



The City of New York  
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**DOI ISSUES REPORT TODAY ON CORRUPTION VULNERABILITES IN THE CITY'S  
OVERSIGHT AND ADMINISTRATION OF NONPROFIT HUMAN SERVICES CONTRACTS**

Margaret Garnett, Commissioner of the New York City Department of Investigation ("DOI"), issued a Report today on the "Corruption Vulnerabilities in the City's Oversight and Administration of Not-for-Profit Human Services Contracts," which provides 23 recommendations for reform. The Report is a detailed examination of how the City can strengthen the budgeting, invoicing, and auditing of the nonprofit human service contracts it awards, and which in Fiscal Year 2020 expended more than \$4 billion of the City's funds. DOI has conducted dozens of investigations into corruption, waste, fraud, and other abuse involving these outsourced human service contracts that deliver a variety of vital services, including housing, education, and health services, and are intended to help New Yorkers lead better lives. These investigations have led to criminal charges against nonprofit executives and board members, numerous administrative referrals, and more than 100 recommendations to close corruption vulnerabilities at individual City agencies. This Report draws on DOI's observations from those investigations, as well as its broader oversight work in this area, in order to identify reforms to City-wide practices that can help to address these gaps in a systemic manner. A copy of the Report is attached to this release and can be found at the following link: <https://www1.nyc.gov/site/doi/newsroom/public-reports.page>

DOI Commissioner Margaret Garnett said, "This Report culls the insights from dozens of investigations the agency has conducted over the past seven years regarding City-funded nonprofits and that have led to more than 100 recommendations for reform. DOI has found that developing Citywide policies and procedures, instituting more rigorous reviews, and requiring that contractors both certify their compliance with competitive bidding requirements and clearly disclose executive compensation on an annual basis are among 23 improvements the City can make to strengthen its policies and procedures in this area. The City spends enormous amounts of money to support these human services programs and they are targeted to helping the most vulnerable New Yorkers; therefore, there is no substitute for effective and standardized procedures around these important contracts to ensure that this crucial public money is not stolen or wasted."

DOI reviewed City oversight procedures with a focus on five agencies that outsource significant amounts of their services to nonprofit contractors: The Department of Youth and Community Development ("DYCD"), the Department for the Aging ("DFTA"), the Department of Health and Mental Hygiene ("DOHMH"), the Department of Social Services ("DSS") – which oversees the Human Resources Administration ("HRA") and Department of Homeless Services ("DHS") through a joint management structure – and the Administration for Children's Services ("ACS"). The review further focuses on the agencies' practices with respect to three contract management functions:

1. Budgeting, a forward-looking process when City agencies allocate funds that will be used to pay for the nonprofit's work. DOI found the City misses opportunities to control fraud and waste at the annual budgeting stage.
2. Invoicing, the process through which nonprofit contractors seek reimbursement for their expenses. DOI found the City conducts insufficient review of invoiced expenses.

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3. Auditing, which typically includes a review of the organization's financial position and may also review compliance with City contracts or other rules. DOI found the City should set uniform audit policies designed to increase coverage and promote efficiency.

The Report is separated into these three areas, summarizes DOI's investigative findings, highlights the corruption vulnerabilities, and makes recommendations to implement standard procedures across the City intended to close those gaps. Among DOI's recommendations are that the City:

- Develop standard, City-wide conflict of interest disclosure forms for nonprofit human service contractors.
- Require that contractors certify their compliance with competitive bidding requirements.
- Develop a policy to conduct more rigorous reviews of large expense categories that may pose a greater risk, specifically costs of occupancy and subcontracts.
- Require that contractors clearly disclose executive compensation to the City on an annual basis.
- Develop a standard, City-wide policy for evaluating and approving City-funded executive compensation, including potential limitations on the amount that the City will fund.
- Revise its standard invoicing templates to ensure that contractors disclose an appropriate level of detail about expenses for which they are seeking reimbursement.
- Develop agency invoice review practices that are in line with New York City Comptroller Directive 2, which implicitly recognizes risks posed by cost reimbursement contracts, and sets out specific guidelines for controlling waste and fraud in this area.
- Develop a uniform, City-wide "risk-based" audit system that increases coverage and focuses resources on contracts that pose greater risk for waste, fraud, and abuse.

These recommendations are intended to safeguard public resources, provide additional consistency and predictability for the nonprofit organizations working on behalf of the City, and enhance public trust in the City's methods of providing these important human services. Some recommendations may require the City to invest additional resources in order to implement more effective compliance mechanisms; however, any such investments may be offset by agencies' enhanced ability to spot disallowed, wasteful, or fraudulent spending. The recommendations may also require that the City designate one central authority to issue and ensure compliance with uniform policies.

The investigation was conducted by the Office of the Inspector General for City-funded Not-for-Profits, specifically, Deputy Inspector General Jennifer Way, Confidential Investigator Emily Ostrowski, and Confidential Investigator Rushelle Sharpe, with assistance from Senior Investigative Auditor Jeffrey Freeman, Senior Investigative Attorney Carolyn Tomsu, and First Deputy Inspector General Ivette Morales, under the supervision of Senior Inspector General Andrew Sein, Deputy Commissioner/Chief of Investigations Dominick Zarrella, and First Deputy Commissioner Daniel G. Cort.

*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



# DOI Report on Corruption Vulnerabilities in the City's Oversight and Administration of Not-for-Profit Human Services Contracts

Margaret Garnett  
Commissioner

Andrew Sein  
Senior Inspector General

November 2021

# Report on Corruption Vulnerabilities in the City’s Oversight and Administration of Not-for-Profit Human Services Contracts

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## **Introduction**

Each year, the City of New York allocates billions of dollars to nonprofit organizations that deliver human services to New Yorkers. In Fiscal Year 2020 alone, even with disruptions in services caused by COVID-19, the City made payments to nonprofit human services contractors totaling more than \$4 billion. These contractors supplement City government by delivering a variety of vital services—including housing, education, and health services—that are intended to help New Yorkers lead better lives.

In many cases, the City funds these nonprofit organizations' work by reimbursing their costs. This gives City agencies the heavy responsibility of ensuring that these providers are using public funds appropriately and in compliance with their contracts. Although the vast majority of these organizations focus on providing high-quality services and use their best efforts to administer public funds responsibly, it is important that the City have robust procedures to safeguard its resources in this area, where funding is limited and many recipients of services are among the City's most vulnerable.

DOI has conducted dozens of investigations into corruption, waste, fraud, and other abuse involving these outsourced human services contracts. The investigations have led to criminal charges against nonprofit executives and board members, numerous administrative referrals, and more than 100 recommendations to close corruption vulnerabilities at individual City agencies. This report draws on DOI's observations from those investigations, as well as its broader oversight work in this area, in order to identify reforms to City-wide practices that can help to address these gaps in a systemic manner.

In the report, DOI reviews City oversight procedures with a focus on five agencies that outsource significant amounts of their services to nonprofit contractors: the Department of Youth and Community Development ("DYCD"); the Department for the Aging ("DFTA"); the Department of Health and Mental Hygiene ("DOHMH"); the Department of Social Services ("DSS"), which oversees the Human Resources Administration ("HRA") and Department of Homeless Services ("DHS") through a joint management structure; and the

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Administration for Children's Services ("ACS"). The review further focuses on the agencies' practices with respect to three contract management functions: (1) annual budgeting, a forward-looking process when City agencies allocate funds that will be used to pay for the nonprofit's work; (2) invoicing, the process through which nonprofit contractors seek reimbursement for their expenses; and (3) auditing, which typically includes a review of the organization's financial position and may also review compliance with City contracts or other rules.

This report summarizes DOI's investigative findings, highlights the corruption vulnerabilities, and ultimately makes recommendations to implement standard procedures across the City intended to close those gaps. Among DOI's recommendations are that the City:

- Develop standard, City-wide conflict of interest disclosure forms for nonprofit human services contractors;
- Require that contractors certify their compliance with competitive bidding requirements;
- Develop a policy to conduct more rigorous reviews of large expense categories that may pose a greater risk, specifically costs of occupancy and subcontracts;
- Require that contractors clearly disclose executive compensation to the City on an annual basis;
- Develop a standard, City-wide policy for evaluating and approving City-funded executive compensation, including potential limitations on the amount that the City will fund;
- Revise its standard invoicing templates to ensure that contractors disclose an appropriate level of detail about expenses for which they are seeking reimbursement;
- Develop agency invoice review practices that are in line with New York City Comptroller Directive 2; and
- Develop a uniform, City-wide "risk-based" audit system that increases coverage and focuses resources on contracts that pose greater risk for waste, fraud, and abuse.

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These recommendations are intended to safeguard public resources, provide additional consistency and predictability for the nonprofit organizations working on behalf of City, and ultimately enhance public trust in the City's methods of providing these important human services. Some recommendations may require the City to invest additional resources in order to implement more effective compliance mechanisms; however, any such investments may be offset by agencies' enhanced ability to spot disallowed, wasteful, or fraudulent spending. The recommendations may also require that the City designate one central authority to issue and ensure compliance with uniform policies.

## Budgeting

### 1. The City Misses Opportunities to Control Fraud and Waste at the Budgeting Stage

#### a. Introduction to Budgeting

The City typically pays human services vendors either by reimbursing their expenses or by paying an established rate for the work they perform. In either case, the contractor proposes an annual budget that projects the cost of providing the services each year, which the City agency uses to establish the total amount of the contract. Under the cost reimbursement model, a contractor must resubmit its proposed budget every year and obtain approval from the agency before invoicing.

Agency staff who review and approve these annual budgets have historically done so in accordance with their individual agency's fiscal manual, but are now also subject to the new City-wide *Health and Human Services Cost Policies and Procedures Manual* (the "Cost Manual") and *Standard Health and Human Service Invoice Review Policy* ("Standard Review Policy"). The Cost Manual was introduced in February 2019. However, the Standard Review Policy was introduced only in December 2020, meaning that, in some respects, the manner in which individual agencies will implement it is yet to be seen.

The Cost Manual broadly categorizes costs as "allowable" or "unallowable." An allowable cost "directly or indirectly benefits a particular Contract and contributes to the Provider's provision of services under the Contract." The Cost Manual details nine criteria that a cost must meet to be allowable, including its "reasonableness." In contrast, an "unallowable" cost "neither directly nor indirectly benefit[s] a particular Contract." A cost is unallowable unless it affirmatively meets the nine criteria for being "allowable."

The Cost Manual also establishes procedures for providers to establish what is known as an "indirect cost" rate. An expense is considered "direct" if it is the cost of a good or service that is necessary to the services funded by the contract, such as the salary of a staff member who meets with clients, or rent at a location where the program operates. An "indirect" expense is an organizational cost that is not

related to the contract directly, such as accounting software, utility bills, or the salary of an executive director who oversees numerous organization programs. The provider sets its indirect rate on a contract by calculating the “proportion of [i]ndirect [c]osts an individual [p]rogram should bear.” *See Cost Manual Section I.*

These new policies and procedures bring much-needed standard guidance for not-for-profit contractors and City agencies. However, as discussed below, DOI recommends that the City implement certain additional controls at the budgeting stage in order to curb waste, fraud, and abuse.

**b. Finding #1: The City Can Take Additional Steps to Identify Conflicts of Interest and Improper Transactions at the Budgeting Stage**

The City prohibits conflicts of interest in the performance of its human services contracts. The Human Services Standard Contract (the “Standard Contract”)<sup>1</sup> contains a general prohibition on conflicts (Appendix A, Section 2.02) and contains various other protections intended to prevent conflicted transactions, including requirements that subcontracted services be obtained through a competitive bidding process (Section 4.05 (B)) and prohibitions on nepotism (Section 6.05 (C)).

