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

Division of State Government Accountability

Cost Reporting of Programs Operated by Gateway-Longview, Inc.

State Education Department
Office of Children and Family Services
Office of Mental Health
Department of Health

Report 2012-S-17

December 2014

Executive Summary

Purpose

To determine whether the costs reported by Gateway-Longview, Inc. (Gateway) to the State Education Department (SED), the Office of Children and Family Services (OCFS), the Office of Mental Health (OMH) and the Department of Health (DOH) were properly calculated, adequately documented and allowable under the respective governing guidelines of these State agencies. This audit covered the period July 1, 2008 through June 30, 2011.

Background

Gateway, located in Buffalo, New York, is a not-for-profit organization that provides supportive, educational, housing and substitute care services for children, youth and families. Gateway receives funding from multiple sources including SED, OCFS, OMH and DOH. These agencies have issued manuals and guidelines to provide direction on reimbursable costs. For the three fiscal years ended June 30, 2011, Gateway received about $68.6 million in revenue from government sources.

Key Findings

- For our audit period, we disallowed a total of nearly $2.4 million in ineligible costs, including costs lacking required documentation and/or sufficient details of the charges. Gateway routinely entered into business transactions with companies affiliated with members of Gateway's Board of Directors without competitive bidding or evidence that transactions were fair and reasonable. The cost of these related-party transactions totaled $7,042,903. We disallowed $1,999,744 for the amounts charged to the programs.
- We also disallowed $378,946 for items such as expenses lacking documentation; expenses that were not program-related; and expenses for ineligible items such as food, flowers, personal expenses and gifts for staff. These disallowances also included $64,110 in payments for car and cell phone allowances for Gateway's former Chief Executive Officer and other officials. These costs were inappropriate, not properly documented and/or not reimbursable.
- We also questioned certain actions involving Gateway's Board of Directors that pertain to the related-party business arrangements. Based on these actions, we concluded that significant improvements in the Board's conduct are needed to ensure the financial and programmatic integrity of Gateway's programs in the future. In addition, we questioned $792,704 in interest costs on loans to cover operating losses.

Key Recommendations

- SED, OCFS, OMH and DOH should follow up on the inappropriate and unsupported expenses identified in our report, revise the reimbursement rates for Gateway and seek restitution, as appropriate.
- Direct Gateway to ensure that board members avoid conflicts of interest and annually file written disclosures of any business involvement with Gateway or related parties.

Other Related Audits/Reports of Interest

Westchester School for Special Children: Compliance With the Reimbursable Cost Manual (2011-S-41)

Office of Children and Family Services/State Education Department: Maintenance and Tuition Payments to The Lake Grove School and Mountain Lake Children's Residence (2009-S-90)

State of New York
Office of the State Comptroller

Division of State Government Accountability

December 30, 2014

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Dear Dr. King, Ms. Carrion, Mr. Tauriello, Dr. Zucker and Ms. DeFranco:

The Office of the State Comptroller is committed to providing accountability for tax dollars spent to support government-funded services and 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 intended to safeguard assets.

Following is a report of our audit of the expenses submitted by Gateway-Longview, Inc. to the State Education Department, the Office of Children and Family Services, the Office of Mental Health, and the Department of Health (for the purposes of determining reimbursement amounts for the programs these agencies support) entitled *Cost Reporting of Programs Operated by Gateway-Longview, Inc.* This audit was performed pursuant to the State Comptroller's authority under 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,

Office of the State Comptroller
Division of State Government Accountability

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Background

Gateway-Longview, Inc. (Gateway), located in Buffalo, New York, is a not-for-profit organization that provides supportive, educational, housing and substitute care services for children, youth and families who are deemed to be in need of such services. Gateway provides special educational services to school-age and pre-school children between 3 and 21 years of age. This includes a residential educational program for school-age children.

Gateway receives funding from multiple sources, including the State Education Department (SED), the Office of Children and Family Services (OCFS), the Office of Mental Health (OMH) and the Department of Health (DOH). SED and OMH require providers to report their income and expenses on Consolidated Fiscal Reports (CFRs), while OCFS requires its providers to report similar information on Statewide Standards of Payment reports (SSOPs). SED, OCFS and OMH review the income and expenses reported on the CFRs and SSOPs and use this data to determine the funding levels for the programs they support. For DOH, Gateway is required to submit claims to be reimbursed for meals served in its day care programs. SED, OCFS, OMH and DOH have issued manuals and guidelines to provide direction on reimbursable costs. For the three fiscal years ended June 30, 2011, Gateway received about $68.6 million in revenue from government sources.

As of March 15, 2012, Gateway had 28 members on its Board of Directors. During 2013 there was significant change in the management structure of Gateway as both the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) left Gateway.

Audit Findings and Recommendations

We disallowed about $2.4 million in ineligible expenses, many of which lacked required supporting documentation. Further, Gateway routinely entered into business transactions with companies affiliated with its board members or a member of the Gateway-Longview Foundation board. Gateway officials acknowledged that some of these business arrangements were not competitively procured, and for others, they were unable to provide documentation of competitive procurement. Further, Gateway's management did not provide contemporaneous documentary evidence these related-party transactions were fair, reasonable and at or below market rates. In total, we disallowed $1,999,744 for these related-party transactions.

In addition, we disallowed $378,946 for items such as expenses lacking documentation; expenses that were not program-related; and expenses for ineligible items such as food, flowers, personal expenses and gifts for staff. These disallowances also included $64,110 in payments for car and cell phone allowances for Gateway's former Chief Executive Officer and other officials. These costs were inappropriate, not properly documented and/or not reimbursable.

Also, we questioned certain actions involving Gateway's Board of Directors. These actions pertain to the aforementioned related-party business arrangements. In addition, we questioned $792,704 in interest costs on loans to cover operating losses.

Ineligible Costs Pertaining to Related-Party Transactions

Each of the State oversight agencies has established guidance regarding the documentation required to support costs claimed for rate-setting and reimbursement. Such documentation must show that claimed costs were reasonable, necessary, most economical and otherwise eligible for reimbursement. The required documentation includes billing records, such as receipts and invoices. OCFS and OMH require agencies to maintain such documentation for at least six years, and SED requires documentation be maintained for seven years. Gateway was responsible for maintaining adequate documentation to support its claimed costs.

In addition, SED's Reimbursable Cost Manual includes the "Statement on the Governance Role of a Trustee or Board Member," published by the State Board of Regents. According to the Statement on Governance, "The conduct of a trustee/board member must, at all times, further the institution's goals and not the member's personal or business interests. Consequently, trustees/board members should not have any personal or business interest that may conflict with their responsibilities to the institution. A trustee/board member should avoid even the appearance of impropriety when conducting the institution's business. Acts of self-dealing constitute a breach of fiduciary responsibility that could result in personal liability and removal from the board." Also, per OCFS regulations, no member of the governing board of an agency or any of its advisory bodies may engage, directly or indirectly, in any business or activity which is in substantial conflict with the proper discharge of his duties as a member of such governing board or advisory body.

Nonetheless, Gateway routinely entered into business arrangements with companies affiliated with Gateway Board members. In fact, we identified 14 material business arrangements with 12 Board-affiliated companies (related to 10 different Board members) during our three-year audit period. These arrangements included new construction and renovation projects, legal services, information technology, cleaning, maintenance and staffing as well as various types of goods and services. The cost of the related-party transactions totaled about $7 million. We disallowed $1,999,744 for the ineligible amounts charged to the programs we examined.

These transactions lacked adequate supporting documentation. Specifically, required payment-related documents (such as invoices/receipts) were not available, or the available documentation lacked required details of the goods or services provided. In addition, there was generally little or no evidence of competitive procurement. In response to our preliminary findings, Gateway officials admitted they had internal control weaknesses and indicated they needed to strengthen their record-keeping protocols. Several examples of the major transactions in question are presented in the following narratives.

Payments to Businesses Affiliated With Board Member I

Gateway awarded four contracts, totaling about $5 million, to companies affiliated with this Gateway Board member. This included three contracts, with a total cost of about $4.7 million, with Savarino Construction Corporation (Savarino), for which the member is President and CEO. One contract was for the construction of a new Residential Youth Facility, and the other two contracts were for renovations to existing buildings. Also, one of the renovations required formal prior approval from SED; however, Gateway did not apply for nor receive such approval.

SED requires agencies to maintain bidding documentation, and requires entities to demonstrate that their contractors were the most economical and/or appropriate. In addition, the IRS requires certain tax-exempt organizations to file annually Form 990, which includes information on an entity's mission, programs and finances. Gateway must file a Form 990. On Gateway's Form 990, officials stated that the contracts with Savarino were competitively bid. However, Gateway was unable to provide documentation showing it competitively bid any of the three construction contracts in question. Thus, Gateway officials had little assurance that the contracts were fair, reasonable and at (or below) market value.

For one project, Gateway did provide us with a formal agreement which required Savarino to provide Gateway with all project development and preconstruction services at no initial cost. In exchange, if the project proceeded to construction, Gateway agreed Savarino would be the project's Contractor or Construction Manager and the costs would be part of the contract price. We believe this arrangement obligated Gateway to contract with Savarino and explains why there was no evidence of competitive bidding for the project. Subsequently, Gateway used Savarino's existing presence on site as justification for not bidding one of the renovation projects. Moreover, for each of the three projects, Gateway was required to maintain adequate documentation and records necessary to certify the nature and extent of the costs claimed for reimbursement. However, Gateway lacked the required documentation for the projects in question. Consequently, we disallowed costs totaling $194,839 that Gateway claimed for these projects.

In November 2007, Gateway awarded a no-bid contract for speech-language therapy services to the Buffalo Hearing and Speech Center (Center). The Board member is the former board chairman of the Center and is the founding board chairman of the Center's Foundation. According to Gateway officials, an internal therapist resigned in 2007, and Gateway was unable to find a suitable replacement. Consequently, Gateway entered into a "short-term" contract with the Center to provide certain mandated services. Although intended for short-term use, Gateway continued to obtain services under this contract into 2012. Further, Gateway did not competitively bid this service until May 2012.

To be claimed for reimbursement, the State requires special education providers to adequately document costs incurred for the use of consultants. Specifically, such costs should be supported by invoices which detail the date and duration of the services provided, as well as the identities of the students to whom the services were rendered. The Center's bills, however, lacked the required information, and therefore the related Gateway payments were not adequately supported. Thus, we disallowed the $255,775 in payments made to the Center which Gateway claimed during our audit period.

Payments to a Business Affiliated With a Gateway-Longview Foundation Board Member

The owner operator of DVS Group/Amalgamated (or DVS group) was a board member of the Gateway-Longview Foundation during our audit period. Gateway paid DVS Group $941,532 for cleaning services during that period. Gateway officials told us that the contract for cleaning services was bid. However, officials were unable to provide any documentation of competitive procurement and told us the documentation had been discarded. The only bid officials provided was a 2007 proposal from DVS Group. Moreover, because of the absence of documentation of competitive procurement, Gateway was unable to justify that the DVS Group was the most economical and appropriate available for the particular service provided, as otherwise required. Further, supporting documentation sometimes did not include details of the services/supplies provided by location. Therefore, we disallowed the $941,532 paid to the DVS Group.

Payments to Businesses Affiliated With Board Member II

This Board member was a partner in Consilium1 and AP/Advantage Professionals during our audit period. During that period, Gateway claimed costs totaling $252,080 for payments to Consilium1 and AP/Advantage Professionals. Gateway hired Consilium1 to review its computer network environment/infrastructure, to provide and implement system design recommendations and to provide support services. According to Gateway's IRS 990s, "Fees for services are based on competitive market rates." Gateway also leased computer equipment from Consilium1. Although Gateway officials told us that these contracts were competitively bid, they were unable to provide adequate documentation of proper competitive procurement. In addition, Gateway was unable to provide documentation for significant phases (planning and implementation) of this project. Gateway also contracted with AP/Advantage Professionals, a firm that provides temporary staff and permanent employees for fees. According to Gateway's former CFO, each time Gateway would need temporary or permanent staff, they would contact other staffing firms (in addition to AP/Advantage Professionals) to obtain the best price. However, the CFO did not provide any documentation that this occurred during our audit period.

