



The City of New York
Department of Investigation
MARK G. PETERS
COMMISSIONER

80 MAIDEN LANE
NEW YORK, NY 10038
212-825-5900

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**CONTACT: DIANE STRUZZI
NICOLE TURSO
212-825-5931**

DOI INVESTIGATION LEADS TO ARREST OF CITY-FUNDED NONPROFIT EXECUTIVE AND SPOUSE ON THEFT CHARGES AND FINDS CONCERNS WITH NYC AGING DEPARTMENT'S AUDITING PRACTICES AND OVERSIGHT OF CONTRACTORS

Mark G. Peters, Commissioner of the New York City Department of Investigation ("DOI") and Preet Bharara, United States Attorney for the Southern District of New York, today announced the arrest of two defendants charged with nearly \$1 million in fraud from a City-funded not-for-profit that serves senior citizens in Upper Manhattan. In conjunction with the arrests, DOI also released a report documenting vulnerabilities in the City Department for the Aging's ("DFTA") oversight of fiscal practices at not-for-profit organizations to which it provides taxpayer funds. Those vulnerabilities, which DOI is working with DFTA to correct, came to light during an investigation of the United Block Association ("UBA") and the theft of almost \$1 million intended to provide services, including meals, to senior citizens. Those funds were instead used, among other things, to pay for the defendants' personal expenses, including a mortgage on a four-bedroom home on Long Island, utility bills and part of the purchase of a late-model luxury sedan. A portion of the proceeds from the criminal scheme were laundered through a shell corporation established by the defendants, according to the criminal complaint.

DOI's review of DFTA's oversight program highlights breakdowns in the agency's auditing practices and recommends specific ways to improve fraud detection and limit future fraud. A copy of DOI's Report follows this release and can be found at the following link: <http://www.nyc.gov/html/doi/html/doireports/public.shtml>.

Commissioner Mark G. Peters said, "The defendants stole food from the mouths of New York's seniors, diverting almost a million dollars from programs designed to provide meals and services to the elderly, according to the criminal complaint. Our investigation revealed systemic vulnerabilities in the Department for the Aging's practices that we are now working with the agency to correct so that City services get to New Yorkers in need – not to crooks who prey on them. I thank the U.S. Attorney for his continued partnership in these investigations."

U.S. Attorney Preet Bharara said, "As alleged, an executive director of a non-profit organization, with the assistance of his wife, abused his position of trust as a provider of public services to enrich himself and his family. Kwame Insaadoo and Roxanna Pearson allegedly diverted close to a million dollars in public funds designed to assist our City's elderly and spent it on themselves. I thank our partners in this investigation for their work in rooting out public corruption."

Today, UBA executive director KWAME INSAIDOO, 59, of Bay Shore, NY, and ROXANNA PEARSON (a.k.a. ROXANNA INSAIDOO), 62, of Bay Shore, NY, were each arrested and charged with conspiracy to commit wire fraud, wire fraud, embezzlement of government funds, and money laundering conspiracy, federal offenses that upon conviction are each punishable by up to 20 years in prison; and conspiracy to embezzle government funds, a federal offense that upon conviction is punishable by up to five years in prison.

According to the criminal complaint, UBA is a nonprofit that receives public funds through DFTA. KWAME INSAIDOO has been UBA's executive director since 1993 and was responsible for reporting to DFTA on UBA's compliance with the City's fiscal requirements. INSAIDOO's wife, ROXANNA PEARSON, is a registered nurse and was purportedly a consultant with UBA until her resignation in August 2012. The investigation found PEARSON continued to

receive unauthorized funds from UBA after her resignation for violating City requirements that prohibit a manager having authority over an immediate family member without written consent from DFTA. DOI's investigation found bank accounts into which INSAIDOO transferred City funds but never disclosed to the City, as he should have done by City contractual requirements, and that UBA over-billed the City for purchases at the same time he was authorizing transfers of thousands of dollars from UBA's accounts to himself, his wife, and a shell corporation named Allied Home Care ("AHC"), which reportedly operated out of the couple's home. UBA issued more than \$190,000 in checks to AHC that were deposited into bank accounts in which INSAIDOO signed as AHC's president and PEARSON signed as AHC's Vice President. These funds were used to pay for personal items for INSAIDOO and his wife, including a mortgage for a Long Island home, clothes, utilities and insurance. AHC was incorporated in 1996 and received funds from UBA since at least 2008; it first submitted a required filing to the New York State Charities Bureau in June 2015 after the City sent UBA a letter regarding a follow up it was doing on an audit.

