidelines, Palladia is required to maintain complete and accurate books, records, documents, receipts, accounts, and other evidence directly pertinent to its performance under the contract. Despite numerous requests from October 2020 through May 2021, Palladia could not support $635,115 in OTPS expenses for fiscal year 2016-17. Palladia officials could not provide a detailed general ledger for administrative OTPS expenses. Instead, officials provided only a summary of expenses per expense line item, which did not include sufficient information required to support the reported expenses. For example, one journal entry documented that $168,746 in "Contracted Services for Temp Help" was accrued on the last day of the fiscal year; however, no additional detail was provided, such as a listing of contracted workers or payment information.

We recommend that OASAS recover the $635,115 in OTPS costs that did not comply with the requirements in OASAS' Guidelines and the contract.

## Unallowable Expenses

The Guidelines require service providers to maintain adequate documentation in support of reported revenues and expenditures. According to the CFR Manual, providers must support the methodology used to allocate parent agency administration costs to subsidiaries and affiliates. Costs are not allowable when they are not properly related to program/site participant care or treatment and when they principally afford diversion, entertainment, or amusement to owners, operators, or employees. Additionally, real estate taxes are non-allowable unless required as part of a lease agreement. Costs resulting from violations of, or failure to comply with, federal, State, and local government laws, rules, and regulations (including fines, parking tickets, and the costs of insurance policies obtained solely to insure against such penalty) are also not allowable. Further, expenses included as a cost of any other program in a prior, current, or subsequent fiscal period are not allowable. We selected a judgmental sample of 231 expenses totaling $2,185,587 and determined that $144,343 was not in compliance with the Guidelines and the CFR Manual, as follows:

- $121,436 in unsupported and ineligible costs, including:
    - $70,349 in unsupported agency administration-allocated costs (e.g., consulting fees).
    - $22,016 in expenses that were not corroborated with supporting invoices or documentation to support the amount claimed for reimbursement. These expenses included $19,741 in information technology support/hardware purchases for which support could not be provided for the OASAS programs.

- $13,746 in real estate taxes for which payment terms were not explicitly stated in the lease agreements.
- $11,095 in fines and violations.
- $2,173 for expenses incurred outside of the proper reporting period.
- $1,256 related to non-allowable household supplies. These costs are generally covered by a personal needs allowance funded by other sources, such as the Office of Temporary and Disability Assistance.
- $801 related to staff kitchen supplies (e.g., water cooler, coffee machine).

- $22,907 in non-program-related expenses, including:
  - $10,231 for Housing Quality Standard inspection visit costs related to a Housing and Urban Development-funded Flora Vista program.
  - $7,410 in furniture costs related to the Office of Mental Health-funded Fox Point program.
  - $5,000 in web-based software expenses not related to the OASAS programs.
  - $266 in staff travel expenses for employees who did not work directly for the OASAS programs.

We recommend that OASAS recover $144,343 in costs that were not in compliance with the Guidelines and the CFR Manual.

## Parent Agency Administration Costs

According to the CFR Manual, parent agency administrative expenses are reimbursable if they are completely supported. Additionally, the CFR Manual does not allow OASAS service providers, such as Palladia, to claim vacation leave accruals and depreciation for reimbursement. The CFR Manual also states that food costs and special events are non-allowable for the provider's employees. During the fiscal year ended June 30, 2018, SUS provided Palladia with administrative and management services, including organizational strategy and financial services. In total, $835,710 in parent agency administration costs were allocated to the OASAS programs. We determined that $49,311 in parent agency administration costs were not allowable and/or unsupported as follows:

- $25,061 in non-allowable equipment and property depreciation expenses;
- $17,186 in non-allowable vacation leave accruals;
- $4,082 in other non-allowable costs such as food for staff and special events (e.g., theater tickets, dinners); and

- $2,982 in non-program-related expenses related to an Office for People With Developmental Disabilities-funded program.

We recommend that OASAS recover $49,311 in parent agency administration costs that were not in compliance with the CFR Manual.