Notwithstanding these rules, the City does not have uniform systems for contractors to disclose possible conflicts of interest or to affirmatively certify that they have followed competitive bidding requirements. As discussed below, DOI makes several recommendations intended to develop an effective and consistent approach for making such disclosures, based in part on a model used by certain New York State agencies. These disclosures should be reviewed and evaluated during the annual budgeting process in order to proactively identify conflicted transactions that may inflate the costs of service or otherwise undermine the integrity of the contract.

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<sup>1</sup> This is a boilerplate agreement used for many of the City’s human services contracts. Among other things, the Standard Contract specifies the scope of service to be provided, sets forth requirements concerning record retention, and prohibits conflicts of interest in connection with performing the services.

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Furthermore, City agencies do not perform a sufficient review of two high-value expenditures that are susceptible to waste, fraud, and abuse: costs billed for occupancy and significant costs billed for work by subcontractors and vendors. Although the new Standard Review Policy does indicate that agencies should collect basic documents relating to these cost categories (specifically rent costs and subcontractor agreements), it does not establish clear procedures for what review agencies should conduct after receiving those documents. These enhanced reviews should take place during the budgeting process, which is discussed further below.

### **(i) The City Should Expand Certifications and Disclosures as to Conflicts of Interest**

In order to standardize reviews for conflicts of interest, the City should look to the example of State government, where a committee of major State social service agencies have adopted standard conflict of interest disclosure forms. These forms are included as schedules to the Consolidated Financial Reports (“CFRs”), documents that these State agencies use to also standardize disclosure of budgeted costs and cost allocations.<sup>2</sup> In some cases, the contractor’s conflict of interest disclosures are examined by an independent certified public accountant prior to submission of the CFRs.

Under the State’s system, the organization’s chief executive officer must certify, among other things, on Schedule CFR-iv that the organization’s purchases have complied with competitive bidding requirements, that the organization has remained current with tax obligations and rental payments, and that the organization has “properly disclosed all financial transactions with related organizations/individuals.”

Similarly, Schedule CFR-5 asks, “During the reporting period, were there any PAYMENTS TO related organizations or individuals associated with the provider that involved any OASAS, OMH, OPWDD, SED, DOH and/or OCFS programs and/or agency administration?” If the

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<sup>2</sup> Four State agencies require reporting on the CFR: the State Education Department (“SED”), the Office of Alcoholism and Substance Abuse Services (“OASAS”), the Office of Mental Health (“OMH”), and the Office for People With Developmental Disabilities (“OPWDD”). The Department of Health (“DOH”) and the Office of Children and Family Services (“OCFS”) are also members of the committee and accept CFRs.

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contractor answers this question in the affirmative, it must list the transaction and its amount, describe the transaction, and provide the name of the related organization or individual, as well as the relationship to the provider.

DOI recommends that the City create a standard disclosure and certification form to be submitted for agency approval and modeled on the above schedules to include questions about: (1) whether the organization has entered into any financial transactions with entities or individuals who are associated with the organization or its key employees; and (2) whether the organization has complied with contractual requirements that it competitively bid significant expenditures on subcontractors and vendors. This is set forth in Policy and Procedure Recommendation (“PPR”) #1, below. A proposed disclosure form is attached in Appendix 1 to this report. Again, such a disclosure form would help to ensure that the City receives complete information about potentially conflicted transactions in a uniform manner, and would allow the City to identify and reject improper conflicts at the earliest possible opportunity.

DOI’s proposed disclosure form would also require providers to disclose any employees of the organization who supervise members of their own family with respect to work on the City contract. During the course of its investigations, DOI has repeatedly identified instances of employees providing services on City contracts who are supervised by family members apparently without the knowledge and authorization of the funding City agency, in violation of the Standard Contract. DOI has identified such instances at vendors funded by ACS, DFTA, DYCD, DOHMH, and DSS. DOI has previously issued PPRs to several of these agencies recommending the development of a standard disclosure process for such issues, and therefore recommends that any such disclosure forms developed to date be integrated into the standard forms recommended above.<sup>3</sup>

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<sup>3</sup> Specifically, DOI has recommended that DYCD, DFTA, ACS, and DSS “should identify and implement a clear method by which City-funded not-for-profit organizations can disclose potential conflicts of interest affecting their City contracts, including familial relationships with other officers and staff or ‘related party transactions’ in which they are involved.” DOI also made recommendations to DOHMH and the Mayor’s Office of Criminal Justice with respect to similar issues. As of the date of this report, only DYCD has reported to DOI that it has implemented this recommendation.

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The proposed disclosure system should supplement, but not replace, a process for conducting routine vetting of human services contractors in connection with the “responsibility determination” described in the City’s Procurement Policy Board (“PPB”) Rules. *See* PPB Rules § 2-08. Although this process is beyond the scope of this report, a proposed set of uniform responsibility determination procedures is attached as Appendix 6.

### (ii) The City Should Develop Enhanced Reviews for Occupancy Costs

Occupancy is among the largest categories of expenses for City-funded human services programs. According to statistics in the HHS Accelerator<sup>4</sup> system, organizations invoiced the City more than \$884 million for rent expenses in Fiscal Year 2020, close to 20% of total invoiced expenses for that year. Historically, however, many agencies have not reviewed documentation necessary to confirm that occupancy costs have been fairly charged to the contract, with some not even obtaining the organization’s lease to verify its price and terms. Given the magnitude of these expenditures and, as discussed below, the particular risk that these costs can be inflated, agencies must conduct more comprehensive and uniform reviews of these costs.

Many agencies also have not obtained cost allocation plans when approving shared occupancy costs, which, if not properly allocated, could be charged to the City in amounts exceeding the program’s fair share. In an investigation involving a Bronx-based not-for-profit, DOI found that DFTA had been paying for the expenses related to office space that was being used for both DFTA and HRA programs.<sup>5</sup>

The Standard Review Policy has recently established some baseline requirements in this area, stating that occupancy costs and the cost

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<sup>4</sup> HHS Accelerator is an online City procurement management system through which vendors submit their budgets and invoices for approval.

<sup>5</sup> DOI also found that the organization used close to \$800,000 in government funding intended for an affiliated home care service organization to pay for leasing costs at a different administrative office space that was in fact vacant. DOI referred its findings to the Attorney General’s Office, which announced in 2015 that it had entered into a settlement with the not-for-profit requiring it to repay the approximately \$800,000 to the Medicaid program. Press Release, New York State Attorney General’s Office, A.G. Schneiderman Announces \$800,000 Settlement with Bronx Nonprofit that Diverted Money Intended for Services for Elderly (Feb. 25, 2015), *available at* <https://ag.ny.gov/press-release/2015/ag-schneiderman-announces-800000-settlement-bronx-nonprofit-diverted-money>.

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allocation plan “will be documented and verified during the budget approval process.” However, agency staff will need more detailed procedures and training to create effective controls on these large expenses, including processes to verify that the cost is reasonable, that the expense was properly allocated, and that transactions are free from conflicts of interest. Appendix 2 is a proposed draft of such procedures, which include directions that agency staff:

- Review primary documents, such as leases, in conjunction with secondary documents, such as cost allocation plans and general ledgers.
- Review leases to verify that occupancy expenses are reasonable, including requesting a market evaluation for any new leases or using lease cost data from other contracts as a comparison. *See* Cost Manual Section IV, V (discussing allowable rental costs).
- Verify that occupancy costs are properly allocated if space is shared by more than one program or function, including reviewing the methodology for allocation (*e.g.*, square footage or another method) and ensuring that the methodology was correctly and consistently applied.
- Verify that the real estate being charged to the contract provides a direct benefit to the contract. *See* Cost Manual Section IV, O (disallowing costs related to “idle facilities”). DOI has identified examples where the City has paid for office space that went unused.
- Determine whether the rental agreement is part of a “sale and leaseback” arrangement, where costs are limited to “the amount that would be allowed had the Provider continued to own the real property or equipment.” Cost Manual Section IV, V; *see also* 2 C.F.R. § 200.465 (federal regulations imposing similar limits). In one investigation, DOI found that an agency had implicitly approved a provider’s occupancy costs under a sale and leaseback arrangement, even though the invoices had exceeded these limits.

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- Perform consistent, detailed reviews to determine whether significant leasing transactions are with related parties and, if so, whether the related parties are being compensated excessively.

These recommendations are also set forth in PPR #2.

With respect to the final point concerning related party transactions, the City's online contractor registration system (known as PASSPort) already requires City contractors to report any real property they occupy and in which "any principal owner or officer . . . or any member of his/her immediate family" has an ownership interest by asking the following question:

*Does any principal owner or officer of the submitting vendor, or any member of his/her immediate family, have an ownership interest in any entity that holds the title or lease to any real property used by the submitting vendor in the New York City metropolitan area?*

Providers must respond to this question as part of a questionnaire every time they enter into a contract with the City exceeding \$250,000 or for every contract, when their aggregate contracts have already exceeded \$250,000 over a twelve-month period. The questionnaire may be signed and certified by any individual designated by the organization, regardless of their rank or role at the entity. However, it is not clear that agency contracting officers review these questionnaires in a consistent manner.<sup>6</sup>

Agencies should obtain these PASSPort reports and review the provider's answers to this question as part of their normal review procedures. In cases where a provider answers this question with "yes," agency staff should require further disclosures as to the nature and

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<sup>6</sup> DOI's investigations have also revealed instances in which vendors have inaccurately replied "no" to this question when their principal owners have in fact held such an ownership interest. In one case, the board chair of an ACS-funded not-for-profit day care owned a building where the organization maintained administrative offices and falsely answered that he had no such ownership interest. That board chair ultimately pleaded guilty to one felony count of Offering a False Instrument for Filing in the First Degree. Press Release, New York State Attorney General's Office, Attorney General James, Comptroller DiNapoli, and Department of Investigation Commissioner Garnett Announce Guilty Verdict of Non-Profit Executive in Corruption Scheme (Oct. 28, 2019), available at [https://www1.nyc.gov/assets/doi/press-releases/2019/oct/Mendez\\_Verdict\\_10282019.pdf](https://www1.nyc.gov/assets/doi/press-releases/2019/oct/Mendez_Verdict_10282019.pdf).

percentage of the ownership interest, as well as the profits earned by the principal owner or officer or member of his or her immediate family. A draft supplemental disclosure form with respect to these issues is attached in Appendix 3, which is modeled in part on disclosures required by the State in Schedule CFR-5 when related parties are involved in “lease/rental agreements.” This recommendation is set forth in PPR #3.

**(iii) The City Should Develop Enhanced Reviews for Subcontractors**

Funds paid to subcontractors also warrant enhanced scrutiny both at the budget and invoice stages. Subcontractors provide a wide array of services to human services providers, such as construction services at a building where services are provided, meals for program clients, or security at program facilities. While subcontracts are subject to restrictions under the Standard Contract and the PPB Rules, the procurement process is conducted by the not-for-profit provider, not the City. The provider is also primarily responsible for evaluating the subcontract’s costs through a competitive bidding process, but may not have the same incentives as the City to control costs. Since the City essentially outsources these important tasks, it is particularly important that the City make a focused effort to ensure that its rules are followed and that significant subcontracted expenditures are free from waste, fraud, and abuse.

The new Standard Review Policy states that “subcontractor agreements, license agreements, [and] vendor agreements” should be “documented and verified” before the City agency approves a budget. This is consistent with previous requirements in the Standard Contract, which required agencies to approve subcontracts with a value exceeding \$20,000 before the work is performed. *See* Standard Contract, Appendix A, Section 3.02. The subcontractor must also complete PASSPort questionnaires if their aggregate awards exceed \$250,000 in a twelve-month period. PPB Rules § 2-08.