Because of the absence of documentation of competitive procurement, Gateway was unable to justify that Consilium1 and AP/Advantage Professionals were the most economical and appropriate sources available for the particular services provided. Further, there was insufficient documentation of the services billed, including a lack of details of the dates and hours of service provided. Therefore, we disallowed the $252,080 in payments to Consilium1 and AP/Advantage Professionals.

In addition to the aforementioned related-party business arrangements, seven other Gateway Board members were affiliated with businesses that received payments from Gateway during our audit period. Gateway claimed a considerable portion of the costs associated with these payments in their financial reports to the State. A detailed summary of all the related-party business transactions we disallowed is included in Exhibit B.

Other Ineligible Costs

We further identified $378,946 in other ineligible costs claimed by Gateway. Among a range of ineligible costs, we found expenditures lacking required supporting documentation, personal expenses and expenses that were ineligible for reimbursement and/or not program-related. Specifically, the disallowances included:

- $199,395 in expenditures that lacked the required supporting documentation. Claimed program costs must be properly documented, including invoices, receipts and canceled checks. For many of the expenses that Gateway claimed, officials were unable to provide required supporting documentation.
- $64,110 for items for the personal benefit of certain employees. Personal expenses are not eligible for reimbursement, and often such costs were not properly documented. Specifically, the former CEO received personal benefits totaling $39,138. Included in this total was a $600 monthly allowance for the purchase or lease of a vehicle, a cell phone allowance and reimbursement for membership fees to private social clubs. Other Gateway officials received benefits totaling $24,972. This includes an employee's commuting costs totaling $16,252. According to New York State travel guidelines, normal travel between an employee's home and his/her official work station is not reimbursable. In addition, nine other employees received cell phone allowances. These employees did not maintain the required documentation to support the business use of their phones, and as such, we disallowed the related costs.
- $59,278 in expenditures for expenses which are not permissible per the formal guidance of State oversight authorities. Among the claimed costs were payments for food, flowers, personal expenses and gifts for staff, all of which are prohibited.
- $56,163 for expenditures which were not program-related. Costs will be considered for reimbursement provided they are reasonable, necessary and program-related. However, Gateway spent $40,599 on public relations expenses, including printing of newsletters and

fees to attend a public relations event that included "open bar, elaborate food stations and award presentations." Gateway also spent $2,830 on fund-raising events. Because many of these items benefitted the Gateway Foundation or were for fund raising, Gateway officials agreed that many of these items were not reimbursable.

In addition, we questioned $792,704 in interest costs for a $4.5 million loan Gateway obtained to address cash shortfalls resulting from operating losses. The operating losses occurred at least in part because Gateway routinely incurred costs that exceeded thresholds (cost screens) established by State oversight agencies for their rate-setting processes. The interest costs associated with these loans were allocated across all programs. The loan and associated interest costs in question were necessary to offset these operating losses. To allow costs of this nature minimizes the impact of the cost screen process, and as such, we question whether such costs should be allowed. Gateway also had a $1.2 million line of credit, which they used to offset short-term revenue shortfalls. The existence of this line of credit further caused us to question the $792,704 in interest costs associated with the $4.5 million loan.

Board Governance

In addition to the disallowances that we identified, we questioned certain actions involving Gateway's Board of Directors that pertain to the aforementioned related-party business arrangements. Based on these actions, we concluded that significant improvements in the Board's conduct are needed to ensure the financial and programmatic integrity of Gateway's programs in the future.

Related-Party Business Transactions

Control environment is the attitude toward internal controls and control consciousness established and maintained by the management of an organization and its employees. It is a product of management's philosophy, style and supportive attitude, as well as the competence, ethical values, integrity and morale of the people in the organization. Organizational structure and accountability relationships are key factors in the control environment. Gateway's 28-member Board is responsible for the overall direction of Gateway and has a fiduciary responsibility to exercise due care and diligence in safeguarding the organization's assets. In addition, Board members must avoid conflicts of interest and acts of self-dealing.

Further, the Attorney General's Office issued a booklet entitled "*Right From the Start: Responsibilities of Directors of Not-for-Profit Corporations,"* which provides guidance to boards of directors in regard to their fiduciary responsibilities. Specifically, it states "directors must act in 'good faith' using the 'degree of diligence, care and skill' which prudent people would use in similar positions and under similar circumstances." In addition, "Directors are charged with the duty to act in the interest of the corporation" and "should avoid transactions in which they or their family members benefit personally." Also, as noted previously, SED's "Statement on the Governance Role of a Trustee or Board Member" states that Board members should not have any personal or business interests that may conflict with their responsibilities to the institution.

Nonetheless, Gateway's Board of Directors did not exercise due care and diligence in performing their fiduciary responsibilities. As noted previously, Gateway routinely entered into business arrangements with companies affiliated with Board members and a member of the Gateway Foundation Board. During our three-year audit period, Gateway had 14 significant business arrangements with 12 companies represented by 10 Gateway or Gateway Foundation Board members (see Exhibit B).

Despite the guidance provided by SED and the Attorney General, Gateway's bylaws do not prohibit business arrangements with related parties. In fact, the bylaws allow them. Further, Gateway's bylaws state that Board members who have business transactions with Gateway must disclose such transactions and demonstrate that they are fair, reasonable and authorized by the Board. However, we could not verify that Gateway's Board formally approved several of the contracts in question. According to Gateway officials, there was no specific threshold (dollar amount) at which formal Board approval of a contract was required. Thus, it was unclear when contracts were subject to Board approval, and therefore, certain contracts were not submitted for approval. Further, the bylaws require such arrangements to be at or below market value. However, Gateway maintained no documentation, contemporaneous with the contracts and Gateway's related payments, to demonstrate that the arrangements were fair and reasonable and that the goods and services were provided at or below market value.

Recommendations

To SED, OCFS, OMH and DOH:

1. Follow up on the inappropriate and unsupported expenses identified in our report, revise the reimbursement rates for Gateway and seek restitution, as appropriate. In addition, review the questionable interest costs identified and determine if these costs are reimbursable.

2. For the years subsequent to our audit scope, determine if the matters addressed in this report also impact the related Gateway financial reports. Adjust the financial reports as appropriate and determine the corresponding impact on Gateway's reimbursement rates.

3. Direct Gateway to ensure that board members avoid conflicts of interest and annually file written disclosures of any business involvement with Gateway or related parties.

4. Take steps to ensure Gateway's reporting of expenses includes only those expenses that comply with all program guidelines and requirements.

To Gateway:

5. Ensure that Board members avoid conflicts of interest and annually file written disclosures of any business involvement with Gateway or related parties.

6. Modify the bylaws to ensure the Board of Directors formally approves all contracts at or above a specified dollar threshold and that these decisions are adequately documented. Ensure

the Board is provided with sufficient information and analysis to make informed decisions regarding such contracts.

7. Ensure that reporting of reimbursable expenses complies with all prescribed program guidelines and requirements. At a minimum this should include maintaining supporting documentation for claimed expenses as well as documentation to support competitive bidding efforts.

Audit Scope and Methodology

We audited the costs reported by Gateway to SED, OCFS, OMH and DOH for the three fiscal years ended June 30, 2011. The objective of our audit was to determine whether the costs were properly calculated, adequately documented and allowable under their respective governing guidelines.

To accomplish our objective, we reviewed applicable laws, regulations, policies and procedures, and we interviewed pertinent SED, OCFS, OMH, DOH and Gateway officials and staff. We reviewed Gateway's accounting records, CFRs, SSOPs and audited financial statements for our audit period. We also assessed the internal controls related to the procurement of goods and services for the programs Gateway operated, and performed certain tests to assess the sufficiency of these controls for the three years ended June 30, 2011. To complete our audit work, we reviewed supporting documentation for selected expenditures and made a determination of whether the costs complied with the applicable written program provisions. Our initial audit work indicated that Gateway routinely entered into business arrangements with Board members; consequently, we performed additional testing in this area.

We conducted our 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 (some of whom have minority voting rights) to certain boards, commissions and public authorities. 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 Gateway, SED, OCFS, OMH and DOH officials for their review and formal comment. We considered their comments in preparing this report and have included them at the end of it. In their responses, SED and OMH officials agreed with the audit recommendations and indicated the actions they will take to address them. OCFS officials stated they will review the audit disallowances and act on the recommendations accordingly, and DOH officials concluded the audit findings did not impact the DOH program that Gateway participates in.

Gateway officials generally disagreed with our audit findings. However, officials also indicated they made significant changes, under a new management team, to strengthen internal controls and protocols to help ensure enhanced accountability and protection of the public trust. Based on Gateway's response to the draft report, we revised or deleted certain issues in preparing this final report. In addition, Gateway provided extensive attachments with its response. We did not append those attachments to the final report; however, the attachments will be maintained on file at the Office of the State Comptroller.

Our rejoinders to certain Gateway, SED, OCFS, OMH and DOH comments are included in the report's State Comptroller's Comments.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Commissioners of SED, OCFS, OMH and DOH 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. We also request Gateway officials to advise the State Comptroller of actions taken to implement the recommendations addressed to them, and where such recommendations were not implemented, the reasons why.

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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 A

Gateway-Longview, Inc.
Schedule of Submitted, Disallowed and Allowed Program Costs
For the Three Fiscal Years July 1, 2008 Through June 30, 2011

Program Costs	Amount Per CFR	Amount Disallowed	Amount Allowed	Applicable Requirements (See Notes to Exhibit)
Personal Services	$36,227,957	$0	$36,227,957	
Fringe Benefits (includes leave)	$10,209,417	$10,510	$10,198,907	A, L-N, P-U, X-Z
Other-Than-Personal-Service	$13,326,330	$1,385,064	$11,941,266	A, G, I, J, L-N, Q-X, Z, AA-AC, AE
Equipment	$664,720	$20,979	$643,741	L-N, Q-U, X
Property	$3,157,142	$207,572	$2,949,570	L-O, Q-U, X
Sub Total	**$63,585,566**	**$1,624,125**	**$61,961,441**	
Administration	$7,348,427	$754,565	$6,593,862	A-N, Q-W, AA-AI
Total Program Costs	**$70,933,993**	**$2,378,690**	**$68,555,303**	

Notes to Exhibit A

The Notes shown below refer to specific sections of the Reimbursable Cost Manual (RCM Manual), Part 200 of the Regulations of the Commissioner of Education, OCFS Administrative Directive: 06-OCFS-ADM-02 - Model Contract for Purchase of Foster Care Services, OCFS' Statewide Standards of Payment Program Manual (SSOP Manual), Parts 427.5 and 441.3 of the Regulations of the Commissioner of Social Services, Parts 552.5 and 578 of the Regulations of the Commissioner of Mental Health, Appendix X of the Consolidated Budget and Claiming Manual, and the Travel Manual maintained by the Office of the State Comptroller, upon which we have based our adjustment. We have summarized the applicable section to explain the basis for the disallowance. Details of the transactions in question were provided to SED, OCFS, OMH and Gateway officials during the course of the audit.