## Recommendations

1. Recover $2,508,682 in unallowable and/or unsupported costs from Palladia, including $1,679,913 in personal service costs, $779,458 in OTPS costs, and $49,311 in parent agency administration costs.
2. Establish additional monitoring controls and improve oversight to ensure that Palladia claims only actual expenses and that those expenses are allowable, reasonable, supported, and consistent with the CFR Manual, the Guidelines, and the contract.
3. Ensure Palladia discloses all expenses and allocation methodologies during its budget process, specifically salary expenses shared between OASAS and non-OASAS programs and the details of those expenses included in parent agency administration costs.

# Audit Scope, Objective, and Methodology

The objective of our audit was to determine whether OASAS is effectively monitoring its contracts with Palladia to ensure reimbursed claims are allowable, supported, and program related. The audit covered the period from July 1, 2015 through June 30, 2018.

To accomplish our objective, we reviewed the CFR Manual, the Guidelines, Palladia's CFRs, and relevant financial and program records for the audited period. In addition, we evaluated the internal controls over the costs claimed on, and the schedules prepared in support of, the CFRs submitted to OASAS. We also interviewed key personnel from OASAS, Palladia, and SUS, and reviewed Palladia's financial records and supporting schedules for expenses. Additionally, we selected a judgmental sample of reported costs to determine whether they were supported, program related, and reimbursable. Specifically, we reviewed costs that were considered high risk and reimbursable in limited circumstances based on prior audit report findings, such as salaries and fringe benefit expenses, salary allocation, and OTPS expenses. Our samples were based on the relative materiality of the various categories of costs reported and their associated levels of risk. Our samples were not designed to be projected to the entire population of reported costs.

# Statutory Requirements

## 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.

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.

As is our practice, we requested a representation letter from OASAS and Palladia in which management provides assurance, to the best of their knowledge, concerning the relevance, accuracy, and competence of the evidence provided to the auditors during the course of the audit. The representation letter is intended to confirm oral representations made to the auditors and to reduce the likelihood of misunderstandings. In this letter, officials assert that, to the best of their knowledge, all relevant financial and programmatic records and related data have been provided to the auditors. Officials further affirm that they are in compliance with all laws, rules, and regulations applicable to their operations that would have a significant effect on the operating practices being audited, or that any exceptions have been disclosed to the auditors. We received a representation letter from OASAS confirming the representations and assurances stated above.

We changed the wording in the draft representation letter to Palladia to state that Palladia had not made available all requested records, related data, and unrestricted access to persons deemed necessary to obtain audit evidence. However, Palladia officials have not provided a representation letter in connection with this audit. As a result, we lack assurance from Palladia's officials that all relevant information was provided to us during the audit.

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. 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.

## Reporting Requirements

A draft copy of this report was provided to OASAS officials for their review and formal comment. Their comments were considered in preparing this final report and are included at the end of it. In their response, OASAS officials generally disagreed with most of our conclusions. Our responses to certain OASAS comments are embedded within OASAS' response.

Within 180 days after final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the Office of Addiction Services and Supports 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 where recommendations were not implemented, the reasons why.

# Exhibit

**OASAS Oversight of Contract Expenditures for Palladia, Inc.**
**Three Fiscal Years July 1, 2015 Through June 30, 2018**

| Recommended Cost Recoveries | 2015-16 | 2016-17 | 2017-18 | Totals |
|---|---|---|---|---|
| Personal Service Costs | $444,575 | $352,125 | $883,213 | $1,679,913 |
| Other Than Personal Service Costs | 70,349 | 635,115 | 73,994 | 779,458 |
| Parent Agency Administration Costs | 0 | 0 | 49,311 | 49,311 |
| **Total Recommended Cost Recoveries** | **$514,924** | **$987,240** | **$1,006,518** | **$2,508,682** |

**Office of Addiction Services and Supports**

ANDREW M. CUOMO
Governor

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

July 6, 2021

Mr. Stephen Lynch, Audit Manager
Office of the New York State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

Re: Response to OSC Draft Audit Report (#2020-S-5)

Dear Mr. Lynch:

The NYS Office Of Addiction Services and Supports (OASAS) has reviewed the NYS Office of the State Comptroller's (OSC) draft audit report "Oversight of Contract Expenditures of Palladia, Inc." (report #2020-S-5) that was received on May 27, 2021 and offers the following comments and observations pertaining to your recommendations.