DOI’s review shows that in some cases, not-for-profit providers have not entered subcontracts into the Payee Information Portal (an electronic submission system for City contractors), instead seeking approval of their subcontracts after the work was already performed. When that happens, the agencies may not have an opportunity to review PASSPort

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disclosures from the subcontractor as required by the PPB Rules or to conduct any other vetting of the subcontractor.

The Standard Review Policy's requirement that City agencies identify subcontractors and collect subcontracting agreements is fundamentally important. As with occupancy costs, the City should issue standard operating procedures to ensure that this information is properly reviewed by each agency, and communicate an annual reminder of the provider's obligation to enter its subcontractors into the Payee Information Portal. Appendix 4 is a proposed draft of such procedures, which include directions that agency staff:

- Take measures to enforce the rule that subcontractors enter disclosures in PASSPort if they exceed \$250,000.
- Conduct a basic integrity review of the subcontractor, including, at a minimum, internet research of the entity and its principals. In a recent investigation, an agency evidently did not perform such research in the case of a Staten Island-based not-for-profit subcontractor, where publicly-available reports showed that the purported chairman of the subcontractor organization had been convicted of fraud within the previous decade.
- Perform consistent, detailed reviews to determine whether significant subcontracting and vendor transactions are with related parties and, if so, whether the related parties are being compensated excessively.
- Review bidding documents to ensure that the provider selected the most cost-effective option available, from among the qualified and responsible bidders.

This is discussed further in PPR #4, below.

### **c. Finding #2: The City Lacks Controls Over the Amounts Budgeted for Executive Compensation**

The City, of course, carefully controls and monitors the salaries it pays to its own employees. Municipal salaries are subject to a variety of limitations and are posted publicly, which ensures accountability and transparency. In contrast, the City's systems for monitoring public

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funds directed to the highest salaries at its contractors and subcontractors—to the extent those systems exist at all—are undermined by significant loopholes.<sup>7</sup> In some cases, appropriate agency personnel may not even be aware of the amount that their agency is paying toward salaries of the contractor's highest-level executives.

Although Section 6.02 of the City's Standard Contract requires contractors to disclose the total amount of compensation paid to the "Executive Director, Chief Financial Officer, Chief Operating Officer, and/or the functional equivalent of such positions, and key employees," as well as the source of funding used to pay those salaries, DOI has found that provision is widely unenforced. As a result, executive compensation in many cases remains opaque, with no standard mechanism for the City to collect basic information about the amounts paid to executives or the extent to which City money is funding those salaries.

Moreover, unlike the State and federal governments, the City has no clear guidelines limiting executive compensation paid to its not-for-profit social service contractors. By default, these expenses are limited only by the general "cost reasonableness" provisions of the Cost Manual. *See Cost Manual at 17* (defining a cost as "reasonable" if, "in its nature and amount, it does not exceed the amount that would be incurred by a prudent Provider under the circumstances prevailing at the time the decision was made to incur the Cost.").

Payment of excessive executive compensation is an important issue because, where it does occur, it is often linked to other types of fraud or waste of public resources. Accordingly, this is an area that requires close and continued scrutiny. DOI recommends that the City implement a consistent disclosure mechanism to ensure transparency, and provide guidance to individual agencies about evaluating executive compensation. At least some agency representatives have told DOI that it is challenging to consider the reasonableness of executive salaries without uniform guidance.

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<sup>7</sup> These loopholes will be discussed in more detail in the discussion of indirect costs on pages 16 to 18.

**(i) The City Should Develop a Standard Mechanism for Collecting Executive Salary Amounts and Funding Sources**

The HHS Accelerator system requires human services contractors to disclose salaries charged as “direct” costs, but not salaries billed as “indirect” costs. This leaves a significant gap as to executive compensation, which—as an expense that supports the overall operations of the organization, rather than one particular contract—is more likely to be subsumed within the indirect category.

Although HHS Accelerator’s budget template may not require the disclosure of executive salaries, Section 6.02 of the Standard Contract clearly requires that contractors disclose to the City “current total compensation (including all benefits), all sources of the . . . total compensation . . . and the dollar amount of compensation from each such source” with respect to “the Executive Director, Chief Financial Officer, Chief Operating Officer, and/or the functional equivalent of such positions,” as well as “key employees,” as that term is defined in the IRS Form 990. Thus, if enforced, this provision would collect the information necessary to fill any gaps remaining from HHS Accelerator.

DOI found that, of the five agencies within the scope of this report, only DSS collects any of the information required by section 6.02. DSS began doing so following a DOI recommendation and investigation finding that the chief executive of a DHS-funded provider received a previously-undisclosed and publicly-funded annual salary that reached as high as \$651,000. DSS currently collects a letter from each provider at time of contract award that states the total salary of the organization’s chief executive, although it does not include the sources of funding for that salary. DSS checks the amount against IRS Form 990 executive salary disclosures, and files the information for future reference.

Collecting this information on a City-wide basis would ensure that there is a minimum level of transparency for this important category of expenditures and that City agencies receive this information on a timely basis. It would also bring the City’s practices more closely in line with federal regulations, which require disclosure of this basic information for certain contractors and for “first-tier” subcontractors. 48 C.F.R. § 52.204-10. As described in PPR #5, DOI recommends that City agencies

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begin to follow and enforce this already-existing provision in the Standard Contract.

### (ii) The City Should Develop Guidelines on Reasonableness of Executive Compensation Expenses

In cases where a City agency is aware of the executives' salaries and those salaries are high enough to raise questions of reasonableness, representatives of some agencies told DOI that they may seek evidence that an organization identified comparable salary rates to justify the expense and that the board approved the salary. *See* N.Y. Not-for-Profit Corp. Law § 715. However, this process is not required by the Standard Review Policy and individual agencies exercise their own discretion as to whether a particular salary is excessive.<sup>8</sup>

In contrast, the Federal and State Governments impose caps on overall compensation for their contractors. Federal law currently limits the amount that any contractor can bill the U.S. government for employee salary to \$568,000.<sup>9</sup> The State of New York, following Executive Order 38, prohibits more than \$199,000 in State funds from being used for an individual's annual executive compensation.<sup>10</sup>

Notably, New York City Comptroller's Directive 2, which is discussed in more detail beginning on page 24 below, states that in the context of cost reimbursement contracts, "[c]ompensation for professional services

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<sup>8</sup> Again, agencies are limited by the general "cost reasonableness" provisions in the Cost Manual. The New York State Not-For-Profit Corporation Law also states that compensation must be paid in a "reasonable amount." N.Y. Not-for-Profit Corp. Law § 515.

<sup>9</sup> The limit is adjusted annually. *See* 48 C.F.R. § 31.205-6. Federal agencies may make exceptions for highly skilled specialists that could not be retained within the cap. *See* 41 U.S.C. § 4304(a)(16). Certain agencies also impose lower caps on their contractors' executive salary. The U.S. Department of Health and Human Services limits the amount of public funds that can be paid for direct salaries to the levels set out in Federal Executive Schedule Level II, which is \$199,300 as of January 2021. Similarly, the U.S. Department of Justice ("DOJ") prohibits most grant recipients from using DOJ grant funds to pay compensation over 110% of the highest maximum salary payable to a member of the federal government's Senior Executive Service. *See* <https://www.justice.gov/ovw/file/1030311/download>.

<sup>10</sup> Executive Order 38 directs agencies in State government to implement regulations to address executive compensation and administrative expenses at State-funded entities that provide services to New Yorkers in need. Executive Order 38 requires, among other things, a limit of \$199,000 for executive compensation at entities using State funding for executive compensation with certain limited exceptions. Executive Order 38 is applicable only to "covered providers"—organizations that receive more than \$500,000 in state funding, where that funding accounts for at least 30% of the organization's revenue per year.

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must be limited to that which a reasonable person would pay in a similar circumstance” and states that “[c]aps for executive compensation should follow” guidelines issued by the American Association of State Highway Transportation Officials (“AASHTO”). The AASHTO guidelines refer to a “National Compensation Matrix” that, in turn, references the above-referenced federal statutory cap. However, as discussed in detail below, Directive 2 has only been strictly applied by the City’s building and infrastructure agencies, not by social service agencies, meaning that salary caps are not even applied consistently across City agencies.

This report does not take a position on whether a hard cap on executive compensation or less stringent guidelines would be more appropriate for the City. DOI recognizes that the question of what is reasonable is a complex and fact-specific judgment, which requires balancing the need to be prudent with City funds against the need to recruit and retain executives who are capable of overseeing entities that deliver critical services to New Yorkers. However, that complexity underscores the need for agencies to be equipped with guidance as to how to evaluate the reasonableness of requests.

As described in PPR #6, DOI does recommend that the Mayor’s Office of Contract Services (“MOCS”)<sup>11</sup> convene a working group to: (1) develop a City-wide policy that will ensure transparency in this area to City agencies and to the public; and (2) develop appropriate guidance to agencies in making determinations as to the appropriateness of executive compensation for contractors and first-level subcontractors, including obtaining additional documentation regarding board oversight and approval if the salary is potentially excessive; and (3) consider whether a cap on executive compensation or other parameters would be appropriate for New York City.

### **d. Finding #3: “Indirect” Costs Are Not Sufficiently Reviewed by Agencies**

As noted above, “indirect” costs are intended to pay for expenses that are not attributable to a single program, but instead support the organization as a whole. Indirect costs may include expenses such as executive staff who focus on more than one particular contract, utility

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<sup>11</sup> MOCS oversees implementation of the City’s procurement policy for mayoral agencies. MOCS also supports the City’s relationship with vendors, and, in recent years, has convened vendor working groups in support of its efforts to modernize the City’s procurement systems.

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bills for administrative offices, and information technology costs. The City pays a flat rate on top of direct expenses to support the providers' overall health and sustainability.

The City overhauled its system for reimbursing indirect costs in Fiscal Year 2020, through what it called the Indirect Cost Rate ("ICR") Funding Initiative. Through the ICR Funding Initiative, most contractors are permitted to set their own indirect rates<sup>12</sup> through one of three methods: (1) a default "de minimis" rate of 10%, which is the same rate used by the United States Office of Management and Budget for federal not-for-profit contracts; (2) an indirect rate that was approved by a federal contracting agency for that not-for-profit organization, if applicable; or (3) a rate based on a schedule of expenses audited by the organization's independent auditor and accepted by staff from MOCS and the City's Office of Management and Budget.<sup>13</sup>

A sample of rate proposals submitted through the third option (*i.e.*, those indirect rates based on a schedule of expenses) are audited by the City to ensure their accuracy. If accepted by the City, a provider's rate can be used to add money to their contracts for up to three years. As of November 2020, 262 organizations had completed the review process and the City had accepted their indirect rate.

The ICR Funding Initiative has standardized the process of selecting an indirect rate. Notably, however, the City often performs no review whatsoever of the expenses that are paid using that indirect rate. At most, the costs are reviewed by staff from MOCS and OMB once every three years as part of an audit, and that is only when the contractor uses the third option to set an individual indirect rate with the City. If the contractor chooses to claim a de minimis 10% indirect rate, City agencies do not even receive the indirect expenses to ensure they are allowable,

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<sup>12</sup> Agencies may add funds to eligible contracts to pay each contractor's accepted indirect rate after confirming whether each expense is a direct or indirect cost. The contractor must provide this breakdown on a budget spreadsheet called a "Delta Template," which requires the Executive Director to attest that costs are not billed as both direct and indirect costs.