A. RCM, Section I (08-09), Section II (09-10 and 10-11) - Costs will be considered for reimbursement provided such costs are reasonable, necessary, and directly related to the education program and are sufficiently documented.
B. RCM, Section I.3.A (08-09), Section II.3.A (09-10 and 10-11) - Advertising costs for the purpose of recruiting students into programs or soliciting fund raising monies or donations are not reimbursable and remain nonallowable in the calculation of tuition rates.
C. RCM, Section I.14.A.7 (08-09), Section II.14.A.6 (09-10 and 10-11) - Expenses of a personal nature, such as a residence or personal use of a car, known as perquisites (or perks), are not reimbursable. When costs are disallowed because they are of a personal nature, providers should inform the employee(s) in writing, that the employee(s) must refund the disallowed costs to the provider within a date certain. If the employee(s) fails to do so, the amount should be recovered through a reduction in compensation.
D. RCM, Section I.21.A (08-09), Section II.21.A (09-10 and 10-11) - Costs incurred for entertainment of officers or employees, or for activities not related to the program, or any related items such as meals, lodging, rentals, transportation, and gratuities, are not reimbursable.
E. RCM, Section I.21.B (08-09), Section II.21.B (09-10 and 10-11) - All personal expenses, such as personal travel expenses, laundry charges, beverage charges, gift certificates to staff and vendors, flowers or parties for staff, holiday parties, repairs on a personal vehicle, rental expenses for personal apartments, etc., are not reimbursable unless specified otherwise in this Manual.
F. RCM, Section I.22 (08-09), Section II.22 (09-10 and 10-11) - Costs resulting from violations of, or failure by, the entity to comply with Federal, State, and/or local laws and regulations, are not reimbursable.
G. RCM, Section I.30.3 (08-09), Section II.30.C (09-10 and 10-11) - Costs for food, beverages, entertainment and other related costs for meetings, including Board meetings, are not reimbursable.
H. RCM, Section I.37 (08-09), Section II.37 (09-10 and 10-11) - Costs of the school's membership in civic, business, technical, and professional organizations are reimbursable subject to the following restrictions:
    a. The benefit from the membership is related to Article 81 and/or Article 89 programs.

b. The cost of membership is reasonably commensurate to the value of the services or benefits received.

c. The expenditure is not for membership in an organization whose primary purpose is to influence legislation.

I. RCM, Section I.55.A (08-09), Section II.55.A (09-10 and 10-11) - Costs incurred for telephone service, local and long distance telephone calls, electronic facsimiles (FAX) and charges for cellular telephones, etc., are reimbursable provided that: (1) They pertain to the special education program; and (2) Long distance telephone or message charges are documented by monthly bills and proof of payment and directly attributable to the Article 81 and Article 89 funded programs.

J. RCM, Section I.55.B (08-09), Section II.55.B (09-10 and 10-11) - Long distance telephone charges and all cell phone charges that are not properly documented will not be reimbursed.

K. RCM, Section I.57 (08-09), Section II.57 (09-10 and 10-11) - Travel costs include costs of transportation, lodging and subsistence incurred by employees in travel status on official school business. Reimbursement for such travel costs shall be consistent with Bulletins issued by the N.Y.S. Division of the Budget and the Office of the State Comptroller.

RCM, Section II.A (08-09), Section III.1 (09-10 and 10-11) - Costs will not be reimbursable on field audit without appropriate written documentation of costs. Documentation includes but is not limited to:

L. RCM, Section II.A.3 (08-09), Section III.1.C.2 (09-10 and 10-11) - Adequate documentation includes, but is not limited to, the consultant's resume, a written contract which includes the nature of the services to be provided, the charge per day and service dates. All payments must be supported by itemized invoices which indicate the specific services actually provided; and for each service, the date(s), number of hours provided, the fee per hour, and the total amount charged. In addition, when direct care services are provided, the documentation must indicate the names of students served, the actual dates of service and the number of hours of service to each child on each date.

M. RCM, Section II.A.3 (08-09), Section III.1.C.3 (09-10 and 10-11) - Requests for proposals (RFP) or other bidding documentation must be kept on file by the entities operating the program. The entity will need to justify that the consultant hired was the most economical and/or appropriate available for a particular service.

N. RCM, Section II.A.4 (08-09), RCM, Section III.1.D (09-10 and 10-11) - All purchases must be supported with invoices listing items purchased and indicating date of purchase and date of payment, as well as canceled checks. Costs must be charged directly to specific programs whenever possible. The particular program(s) must be identified on invoices or associated documents. When applicable, competitive bidding practices should be used in conformance with the School Business Management-Handbook Number 5.

O. RCM, Appendix D.I.A (08-09 – 10-11) - All applications for capital projects must be put in writing to their VESID Special Education and Quality Assurance Office and the Rate Setting Unit. The application must include line drawings of existing and proposed facilities with square footages listed for each room, cost estimates that include all estimated construction and incidental costs, current enrollment data and student staffing ratios. Additionally, documentation of health/safety issues or violations, building code non-compliance, and/or non-compliance with accessibility requirements must be provided to justify the need for the proposed project. Project plans will be reviewed by the RSU, VESID Special Education and Quality Assurance Office and the Office of Facilities Planning. The agency will be notified in writing of the capital project cost that is approved by the New York State Division of the Budget and will be considered for reimbursement in future tuition rates.

P. 8 NYCRR 200.9 (e)(i)(a)(1) (08-09 – 10-11) - Private providers and special act school districts shall submit the New York State Consolidated Fiscal Report certified by a licensed or certified public accountant independent of the program's operation.

Q. 8 NYCRR 200.9 (d) (3) Programs shall retain all pertinent accounting, allocation and enrollment/attendance records for a period of seven years following the end of each reporting year. Information relating to the acquisition of fixed assets, equipment, land or building improvements and any related financing arrangements and grants must be retained as long as the facility is used by any educational program the provider operates if this period exceeds seven years.

R. 06-OCFS-ADM-02, Section VII (08-09 – 10-11) - The Agency and its subcontractor(s) agree to retain all books, records and other documents relevant to this Agreement for six (6) years after the Agency receives final payment for the services to which they relate, during which time authorized county, State and/or federal auditors will be provided with full access to and the right to examine the same. In addition, the Agency and its subcontractor(s) must make available, upon written request, this Agreement, and books, documents, papers and records of the Agency or subcontractor(s) that are necessary to certify the nature and extent of such costs involved, to the Secretary of the United States Department of Health and Human Services, or upon request, to the New York State Office of the State Comptroller, New York Attorney General's Office, or any of their duly authorized representatives.

S. 06-OCFS-ADM-02, Section VIII (08-09 – 10-11) - The agency covenants and agrees that neither it nor any of its directors, officers, members, or employees has any interest, nor will they acquire any interest, directly or indirectly, which would substantially or adversely conflict in any manner or degree with the Agency's performance of this Agreement. The names and addresses of the members of the Board of Directors of the Agency is to be annexed to this Agreement.

T. SSOP, Chapter 4.A.c (08-09 – 10-11) - The amount of State reimbursement shall be available up to the maximum State aid rate established for each program, for costs deemed reasonable by the Department.

U. SSOP, Chapter 4.C.14 (08-09 – 10-11) - Allowable expenses are those expenses related to the care, maintenance and services provided to the child in a program.

V. SSOP, Chapter 4.C.14 (08-09 – 10-11) – Non-allowable expenses are those expenses not related to the provision care, maintenance and services. Examples of non-allowable expenses include special research or demonstration projects for public or private organizations. Fund raising expenses and investment counseling fees are non-allowable and are reported in the non-MSAR programs.

W. SSOP, Chapter 4.C.14.10 (08-09 – 10-11) - Payments for retreats for religious staff are non-allowable.

X. 18 NYCRR 441.3 (a)(3) (08-09 – 10-11) - No member of the governing board of an agency or any of its advisory bodies may engage, directly or indirectly, in any business or activity which is in substantial conflict with the proper discharge of his duties as a member of such governing board or advisory body.

Y. 18 NYCRR 427.5 (a) (08-09 – 10-11) - Each authorized agency shall submit to the department for each institution, group residence, group home program, agency boarding home program and family foster boarding home program and approved school for the handicapped, an income and expenditure report for the past fiscal period, including a program description and any supplemental reports in whatever form specified by the department.

Z. SSOP Chapter 4 (08-09 – 10-11) – As of August 2006, Standards of Payment Submissions will only be accepted electronically via the Statewide Standards of Payment (SSOP) application.

AA. 14 NYCRR 552.5 (a) (08-09 – 10-11) - All fiscal, statistical and programmatic records and reports and all underlying books, records, documentation and reports which formed the basis for the provider of service's fiscal, statistical and programmatic reports are subject to audit including records of a related party or holding company. Such information must be kept and maintained by the provider of service for a period of not less than six years of filing of the fiscal, statistical or programmatic report, or the date such records were required to be filed.

AB. 14 NYCRR 578.4 (a) (08-09 – 10-11) - To be allowable, costs must be reasonable and must relate to patient care.

AC. 14 NYCRR 578.5 (a) (08-09 – 10-11) - Each residential treatment facility shall maintain records, and shall prepare and submit to the commissioner financial and statistical reports in accordance with the requirements of the commissioner. (c) All reports required to be prepared and submitted to the commissioner: (2) shall be certified by an independent certified public accountant or an independent licensed public accountant and the operator or director of the residential treatment facility.

AD. 14 NYCRR 578.14 (a) (08-09 – 10-11) - To be considered as allowable in determining the rate of payment, costs must be properly chargeable to necessary resident care rendered in accordance with the requirements of Part 584 of this Title and any applicable codes, rules, regulations and laws pursuant to title XIX of the Social Security Act. The allowability of costs shall be determined in accordance with the following:

- (h) Allowable costs shall not include costs which principally afford entertainment or amusement to owners, operators or employees.
- (i) Allowable costs shall not include any interest charged or penalty imposed by governmental agencies or courts, nor the costs of policies obtained solely to insure against the imposition of such a penalty.
- (j) Allowable costs shall not include the direct or indirect costs of advertising, public relations and promotion except in those instances where the costs are specifically related to the operation of the residential treatment facility and not for the purpose of attracting residents.

AE. Appendix X (#8) (08-09 – 10-11) - Costs applicable to services, facilities, and supplies furnished to the provider by organizations related to the provider by common ownership or control are excluded from allowable cost of the provider if it exceeds the cost to the related organization. Therefore, such cost must not exceed the lower of actual cost to the related organization or the price of comparable services, facilities or supplies that could be purchased elsewhere.

AF. Travel Manual: General Guidelines: Employees are in travel status when they are more than 35 miles from both their official station and their home.

AG. Travel Manual: General Guidelines: Travel between the employee's home and official station is considered commuting and is not reimbursable.

AH. Travel Manual: Reimbursement Allowances: Travelers may be reimbursed for breakfast and/or dinner for day trips based on departure and return times. Travelers are entitled to reimbursement for breakfast if they have to leave at least one hour before their normal work start time, and/or for dinner if they return at least two hours later than their normal work ending time.

AI. Travel Manual: Reimbursement Allowances: Travelers without meal receipts are reimbursed $5.00 for breakfast and/or $12.00 for dinner. Travelers with meal receipts are reimbursed up to the maximum amount of the meal per diem allowance (Method 2) specified for the particular area of travel. The meal per diem allowance is apportioned for breakfast and dinner.