As outlined in the Report issued today, DOI's investigation into these facts raised concerns about vulnerabilities in DFTA's monitoring of its City-funded nonprofits, specifically finding that DFTA's process of conducting so-called "flash" audits of DFTA-funded organizations, in lieu of more complete reviews, should be strengthened. Just two staff members are responsible for conducting all of DFTA's audits of non-profits with which it contracts, with each auditor carrying a caseload of more than 100 organizations. This structure leaves auditors with insufficient time to conduct tests to determine if rules are being followed or to evaluate the integrity of the not-for-profits. In the UBA case specifically, DOI determined that auditors had received records showing suspicious money transfers from UBA to unidentified accounts, but did not obtain further information about how the money was spent or address the transfers in their audit reports.

DOI's investigation also revealed that invoices meant to categorize an organization's monthly expenses on an item-by-item basis contain few details, and that DFTA collects only a limited number of supporting invoices to substantiate the claims. By exploiting this vulnerability, UBA was able to overbill DFTA for expenses, in one instance, apparently over-reporting its total expenses for four senior centers it operates by more than 500%.

DOI's recommendations – which DFTA has said it will implement – include:

- DFTA should ensure that auditors have the time and resources to do their job effectively and be instructed to spend additional time at a site when they identify significant concerns with an organization.
- DFTA should collect some quantity of third-party vendor invoices and other appropriate backup documents to substantiate a contractor's claims for reimbursement, at least on a random basis.
- DFTA should ensure that not-for-profit contractors complete Corrective Action Plans when issues are identified, and develop a system for enforcing the terms of these plans and appropriate consequences for organizations that do not comply with DFTA's fiscal practices.

DOI Commissioner Peters thanked U.S. Attorney for the Southern District of New York Preet Bharara and DFTA Commissioner Donna M. Corrado, and their staffs, for their cooperation and assistance in this investigation.

The investigation was conducted by DOI's Office of the Inspector General for City-funded nonprofits, specifically Investigative Auditor Elizabeth Mack, under the supervision of Deputy Inspector General/Chief Forensic Auditor Ivette Morales, Inspector General Andrew Sein, Associate Commissioner Susan Lambiase, Deputy Commissioner/Chief of Investigations Michael Carroll and First Deputy Commissioner Lesley Brovner.

Assistant United State Attorney Eli J. Mark from the U.S. Attorney's Office for the Southern District of New York is prosecuting the criminal case.

A criminal complaint is an accusation. Defendants are presumed innocent until proven guilty.

DOI is one of the oldest law-enforcement agencies in the country and New York City's corruption watchdog. Investigations may involve any agency, officer, elected official or employee of the City, as well as those who do business with or receive benefits from the City. DOI's strategy attacks corruption comprehensively through systemic investigations that lead to high-impact arrests, preventive internal controls and operational reforms that improve the way the City runs.

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New York City Department of Investigation

**Report on Fraud and Program Vulnerabilities
at the New York City Department for the Aging**

**MARK G. PETERS
COMMISSIONER**

February 2016

I. DOI's Investigation

The New York City Department of Investigation (DOI) has conducted an investigation into misappropriation of funds at the United Block Association (UBA), a not-for-profit organization funded by the New York City Department for the Aging (DFTA). On February 3, 2016, DOI, working jointly with the United States Attorney's Office for the Southern District of New York, arrested Kwame Insaadoo (Insaadoo), UBA's executive director, and his wife, Roxanna Pearson-Insaadoo (Pearson), on charges of embezzlement of government funds, mail fraud, and money laundering conspiracy. The federal criminal complaint charges that Insaadoo and Pearson participated in a multi-year scheme to misappropriate more than \$950,000 in UBA funds.