<sup>13</sup> Certain programs, such as contracts for ACS-funded residential foster care and HRA-funded emergency domestic violence shelter, are excluded from this indirect cost structure. Cost Manual, Section II.B. Such programs may be excluded because service providers are paid according to established rates, rather than through a cost reimbursement model. Providers of HRA-funded emergency domestic violence shelters, for example, are paid according to an established rate set by the State Office of Children and Family Services.

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creating what is essentially an “honor system” method of overseeing these public funds. This appears to be contrary to the Comptroller’s general guidance in Directive 2, which says “[t]he audit of indirect costs . . . is an area that requires close attention.” Directive 2 at 1.

If agencies do not receive and review information about expenses paid with the indirect rate, they are at risk of reimbursing unallowable costs. DOI recommends that agencies review expenses charged to indirect prior to approving budgets with indirect rates. Like the lack of disclosure on executive compensation, there is a lack of transparency regarding the costs that make up the indirect rate. Agencies should require disclosure of costs being allocated in the indirect rate, regardless of which method the contractor chooses. Agencies should then review this information to ensure expenses are allowable under the Cost Manual and to ensure expenses have not been billed to both direct and indirect budgets. This recommendation is set forth in PPR #7, below.

### e. Policy and Procedure Recommendations

Based on the above, DOI makes the following recommendations.

DOI issues these PPRs principally to MOCS, and recommends that MOCS leads the process of developing and issuing written City-wide guidelines that address the corruption vulnerabilities raised in this report, either by integrating new procedures into existing policies or by developing new policies as necessary. In support of that process, MOCS should convene a group of relevant stakeholders in City government to consider implementation of, at a minimum, new executive compensation policies (*see* PPR #6), but which should also consider implementation of other PPRs as appropriate.

These PPRs are also issued separately to the City agencies that hold the largest portfolios of cost reimbursement human services contracts with not-for-profit contractors: ACS, DFTA, DOHMH, DSS, and DOHMH.

- **Policy and Procedure Recommendation #1:** Agencies should require human services contractors to complete a standard disclosure and certification form that will assist in identifying potential conflicts of interest and noncompliance with the City’s

competitive bidding requirements. A proposed disclosure and certification form is attached as Appendix 1.

- **Policy and Procedure Recommendation #2:** Agencies should direct and train budget review staff to implement standard operating procedures similar to those identified in Appendix 2 to review occupancy costs. The review should include a review of leases with allocation plans, verification that expenses are reasonable through a market evaluation, and verification that the expenses are necessary to fulfill the contract. If the lease is with a related entity, it should also include a determination that the City is not being charged more than the actual operational costs.
- **Policy and Procedure Recommendation #3:** When a provider reports in PASSPort that it leases space from a related party or has paid a related party for goods or services, agencies should collect additional disclosures in order to identify potential conflicts of interest and their impact, if any, on City funds. See Appendix 1 and Appendix 3.
- **Policy and Procedure Recommendation #4:** Agencies should direct and train budget review staff to implement standard operating procedures similar to those identified in Appendix 4 to review proposed subcontractor expenses. The review should include determinations of whether subcontractors have been entered into the City's Payee Information Portal and whether subcontractors have completed PASSPort disclosures as required. It should also include a basic integrity review of each subcontractor, including whether subcontractors are related to key people at the contractor, as well as a review of documentation to ensure that there was a bona fide competitive bidding process.
- **Policy and Procedure Recommendation #5:** Agencies should enforce Section 6.02 of the Standard Contract by requiring contractors to disclose the current total compensation of executive staff and how the compensation is allocated. Draft questions requesting this information are included within Appendix 1.
- **Policy and Procedure Recommendation #6:** MOCS should convene a group of representatives from City agencies to develop

a mechanism for disclosing information relating to executive compensation and determine the practicability of requiring similar disclosures from first-tier subcontractors. The group should also develop appropriate guidance to agencies in making determinations as to the appropriateness of executive compensation for contractors and first-tier subcontractors, including obtaining additional documentation regarding board oversight and approval if the salary is potentially excessive. The group should also consider setting a cap or other parameters on City-funded executive compensation.

- **Policy and Procedure Recommendation #7:** Agencies should require disclosure of costs being allocated in the indirect rate. Agencies should then review this information to ensure expenses are allowable under the Cost Manual and to ensure expenses have not been billed to both direct and indirect budgets.

## Invoicing

### 2. The City Conducts Insufficient Review of Invoiced Expenses

#### a. Introduction to Invoicing

Once a line-item budget is approved by the agency, the provider must submit invoices to claim reimbursement.<sup>14</sup> Those invoices—which, like budgets, are typically submitted through the HHS Accelerator system—provide perhaps the City’s most significant opportunity to prevent payment of public money for “unallowable” expenses that are outside the scope of the contract, wasteful, or fraudulent.

Until the relatively recent introduction of the Standard Review Policy, each City agency followed its own individual procedures for reviewing not-for-profit contractor invoices. Without a uniform policy, at least one human services agency did not review individual expenses on reimbursement-based contracts as part of making payment. The City’s newly-issued Standard Review Policy establishes several important baselines for invoice review where, until recently, there were none. Specifically, the Standard Review Policy:

- Directs City agencies to perform a limited pre-payment review of invoices by comparing invoicing trends against the approved budget. Such reviews could catch, for example, cases in which an organization is on track to exceed its budgeted expenses or fail to make purchases that benefit clients (*e.g.*, client supplies, client food, or client travel). These reviews may also identify programmatic concerns, such as excessive staff vacancies.
- Requires agencies to collect payroll ledgers to verify personnel expenses and “backup” documentation to verify equipment purchases.

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<sup>14</sup> Again, this section focuses on reimbursement-based contracts, not contracts based on established service rates, milestones, or incentives. In the latter cases, the City is paying an established rate in exchange for the performance of a service. Therefore, the City agency’s oversight must focus on verifying whether services were actually performed; the question of how the contractor spent the fees it received for performing the work will, in many cases, not be relevant to the City.

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- Requires agencies to review documentation supporting one or two invoice lines billed as “other than personal services” (“OTPS”) through a “post-payment review.” The post-payment review involves a limited sampling of expenses for irregularities and is distinct from an audit.

The overall system, now subject to the Standard Review Policy, is improved in that it is consistent across City agencies. However, continued vulnerabilities are discussed below.

### **b. Finding #1: Invoices Do Not Contain Sufficient Detail to be Properly Evaluated**

Although HHS Accelerator brought standard, minimum levels of disclosure to City agencies, the system's invoice template has at least two built-in limitations: (1) it limits the level of detail available to agencies as they review invoices, and (2) it does not require contractors to disclose information about their allocation of major expenses across multiple government contracts.

First, HHS Accelerator requires most expenses to be reported as aggregated line items, such as “participant activities” or “transportation,” without reporting the payees, payment amounts, purpose of payment, or date of payment. A copy of the template is attached as Appendix 7. The introduction of this standard template in 2014 actually had the effect of *reducing* the level of detail collected by at least one agency, DYCD, which had previously required a complete accounting of a provider's monthly expenses on its “Program Expense Report Summaries.” Without this level of detail, the City agency may not be in a position to identify whether purchases appear to be routine, such as “office supplies” purchased from an established office supply vendor, or raise red flags, such as “office supplies” purchased from a luxury furniture store.

However, with respect to payments for contracted services and rent—two categories that are typically larger and may pose greater risk—HHS Accelerator does require the contractor to disclose information about the identity of the payee and purpose of the expense.

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Second, unlike the State's CFR, HHS Accelerator does not require contractors to disclose how expenses are allocated across multiple contracts or funding sources. For example, if a contractor uses its office space to operate multiple programs, HHS Accelerator does not require it to disclose the percentage of space and expense that is allocated to each funding source. State agencies that receive this information on the CFR can confirm that the expenses are correctly allocated to their programs and do not, in the aggregate, exceed 100% of the actual cost.<sup>15</sup> City agencies using HHS Accelerator can only review the amount charged to one contract at a time, making it difficult, if not impossible, for agencies to determine whether expenses were correctly allocated to the City or to identify overbilling allocated over multiple contracts.<sup>16</sup>

One DOI investigation highlighted the challenges in reviewing expenditures that are spread across multiple contracts and not accompanied by clear disclosures about cost allocation. In that case, relating to homeless services provider Bushwick Economic Development Corporation, the amounts that were allocated for a Chief Executive Officer's salary across multiple contracts, in their aggregate, significantly exceeded the amount reported elsewhere as that CEO's total salary. Specifically, budget documents reported the CEO's "Average Salary/FTE" (full-time equivalent) variously as \$142,117, \$235,000, or \$250,000, while the aggregate amounts allocated across each contract added up to \$308,705. The City agency did not identify this discrepancy, in part, because its employees did not have a practice of comparing and adding the amounts reported on each contract's budget form, and the City had no central policy requiring such a review.

As discussed in PPR #8, DOI recommends that the City require: (1) not-for-profit contractors to submit a general ledger report that supports the HHS Accelerator invoice, and (2) City agencies to review the general ledgers in order to confirm expenses are accurate and properly allocated

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<sup>15</sup> Certain City programs that are funded by New York State agencies also require contractors to submit CFRs, such as contractors that provide mental hygiene services to DOHMH.

<sup>16</sup> Although some agencies collect "cost allocation plans" as required by Section 3.04(B) of the Standard Contract, these allocation plans do not necessarily reflect amounts billed to other contracts, and may only include disclosure of the "allocable share" of an allowable cost that benefits multiple programs or funding sources. Furthermore, DOI has reviewed cost allocation plans that are in narrative format, that do not specify the actual costs shared, the purpose of the costs being charged to the contract, or which other funding sources were sharing the costs.

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prior to making payment. This information would better equip agencies to identify unallowable costs, as well as verify that shared costs are being allocated in accordance with the cost allocation plan approved with the budget. This general ledger report, a detailed list of expenditures, should be easily generated from organizations' accounting systems and should therefore impose limited additional burden on not-for-profit organizations that are already complying with their City contracts. *See* Standard Contract, 4.02(A).

### **c. Finding #2: Expense Review Practices Fail to Comply with Comptroller Directive 2**

New York City Comptroller's Directive 2 sets forth procedures that City agencies must follow for reviewing, verifying, and authorizing payments under cost reimbursement contracts. Directive 2 requires that agencies conduct a rigorous "audit"<sup>17</sup> of invoices submitted under such contracts prior to authorizing payment, which includes a review of whether expenses are allowable and a review of the contractor's internal controls.

Directive 2 establishes standards for reviewing and independently verifying the contractor's direct and indirect costs before the City makes payment, a process it refers to as the "payment request auditing function." Directive 2 at 2. These pre-payment "audits" include procedures to ensure that the contractor properly employed competitive bidding processes as part of its own procurement process and, with respect to the contractor's purchase of materials and supplies, a review of "all source documentation supporting the purchase (from purchase requisition to receipt and payment for purchases)." *Id.* at 11. The Directive states that these audits be performed "prior to approving requests for payment," *id.* at 2, and "conducted by properly trained staff," who are independent of teams performing other payment and procurement functions. *Id.* at 3.

Directive 2 implicitly recognizes risks posed by cost reimbursement contracts, and sets out specific guidelines for controlling waste and fraud in this area. However, DOI found that its principles are generally followed only at the City's construction and infrastructure agencies,

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<sup>17</sup> Although the Directive refers to this process as an "audit," it actually serves as a pre-payment expense review, not the type of post-payment "audit" that is discussed in more detail in the Auditing section of this report.

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such as the Department of Transportation and Department of Design and Construction, and not by many of the City's human services agencies.