**OSC Recommendations #1:**

**Recover $2,508,682 in unallowable and/or unsupported costs from Palladia, including $1,679,913 in personal service costs, $779,458 in OTPS costs, and $49,311 in parent agency administration costs.**

The report contained numerous references where the OSC determined that Palladia lacked sufficient documentation to support claimed expenses and had claimed expenses for both personal services and OTPS costs that were not in accordance with contractual requirements or those specified in the Consolidated Fiscal Report (CFR) manual or the Administrative and Fiscal Guidelines for OASAS-Funded Providers. Additionally, while the administrative expenses claimed were quite low as a percentage of overall expenses, this single line item entry, where a group of expenses were lumped together with no provided detail, contained expenses that were determined to be non-allowable.

Upon receipt of the OSC's final audit report, OASAS will send auditors from our Fiscal Audit and Review Unit (FARU) to compare entries in Palladia's financial books and records with what they claimed in their CFR submissions. It is at that time, as is our customary process, when we will determine the propriety of their claims and recover all dollars that Palladia may have been paid for which they were not entitled.

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**OSC Recommendation #2:**

**Establish additional monitoring controls and improve oversight to ensure that Palladia claims only actual expenses and that those expenses are allowable, reasonable, supported, and consistent with the CFR Manual, the Guidelines, and the contract.**

OASAS disagrees with this this recommendation and the statement that: *OASAS is not effectively monitoring the expenses reported by Palladia to ensure that reimbursed claims are allowable, supported, and program related.*

**State Comptroller's Comment** – We disagree. The $2,508,682 in unallowable and/or unsupported costs identified by our audit indicates that additional monitoring controls and improved oversight need to be established to ensure that claimed expenses comply with the requirements in the CFR Manual, the Guidelines, and the contract.

We also take exception to the statement that: *OASAS did not adequately monitor Palladia's fiscal activities to ensure that Palladia maintained adequate records, and that guidelines and controls used by OASAS were not sufficient to detect or prevent unallowable and unsupported expenses from being claimed by Palladia.*

**State Comptroller's Comment** – We stand by our statement. Our audit report identified many instances where Palladia officials did not maintain adequate records – including $635,115 for which Palladia officials could not provide us with a detailed general ledger of administrative OTPS expenses. The existing OASAS controls were not sufficient to detect or prevent this and other unallowable or unsupported expenses from being claimed by Palladia.

While the OSC's draft report contends that OASAS does not effectively monitor reported expenses and needs to establish controls and improve oversight, such a statement is overly broad and must be put into its proper perspective.

OASAS funds its providers using a methodology known as Net Deficit Funding that starts with the creation of a Consolidated Budget Report (CBR) that is submitted by the provider to the OASAS Regional Office (RO). This report details specific line items of all expected revenue and expenses and culminates with the presentation of an operating deficit that the provider is asking OASAS to fund. It is important to note that the approved budget is an estimate of anticipated net deficit funding based on historical revenues and expenditures that is subject to modification. The RO evaluates the proposal and, based on its merits, determines the amount of available OASAS funding to help fill that deficit. The final result is the provider's operating budget of record for the upcoming fiscal period.

**State Comptroller's Comment** – Our statement is not overly broad. While OASAS' Regional Offices review and approve the provider's budget proposal, this review is performed prior to the start of the fiscal year in which expenses will be incurred. Throughout the course of the year, and at fiscal year end, OASAS did not actively monitor the expenses the provider claimed on its CFR. Instead, a desk audit of the submitted CFR was performed, including a comparison of the amounts claimed on the CFR with the budget. If

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the expenses were within the approved budgeted amounts, OASAS did not perform any further reviews of the expenses submitted on the CFR. Additionally, as stated on page 7 of the report, OASAS found similar issues during its review of Palladia, specifically the incorrect allocation of personal service costs that we found in subsequent years.

Providers receive the agreed upon State funding in quarterly advances and must submit a CFR to OASAS five months after the end of their operating year. The CFR reports on various activities, including a listing of all programs operated by the provider, the units of service provided during the year, and a reconciliation of their net deficit funding based on self-reported and not audited financial information. This document is first subject to a desk audit by the OASAS CFR Review Unit to determine compliance with several requirements, including whether the submitted claim contains any obvious non-allowable expenses. If any are found, this unit interacts directly with the provider, which often results in the submission of a revised CFR. The OASAS State Payments Unit then analyzes the approved CFR claim, comparing the financial reconciliation to the agreed upon budget of record, and reconciles the claim based on established processes.