Exhibit B

Board Member	Affiliated Company	Total Cost	Amount Charged During Audit Period	Description/Comments
I	Savarino Construction Corporation: CAB Project	$3,949,288	$80,585	Gateway did not provide any documentation of bidding. Gateway officials stated the subcontractors for this project were bid, but did not provide documentation to support these claims. For this project, Gateway did not meet the documentation requirements listed in notes R, S and X to Exhibit A.
I	Savarino Construction Corporation: Knox Project	574,048	72,578	Gateway did not provide any documentation of bidding. Gateway officials also stated subcontracts for this project were not bid. Further, Gateway officials did not provide documentation to show they obtained the required SED approval to complete the construction project. For this project, Gateway did not meet the documentation requirements listed in notes L, M, N and O to Exhibit A.
I	Savarino Construction Corporation: FRC Project	174,326	41,676	Gateway did not provide any documentation of bidding. Gateway officials also stated subcontracts for this project were not bid. For this project, Gateway did not meet the documentation requirements listed in notes AA, AC and AE to Exhibit A.
I	Buffalo Hearing and Speech Center	255,775	255,775	According to Gateway officials, at the time they entered into this contract, an internal therapist left Gateway and they could not find a suitable replacement. Officials stated they were mandated to provide this service, so they entered into a short-term no bid contract with the Buffalo Hearing and Speech Center in order to complete the school year. However, Gateway officials did not bid out this contract until May 2012, nearly five years after they first entered into this arrangement. For this contract, Gateway did not meet the documentation requirements listed in notes L, M and N to Exhibit A.
Member Gateway Foundation Board	DVS Group/ Amalgamated	941,532	941,532	Gateway officials indicated that contract was bid. However, they also indicated that all supporting documentation was discarded. Officials were only able to provide a 2007 bid from DVS Group. For this contract, Gateway did not meet the documentation requirements listed in notes L, M, N, Q, R, S, X, AA, AC and AE to Exhibit A.

Board Member	Affiliated Company	Total Cost	Amount Charged During Audit Period	Description/Comments
II	Consilium1	206,684	206,322	Gateway officials claimed this contract was bid; however, they did not provide adequate support for their contentions. For these payments, Gateway did not meet the documentation requirements listed in notes L, M, N, Q, R, S, X, AA, AC and AE to Exhibit A.
II	Consilium1 – IT Loan	445,295	28,090	Gateway leased computer equipment from Consilium1 through M&T Bank. The total cost of this lease was $445,295 ($402,823 plus interest). Gateway officials claim the Consilium1 contract was bid; however, they did not provide adequate supporting documentation. For this contract, Gateway did not meet the documentation requirements listed in notes L, M, N, Q, R, S, X, AA, AC and AE to Exhibit A.
II	AP/Advantage Professionals	17,668	17,668	AP/Advantage Professionals is a full-service staffing firm that provides temporary and permanent employees for a fee. According to Gateway's former CFO, each time Gateway would need/hire someone, they would contact other staffing firms (in addition to AP Professionals). However, he did not provide any documentation this occurred during our scope period. For these payments, Gateway did not meet the documentation requirements listed in notes L, M, N, Q, R, S, X, AA, AC and AE to Exhibit A.
III	John W. Danforth Company: Other Maintenance Expenses	79,098	64,956	Gateway's former CFO stated that a service contract was bid for maintenance at Gateway's Main Street and Niagara Street locations. However, officials had no documentation to show the work was bid. The CFO also stated that Gateway used Danforth for emergency work at the East Ferry Street location. However, this work was not bid out. Further, Gateway did not provide a maintenance agreement with Danforth for any portion of our audit period. Gateway did not meet the documentation requirements listed in notes L, M, N, Q, R, S, X, AA, AC and AE to Exhibit A.

Board Member	Affiliated Company	Total Cost	Amount Charged During Audit Period	Description/Comments
IV	Prentice Office Environments	125,267	16,640	Prentice provides Gateway with used office furniture. However, Gateway did not bid the Prentice contract or each individual purchase. Instead, officials provided us with some examples of quotes they obtained from Prentice. They state the quotes showed the State contract price and the Prentice invoice number billed to Gateway. However, the State contract prices are for new furniture, while Prentice provides Gateway with used furniture. For these payments, Gateway did not meet the documentation requirements listed in the notes M, R, S, X, AA and AE to Exhibit A.
V	Lippes Mathias Wexler Friedman LLP	144,573	144,573	According to Gateway's former CFO, Lippes provided legal services, primarily for contracts and lawsuits. Gateway officials provided no documentation of competitive procurement or rationale for selecting Lippes. No contract was maintained. For this arrangement, Gateway did not meet the documentation requirements listed in notes L, M, N, R, S, X, AA and AE to Exhibit A.
VI	John Donovan	68,000	68,000	According to Gateway's former CFO, John Donovan provides legal services related to labor issues. Gateway officials provided no documentation of competitive procurement or rationale for selecting Donovan. For this arrangement, Gateway did not meet the documentation requirements listed in the notes L, M, N, R, S, X, AA and AE to Exhibit A.
VI	Phillips Lytle LLP	48,656	48,656	According to Gateway's former CFO, Phillips Lytle provides legal services related to union benefits. He also stated that the Board member is a retired Phillips Lytle partner. Gateway officials provided no documentation of competitive procurement or rationale for selecting Phillips Lytle. For this arrangement, Gateway did not meet the documentation requirements listed in the notes L, M, N, R, S, X, AA, AC and AE to Exhibit A.

Board Member	Affiliated Company	Total Cost	Amount Charged During Audit Period	Description/Comments
VII, VIII	Damon Morey LLP	7,282	7,282	According to Gateway's former CFO, Damon Morey was used for Medicaid Law issues and an M&T loan. Gateway officials provided no documentation of competitive procurement or rationale for selecting Damon Morey. For this arrangement, Gateway did not meet the documentation requirements listed in notes M, R, S, X, AA and AE to Exhibit A.
IX	Nottingham Advisors	5,411	5,411	Nottingham Advisors was chosen to serve as the investment advisor for Gateway's defined benefit pension plan. Within Gateway's Executive Board Minutes, we found Gateway did bid the investment advisor position, but the only bids solicited were from three related parties. For this arrangement, Gateway did not meet the documentation requirements listed in notes M, S, X, AA and AE to Exhibit A.
Total Members - 10	**Total Business Affiliates - 12**	**$7,042,903**	**$1,999,744**	

Agency Comments - Gateway-Longview, Inc.

GT GreenbergTraurig

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October 17, 2014

David Fleming
Audit Manager
New York State Comptroller's Office
Division of State Government Accountability
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Re: Gateway-Longview, Inc. ("Gateway")//2012-S-17//
"Accountability Audits of Private Special Education Providers"

Dear Mr. Fleming:

We have reviewed the OSC draft audit findings of Gateway-Longview, Inc. ("Gateway") for audit years 2008-09, 2009-10 and 2010-11 as referenced above and gratefully acknowledge the initial revisions made based upon our explanation of items identified by the auditors in the preparation of the preliminary report and the materials provided in support of the restoration of certain preliminary disallowances as discussed in detail at the exit conference with OSC staff and Gateway Board Members and management staff. We must, however, renew our challenges to the remaining findings as set out below and request that the OSC reconsider this information in finalizing the audit.

While the initial audit notice reflected OSC intent to audit the Agency's New York State Education Department (NYSED) approved program costs and expenses against the NYSED Reimbursable Cost Manual (RCM) governing educational program cost reporting, the auditors subsequently expanded their review of complementary state funding sources -- Office of Children and Family Services (OCFS), the Office of Mental Health (OMH) and the Department of Health (DOH). We believe the complexity of the interface of these diverse funding sources and the distinctive characteristic of both program and fiscal requirements unique to each of these state agencies may have led to the misconstruction or misapplication by the auditors of select cost reporting principles. More specifically, as reflected in the attached New York State Consolidated Fiscal Reporting and Claiming Manual, the SED RCM governs the allowance of education programming costs, the SSOP governs OCFS costs (See: Appendix A) and CFR Appendix X governs all other Agency expenses. (See: Appendix B). Accordingly, general findings of disallowance -- i.e., cell phones -- must be modified to reflect only those expenses specifically disallowed by the governing claiming manual. Costs disallowed under the RCM, for example, may be wholly allowable under SSOP.

*
Comment
1

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* See State Comptroller's Comments on Page 50.

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We are confident that the additional clarifications provided herein, supported by attached documentation, will allow the auditors to reframe their initial findings and, in fact, modify or delete a significant portion of the preliminary report.[1]

We further request that all identifying information, including individual and business names, be redacted on the final audit report. We appreciate the use of Roman numbers in the referencing of the Board members and would anticipate a similar approach in the presentation of the auditors' descriptions and comments and references to vendors.

We would also presume deletion throughout the report of all references to initial findings which were addressed sufficiently to warrant deletion from the Draft Report such as interest costs. 1

Key Findings

While challenges to specific findings are made in greater detail below, Gateway must clarify at the outset that, as acknowledged by the auditors, the vast majority of the issues identified in the audit report occurred while the now former CEO and CFO were employed by Gateway. The Agency has undergone significant changes under the leadership of the new management team of CEO, CFO and Compliance Officer - - installed in 2013 - - in advance of the OSC audit but subsequent to the audited years. Since its installation, the management team, as directed by the Board of Directors, has undertaken a number of actions to identify potential weaknesses in internal controls and protocols and has applied the expertise of its new Compliance Officer to strengthen these weaknesses to assure enhanced accountability and protection of the public trust. More specifically, relative to internal controls, policies and procedures, the Management team and Board governance has been strengthened through implementation of revised policies which assure that:

* Comment 2

- Nearly the entire Board has been reconstituted since the OSC audit;
- All Board members with prior LTAL transactions identified in the report have termed off or resigned from the Board;
- Current and/or prospective Board members will only engage in less than arms' length (LTAL) transactions which comport with applicable rules governing conflicts of interest, disclosure and competitive bidding;
- Comprehensive orientation training has been implemented for Board of Director candidates;
- All Board members have been provided and trained on **NPCL** Provisions and *Right From the Start* manuals and other pertinent resources. All Board members executed signed

[1] We have taken the liberty of identifying some spelling or grammatical errors on the attached Draft document.
See 1

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attestations regarding the Code of Conduct, Code of Ethics, and Conflict of Interest statements;

- The Agency By-Laws have been revised consistent with New York State Non-Profit Revitalization Act of 2013;
- The Agency's Conflict of Interest Policy has been revised consistent with New York State Non-Profit Revitalization Act of 2013;
- The role of Audit and Compliance Board Committee has been enhanced with accountability to report to the full Board of Directors;
- The Board minutes have been enhanced to clearly reflect Board deliberation and resolutions;
- An on-line Board Portal has been instituted to include Board and committee minutes to enhance transparency;
- Ongoing Board education on financial accountability, cost reporting, and risk management has been initiated;
- A new independent auditing firm has been retained by the Agency's Audit and Compliance Committee;
- The Procurement Policy has been revised with a clear dollar threshold for Board approval;
- The Agency's Corporate Compliance Department has expanded through additional staffing to ensure adherence to the Code of Conduct and Ethics;
- Internal department reviews of compliance are reconcurrently conducted with internal controls, the findings of which are reported quarterly to the Board;
- The Corporate Compliance Plan has been revised to incorporate standards established by the New York State Education Department, Office of Children and Family Services, Department of Health, Office of Mental Health and the Not-for-Profit Revitalization Act;
- Staff training on whistleblower reporting has been enhanced; the reports of which are immediately provided to the Board;
- The Document Retention Plan as audited by the Compliance Department has been revised;
- Corporate Compliance annual training for all employees, volunteers/interns and Directors has been enhanced;
- The Procurement Policy including bidding requirements, authorization and required retention of documentation has been revised;
- Significant contracts such as cleaning and legal services have been rebid to ensure competitive pricing and best value;
- RFPs have been posted on both Agency and NYS Contracts websites to increase transparency and enhance the number of competitive bids; and

- The CEO and CFO have attended CFR training provided by the Department of Mental Health and on-line training provided by NYSED.

Gateway recognizes that the OSC audit revealed certain weaknesses in internal controls and governance which, as indicated above, the Agency has committed substantial resources to strengthening. Gateway challenges, however, the misperception reflected in the Audit that Gateway officials and its Board "failed to exercise due care and diligence in performing its fiduciary responsibility primarily because…Gateway routinely enters into business transactions with companies (with which) Gateway Board members are affiliated". We strongly believe this accusation mischaracterizes the manner in which the Agency conducts its business transactions.