While each agency has its own payment review procedures, the City's construction and infrastructure agencies typically require not-for-profits operating under cost reimbursement contracts to disclose complete details of their expenses (which are significantly more detailed than those collected through the HHS Accelerator template discussed above), as well as (with some exceptions) supporting documents such as original invoices substantiating those expenses. The City's Department of Transportation, for example, requires contractors to provide ledgers of every expense they incur (including name of the payee, date of payment, amount invoiced, and allocation of expense to the contract), as well as documentation in the form of supporting invoices or receipts. The Department of Parks and Recreation and the Department of Design and Construction require similar disclosures for what those agencies refer to as "time and materials" or cost reimbursement contracts. Staff within each agency's engineering audit office use their professional judgment to identify a sample of expenses that will ultimately be scrutinized more closely before payment.<sup>18</sup>

In general, the City's human services agencies have less robust procedures for reviewing contractor invoices. None of the human services agencies systematically follow the significant list of review procedures or timing requirements set forth in Directive 2, which include reviewing an entity's internal controls, competitive bidding processes, and the purpose of travel expenses.<sup>19</sup>

The type of review contemplated by Directive 2 would be more effective in identifying spending that is unreasonable, improper, or otherwise disallowed. Until the City requires complete spending transparency and directs agencies to conduct a thorough review of expenses, as required by Directive 2, it will significantly limit its own ability to identify such concerns. Again, preventing waste and fraud at these early stages will

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<sup>18</sup> Comptroller Directive 7 requires infrastructure agencies to appoint an Engineering Audit Officer who is responsible for reviewing payment requests.

<sup>19</sup> There are some exceptions within individual agencies. Some programs are governed by federal or state rules that require additional oversight and scrutiny that is, in fact, consistent with the requirements of Directive 2.

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require City-wide policies that are articulated and enforced by one central authority.

As discussed in more detail below, DOI recommends that the City revise its standard invoice review practices to make them more consistent with Directive 2. Specifically, DOI recommends that all agencies collect an appropriate level of supporting documentation that demonstrates how City funds were spent, develop risk-based criteria for identifying an appropriate review sample to review before payment, and follow additional significant Directive 2 review protocols, such as reviewing internal controls and competitive bidding procedures on a routine basis.

### **(i) Agencies Do Not Collect or Review Supporting Documentation to the Extent Required by Directive 2**

Unlike the infrastructure agencies, some human services agencies have not required a full set of documentation to substantiate that expenses were legitimate and payment was made by the vendor.<sup>20</sup> Routinely reviewing such information would help to ensure that invoices are accurate and that the contractor did ultimately use the City funds to pay the expenses reported in invoices.

DOI has conducted multiple investigations where City-funded nonprofits did not ultimately spend funds as reported on their invoices to the City. For example, in at least three investigations, DOI has found that City-funded housing providers failed to pay landlords for City clients' rent expenses, instead diverting City funds to other purposes.<sup>21</sup> In another investigation, DOI found that a City-funded after-school provider did not pay its payroll tax obligations, leading it to accumulate a significant debt to tax authorities even though the City was "reimbursing" the organization for those expenses. In each of these cases, this misconduct or other mismanagement of City funds might have been discovered earlier if agencies had required supporting documentation sufficient to confirm that City funds were in fact being spent as reported.

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<sup>20</sup> Ordinarily, the only other opportunity agencies have to review whether expenses are permissible is at the time of audit, which may take place long after payment and where review samples sizes may also be quite limited.

<sup>21</sup> In one of those cases, the former executive director of the organization subsequently pleaded guilty to federal charges related to the embezzlement of funds intended for the housing program.

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Before the implementation of the Standard Review Policy in January 2021, each agency followed its own protocol for collecting and reviewing expense backup, with practices varying widely across the City. DOI has no evidence that ACS collected any documents at all, while DFTA collected only documents related to significant equipment expenses and other large, one-time payments. In contrast, DOHMH collected and reviewed supporting documentation related to a wide variety of significant expenses, including for rent, subcontractors, out-of-state travel, and equipment. DHS and HRA programs that were structured as cost reimbursement also required some documentation and review of expenses.

The Standard Review Policy, which went into effect on January 1, 2021, implemented standard, City-wide procedures for collecting and reviewing samples of documentation supporting costs claimed on invoices. Under this new policy, all agencies will collect a limited set of backup documents—payroll ledgers and documents related to equipment expenses—and review no more than “1-2” items at some point after payment. This Standard Review Policy has actually *reduced* the amount of documentation being collected by DOHMH and within certain programs at DSS. Moreover, the Standard Review Policy does not explicitly advise agencies to review this sample of backup documents for every invoice or every provider; perhaps as a result, representatives of several agencies informed DOI that their agency only reviews this limited backup as to a smaller selection of invoices.

In contrast, the City's infrastructure agencies routinely collect an extensive set of supporting documents. After those agencies' assigned project managers review the invoices, they are forwarded to the agency's engineering audit office, where an auditor designs a sampling methodology to identify a set of expenses for which supporting documentation will be reviewed. At DEP, for example, auditors generally choose a sample of ten percent of expenses to test and review.

As discussed below and in PPR #9, DOI recommends that agencies collect more supporting documentation and conduct reviews in a targeted, risk-based manner in order to identify “disallowed” expenses prior to payment. Although the Standard Review Policy does require a minimal review of “one to two” invoice line items, the policy does not provide agencies with any guidelines for how to conduct the review. (The

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issue of how to review these submissions will be discussed in the next section concerning Directive 2.) Moreover, the sample size of one to two lines is too limited for the review to be meaningful.

### (ii) **Agencies that Do Collect Supporting Documents Do Not Review Expenses Prior to Payment or in Accordance with Other Directive 2 Procedures**

In addition to directing agencies to review certain supporting documentation, Directive 2 also contains specific and comprehensive procedures as to how and when agencies should conduct their review of documents submitted under cost reimbursement contracts. These steps ensure that the funds were spent as intended and that the contractor has accounting procedures needed to properly record transactions in its records. Among other things, Directive 2 specifies that the agencies' review should include:

- Twelve audit procedures for expenditures on wages and salaries, including reviewing the adequacy of internal controls over payroll activities and “[v]erifying that the wages and salaries charged to the contract are for employees who are actually working on the contract.”
- Six audit procedures for expenditures on materials and supplies, including confirmation that the contractor’s procurement procedures “have proper internal controls” and that “[c]ompetitive bidding was used if required by the contract.”
- Six audit procedures for travel expenses, including “[d]etermining that the purpose of the travel is acceptable under the contract’s terms and the expenses charged are reasonable.”

For the most part, the new Standard Review Policy does not include these procedures.

Directive 2 also states that source documentation supporting an expense must be verified with backup documentation and must match the organization’s accounting records, including its general ledger, *before* the agency approves payment. Unlike the City’s infrastructure agencies, human services agencies generally conduct this review after payment, if

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they do so at all. Furthermore, the Standard Review Policy only requires its limited invoice review to be conducted post-payment.

As discussed in PPRs #9 through 12, DOI recommends that the Standard Review Policy be amended to require additional procedures in line with Directive 2.

### **(iii) Invoice Review and Payment Are Not Performed by Staff Segregated from Other Functions as Required by Directive 2**

Directive 2 further states that invoices must be reviewed by “properly trained staff” who are “independent of the purchasing, receiving, and payment request preparation functions.” The purpose of this segregation of duties is to “ensure the integrity of the audit function.”

DYCD, DFTA, and ACS have not appointed a separate team to inspect and approve contractor invoices, instead relying on their fiscal staff to perform these tasks.<sup>22</sup> Fiscal staff at DYCD and DFTA review and approve invoices solely on the basis of whether the invoiced expenses are within the budget, although their program staff may compare the units of service that were billed to other records in order to identify any inaccuracies.

Even if fiscal staff were directed to change their approach and review whether expenses are allowable, their current role in the review process is contrary to Directive 2. First, much of the time, the same fiscal staff also processes payment requests and issues payments, where their objective is typically to make payment quickly. This creates competing incentives and is contrary to Directive 2's requirement that the review be conducted by “independent” staff. Second, fiscal staff may not be prepared to review expenses for whether they are allowable, as they may lack familiarity with the types of expenses needed to operate the program and restrictions in the contract. *See* Directive 2 at 4.1 (reviewer must “develop a working knowledge of the contract and its payment provisions”).

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<sup>22</sup> As discussed below, following a 2016 report by KPMG LLP, ACS established a plan to hire “contract managers” who would review these invoices. DOI was informed in 2021 that the agency still has not established this system due to budget constraints. However, in connection with responding to the findings of this report, ACS informed MOCS that it has assigned certain program staff to perform these functions.

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For example, during the course of one investigation, DOI found that leaders of a City-funded nonprofit had used thousands of dollars in public funds for personal travel. Airline travel was in fact reported on an invoice to the City, although it was described using a slight variation on the airline's name. The agency's fiscal staff, responsible for approving payment to the nonprofit, approved these expenses without identifying them as requiring further examination.

In 2015, KPMG LLP was engaged by the City to conduct an analysis of ACS's contracting practices. In its final report in 2016, KPMG also identified the value of involving the program unit in the invoice review process, finding that at ACS:

Vendor invoices are not consistently shared with the Program Areas. Furthermore, Program Areas are not required to approve each invoice, or review the value and scope of spend. In addition, detailed information related to the scope of spend related to each invoice is not always provided to either Financial Services or the Program Area. This can put the Agency at risk for overpaying, paying for services that are not within the scope of the contract, or paying for services that do not meet the required quality standards.

Section 3.4, page 19.

DOHMH, HRA and DHS, in contrast, have created separate expense review teams within their program divisions. These teams are separated from the payment process, as required by Directive 2, but also located within a division that has expertise in the program itself and what expenditures are appropriate to operate the program effectively.

- DOHMH's Mental Hygiene Fiscal Unit has a team of eight analysts who perform "claims verification" for each contract annually. The analysts review contractors' Quarterly Financial Reports, which list all expenditures allocated by program, and test 10-20% of the expense "backup" documentation submitted to DOHMH with each monthly invoice for payment.

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- At DHS, analysts in each program area are responsible for conducting review of invoices.
- Most units within HRA have “contract managers” within the program units who are assigned to review contract budgets and invoices with varied level of detail. However, in at least one unit, invoices and supporting documentation are reviewed in the agency’s central finance department.

As discussed in PPR #13, DOI recommends agencies require program staff, who are best prepared to identify inappropriate or disallowed expenses, to play a formal role in reviewing and approving invoices in order to confirm expenses are consistent with program operations.

### **d. Policy and Procedure Recommendations**

As has been widely reported, the City is frequently late in making payments to its nonprofit contractors. Although an examination of these delays and their ultimate cause is beyond the scope of this report, the delays present a real and serious problem that can put contractors in a precarious financial position. Late payments also create their own inefficiencies, such as forcing providers to obtain bridge loans in order to pay operating expenses.

Among other things, DOI recommends below that City agencies conduct a more thorough review of expenses prior to making payment. Although this may add an additional step to a payment process that is at times already too slow, we note the following. First, the recommendations below affect only the payment process (a process that, according to MOCS, currently has a “5 day median cycle time”), not the more complex and lengthy process of registering a contract. Second, in the unusual instances where pre-payment review is impracticable because the nonprofit contractor is in need of immediate payment and unable to produce backup documents, agencies should have the discretion to advance payment pending completion of the review (or audit, in cases where contractors do not provide required documentation over time). Third, and finally, the City has recently taken steps to improve cash flow challenges within this sector by making contracts “eligible for advance payments of at least 25%” of an annual budget “at the start of the fiscal year,” which would presumably reduce the number of instances where

the time spent reviewing invoices has a material effect on the organization's finances.