The process of oversight then moves to our Fiscal Audit and Review Unit (FARU), that uses a risk assessment tool to prioritize which of the more than 500 funded providers to examine in more depth. The risk assessment provides a numerical score that factors in certain conditions including the total amount of funding, the result of the last examination and its findings, and the length of time since the last review. It is at this time that staff go on site to confirm the accuracy of the provider's CFR submission and hold the provider accountable for all the provisions contained in the CFR manual, the Administrative and Fiscal Guidelines for OASAS-Funded Providers and, as applicable, the funding contract.

Similar to the OSC, the work of the FARU auditors takes place years after the concluded operating periods. When issues are uncovered concerning either claimed revenue or expenses, it often requires the submission of a corrected CFR, and also the repayment of monies that may have been paid inappropriately to the provider. This process is similar to what the OSC did by auditing Palladia's books and records. The key is that the oversight you are suggesting can only be done after the fact and is not something that can be accomplished on a live basis.

We therefore believe that OASAS does appropriately monitor and oversee the fiscal activities of its providers. Furthermore, as evidenced by Palladia being at the top of our risk assessment tool, had the OSC not selected them for an audit, our FARU would have commenced one. This is one more confirmation that the current oversight practices are working.

**State Comptroller's Comment** – We disagree. OASAS did not appropriately monitor and oversee the fiscal activities of Palladia. We found significant non-compliance in the areas of both personal services and OTPS that could have either been prevented or detected earlier with stronger oversight from OASAS. As stated on page 7 of our report, a 2010 OSC audit report and a 2016 OASAS fiscal review both identified issues with salary allocation. We determined these same issues still existed during our audit.

It is commendable that FARU has identified Palladia as a high-risk provider; however, this

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supports OSC's conclusion that Palladia's submitted expenses needed to be closely monitored, which would include more detailed and frequent reviews of financial records.

**OSC Recommendation #3:**

**Ensure Palladia discloses all expenses and allocation methodologies during its budget process, specifically salary expenses shared between OASAS and non-OASAS programs and the details of those expenses included in parent agency administration costs.**

OASAS disagrees with this recommendation and the statement that OASAS*: did not verify that Palladia maintained an allocation methodology to support shared expenses, instead relying on budgeted costs to determine whether the amounts claimed on the CFR were reasonable and further that OASAS "may" view annual costs as appropriate as long as the total program costs are below the provider's approved budget, which incentivizes providers to report budgeted rather than actual expenses on their CFRs.*

As noted in more detail in the previous section, OASAS takes every measure to ensure that a provider's agreed upon budget of record is as accurate as possible and that it is based on reasonable estimates of revenue and expenses. This also includes ensuring that proposed line item administrative costs are reasonable, appropriate and, through a ratio value calculation, considers all proposed administrative expenses for both OASAS and non-OASAS programs, to ensure that OASAS only funds its appropriate share of these expenses.

Further, while the budget negotiation contained line item administrative costs to consider, Palladia lumped most of those expenses into a single CFR line item "Parent Agency Admin" without providing detail of what was included. For more than two years, our CFR Review Unit has required that all providers who have entries on this single line item detail its contents to ensure the appropriateness of what is comprises. The periods audited by the OSC in its examination of Palladia predated this enhanced oversight.

**State Comptroller's Comment** – While it is commendable that OASAS has updated its requirements, this does not change the fact that, during fiscal year 2017-18, Palladia included its parent agency administration costs on the single line item without OASAS verifying what was included and whether it was allowable as per the CFR Manual, the Guidelines, and the contract.

Given that the issue is one of how expenses were claimed and not how they were budgeted, OASAS contends that its budgeting process is appropriate and accurate.

**State Comptroller's Comment** – OSC is not questioning OASAS' budgeting process, nor was this process the focus of the audit. Rather, this audit focused on the amounts claimed on the CFR, which should be based on actual expenses that comply with the CFR Manual, Guidelines, and the contract. However, both OASAS and Palladia officials stated that if CFR expenses are within approved budgeted amounts, they will generally be accepted. Compliance with the budget process should not justify unallowable costs being claimed on the CFR.

Thank you for the opportunity to respond and for your consideration of our comments.

Very truly yours,

Steven J. Shrager

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