DOI's investigation revealed that Insaadoo and Pearson misappropriated these funds in a variety of ways. For example, from approximately July 2008 to April 2015, UBA transferred funds to a bank account that it had not reported to DFTA and, from that account, issued more than 200 checks to a shell corporation controlled by Insaadoo and Pearson. These funds were subsequently used to pay for Insaadoo and Pearson's personal expenses, including the mortgage on their home on Long Island, utility bills, and at least part of the cost of a late-model luxury sedan. During approximately the same time period, Insaadoo also signed and issued UBA checks to himself that exceeded his wages, as reported on his IRS Forms W-2, by more than \$200,000. Furthermore, from approximately July 2008 to August 2014, UBA made total payments to Pearson of more than \$195,000, a portion of which was paid after DFTA explicitly informed UBA that it was not permitted to employ Insaadoo's family members.

DFTA is responsible for overseeing fiscal practices at not-for-profit organizations to which it provides funding, and its oversight takes several forms. For example, DFTA publishes a lengthy Fiscal Management Manual that it provides to its contractors, DFTA's contracts set forth a variety of record-keeping requirements, and DFTA auditors visit the organizations to review their books and records on roughly an annual basis. Nevertheless, DOI's investigation has revealed vulnerabilities in DFTA's oversight program that could be exploited by individuals who wish to commit fraud. This report highlights several of these vulnerabilities and recommends measures DFTA can take to limit future fraud by its contractors.

II. DOI's Findings

A. The Alleged Embezzlement was Facilitated by Vulnerabilities in DFTA's Oversight Program

DFTA receives federal, state, and city funds to provide services to New York City's senior population. DFTA's budget for Fiscal Year 2016 is more than \$316 million, the majority of which

is allocated for contracts with not-for-profit organizations that provide direct services to New York City seniors. UBA, which manages four senior centers in Manhattan, is one such organization.¹

1. DFTA's Method of Auditing Its Contractors Should be Reevaluated

a. The Current "Flash" Audit Process is Inadequate

DFTA's audits of its contractors provide significant opportunities to identify not-for-profit organizations' fraud or misuse of DFTA program funds. However, these audits are not as effective as they should be. Referred to as "flash" audits, DFTA provides the organization with advance notice of the visit date and the records that it should prepare for review, and the DFTA auditor typically spends one to two business days conducting the review. At the conclusion of the audit, DFTA's field auditor holds an exit conference with the organization. Thereafter, DFTA provides a written report to the organization summarizing its findings, to which the organization then provides a written response.

DFTA performs these limited flash audits, rather than more complete reviews, largely because of resource constraints. DFTA's audit team is understaffed and overburdened. Two staff members are responsible for conducting these audits, and each carries a caseload of more than 100 organizations. Under this model, auditors have insufficient time to conduct appropriate financial tests or to properly evaluate the financial health of the not-for-profit and follow up on problems that they uncover. As discussed below, DOI recommends that DFTA empower its auditors to conduct more thorough reviews that include a focus on identifying indicia of fraud.

b. A More Thorough Review of UBA's Records Could Have Uncovered the Alleged Fraud Before DOI's Investigation

This investigation is a case study of how limitations on DFTA's audit resources create the conditions that can allow for fraud. Even where DFTA requires certain disclosures or prohibits certain fiscal practices in an effort to prevent fraud, its auditors do not have the time to conduct tests necessary to determine whether these rules are being followed or to follow up when it is clear they are not.

As one example, DFTA's contract requires UBA to "notify [DFTA] of the name, locations and account numbers of all bank accounts" in which funds related to the contract are maintained. Here, UBA appears to have provided DFTA with only a subset of accounts to which it transferred City funds. As the investigation revealed, Insaidoo transferred UBA funds to one particular bank

¹ UBA manages the A. Philip Randolph Senior Center, located at 108 West 146th Street; the Mary McLeod Bethune Senior Center, located at 1970 Amsterdam Avenue; the Manhattanville-Riverside Senior Center, located at 3333 Broadway; and the Beatrice Lewis Senior Center located at 2322 Third Avenue. According to UBA's IRS Form 990 for 2013, the organization's mission is to serve meals, distribute food, provide health and nutrition education, and provide its clients with referrals for social services. Since 1999, UBA has been awarded contracts with the City totaling more than \$24 million.

account that UBA did not identify to DFTA, and then, along with Pearson, misappropriated that money for personal use.