Based on the above, DOI makes the following recommendations. As discussed on page 18, DOI issues these PPRs principally to MOCS and recommends that it leads the process of developing and issuing written City-wide guidelines reflecting these procedures. DOI also separately issues the PPRs to ACS, DYCD, DFTA, DSS, and DOHMH.

- **Policy and Procedure Recommendation #8:** Agencies should require contractors to submit a general ledger report supporting each HHS Accelerator invoice. Agency staff should review the general ledger report to confirm expenses support the invoiced amounts and are allocated properly prior to approving payment.
- **Policy and Procedure Recommendation #9:** Agencies should review a more significant sample of supporting documentation prior to approving payment, and should provide more specific guidance to agency staff as to what factors in a payment request warrant further review.
- **Policy and Procedure Recommendation #10:** Agencies should review the adequacy of internal controls for payroll and salaries at least annually. For each invoice, agencies should verify that a sample of employees charged to the contract are actually working on the contract. Furthermore, agencies should take steps to ensure that payroll payments charged to the contract have been paid to the employees and that payroll taxes funded by the City have been remitted to the Internal Revenue Service.
- **Policy and Procedure Recommendation #11:** Agencies should evaluate whether the contractor's procurement policies are subject to appropriate internal controls and that competitive bidding is employed as required.
- **Policy and Procedure Recommendation #12:** Agencies should review travel expenses in order to determine that they were allowable and reasonable.

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- **Policy and Procedure Recommendation #13:** Agencies should require that program staff, who are best prepared to identify inappropriate or disallowable expenses, review and approve invoices to confirm expenses are consistent with program operations.

## Auditing

### 3. The City Should Develop Uniform Audit Policies Designed to Increase Coverage and Promote Efficiency

#### a. Introduction to Audits

The City can use audits to test fiscal controls at City-funded nonprofits, including whether the organization's financial statements are presented fairly and whether it has used public funds appropriately. Unlike the invoice review discussed in Section II, which tests compliance contemporaneously with the nonprofit's request for payment, these audits typically look retrospectively to review aspects of the organization's fiscal operations and/or compliance over a defined period of time.

Each City human services agency has its own system for commissioning and overseeing audits by private accounting firms, and most also have their own in-house auditors. Although the agencies' work is partially guided by baseline City-wide policies and directives issued by the City Comptroller, agencies are largely left to design their own approach to conducting and overseeing audits. This decentralization has created a patchwork of audit policies that can vary across agencies and even across programs at the same agency. The inconsistency creates gaps that ultimately leave the City vulnerable to reimbursing disallowed or otherwise inappropriate costs, as well as to other waste, fraud, and abuse.

As discussed below, DOI recommends that the City adopt uniform, City-wide audit standards for human services cost reimbursement contracts that are: (1) grounded in a risk-based assessment similar to one used by the federal government in connection with its "Single Audit"; and (2) designed to take additional routine measures to review providers' use of City funds and ensure that significant contracts are not overlooked. This report also makes several recommendations to improve agency compliance with existing audit guidance in Comptroller Directive 5, as well as to improve information-sharing among agencies that are in possession of audit results.

(i) **The Audit Landscape**

Many nonprofits, particularly organizations with significant revenue, are subject to multiple audits required by state or federal law, as well as by their agreements with funding agencies. These audits include:

- New York State-Required Financial Statement Audit: Under New York State law, not-for-profit organizations with more than \$1 million in annual gross revenue must file with the Attorney General’s Office each year an “independent certified public accountant’s audit report containing an opinion that the financial statements are presented fairly in all material respects . . .” N.Y. Exec. Law § 172-b. These audit reports provide important information about the nonprofit’s overall financial position, but are not likely to include information specifically related to the organization’s use of City funds or its compliance with the City contract.
- Federal “Single Audit”: Nonprofit organizations receiving federal funds may be required to undergo a “Single Audit,” which is described in Subpart F of the U.S. Office of Management and Budget’s *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the “Uniform Guidance”). The stated purpose of the Single Audit is “obtaining consistency and uniformity among Federal agencies for the audit of non-Federal entities expending Federal awards.” 2 C.F.R. § 200.500.

The Single Audit is required for any entity, including a not-for-profit organization, that “expends \$750,000 or more during [its] fiscal year in Federal awards.” 2 C.F.R. § 200.501. The Single Audit must be performed by an independent auditor in accordance with Generally Accepted Government Auditing Standards (“GAGAS”). 2 C.F.R. § 200.501; 2 C.F.R. § 200.514; GAGAS Section 3.18.

The auditor must follow a “risk-based approach” to determine whether each federal program is classified as “high” or “low”

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risk.<sup>23</sup> Single Audits test compliance with federal rules, regulations and program requirements, as well as a review of the organization's internal controls with respect to the federal program. 2 C.F.R. § 200.514. The Single Audit must cover all high-risk federal programs and must audit a minimum of 40% of the entity's federal program funding. 2 C.F.R. § 200.518. An audit of a low-risk entity must cover at least 20% of the entity's federal program funding. 2 C.F.R. §§ 200.518, 200.520.

- Audits Required by State Funding Agencies: Generally, nonprofits receiving \$750,000 or more in certain State funding must complete a CFR (discussed on pages 6 and 7), which includes a set of schedules reporting revenue and expenses for each State funding agency. The schedule that reports on related party transactions is required to be audited by the recipient's independent auditor in accordance with the attestation and examination standard (Schedule CFR-ii).

### (ii) The City's Current System

The City does not have a uniform policy as to when or how frequently its human services contracts should undergo an audit. New York City Comptroller Directive 5 (titled "Audits of Agency Programs and Operations") leaves it to City agencies to "independently determine that an audit is necessary" unless the audit is otherwise required by law.<sup>24</sup> The *City of New York Standard Audit Process Guide* does set some guidelines for how the audit should be conducted, but also does not address how frequently audits should occur. As a result, each agency

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<sup>23</sup> The Single Audit directs auditors to assess an entity's federal programs in order to identify "major programs" based on relative size and risk level. 2 C.F.R. §§ 200.518, 200.519. The regulations also set forth criteria for determining whether an entity is low risk as a whole. 2 C.F.R. § 200.520.

<sup>24</sup> As discussed above, the Standard Review Policy currently requires that agencies conduct certain limited "sampling and testing" after they have already made payment to a provider. However, this "post-payment review" consists of a sample that will not include "more than 1-2 selections per invoice service period," followed by an additional "sample [of] 1-2 line-items" if the original selections "result[] in a material finding" or are "unable to be documented." Not only is this review extremely limited, but the Standard Review Policy also does not provide clear guidance on how to conduct the review or what an agency should do to address irregularities, other than implementing an "Enhanced Pre-Payment Review Plan" and potentially imposing other "corrective action." As part of clarifying this policy, PPR #15 recommends that the City agency conduct an audit when the provider is unable to produce backup documentation requested during this post-payment review.

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has developed its own selection criteria and timetable, with one identifying contracts for audit using risk-based criteria (DFTA) and others using a rotation system that aims to audit each contract over the course of a defined time period (e.g., DOHMH [every three years for contracts exceeding \$200,000], DYCD [every three to four years for contracts exceeding \$75,000], DHS and HRA [every three years], ACS [every year]).<sup>25</sup>

This agency-by-agency system leaves gaps where some contracts are not audited by the City at all for extended periods of time. Indeed, it was not until 2020 that HRA committed to auditing contracts on a three-year cycle, and the City Comptroller highlighted frequency of the agency's audits as a vulnerability in a 2016 audit report on the HASA program. *Audit Report on the Human Resources Administration's Monitoring and Oversight of Vendors Who Provide Housing to Clients of the HIV/AIDS Services Administration*, available at [https://comptroller.nyc.gov/wp-content/uploads/documents/MD14\\_107A.pdf](https://comptroller.nyc.gov/wp-content/uploads/documents/MD14_107A.pdf) at 15-16.

Agencies do operate with more uniform standards as to *how* their audits will be conducted and what they will test. The *Standard Audit Process Guide* instructs external audit firms to, among other things, “examine, assess, and report” on “adequacy of the provider’s accounting system,” “[s]chedule of contract expenditures and revenue,” “accounting for any related party transactions,” “adequacy of internal controls,” and “[c]ontract compliance.” Furthermore, each human services agency maintains its own standalone audit guide (or an equivalent) that requires external audit firms to test compliance-related issues, like the contractor’s internal controls and whether contract expenditures are allowable.

These existing standards, however, are still vague about the approach that auditors should take when testing compliance and allowability. As a result, agencies’ required sample sizes vary from 10% to 25% and selection may involve both statistical and non-statistical methods. ACS merely requires auditors to “review” expenses, and does not require any particular testing threshold.

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<sup>25</sup> Different programs within the same agency may also follow different timetables when mandated by federal or state rules. For example, DYCD workforce development contracts undergo an additional internal control review annually because of federal and state requirements.

Moreover, there is no comprehensive, City-wide strategy for what agencies should do when an audit identifies concerning information or when a program may pose a particular risk. This is also in contrast to the federal system, which, again, is grounded in a risk-based approach.

**b. Finding #1: Audit Policies Are Not Uniformly Grounded in Risk-Based Analysis**

The City's audit system has been improved in recent years, particularly with the development of the *Standard Audit Process Guide*, but still lacks a comprehensive framework for identifying *when* it is appropriate for a routine or an enhanced audit or for *how* the audit should be conducted. Implementing a uniform, City-wide policy would help to ensure that contracts are not overlooked during the audit process and that resources are allocated to the areas most in need of attention.

As discussed below, DOI recommends that the City adopt a uniform set of audit standards to ensure that: (1) contracts presenting sufficient risk factors are selected for audit, in line with the federal government's Single Audit system; and (2) contracts that are not selected for an audit in a particular year are subject to some procedures that will verify expenses billed to the City on an annual basis. This increased level of consistency can be accomplished through various approaches. However, the federal system's risk-based approach offers a relevant and applicable model.

Standardizing this system and ensuring minimum annual audit coverage may require additional funding in the Fiscal Year 2023 budget. However, if deployed effectively, the cost associated with these audits may be offset, at least in part, by savings identified and risk mitigation strategies implemented. DOHMH, for example, reports that their audit team has conducted close to 1,000 audits for contract expenditures between Fiscal Years 2014 and 2019, and identified over \$15 million in overpayments by the City.

**(i) The City Should Develop More Rigorous Audits for Contracts that Are "High-Risk"**

The City should develop a policy for undertaking more rigorous audits of contracts that pose greater risk of waste, fraud, or abuse. Although

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each agency currently has some individual practice of escalating contracts that warrant further scrutiny, there is no uniform policy identifying when an enhanced audit should take place or how it should be conducted.

The OMB Uniform Guidance has its own risk criteria for identifying programs that require audits, 2 C.F.R. § 200.518, although the City can look to a variety of risk indicators such as previous audit findings, poor performance evaluations, invoicing delays, program staff concerns, and providers' inability to meet documentation requirements as set forth in the Standard Invoice Policy. Where programs raise such risk factors, agencies should deploy their own internal auditors or engage and closely monitor an external auditing firm to further test the contractor's compliance and internal controls. DFTA and HRA regularly use their internal auditors to conduct more robust contract compliance audits, performing approximately 20 per year each. The remaining agencies perform such audits less frequently, often only one or two per year.