* Comment 3

Consistent with NYSED Board of Regents' statements and Attorney General guidance governing the conduct of trustees/board members in exercising their responsibilities, the members of the Gateway Board were fully aware of their duties of care, loyalty and obedience as reflected in the conduct of Board meetings every two months, guided by an itemized agenda which includes reports from management, as well as the separately convened audit/finance and compliance committees -- each committed to acting in good faith and exercising the degree of diligence, care and skill that an ordinary prudent individual would use under similar circumstances in a like position. While the auditors identified a select number of transactions which did not, they assert, comport with applicable requirements governing procurement activities, it is a gross misrepresentation that the former Board breached its duties. In each transaction identified, the Board engaged in reviews and assessments which may have been inadequate – as suggested by the OSC – but were conducted with the intention to comply with applicable standards

* Comment 3

We believe the attached additional documentation supports the conclusion that both Gateway and its Board were guided by competitive bidding requirements and adhered to "best value"[2] procurement protocols and procedures in all instances, letting contracts only upon consideration of factors such as prospective contractors' capacity and financial ability to complete the contract, accountability, past performance, reliability and integrity.[3] Attached documentation reflects multiple project proposals, thoughtful consideration of proposals as reflected in Board meeting minutes, including outright rejection of proposals advanced by companies in which a Board member had an interest when judged not the best value, nor competitive. (See: Attachment 1).

* Comment 3

Importantly, the Reimbursable Cost Manual, which governs the reporting of education costs, directs Agencies to consider "prevailing rates" in the purchase of some services, including consultant services -- a number of the very business transactions the auditors allege violate the applicable procurement protocols. We believe the auditors may have misapplied certain procurement standards and may not have considered relevant information in determining certain business transactions not to be in the best interests of the Agency.

* Comment 4

Specific Challenges

[2] General Municipal Law, Section 103.
[3] OSC, Local Government Management Guide, Seeking Competition in Procurement, page 7.

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Ineligible Costs Pertaining to Related Party Transactions

2 **Governing Principles of LTAL**

Gateway challenges the auditors' assertion that business transactions with companies with which Board members are affiliated reflects a failure by such Board to exercise due care and diligence in performing its fiduciary responsibilities. Point in fact, governing guidance acknowledges the appropriateness of such transactions so long as, consistent with an entity's conflict of interest policy, such transactions are fully disclosed to its Board and appropriate voting protocols are observed.[4] Contrary to the auditors' insinuation that LTAL transactions are inherently insidious, Attorney General guidance authorizes Board approved of transactions that are "fair and reasonable", in satisfaction of such directors duty of loyalty.[5] (See: Attachment 2).

* Comment 3

The Board of Regents' own statement on the Government Role of a Trustee or Board member also recognizes the legitimacy of such transactions when it advises that Board members "must, at all times, further the institution's goals and not the member's personal or business interests." To guard against "self-dealing", the Regents' advise Boards should "have a conflict of interest policy that clearly sets forth the procedures to be followed in instances where a board member's personal or business interests may be advanced by an action of the board, including a provision that the Board member may not participate in any decision to approve any transaction where such conflicting interests may be advanced."[6] (See: Attachment 3). Clearly both the Attorney General and the Board of Regents contemplated agency business transaction with Board members and set the parameters for acceptability -- disclosure and fairness. In each of the business transactions identified by the auditors, a mutual benefit inured to both Gateway (through the actions of its Board) and, incidentally, an individual Board member. At all times, however, "fairness and reasonableness" informed the Board's decision, and Board actions were consistent with the guiding principles of Gateway's conflict of interest policies.

* Comment 5

* Comment 5

3 Documentation was provided to the auditors for each of the business transactions involving a Board member. It is the adequacy of that documentation which the auditors challenge, as clearly distinguished from a total disregard for procurement protocols, as the tenor of the audit might suggest.

* Comment 5

Point of clarification: Gateway officials acknowledged only that procurements made in what the Agency considered "emergency situations" such as immediate replacement of a heating system were not competitively bid.

4 **990/CFR Required Disclosures**

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[4] NYSAG Charities Bureau "Right from the Start: Responsibilities of Directors of Not-For-Profit Corporations." page 7.
[5] Ibid.
[6] RCM (2011) Attachment 3, statement on the Governance Role of a Trustee or Board Member, page 73.

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We challenge the auditor's suggestion that Gateway's IRS Form 990 filings lack integrity. As the auditors are aware, I.R.S. instructions for Schedule L (Form 990) clearly advise that business transactions between a not-for-profit organization and an "interested person" are reportable in only limited instances, including when such payments exceed $100,000 in payments during the applicable tax year, or payments exceed the greater of $10,000 or 1% of the agency's total revenue for the tax year. (See: Attachment 4). Clearly, with minor exception and assuming, arguendo, the existence of a related party relationship, most of the business transactions identified by the auditors do not meet I.R.S. 990 requirements warranting disclosure. (See: Attachment 5).

*
Comment
6

As relates to the reporting of education program costs, the governing RCM provisions advise as follows, assuming arguendo a LTAL relationship:

- 2008-09 RCM: (LTAL) relationships must be "disclosed in the notes to the audited financial statements" (page 46)
- 2009-10 RCM: (LTAL) relationships must be "disclosed in the notes to the audited financial statements" (page 6)
- 2010-11 RCM: (not separately published; 2009-10 RCM governed).

Accordingly, Gateway did, in all instances, comply with RCM and I.R.S. Form 990 disclosure requirements as described above.

Payments to Businesses Affiliated with Certain Board Members

Certain Construction Projects

- **CAB Project**

As the auditors are aware, since funded by the Dormitory Authority of the State of New York, the CAB Project was governed by DASNY requirements and specifications. Point in fact, DASNY does not require three or more competitive bids, but rather determines the legitimacy of the itemized proposed costs and expenses according to its own capital project funding standards. (See: Attachment 6). That the auditors have substituted their own judgments of propriety for that of DASNY is patently inappropriate. However, as the attached documentation clearly reflects, the CAB Project followed standard AIA protocols terms and conditions, included multiple bid proposals on all subcontract components, received informed consideration by the Board with appropriate voting protocols observed, and otherwise comported with applicable procurement standards. (See Attachment 7). We firmly believe that even while the project comports with standard procurement protocols, that the auditors should set aside DASNY approval and elevated scrutiny to further "test" the project is wholly inappropriate. Accordingly, the proposed disallowance of $80,585.48 associated with the DASNY approved CAB Project should be restored.

*
Comment
7

5 ○ **Knox Project**

As shared with the auditors, the Knox Project was undertaken to provide better facility space for the School's students. As the attached detailed analysis reflects, Project renovations of existing space proved most cost-effective -- the single RCM requirement for allowable costs. The Project ultimately resulted in savings to both the School and the State. (See: Attachment 8). Importantly, at the commencement of the renovations, the vendor's equipment was already on site, dramatically reducing the cost of the project. The value of convenience is a well accepted consideration in determining "best value" as even recognized by the Attorney General. Clearly, this consideration should be weighed favorable in the auditor's review, as well, and the proposed disallowance of $72,577.98 associated with the Project should be restored.

* Comment 8

We also dispute the auditor's assertion that Gateway failed to obtain prior approval from the State Education Department relating to these important renovations. As the attached document dated November 9, 2008 reflects, NYSED was clearly engaged in the project review process which culminated in approval. The April 30, 2010 approval letter reflects, effective September 1, 2009, NYSED had sanctioned, acknowledged and otherwise approved operation of classrooms at the renovated Knox building site. (See: Attachment 9).

○ **FRC Project**

OMH guidelines dictate the appropriateness of the FRC project -- guidelines which highlight best value and cost effectiveness. It was through the skillful negotiations of the vendor with the City of Buffalo, in fact, that the cost of adding an elevator was eliminated, saving the Agency and the State several hundreds of thousands of dollars. Again, the auditors appear to have substituted their own judgment for that of the state agency having approved this project, here, Office of Mental Health.

* Comment 9

6 **Purchase of Speech Language Therapy Direct Services**

We challenge the auditors' characterization of this transaction as a payment to a business affiliated with a Board member. The RCM recognizes relationships to be LTAL only when "one party can exercise control or significant influence over its management or operating policies of another party to the extent that one of the parties is or may be prevented from fully pursuing its own separate interests".[7] Clearly, the Board member's relationship with the vendor does not rise to the level of possessing any influence over management of either Gateway or the vendor. Moreover, the circumstances of the transaction clearly fall within the RCM guidance governing the purchase of such health related services assuming, arguendo, a LTAL relationship was found to exist -- allowable and reimbursable to the extent of the actual documented costs of the owner. Only costs in excess of actual costs require written approval.[8] The transaction also meets the "cost-effective" test imposed should such costs exceed owner's costs, which is not the case here -- that such cost-effective purchases, on a per session basis, be less than or equal to the average per session base-year costs of the purchase of such services from other (approved) entities,

* Comment 10

[7] RCM, 2008-09, pg. 46.
[8] RCM, 2008-09, pg. 28.

David Fleming
October 17, 2014
Page **8** of **13**

within (the same STAC) geographic region".[9] Measured against even the most rigorous standard of cost-effectiveness, (not applicable here), the per session rate of services from the vendor was less than or equal to any prevailing rate in the STAC region, based on a survey of like approved entities, including ABC Therapeutics, Optimal Therapy Associates, Therapeutic LINK for Children to name a few (See Attachment 10). In fact, the vendor rate of $52.00/<u>hour</u> is nearly one half the prevailing rate of $50/<u>half-hour</u>. This survey clearly supports restoration of the disallowance in the amount of $255,775.00 for the purchase of these health related services, as wholly consistent with RCM requirements. It must also be noted that these costs have been found to be reasonable and necessary by SRU in the calculation of rates for the subject years.

* Comment 11

We also challenge the auditor's suggestion that rebidding an existing contract nearly five years after the arrangement was first developed is inherently suspect or violative. In point of fact, the RCM is silent on the question of frequency of rebidding, save for provisions relating to the provision of accountant services wherein the RMC clearly suggests rotation of personnel "after five consecutive years on an engagement" - - the period of five years clearly appropriate.

* Comment 11

7 ○ **Payments to a Businesses Affiliated with a Gateway Foundation Board Member**

To be clear, the Board member did not join the Foundation board until October 21, 2009. The initial engagement of the vendor (2007) actually predates his Board membership, and its contract was subsequently renewed upon the vendor agreeing to additional terms and conditions. (See: Attachment 11). Accordingly, the initial agreement was not subject to LTAL disclosure requirements at its inception and any changes to the terms and conditions of the arrangement were clearly to the benefit of Gateway.

* Comment 12

8 ○ **Payments of Businesses Affiliated with a Certain Board Member**

Gateway concedes that a certain individual was a member on both the Gateway and Gateway Foundation Boards, but challenges the proposed disallowance of costs associated with certain related company transactions relating to the purchase of computer network infrastructure and professional staff services. Fees paid to independent contractors are fully reimbursable under the RCM[10], again guided only by RCM standards of "reasonableness" as measured, in part, by comparability,[11] and, in LTAL, actual costs of the vendor.[12] In no instance were costs inflated beyond actual costs, and full disclosure of the relationship and fairness of the proposed arrangement was made at the Board meeting.

By way of context, it must be noted that Gateway's association with the vendor predates the Board member's membership on the Gateway Board. The reasonableness of those service costs were clearly recognized by the New York State Education Department Rate Setting Unit (RSU). Such reasonableness cannot now be challenged simply because the vendor has become a Gateway Board member. As the attached listing reflects, AP was one of several vendors with which Gateway conducted business and clearly the most competitive. (See Attachment 12). In

* Comment 13

[9] RCM, 2008-09, pg. 29.
[10] RCM, 2008-09, pg. 28
[11] RCM, 2008-09, pg. 50
[12] RCM, 2009-10, pg. 7

point of fact, AP's placement fees were discounted by 50% upon the member's appointment to the Board -- a clear reflection of costs below actual cost to the vendor, thus compelling allowance by auditors. Accordingly, the proposed disallowance of $17,667.75 should be restored.