DFTA auditors received UBA records showing transfers from known UBA accounts to this previously-unidentified account. However, the DFTA auditors did not obtain further information about how the money was ultimately spent and did not obtain records associated with this previously-unidentified account in order to identify the final destination of the funds. Furthermore, they did not address the suspicious transfers in their audit reports.

If a DFTA auditor identifies a suspicious or unusual transfer of City funds to an unidentified account, he or she should be instructed to investigate and evaluate the matter fully. At a minimum, the DFTA auditor should: (1) obtain information concerning the newly-revealed accounts, (2) obtain bank statements concerning those accounts, (3) report the discovery and any findings in his or her audit report, and (4) when appropriate, report it to DOI. Similarly, auditors should be instructed to fully investigate and evaluate any other significant “red flags” of fraud. At bottom, DFTA’s audit staff – the first line of defense against fraud – should be provided with the training to identify such red flags, as well as the time and support necessary to fully evaluate potentially significant problems or findings.

2. DFTA Does Not Adequately Review Monthly Invoices Submitted by Its Contractors

DFTA receives monthly “Contract Invoice and Service Reports” from its contractors, which broadly categorize the organization’s monthly expenses on an item-by-item basis. For example, invoices submitted by UBA contain lines that simply list purported monthly expenses for items such as “raw food,” “personnel,” and “consultants.” The monthly invoices contain few details, and DFTA reimburses the organization without obtaining supporting documentation to substantiate these reimbursement requests.

DOI uncovered evidence that, on multiple occasions, UBA overbilled DFTA for its expenses, including for food and personnel. At times, UBA appears to have over-reported total expenses of its four senior centers by more than 500%. As one example, UBA reported raw food costs of \$61,868.80 for June 2015, even though bank statements only show expenditures of \$3,532.08 to food vendors during this time period.

The risk that an organization will overbill for its monthly expenses would be mitigated if DFTA collected and reviewed at least some quantity of invoices and other appropriate backup to substantiate these claims on at least a random basis. DOI recommends that DFTA do so. Further, as discussed below, DOI also recommends that DFTA auditors not only review vendor invoices to substantiate claims, but also compare those invoices to the organization’s bank accounts in order to properly ensure that actual expenditures are in line with amounts claimed.

3. DFTA’s Method of Addressing an Organization’s Non-Compliance with Fiscal Policies Should be More Effective

In its field audit reports from Fiscal Year 2009 through Fiscal Year 2015, DFTA issued findings concerning numerous fiscal problems at UBA, including that: (1) UBA failed to track employee hours worked; (2) UBA failed to pay payroll taxes in a timely manner; (3) UBA’s bank

reconciliations were incorrect; (4) UBA failed to deposit City funds in its senior centers' accounts in a timely manner; and (5) UBA's financial mismanagement caused it to incur overdraft and insufficient funds charges at its bank. Every DFTA audit report issued since Fiscal Year 2009 – 21 in total, covering each of UBA's four senior centers – requests that UBA design a Corrective Action Plan to remedy the deficiencies. However, DOI has not identified any evidence that DFTA ever required UBA to enter into any meaningful Corrective Action Plan.²

DFTA should develop a more effective program for addressing an organization's failure to comply with its fiscal policies or Corrective Action Plans. If an organization continuously flouts DFTA's rules or recommendations, the agency should impose appropriate consequences, including, but not limited to, consulting with the Mayor's Office of Contract Services to evaluate its options for bringing the organization into compliance and potentially transitioning the contract to another provider. Willful or repeated violations of DFTA rules should be reported to DOI.

III. Recommendations to Mitigate the Future Risk of Fraud

In light of DOI's findings, DOI recommends that DFTA reevaluate its fiscal oversight program and make appropriate changes to its audit process, its process for approving monthly payments to contractors, and its method of enforcing compliance with its fiscal policies.