Repeated or systemic risk factors should trigger in-depth audits. In those cases, the City may consider looking to the "performance audit" standard, which provides "an independent assessment of a government, organization, program, activity or function," Comptroller Directive 5.2.2, and requires the auditors to "assess the risk of fraud," GAGAS, 8.71 and 8.72. DFTA's audit team invests significantly in higher-risk audits, identifying 15 to 20 contracts a year for audits based on the program standard.<sup>26</sup> DFTA performs what may be the most thorough and complete audit of contracts that it deems to be higher-risk, although its audits of lower-risk contracts have decreased over time from around 100 audits each fiscal year to just 25 assigned audits of Fiscal Year 2019 expenses.

As set forth in PPR #14, DOI recommends that the City establish a uniform system for identifying contracts that present higher risks and require more thorough and in-depth audits.

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<sup>26</sup> DFTA expanded and reorganized its audit team in 2018, following a joint investigation between DOI and the U.S. Attorney's Office for the Southern District of New York that revealed embezzlement at a DFTA-funded senior center. *See* New York City Department of Investigation, Report on Fraud and Program Vulnerabilities at the New York City Department for the Aging (Feb. 2016), available at [https://www1.nyc.gov/assets/doi/reports/pdf/2016/02UBAarrests\\_Report\\_020316.pdf](https://www1.nyc.gov/assets/doi/reports/pdf/2016/02UBAarrests_Report_020316.pdf).

**(ii) The City Should Develop Annual Expense Verification for “Low-Risk” Contracts**

Most agencies use a rotation system through which they assign contracts over a certain dollar value to an outside firm for audit every three to four years. The rotation system ensures that all contract spending is audited on a regular, albeit infrequent, basis. However, under this system, contracts may not be audited for two to three years at a time.

DOI recommends that at least some expenses from every City cost reimbursement contract exceeding an established funding threshold are reviewed and verified on an annual basis, regardless of the agency and even when the contract is not deemed to pose a particular risk. Without regular and consistent reviews of City expenses, misstatements about spending or other financial concerns may not be identified or addressed in a timely manner. This recommendation is set forth in PPR #16, below.

This type of annual claims verification can be accomplished in several different ways. For example, ACS requires that its nonprofit contractors engage and manage an independent auditor to conduct this review. In contrast, DOHMH uses internal staff to conduct an annual claims verification process with respect to its mental hygiene programs.

Under ACS's model, the nonprofit may simply expand the scope of its State-required annual financial audit to include the review of City contract expenditures. This would allow the City to ensure that contract expenditures are reviewed on a regular basis without a separate audit engagement for that purpose. ACS typically receives these schedules for every contractor every year within three to nine months of the end of the fiscal year.

The City could also theoretically engage its own auditors to conduct this review through a standing “master agreement” managed by MOCS. However, agency staff informed DOI that this arrangement, as currently structured, creates both time pressure and inefficiencies because of the limited number of available firms and because the work is managed centrally by MOCS. Because the City enters into these audit contracts itself, it requires that the City engage in a lengthy and resource-intensive procurement process, which includes registering numerous

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contracts with the accounting firms and each agency registering its own separate task orders with those firms. The City's centralized management of these contracts also contributes to delays in completing audits; indeed, DOI was informed in 2021 that external audit firms were still completing audits for Fiscal Years 2017, 2018 and 2019.

While there could be risks associated with a nonprofit selecting its own auditor,<sup>27</sup> those risks can be mitigated with several precautionary measures. First, the City may require that the nonprofit comply with Not-for-Profit Corporation Law § 712-a, which requires, in part, that the board of directors or an audit committee comprised of independent directors oversee the audit of the corporation's financial statements. Second, the City may require that the nonprofit engage only accounting firms from the City's Prequalified CPA List, which would provide the City with further confidence that the audit is conducted in a manner that meets its basic standards. Third, the City can require or encourage nonprofit contractors to "rotate" its audit firms on a regular basis in order to further ensure their independence. *See* New York State Attorney General, Charities Bureau, Guidance Document, *Audit Committee Requirements and Responsibilities Under New York's Not-for-Profit Corporation Law as Amended through 2017*, September 2018 at 3 (describing such rotation as a "best practice"). These recommended measures are set forth in PPR #20, below.

The question of which model is most appropriate for the City should be further reviewed by appropriate representatives of City agencies as part of the above-referenced group to be convened by MOCS.

### **c. Finding #2: The City Does Not Oversee External Audits in a Consistent Manner**

#### **(i) The City Should Develop Policies to Routinely Review Audit Reports and Follow Up on Audit Findings**

Agencies would also benefit from clear standards as to how they should review and use the information revealed in audit reports. Only ACS and

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<sup>27</sup> Creditors of FECS, a major provider of social services in the City that collapsed in 2015, alleged that the organization's bankruptcy was attributable, at least in part, to its outside auditor. *See, e.g.*, Rick Archer, Accountant's \$18.3 M Oversight Blamed For Nonprofit's Ch. 11, Law360, March 21, 2017.

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DFTA told DOI that their staff review independent audit reports annually for every vendor. DYCD only reviews samples of these reports and DOHMH only reviews independent audit reports where their staff are conducting their own audit.<sup>28</sup>

Agencies should regularly review available audit reports—including annual financial statement audits, federal Single Audits, and City contract audits commissioned by the agency itself or a sister agency—as part of its oversight and compliance function. Agency staff should identify deficiencies and ensure the vendor takes corrective action. This is not only good oversight practice, but also required by Comptroller Directive 5, which emphasizes the importance of “act[ing] promptly upon receipt of auditors’ reports to investigate any questioned costs, implement recommendations, and/or initiate sanctions for audit findings.”

As set forth in PPR #17, DOI recommends that agencies review nonprofits’ independent audits and Single Audits, if applicable, each year, to ensure significant contractors correct any conditions leading to findings and to increase oversight of the contractors with audit findings.

### **(ii) The City Should Develop Policies to Review Independent Auditors’ Working Papers in Accordance with Comptroller Directive 5**

Comptroller Directive 5 provides guidance for the methods by which City agencies should plan and monitor audits, either when audits are required by state or federal awards or the agency chooses to conduct an audit. Directive 5 encourages agencies to use audits strategically, stating: “Agencies should view an audit as a management tool that can be used to analyze an issue or potentially problematic situation.” Directive 5 at 2.2.

Directive 5 provides guidance to agencies deciding whether their own staff can conduct such an audit or whether they must hire an outside accounting firm. When agencies hire an outside firm to conduct an audit on behalf of the City, Directive 5 establishes basic standards for procurement and monitoring of the audit firm. It establishes a

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<sup>28</sup> Both DYCD and DOHMH do also review audit reports in connection with their oversight of certain federally-funded programs.

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“prequalified CPA List” from which an outside firm must be selected. Directive 5 at 3.2.

Directive 5 states that City agencies should monitor independent audit firms and evaluate the “quality of working papers,” which document the auditors’ process, testing procedures, and sample selection methods.<sup>29</sup> Nevertheless, representatives of two agencies—DFTA and ACS—told DOI that they do not routinely review the external auditors’ working papers. These agencies should implement procedures to ensure that they conduct this review in accordance with Directive 5. A DOHMH representative told DOI that the agency does have a comprehensive protocol for reviewing work papers, which allows them to identify errors and reject measures that would be non-compliant with audit standards, such as inadequate testing. *See* PPR #19.

### **(iii) The City Should Routinely Confirm that External Auditors Were Retained and Managed in Accordance with State Law Intended to Ensure Their Independence**

New York State Not-for-Profit Corporation Law § 712-a requires independent members of the board of directors to retain the auditor who performs its annual independent audit. The law also requires the independent board members to “review the results of the audit” and, if the organization’s annual revenue exceeds \$1 million, “review the scope and planning of the audit” and discuss matters including “material risks and weaknesses in internal controls.”

Even though some agencies review their nonprofit contractors’ annual financial statement audit reports, none of them ask for confirmation that the reports were produced in accordance with this provision of the Not-for-Profit Corporation Law. Agencies should confirm that contractors are abiding by these provisions of § 712-a that ensure the effectiveness and independence of their audits. For similar reasons, City agencies should ensure that nonprofit contractors have followed the

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<sup>29</sup> “Work papers” are “the written record of the basis for the auditor’s conclusions that provides the support for the auditor’s representations, whether those representations are contained in the auditor’s report or otherwise.” It “includes records of the planning and performance of the work, the procedures performed, evidence obtained, and conclusions reached by the auditor.” Public Company Accounting Oversight Board Auditing Standard AS 1215: Audit Documentation, Section .02.

Standard Contract's requirement that expenditures exceeding \$25,000 be competitively bid. *See* Standard Contract, 4.05(B).

As discussed in PPR #20, DOI recommends that agencies obtain certifications from the Board Chair or Chair of the Audit Committee that the nonprofit is in compliance with the bidding requirements of their contract and the governance requirements of the Not-for-Profit Corporation Law § 712-a.

**d. Finding #3: Audit Findings and Other “Red Flags” Are Not Routinely Shared Across Internal Programs or with Other City Agencies**

Comptroller Directive 5 instructs that “City agencies should attempt to centrally coordinate the audits they procure to avoid duplication of audit efforts.” Directive 5 at 2.4. DOI found, however, that the City does not provide a mechanism for agencies to share audit reports or findings with sister agencies doing business with the same contractor, even when those agencies are using the same audit firm. As a result, agency staff are deprived of information in the possession of other agencies that could inform their decisions as to the compliance and responsibility of a particular contractor. In fact, in some cases, agencies do not even have a practice of circulating audit reports among their own internal staff unless there are major findings.

For nonprofits holding contracts with multiple agencies or program areas, a deficiency in one program area may serve as a signal that other contracts are also being operated with deficiencies. Other City staff should be alerted so that they can consider whether additional auditing or fact-finding would be appropriate, or at the least so that they can implement additional risk-based monitoring in accordance with the Standard Review Policy (see page 37, above). As a matter of policy, the report should be forwarded to DOI if the audit uncovers material findings or suspicious financial activity, as well as if the organization fails to cooperate with the audit. *See* PPR #22 and PPR #23.

The City may be able to use existing systems to share this information more efficiently across agencies. Most importantly, PASSPort—already a central repository of important documents—may be modified so that agencies can post final audit reports for other agencies to see. The system does not currently allow agencies to upload these documents.

Agencies do have the ability to communicate significant audit findings in PASSPort using the system’s “caution” function. Even though the “caution” function is a widely-used tool for communicating contract risks across the City, DOI did not locate any instances where a City agency entered a “caution” because of audit findings, and only one caution that was automatically generated because a nonprofit contractor self-reported audit findings of material weaknesses in its internal controls and compliance.<sup>30</sup> One agency has described adverse audit findings in annual contractor performance evaluations, although these are less visible to other agencies.<sup>31</sup>

**e. Policy and Procedure Recommendations**

Based on the above, DOI makes the following recommendations. As discussed on page 18, DOI issues these PPRs principally to MOCS and recommends that it leads the process of developing and issuing written City-wide guidelines reflecting these procedures. DOI also separately issues the PPRs to ACS, DYCD, DFTA, DSS, and DOHMH.

- **Policy and Procedure Recommendation #14:** The City-wide audit policy should be revised to provide guidance for agencies as to when a contract presents a higher risk and is therefore appropriate to undergo a more rigorous audit, either by an external firm or by internal auditors. Similarly, the policy should be revised to provide standards as to how higher-risk audits should be conducted, including assessment of the contractor’s compliance with the contract and the quality of the contractor’s internal controls.
- **Policy and Procedure Recommendation #15:** Agencies should conduct audits for any provider that cannot provide

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<sup>30</sup> Indeed, human services agencies rarely use the “caution” tool at all. As of July 2021, more than 3,000 cautions were in the PASSPort system. Only three had been entered by human services agencies, although 18 were entered by MOCS because a human services agency had cited a vendor for poor performance, violations, investigations, or business integrity. Cautions may be added by any City agency or automatically generated by vendor disclosure.