As relates to the computer infrastructure transaction, the attached Board meeting minutes clearly reflect the solicitation and consideration of multiple proposals for the services. The vendor was determined to be the best value and as reflected in the attached document, extremely competitive with comparatives of $461,000 (PCA); $420,000 (Telperion); and $420,000 (Centerbeam) as compared to the vendor's proposal, for example, for costs of services, software, infrastructure and PCs quotes at $391,256. (See Attachment 13). Accordingly, the proposed disallowance of $206,322.38 as relates to the subject contract, together with the $28,089.80 of associated loan interest expenses, should be restored. * Comment 14

A number of the business transactions identified by the auditors as not having been conducted in compliance with applicable protocols or reporting requirements were, in fact, appropriately conducted and reported. More specifically:

9 ○ **Board Member III:** The RCM clearly directs reimbursement of costs incurred for necessary maintenance of the agency plant and equipment, including costs associated with replacement of boilers, consistent with the "reasonable cost" requirements.

By way of context, in March 2007, as the auditors acknowledge, Gateway received three bids for the removal and installation of one boiler, of which the vendor was the best value. It became apparent during the installation, however, that the second boiler was also in need of repair/replacement, as were pipes and other infrastructures related to the boilers, and Gateway extended the terms and conditions of its contract with the vendor to include this additional work in the scope of the initial contract. Rebidding the contract was clearly not advisable and given the vendor's lowest bid on the initial project on one boiler, it was reasonable to believe replacement of the second boiler would be as reasonable and competitive. Moreover, we are unaware of any RCM provision dictating re-bidding of contracts when "change orders" are customary business practice. (See: Attachment 14). Accordingly, the proposed disallowance of $25,620.81 related to the boiler project should be restored. * Comment 15

9 ○ **Board Member IV:** The furniture purchase challenged by the auditors was wholly included within the DASNY CAB project (discussed in greater detail above) and therefore, upon approval DASNY, beyond the scope of auditors review. * Comment 7

9 ○ **Board Member V:** Gateway's engagement of the law firm reflects prevailing rates for like services, supported by attorney business records, in compliance with RCM directives governing consultant services. The comparables provided below are as determinative here in assessing whether the legal fees exceed the prevailing rate of the service as set out in the RCM. Accordingly, the proposed disallowance of $144,572.63 should be restored. * Comment 16

9 ○ **Board Member VI**: Board Member VI's engagement by Gateway for legal services began in 2003 and has continued through 2013. As the attached records indicate, (See:

Attachment 15). The vendor's compensation rate varied from approximately $191/hour in 2008-09, to $174 in 2009-10 and $115 for 2010-11. Review of prevailing rates for "like services" indicates the vendor's rate of compensation was below market rates in each instance rendering formal RFPs or other bidding documentation unnecessary.

* Comment 16

The 2008-09, 09-10 and 10-11 RCMs clearly authorize reimbursement of consultant services, including legal services, provided that the fees do not "exceed the prevailing rate (of such service)", subject to the nondirect care parameter. Costs associated with the vendor's services, therefore, are clearly allowable, consistent with RCM guidance governing consultant services. Contemporaneous business records maintained by the vendor or "log notes", clearly support expenses associated with the services provided. These records also demonstrate full compliance with additional RCM requirements that Gateway "justify that the consultant hired was the most economical and/or appropriate available" for the service. (RCM, 2008-09, page 40)

As determinative, these expenses clearly meet the RCM's complementary requirement that costs be "reasonable" as determined upon consideration of prices for comparable goods or services. (See: RCM, 2008-09, page 50) Accordingly, consultant service costs in the amount of $68,000 should be restored.

9

- **Board Member VI:** A similar analysis must be applied in consideration of legal services provided by Board Member VI at prevailing rates. The auditors' assertion that the vendor's former association with the law firm is determinative is a misapplication of RCM principles. To the contrary, the principles and provisions referenced above as related to the vendor's compensation apply equally to the costs associated with the firm's legal expenses. Formal RFP's or competitive bidding protocols need not be employed where, as here, the business transaction meets all applicable RCM requirements governing prevailing rates and comparability. (See: Attachment 15). We must also challenge the auditors' characterization of the vendor's relationship with the law firm in question. The individual retired from the firm in January 1, 1991, with a courtesy title "of counsel" without ownership interest or compensation. Disclosure of the firm's engagement then, as a related party transaction, is clearly unwarranted where, as here, the relationship between the individual and the firm has been severed for two decades. No public policy is advanced in disclosure of relationship so distant in time and relevance. Accordingly, the proposed disallowance of $48,656.55 should be restored.

* Comment 16

9

- **Board Member VII, VIII**: As indicated above, the reasonableness of the law firm's costs associated with provided services is assessed by comparison with prevailing rates. (See: Attachment 15). Gateway initiated its relationship with the firm in advance of the audit years and engaged the firm at prevailing rates, as reflected in a 2006 engagement letter. The terms and conditions of that engagement letter were, as is often common practice, extended beyond the scope of the initial engagement to other matters as the need arose.

* Comment 16

We believe the attached 2012 engagement letter appropriately reflects the true business relationship between Gateway and the firm - - one based upon courtesy rate discounts and not as the auditors would suggest, self-dealing to the detriment of the Agency in violation of Board members duties of loyalty. Each engagement was guided, in fact, by considerations of fairness

David Fleming
October 17, 2014
Page **11** of **13**

to the obvious benefit of the Agency. Accordingly, the proposed disallowance of $7,282.00 should be restored.

- **Board Member IX:** Gateway has provided the auditors with copies of multiple proposals for consultant services related to defined benefit plans. Each of the proposals was reviewed by the Board as reflected in Board meeting minutes and the best valued proposal was chosen consistent with RCM guidelines for consultant services and applicable LTAL voting protocols. (See: Attachment 16). Accordingly the disallowance in the amount of $5,411.07 should be restored.

* Comment 17

10 **Other Ineligible Costs**

Gateway recognizes the need to strengthen its record keeping protocols as a guiding principle. However, we believe a number of the auditors' disallowances reflect the mis-characterization of expenses rather than any inappropriateness of costs. For example, the RCM clearly requires travel logs in support of motor vehicle expenses allocated to the educational program only. However, the complementary funding sources imposed no such requirement. Even the RCM concedes that G.A.A.P and I.R.S. guidelines apply in the absence of RCM directives to the contrary. Accordingly, as the attached guidance directs, employers may reimbursement employees for use of personal cell phones without "burdensome record keeping requirements". (See: Attachment 17). Similarly, we look to the I.R.S. guidelines governing costs associated with business and professional organizations licenses and dues when assessing the propriety of certain such costs not allocated to the education program. (See: Attachment 18). The I.R.S. guidelines clearly authorize favorable treatment of certain club memberships, including "public service organizations" and "business leagues". Accordingly, all disallowances attributed to such membership and cell phone usage should be restored.

* Comment 18

We would also suggest that reporting adjustments may be made to correct past reporting errors such as those related to the CIO/VP of Technology's travel costs not being reported as part of compensation. Properly reporting, these costs would be otherwise allowable, subject to screens.

We provide additional clarification of the "additional disallowances totaling $378,946 as follows:

* Comment 18

- **$134,737.50 relating to psychiatry services.** As the attached documentation reflects, upon review, NYSED Rate Setting Unit allowed the salary costs associated with the auditors' finding in calculating applicable rates. (See: Attachment 19).

- **Mileage and Travel Expenses:** The attached mileage and travel expense report supports reinstatement of the previous CEO's mileage expenses as relates to the non-educational programs. (See: Attachment 20).

- **Phone Expenses:** Gateway's "Cricket" phone plan served the needs primarily of its Supervised Independent living Program consumers, as detailed in the

David Fleming
October 17, 2014
Page **12** of **13**

attached record account. The Plan did not allow for individual details but its "unlimited use" feature was of significant benefit to the SILP clients. (See: Attachment 21).

- **Pharmacy Expenses**: The attached invoices from Buffalo Pharmacy support reported costs associated with the proposed disallowance. (See: Attachment 22).

* Comment 18

12 **Gateway's Land Sale**

* Comment 19

Gateway challenges the auditors' assertion that the Agency did not receive the best price for the Main Street parcel, and objects strenuously to the insinuation that the best interests of the Agency were not of primary concern to the Board throughout the entire transaction, nor adequately advanced or served upon completion of this transaction. As the attached document reflects, consideration of the real property transfer began in 2003 and culminated in the receipt of multiple inquiries of interest and formal bids, revised during the negotiation process. (See: Attachment 23).

As the attached narrative reflects, the ensuring negotiations were at all times open and transparent notwithstanding the auditors' assertion to the contrary based upon conversations with "one of the bidders on the land, who was not ultimately chosen" (a context which we would argue, casts a shadow over the comments). By the auditors' own acknowledgement, multiple bids were advanced and considered.

As the attached chart reflects, each of the respondents offered varying terms and conditions, a common practice in such transactions. Upon closer review, the offer which ultimately prevailed was, in fact, clearly the most reasonable, upon consideration of "sum certain" factors.

We challenge the auditors' assessment that the best price was neither pursued, nor obtained. The RCM provides no criteria by which to assess the value of assets, nor the appropriate mechanism to, in fact, transfer ownership. There are, in fact, no applicable guidelines for the sale of real property assets and no objective test against which the transaction can be measured. Simply stated, we are concerned that the auditors' unfavorable perception of certain other of Gateway's business transactions may have tainted their assessment of the real property transfer. Common standards of reasonableness and fairness apply here in the absence of specific RCM requirements. Accordingly, the protraction of the negotiation process, the obvious consideration of all legitimate proposals and the clear demonstration of thoughtful and business-minded deliberations by Board members is testament to the fairness and reasonableness of the real property transaction.

11 **Conclusion**

While Gateway acknowledges that a select number of internal controls and polices relating to recording, keeping and documentation may require strengthening as reflected in the

Report findings, these weaknesses are in no way reflective of the Agency's generally pervasive approach of fiscal and programmatic compliance. Nor are the business transactions involving Board members reflective of Board breach of fiduciary duties or a violation of the public trust, as the Report asserts. In each of the transactions identified in the Report, the Agency maintained records of the arrangements, however viewed by the auditors as inadequate. At no time did the Board or its members look to subvert the applicable bidding requirements, nor engage in "secret" transactions. At all times the Board advanced the interests of the Agency and the communities it serves - - the transgression being relaxed record keeping.

Accordingly, Gateways requests restoration of disallowances based upon inadequacy of documentation in all instances where materials have been provided..

Very truly yours,

GREENBERG TRAURIG, LLP

Pamela A. Madeiros

PAM/kac
Enclosures
ALB 1807853v4

*
Comment
20

Agency Comments - State Education Department

THE STATE EDUCATION DEPARTMENT / THE UNIVERSITY OF THE STATE OF NEW YORK / ALBANY, NY 12234

DEPUTY COMMISSIONER
Office of Performance Improvement and Management Services
O: 518.473-4706
F: 518.474-5392

October 1, 2014

Mr. David Fleming
Audit Manager
Office of the State Comptroller
Division of State Government Accountability
110 State Street – 11th Floor
Albany, NY 12236

Dear Mr. Fleming:

The following is the New York State Education Department's (Department) response to the draft audit report, (2012-S-17) of the State Education Department, Office of Children and Family Services, Office of Mental Health, Department of Health Cost Reporting of Programs Operated by Gateway-Longview, Inc.