Specifically, DOI recommends the following:

- (1) DFTA should immediately reevaluate its system for auditing contractors to which it provides City funds.
 - a. DFTA should make all reasonable efforts to rightsize its audit staff to ensure that auditors have the time and resources to do their job effectively.
 - b. DFTA auditors should be instructed to spend additional time at a site when they identify significant concerns during the course of their work.
 - c. When DFTA auditors identify suspicious or unusual transfers of City funds to accounts with which they are not familiar, they should obtain records sufficient to confirm that the transaction was related to a legitimate and appropriate business purpose.
 - i. At a minimum, DFTA auditors should obtain a general ledger for the account to which the City funds were transferred.
 - ii. Failure to provide relevant records to a DFTA auditor should be reported immediately to a supervisor, who should escalate the issue internally as needed. If necessary, the non-cooperation should be reported to DOI and documented in the organization's VENDEX evaluation.

² DFTA repeatedly provided UBA with blank Corrective Action Plan forms, which request a list of specific steps an organization will take to address deficiencies. It does not appear that UBA ever completed these forms. Instead, UBA responded to DFTA's audit reports with letters containing vague commitments to address the problems that had been identified.

- d. DFTA’s auditors should obtain documents sufficient to substantiate expenditures reported in monthly invoices. At a minimum, auditors should perform tests on the last month of the fiscal year – when the incentives to inflate costs may be at their highest – and one other random month.
 - i. When an organization’s monthly invoice shows unusually high expenses or other aberrations, DFTA auditors should investigate further.
 - e. DFTA should provide its audit staff with appropriate training with respect to: (1) identifying indicia of fraud, and (2) DFTA’s own policies for escalating matters to supervisors or to DOI.
 - f. Audit supervisors should not only review audit reports, but also backup documents collected during the audit to identify potentially significant conclusions.
 - g. Audit supervisors should flag serious or recurring fiscal problems at an organization and ensure that DFTA conducts further evaluation of such issues.
 - h. Audit supervisors should report serious or recurring fiscal problems at an organization to DOI, including, but not limited to, unexplained transfers of City funds to unidentified bank accounts.
 - i. When DFTA has identified significant fiscal deficiencies at an organization, DFTA’s fiscal staff should review those findings with the organization’s Board of Directors.
- (2) DFTA should immediately reevaluate its system for reviewing contractors’ monthly invoices.
- a. DFTA should collect at least some quantity of third-party vendor invoices and other appropriate backup to substantiate a contractor’s claims for reimbursement on at least a random basis.
 - i. DFTA should conduct an appropriate number of tests to identify situations where vendor invoices do not support the DFTA contractor’s claim for reimbursement.
 - b. Each month, DFTA should obtain specific information about consultants the organization has paid during that time period, including the names, qualifications, nature of the work performed, hours worked, and amounts paid.
- (3) DFTA should design a more effective “escalation” process to address problems repeatedly identified by its auditors.
- a. DFTA should ensure that, when appropriate, a not-for-profit contractor completes a Corrective Action Plan, including specific steps to achieve specific goals by specific dates.
 - b. DFTA should develop a system for enforcing the terms of their Corrective Action Plans and imposing appropriate consequences upon organizations that do not comply with DFTA fiscal practices.

- c. If a DFTA-funded organization intentionally or repeatedly fails to comply with a DFTA Corrective Action Plan, DFTA should engage the Mayor's Office of Contract Services to evaluate its options for bringing the organization into compliance and potentially transitioning the contract to another provider. The failure to comply with DFTA's Corrective Action Plan should be documented in the organization's VENDEX evaluation.
- d. DFTA should designate a staff member to follow up on measures listed in any organizations' Corrective Action Plans and monitor until they have been successfully implemented.

IV. Conclusion

DOI's investigation revealed significant fraud involving City funds provided to UBA and resulted in criminal charges against two individuals. During the course of its investigation, DOI also identified vulnerabilities in DFTA's oversight of its contractors, which it can address, at least in part, by implementing the recommendations listed above. DOI has discussed the above recommendations with DFTA, which agrees with them and agrees to work in collaboration with DOI on these issues. DOI will monitor DFTA's responses to and implementation of these recommendations.