In addition to the actions that will be taken in response to the specific recommendations described below, the Department will closely examine the circumstances that led to the findings described in the audit report. This examination will include an assessment of the programmatic oversight and fiscal management employed at Gateway-Longview Inc., and will be a factor in the consideration of the continued approval of this provider and the corrective action or enforcement actions that may be warranted.

* Comment 21

Recommendation 1: Follow up on the inappropriate and unsupported expenses identified in our report, revise the reimbursement rates for Gateway and seek restitution, as appropriate. In addition, review the questionable interest costs identified and determine if these costs are reimbursable.

We agree with this recommendation. The Department will review the expenses and costs as noted in the report and make adjustments to the reimbursable costs to recover any overpayments as appropriate by recalculating tuition rates. We will also review and consider additional information Gateway-Longview Inc. may submit in response to this report.

Recommendation 2: For the years subsequent to our audit scope, determine if the matters addressed in this report also impact the related Gateway financial reports. Adjust the financial reports as appropriate and determine the corresponding impact on Gateway's reimbursement rates.

We agree with this recommendation. We will review the financial reports submitted to the Department by Gateway-Longview Inc. and determine the impact to reimbursement for subsequent years as appropriate.

Recommendation 3: Direct Gateway to ensure that board members avoid conflicts of interest and annually file written disclosures of any business involvement with Gateway or related parties.

We agree with this recommendation. The Department's Reimbursable Cost Manual (RCM) requires entities receiving public funding to develop a written Code of Ethics (which must include a specific conflict of interest policy) and Code of Conduct policies. The conflict of interest policy must include a requirement and process for identifying and fully disclosing all less-than-arms-length relationships and transactions on an ongoing basis as well as on the Consolidated Fiscal Report. The Department will require that Gateway submit its written Conflict of Interest and related internal control policies and procedures to the Department for review.

Recommendation 4: Take steps to ensure Gateway's reporting of expenses includes only those expenses that comply with all program guidelines and requirements.

We agree with this recommendation. The Department will continue to provide technical assistance whenever requested and will strongly recommend Gateway-Longview Inc. officials take advantage of our availability to help them better understand the standards for reimbursement as presented in Regulation and the Reimbursable Cost Manual (RCM). Furthermore, Consolidated Fiscal Report (CFR) training is available both in person, at one of the six locations it is offered across the State, and online on the Department's webpage. The Department recommends that all individuals signing the CFR certification statements, namely Executive Directors and Certified Public Accountants, complete this training. At the direction of the Board of Regents, the Department intends to require that this training be mandatory and will require individuals to verify that they have completed the training.

If you have any questions regarding this response, please contact Suzanne Bolling, Director of Special Education Fiscal Services at (518) 486-7859.

Sincerely,

S. Cates-Wi

Sharon Cates-Williams

c: James P. DeLorenzo
Suzanne Bolling
Maria Guzman

Agency Comments - Office of Children and Family Services

October 1, 2014

Mr. David Fleming
Office of the State Comptroller
110 State Street
Albany, NY 12236

New York State
Office of
Children &
Family
Services

http://ocfs.ny.gov

Andrew M. Cuomo
Governor

Sheila J. Poole
Acting Commissioner

Capital View Office Park

52 Washington Street
Rensselaer, NY
12144-2834

Dear Mr. Fleming:

This is the Office of Children and Family Services (OCFS) response to the draft audit report on Cost Reporting of Programs Operated by Gateway-Longview, Inc. (Gateway) provided by the Office of the State Comptroller (OSC). The document addresses contracts administered by OCFS, the State Education Department (SED), the Office of Mental Health (OMH) and the Department of Health (DOH).

There are four recommendations in this report. These recommendations include following up on inappropriate and unsupported expenses, revising reimbursement rates, and seeking restitution as appropriate. Here, by recommendation, is the OCFS reply:

Recommendation 1: The recommendation is that the four State agencies: follow up on the inappropriate and unsupported expenses identified in the OSC report; revise the reimbursement rates and seek restitution, as appropriate; and review the questionable costs identified to determine if those costs are reimbursable. The draft report does not provide enough information for OCFS to respond to this recommendation. The draft report refers to ineligible costs pertaining to related party transactions, but does not clearly identify the transactions at issue or which State agency or agencies were involved in funding the transactions at issue. The same is true of the "Other Ineligible Costs" set forth. There is a reference to expenditures for program costs that were not properly documented, but the program costs at issue are not identified. There are descriptions of various costs that OSC says were ineligible because they were for the benefit of employees, not program-related or not permissible under the formal guidance of the State agencies. However, the agency or agencies whose funds were used for these costs, and which agency or agencies provided the formal guidance at issue, are not identified.

* Comment 21

The same problem applies to the costs OSC classifies as "questionable". Those costs are interest payments on a loan Gateway obtained to (according to OSC) cover cash shortfalls from operating

* Comment 22

An Equal Opportunity Employer

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losses. OSC appears to view the use of a loan to meet operating costs as being inherently suspect. If that is the case, OCFS does not share that view.

The use of loans to meet operating expenses has become increasingly common among the programs for which OCFS sets reimbursement rates, and we do not see it as necessarily signifying financial improprieties or mismanagement. However, even if there is an issue with the loan, the programs that suffered the alleged operating losses are not identified, which makes it impossible to determine which State agency or agencies' programs were affected by the shortfall. OSC also asserts that the operating losses occurred because Gateway routinely incurred costs that exceeded the thresholds established by the State agencies, but is not specific as to whether this includes all four agencies or only some of them, and again the programs are not identified, leaving OCFS with no way to verify the OSC claim.

* Comments 21 and 23

In order to determine the validity of the disallowances and of the questioned costs, and how to apportion the costs at issue among the four agencies, OCFS would need to know: the specific items OSC believes should be disallowed; OSC's opinion as to the legal justification for those disallowances; and the cost centers to which the costs of those items were charged. Without this additional information, OCFS cannot respond to this recommendation.

* Comment 21

Recommendation 2: The recommendation is that the four State agencies determine if the same issues identified in the audit report exist for the years subsequent to the period audited, which was the three fiscal years ending June 30, 2011. Before determining whether such a review is necessary, OCFS would have to determine whether the issues raised in the draft audit report in fact apply to the Gateway programs funded through OCFS and the extent to which those issues raise verifiable concerns. Accordingly, OCFS cannot at this time say whether a review of the Gateway programs for the three years since the period covered by the audit report would be necessary or an effective use of our audit resources.

* Comment 21

Recommendation 3: The recommendation is that the four State agencies "[d]irect Gateway to ensure that board members avoid conflicts of interest and annually file written disclosure of any business involvement with Gateway or related parties". OCFS will not comply with the recommendation as written. Section 715 of the Not-for-Profit Corporation Law (NFPCL) addresses related party transactions by the directors of not-for-profit corporations, and it does not prohibit such transactions. The OCFS regulations on related party transactions at 18 NYCRR 427.3(b)(1)(i) also do not prohibit such transactions. Both the NFPCL and the OCFS regulations establish requirements and parameters for related party transactions. Accordingly, OCFS is willing to advise Gateway that any related party transaction in which board members engage must comply with the requirements of Section 715 of the NFPCL and the OCFS regulations. OCFS agrees with the recommendation to require the board members to file annual written statements disclosing any business involvement with Gateway or related parties.

* Comment 24

Recommendation 4: The recommendation is that the four State agencies "[t]ake steps to ensure Gateway's reporting of expenses includes only those expenses that comply with all program guidelines and requirements". There is no way OCFS could possible "ensure" that Gateway does so. OCFS can review Gateways' reporting of expenses and follow up on items that appear questionable or incorrect, but we cannot "ensure" that Gateway report correctly. How and what Gateway reports is entirely within the control of Gateway, and no outside entity can "ensure" that Gateway report correctly. OCFS will implement the intent of the recommendation by reviewing the reporting of expenses and following up on any that appear questionable or inaccurate, but OCFS cannot implement the recommendation as written.

OCFS appreciates the opportunity to comment on this draft report. Any comments or questions you may have can be sent to Ralph Timber, OCFS Audit Liaison, at Ralph.Timber@ocfs.ny.gov or by calling him at (518) 473-0796.

Sincerely,

Gabrielle Ares, Director
Bureau of Budget Management

Agency Comments - Office of Mental Health

State of New York
Andrew M. Cuomo
Governor

Office of Mental Health
44 Holland Avenue
Albany, New York 12229
www.omh.ny.gov

October 6, 2014

Andrea Inman
Audit Director
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236-0001

Dear Ms. Inman:

The Office of Mental Health has reviewed the Office of the State Comptroller's (OSC's) draft audit report entitled, "Cost Reporting of Programs Operated by Gateway-Longview, Inc." (2012-S-17). Our comments to the findings and recommendations are enclosed.

The Office of Mental Health appreciates the Office of the State Comptroller's efforts to recommend improvements in our operations.

Many thanks for your continued help and cooperation.

Sincerely yours,

Martha Schaefer Hayes

Martha Schaefer Hayes
Executive Deputy Commissioner

Enclosure

OMH 26-01 (12/10)

OFFICE OF MENTAL HEALTH
RESPONSE TO THE OFFICE OF THE STATE COMPTROLLER
DRAFT AUDIT REPORT 2012-S-17
COST REPORTING OF PROGRAMS OPERATED BY GATEWAY-LONGVIEW, INC

Overall OMH Comments

OMH has reviewed OSC's draft audit report and is appreciative of the work OSC has done in identifying problems with Gateway-Longview's cost reporting. OMH plans to follow up on OSC's recommendations and to implement corrective measures as appropriate.

During OSC's three-year audit scope covering July 1, 2008 to June 30, 2011, Gateway operated three MH programs: a family resource center, an intensive case management program and a wrap care program. OMH funding for these three programs totaled less than nine percent of Gateway's total revenue for that same three-year period. As the reimbursement for these OMH programs is fee based rather than based on reported costs, it appears any potential recoveries initiated by OMH will be focused on the areas of administrative and construction costs of the family resource center.

* Comment 21

OMH's Responses to OSC's Recommendations

OSC Recommendation No. 1

Follow up on the inappropriate and unsupported expenses identified in our report, revise the reimbursement rates for Gateway and seek restitution, as appropriate. In addition, review the questionable interest costs identified and determine if these costs are reimbursable.

OMH Response

OMH will follow up on those areas included in OSC's first recommendation and will recover program overpayments where appropriate.

OSC Recommendation No. 2

For the years subsequent to our audit scope, determine if the matters addressed in this report also impact the related Gateway financial reports. Adjust the financial reports as appropriate and determine the corresponding impact on Gateway's reimbursement rates.

OMH Response

OMH will review the financial reports subsequent to the audit scope period and will require Gateway to submit corrected cost reports as necessary.

<u>OSC Recommendation No. 3</u>

Direct Gateway to ensure that board members avoid conflicts of interest and annually file written disclosures of any business involvement with Gateway or related parties.

<u>OMH Response</u>

OMH will issue a letter to Gateway, reminding board members of their obligation to avoid conflicts of interest and to file annual written disclosures of any business involvement with Gateway or related parties as required by applicable provisions of the Nonprofit Revitalization Act of 2013.

<u>OSC Recommendation No. 4</u>

Take steps to ensure Gateway's reporting of expenses includes only those expenses that comply with all program guidelines and requirements.

<u>OMH Response</u>

OMH will review all the requirements currently in place governing the reporting of expenses on the Consolidated Fiscal Report and will take steps as appropriate to ensure that Gateway's reporting of expenses comply with program guidelines and requirements.

Agency Comments - Department of Health

NEW YORK
state department of
HEALTH

Howard A. Zucker, M.D., J.D.
Acting Commissioner of Health

Sue Kelly
Executive Deputy Commissioner

September 26, 2014

Mr. David Fleming, Audit Manager
Office of the State Comptroller
Division of State Government Accountability
110 State Street – 11th Floor
Albany, NY 12236-0001

Dear Mr. Fleming:

Enclosed are the Department of Health's comments on the Office of the State Comptroller's Draft Audit Report 2012-S-17 entitled, "Cost Reporting of Programs Operated by Gateway-Longview, Inc."

Thank you for the opportunity to comment.

Sincerely,

Sue Kelly
Executive Deputy Commissioner

enclosure

cc: Michael J. Nazarko
Robert W. LoCicero, Esq.
Diane Christensen
Lori Conway

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Department of Health
Comments on the
Office of the State Comptroller's
Draft Audit Report 2012-S-17 entitled
Cost Reporting of Programs Operated by Gateway-Longview, Inc.

The following are the Department of Health's (Department) comments in response to the Office of the State Comptroller's (OSC) Draft Audit Report 2012-S-17 entitled, "Cost Reporting of Programs Operated by Gateway-Longview, Inc."

There were no findings or recommendations directed toward the Department in the draft audit report. Gateway-Longview Inc. (Gateway) participates in the Department's Child and Adult Care Food Program (CACFP). Notes to Exhibit A include details of transactions in question and identifies references to various sections of manuals and guidance for the program areas in question. There were no references to CACFP's financial guidance or regulations in the Notes to Exhibit A. Exhibit B summarizes the $2,025,365 in disallowed costs for related party transactions. None of the related party transactions in the exhibit were associated with CACFP.

*
Comment
21

CACFP is a federally funded entitlement program that reimburses participating sponsoring organizations for meals served in a day care setting. The audit was for a three year period, from July 1, 2008 through June 30, 2011, during which time Gateway received approximately $70.9 million in government funds. CACFP reimbursed Gateway $120,904.43 during the audit period. CACFP funding is restricted and can only be used for the purchase of food or other related costs in providing the meals or snacks to participants.

Gateway began participation in CACFP effective December 1, 1996. The initial budget, and all subsequent budgets submitted by Gateway, and approved by CACFP, included only food expenses. No other operating or administrative expenses were requested in Gateways' budget submissions. CACFP is required to conduct a program review of each sponsoring organization every three years to ensure program compliance. Five program reviews have been conducted of Gateway by CACFP staff beginning in 2000 and the last review in 2012. Each of the five reviews found the food costs exceeded the CACFP reimbursement, which corresponds to the approved budgets. There were no major findings identified during the program reviews. Only small disallowances were noted in the reviews regarding inaccurate eligibility determinations and meal counts. All disallowances were disregarded as they were less than the recovery threshold, which is the lessor of $600 or 10% of the monthly claim. Gateway uses an outside vendor for their food service. CACFP monitored the initial procurement and award of the outside food service vendor contract, which found there were no related parties involved.

Gateway is required to provide a list of board members and responsible individuals when applying to participate in CACFP. The CACFP Information and Payment System (CIPS) currently retains three individuals identified as the chairman of the board, vice chair and executive director. The required information includes the individual's place of employment and address, home address and phone number(s), and their date of birth. Only the executive director is identified as working for Gateway.

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The CACFP reimbursement during the period audited was less than two tenths of one percent of the total government funds received by Gateway. The organization spent more on food than the monthly meals reimbursement, which limits exposure of any CACFP funds being used for other than intended purposes. CACFP will continue to monitor Gateway's operation of the food service and monitor issues disclosed in Gateway's A-133 audit reports.

State Comptroller's Comments

1. Our audit applied each State agency's respective governing requirements to determine whether the costs reported by Gateway were allowable. Further, during the audit, OSC staff routinely conferred with SED, OCFS, OMH and DOH officials to obtain confirmation of the pertinent audit-related matters. Consequently, we maintain that our conclusions regarding the issues we disclosed in this report are correct. In their responses to our draft audit report, State agency officials indicated they would review our findings and take corrective action as appropriate.
2. We are pleased to see that Gateway officials have taken actions to address the internal control and board governance issues we identified during the audit. We anticipate the actions will improve Gateway's ability to ensure the financial and program integrity of the programs it operates.
3. As detailed in the report, Gateway routinely entered into business arrangements with companies affiliated with Board members and a member of the Gateway Foundation Board. During our three-year audit period, Gateway had 15 significant business arrangements with 12 companies represented by 10 Gateway or Gateway Foundation Board members. We concluded Gateway's Board of Directors did not exercise due care and diligence in performing their fiduciary responsibilities for several reasons, including (but not limited to) Gateway's failure to provide contemporaneous documentary evidence that related-party transactions were fair, reasonable and at or below market rates, and that claimed costs were the most economical. We maintain that our presentation of board governance issues accurately reflects the conditions that existed at Gateway.

   We also commend the actions Gateway has taken to address the board governance issues identified by our audit. For example, taking steps to ensure related-party transactions comport with applicable rules regarding conflicts of interest, disclosure and competitive bidding should enhance Gateway's ability to comply with program funding requirements.
4. Our audit applied the respective governing guidelines, including the Reimbursable Cost Manual, to determine whether costs reported by Gateway were allowable. The audit findings were formulated with SED's guidance and were based on the documentation Gateway provided to our auditors for examination. Consequently, we maintain there are no misunderstandings regarding our application of the rules that govern this program. Moreover, in their response to our draft audit report, SED officials agreed with our audit findings.
5. We did not explicitly state or otherwise imply that related-party transactions are inherently insidious. Rather, the audit's findings are based on the fact that many of these transactions lacked the required supporting documentation to show that these business arrangements were fair, reasonable and at or below market rates. Gateway, in their response to this report, acknowledged that our audit revealed weaknesses in their internal controls and board governance. This report is reflective of the deficiencies that existed at Gateway.
6. The audit's conclusions regarding Gateway's IRS 990 filings are accurate. Contrary to Gateway's assertions, we did not raise concerns about Gateway's compliance with IRS 990 disclosure requirements. Instead, our report states that although Gateway noted in its

990 filings that its contracts with the Savarino Construction Corporation (Savarino) were competitively bid, Gateway was unable to provide documentation supporting competitive bidding for any of these contracts. Gateway has not disputed this point.

7. We did not substitute our own judgments of propriety for that of DASNY. Although Gateway used DASNY to obtain capital funding for its CAB project, that arrangement did not obviate Gateway from complying with the requirements set forth by OCFS, the State oversight authority in this instance. Specifically, Gateway was required to maintain adequate documentation and records necessary to certify the nature and extent of the costs claimed for reimbursement. However, as detailed in our report, Gateway lacked the required documentation, and consequently, we disallowed the costs associated with this related-party project.
8. We acknowledge that Gateway had SED approval to operate a special education program at this site. However, we concluded that Gateway did not obtain the required SED prior approval for its capital projects. The supplemental information provided with Gateway's response did not constitute SED approval for this renovation project. Further, when we questioned Gateway's former CFO about SED approval, he confirmed that Gateway did not obtain it. Thus, absent such approval, we disallowed the costs associated with this project.
9. The auditors did not substitute their own judgment for that of the state agency that approved this project. Rather, we tested Gateway's compliance with the applicable cost reporting requirements prescribed by OMH. Similar to the other projects with this related party, Gateway failed to provide the required documentation demonstrating the use of competitive bidding. As such, we disallowed the costs associated with this project.
10. As stated in our report, the Board member in question was the former board chairman of the Buffalo Hearing and Speech Center (Center) as well as the founding board chairman of the Center's Foundation. When combined with his position on Gateway's Board, we concluded that this member's organizational stature could have influence on significant program and senior management decisions that are made.
11. SED's Reimbursable Cost Manual requires the entity to justify that any consultant hired was the most economical and/or appropriate for a particular service. Gateway was unable to demonstrate that this was the case during the conduct of the audit. Supplemental documentation provided with Gateway's response to our draft audit report was not contemporaneous to the period in time in which the services were obtained. Further, Gateway did not maintain the required documentation that detailed the services provided by this consultant.
12. For payments to this consultant, Gateway was required to keep supporting records for at least six years to demonstrate that the services in question were obtained in an economical manner. However, Gateway indicated to us that all supporting documentation for this consultant had been discarded. As such, we had no basis for adjusting the disallowance for payments to this vendor.
13. Similar to other consultant service procurements, Gateway was required to maintain records supporting payments, including bidding documentation. However, Gateway had no documentation supporting that the services were competitively bid. Therefore, we disallowed the cost associated with these services.
14. For this consultant service procurement, Gateway was unable to provide the required

documentation of competitive procurement for two of the four vendors who bid on this project. Further, Gateway also did not maintain the documentation required for two key phases (planning and implementation) of this project. Absent the required documentation, we disallowed the costs associated with this project.

15. Based on the information provided by Gateway officials, we deleted the reported costs ($25,621) for these services from our recommended audit disallowances.
16. Gateway did not provide sufficient documentation to support that any of the four related-party law firms, used during our audit period, were obtained through a competitive procurement process. The supplemental documentation provided with Gateway's response to our draft audit report is a compilation of the rates charged by the four firms in question. It does not, however, provide contemporaneous documentary evidence that these related-party transactions were fair, reasonable and at or below market rates.
17. Gateway officials were unable to provide the documentation required to justify that the selection of this related-party vendor was the most economical and appropriate for the services they procured. Absent proper documentation, we disallowed the cost associated with these services.
18. Contrary to Gateway's assertions, each of the funding agencies requires that expenses incurred must be reasonable, adequately documented and related to the services provided to children in the program. We concluded these costs did not meet these requirements and, as such, we recommended they be disallowed.
19. Based on the information and documentation provided with Gateway's response, we deleted this matter from the final audit report. We note that there was no recommended disallowance associated with this transaction, and Gateway indicates that actions have been taken to address internal control and board governance matters that relate to issues such as this.
20. The response from Gateway included a copy of the draft audit report and other supplemental documentation (attachments). We did not append the draft audit report or the supplemental information to the final audit report. However, we have retained these documents on file at the Office of the State Comptroller.
21. Subsequent to the issuance of the draft audit report, we provided each of the funding agencies with a detailed breakdown of the disallowed expenses and questioned costs identified by the audit. Thus, each funding agency has the detailed information needed to independently assess the propriety of the costs in question and make adjustments to rates and/or seek restitution, as appropriate.
22. We do not state or otherwise imply that loans to obtain operating funds are inherently suspect. However, as detailed in the report, the $792,704 in questioned interest costs pertained to a $4.5 million loan Gateway obtained to address cash shortfalls resulting from overall program operating losses generated over the years. Moreover, the extent to which an agency incurs allowable loan interest costs likely reduces the amount of funding available to provide services directly to students or youth. As we also noted, Gateway had a $1.2 million line of credit during the audit period to cover short-term revenue shortfalls. We did not question the interest costs associated with the line of credit.
23. The interest cost ($792,704) that Gateway incurred on the $4.5 million loan was not directly charged to any one particular program. Instead, the interest expense was apportioned to multiple programs through Gateway's cost allocation process. Moreover, given the

unusual nature and materiality of this interest cost, we maintain that the respective State oversight agencies should assess the propriety of such cost for reimbursement rate-setting purposes.

24. The disallowances identified in this audit are not solely attributable to related-party relationships. Rather, they are primarily the result of Gateway's inability to provide the required supporting documentation for the costs in question. The absence of appropriate documentation, and the fact that many of the costs in question pertained to companies affiliated with Gateway board members or a member of the Gateway-Longview Foundation board, resulted in disallowances of such costs. As previously noted, Gateway could not demonstrate that costs were fair, reasonable and at or below market rates. Nevertheless, we are pleased that OCFS officials will be taking action to advise Gateway of the steps it should take to comply with the Not-for-Profit Corporation Law and OCFS regulations pertaining to related-party transactions.