<sup>31</sup> This is because “Fiscal Administration and Accountability” is only one of three categories factored into the performance evaluation’s overall score. The overall score is what is displayed readily in PASSPort. Thus, it may be easy to overlook information about audit findings in a performance evaluation even if the agency includes it.

requested backup documentation in accordance with the Standard Invoice Review Policy during the fiscal year.

- **Policy and Procedure Recommendation #16:** All significant City human services contracts should undergo routine and regular reviews (ideally annually) that include verifying a sample of City expenditures, according to a set schedule.
- **Policy and Procedure Recommendation #17:** Agencies should update their procedures to ensure that appropriate staff are instructed to review nonprofits' independent audits and Single Audits, if applicable, each year, to ensure contractors correct any conditions leading to findings and to increase oversight of the contractors with audit findings.
- **Policy and Procedure Recommendation #18:** Agencies should develop procedures to comply with Comptroller Directive 5's guidance that agencies "examine and act promptly upon receipt of auditors' reports to investigate any questioned costs, implement recommendations, and/or initiate sanctions for audit findings."
- **Policy and Procedure Recommendation #19:** Agencies should update their procedures to ensure that appropriate staff are instructed to review auditors' working papers prior to accepting final audit reports.
- **Policy and Procedure Recommendation #20:** The City-wide audit policy should be revised to require each agency to, in concert with collection of the independent audit itself, collect a certification by the board chair or other appropriate representative, that the audit was conducted in accordance with Not-for-Profit Corporation Law § 712-a, if applicable, and that the firm was recently peer reviewed. A sample certification is attached as Appendix 5.
- **Policy and Procedure Recommendation #21:** The City should promulgate policies and procedures for maintaining information about contractor performance in a central place in accordance with the Charter of the City of New York, § 333,

including when agencies should use the PASSPort Corrective Action Plan module, what information should be entered by agencies using the PASSPort caution function, and how audit findings should impact PASSPort performance evaluations. At a minimum, MOCS should direct agencies to enter material weaknesses reported by auditors with respect to internal controls or compliance as cautionary information in PASSPort.

- **Policy and Procedure Recommendation #22:** Agencies should consider any contractor that has serious or recurring fiscal problems, including unexplained transfers to unidentified bank accounts, or any contractor that fails to produce records or comply with a City audit to be at risk for fraud, waste and abuse, and should report any such findings to DOI.
- **Policy and Procedure Recommendation #23:** As a matter of policy, agencies should forward to DOI the results of all audits with material findings relevant to corrupt or criminal activity, conflicts of interest, gross mismanagement, or abuse of authority.

## **Conclusion**

The City's system of overseeing and managing its human services contracts is undoubtedly complex, driven in part by the policy decision to rely heavily on non-City entities to provide these vital services. Although this report highlights a variety of vulnerabilities and proposes specific solutions, these reforms ultimately must be driven by a central authority, like MOCS, that can collect input from stakeholders, implement standard operating procedures and guidance, and enforce City agencies' compliance. This strategy will also leverage expertise to benefit all agencies and facilitate the sharing of information about the City's vendors across agencies, rather than a siloed contract-by-contract, agency-by-agency approach. By empowering one agency to lead this process, the City will take a major step toward making agency policy more consistent and streamlined, as well as preventing corruption, waste, fraud, and abuse in this critically important area.

## Appendix 1: Draft Annual Conflicts of Interest Disclosure Form and Certification

### Compliance with Competitive Bidding Requirements

1. (a) For the period of January 1, 20\_\_ through December 31, 20\_\_, did the Contractor comply with the competitive bidding requirements in Section 4.05(B) of its contracts with the City of New York in connection with its procurement of goods and/or services from any individual and/or entity?

Yes                       No

1. (b) If the answer to Question 1(a) is “no,” please report the following: (i) information sufficient to identify each and every procurement of goods and/or services that did not comply with the competitive bidding requirements in Sections 4.05(B) of its contracts with the City of New York; (ii) the name of the individual and/or entity to which the non-complying procurement was awarded; (iii) an explanation, if any, as to why the procurement was awarded in a manner that did not comply with the competitive bidding requirements in Sections 4.05(B) of its contracts with the City of New York; and (iv) the contract(s) that funded such purchase.

### Salaries of Highly Compensated Employees

2. Please report the following information with respect to the Contractor's Chief Executive Officer, Chief Financial Officer, Chief Operations Officer, and any “key employee” as defined in the IRS Form 990: (i) the employee's name

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and title; (ii) total compensation<sup>32</sup> amount received during calendar year 20\_\_; (iii) all sources of the employee's total compensation, whether from a City, State, federal or private source, and the dollar amount of compensation paid from each source.

**Financial Transactions with Related Parties**

3. (a) For the period of January 1, 20\_\_ through December 31, 20\_\_, did any employee receive reportable compensation from the Contractor AND reportable compensation from any of the Contractor's affiliates, parents, subsidiaries, or related entities equal to or exceeding \$25,000, in any one calendar year, regardless of funding source?

Yes                       No

3. (b) If the answer to Question 3(a) is "yes," please disclose for each such employee: (i) the name of the Contractor's affiliate, parent, subsidiary, or related entity that issued compensation to the employee; (ii) the employee's name and title with respect to each entity; (iii) total amount of compensation paid to the employee from each entity; and (iv) all sources of the employee's total compensation, whether from a City, State, federal or private source, and the dollar amount of compensation paid from each source.

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<sup>32</sup> "Total compensation" includes, but is not limited to, gross salary, fringe benefits, deferred compensation, and any items of value provided to the employee.

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4. (a) For the period of January 1, 20\_\_ through December 31, 20\_\_, did any member of the Contractor's board of directors receive any payment from the Contractor or any of the Contractor's affiliates, parents, subsidiaries, or related entities?
- Yes                       No
4. (b) If the answer to Question 4(a) is "yes," please disclose for each such board member: (i) the name of each such entity that issued payment to the board member; (ii) the board member's name; (iii) the total amount of payment by year; (iv) the purpose of the payment; and (v) provide all sources of the payment(s), whether from a City, State, federal or private source, and the dollar amount paid from each source.
5. (a) For the period of January 1, 20\_\_ through December 31, 20\_\_, did the Contractor enter into any "related party transaction," as that term is defined in Section 102(24) of the New York Not-for-Profit Corporation Law?
- Yes                       No
5. (b) If the answer to Question 5(a) is "yes," please disclose for each such transaction: (i) the name of the entity that was party to the transaction; (ii) the name of the "related party" as that term is defined in Section 102(23) of the New York Not-for-Profit Corporation Law; (iii) the total amount of payment by year; (iv) the purpose of the payment; and (v) provide all sources of the payment(s), whether from a City, State, federal or private source, and the dollar amount paid from each source; and (vi) provide the written agreement governing the transaction, if any.

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6. (a) For the period of January 1, 20\_\_ through December 31, 20\_\_, did any employee or board member of the Contractor have any beneficial interest or financial interest in any transaction involving the Contractor or the Contractor's affiliates, parents, subsidiaries, or related entities?

Yes  No

6. (b) If the answer to Question 6(a) is "yes," please disclose for each such transaction: (i) the name of the entity that issued payment to the employee or board member; (ii) the name of the employee or board member; (iii) the total amount of payment related to the transaction by year; (iv) the purpose of the payment; (v) provide all sources of the payment(s), whether from a City, State, federal or private source, and the dollar amount paid from each source; and (vi) provide the written agreement governing the transaction, if any.

7. (a) For the period of January 1, 20\_\_ through December 31, 20\_\_, did an immediate family member<sup>33</sup> of any employee or board member of the Contractor have any financial interest or beneficial interest in any transaction involving the Contractor or the Contractor's affiliates, parents, subsidiaries, or related entities?

Yes  No

7. (b) If the answer to Question 7(a) is "yes," please disclose for each such transaction: (i) the name of the entity in which the immediate family member had the interest; (ii) the name of the employee or board member, the name of the immediate family member, and the relationship; (iii) the

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<sup>33</sup> For purposes of this questionnaire, "immediate family member" is defined in the same manner as in the New York City PASSPort "Beginner's Guide," and therefore includes "former or current husband(s), and or wife(ves), son(s), daughter(s), stepson(s), stepdaughter(s), adopted child(ren), grandchild(ren), parent(s), brother(s), sister(s), grandparent(s), mother(s)-in-law, father(s)-in-law, brother(s)-in-law and sister(s)-in-law." Vendor Enrollment: A Beginner's Guide to PASSPort (December 1, 2017) at page 65, available at [https://www1.nyc.gov/assets/mocs/passport-downloads/pdf/resources-for-vendors/UserManual-Vendors\\_Beginners\\_Guide\\_to\\_PASSPort.pdf](https://www1.nyc.gov/assets/mocs/passport-downloads/pdf/resources-for-vendors/UserManual-Vendors_Beginners_Guide_to_PASSPort.pdf).

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total amount of payment issued to the immediate family member by year; (iv) the purpose of the payment; and (v) provide all sources of the payment(s), whether from a City, State, federal or private source, and the dollar amount paid from each source; and (vi) provide the written agreement governing the transaction, if any.

8. (a) For the period of January 1, 20\_\_ through December 31, 20\_\_, did any employee or board member of the Contractor hold any ownership interest in any entity doing business with the Contractor or the Contractor's affiliates, parents, subsidiaries, or related entities?

Yes                       No

8. (b) If the answer to Question 8(a) is "yes," please disclose for each such employee or board member: (i) the name of the employee or board member with an ownership interest; (ii) the name of the entity doing business with the contractor; (iii) the nature and percentage of the employee or board member's interest; (iv) the total amount of payment from the Contractor related to business with each such entity by year; (v) the nature of the business; and (vi) provide all sources of the payment(s), whether from a City, State, federal or private source, and the dollar amount paid from each source; and (vii) provide the written agreement governing the transaction, if any.

9. (a) For the period of January 1, 20\_\_ through December 31, 20\_\_, did an immediate family member of any employee or board member of the Contractor hold any ownership interest in any entity doing business with the Contractor?

Yes                       No

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9. (b) If the answer to Question 9(a) is “yes,” please disclose for each such family member: (i) the name of the family member with an ownership interest; (ii) the name(s) of the entity doing business with the contractor; (iii) the nature and percentage of family member’s interest; (iv) the total payment issued by the Contractor for business and/or services with each such entity, by year; (v) the nature of the business; and (vi) provide all sources of the payment(s), whether from a City, State, federal or private source, and the dollar amount paid from each source; and (vii) provide the written agreement governing the transaction, if any.
10. (a) For the period of January 1, 20\_\_ through December 31, 20\_\_, did any employee or board member of the Contractor hold any ownership interest in any real property or other physical space occupied by the Contractor or the Contractor’s affiliates, parents, subsidiaries, or related entities?
- Yes                       No
10. (b) If the answer to Question 10(a) is “yes,” please complete the Supplemental Disclosure Form for Lease with Related Party.
11. (a) For the period of January 1, 20\_\_ through December 31, 20\_\_, did an immediate family member of any employee or board member of the Contractor hold any ownership interest in any real property or other physical space occupied by the Contractor or the Contractor’s affiliates, parents, subsidiaries, or related entities?
- Yes                       No
11. (b) If the answer to Question 11(a) is “yes,” please complete the Supplemental Disclosure Form for Lease with Related Party.

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12. (a) For the period of January 1, 20\_\_ through December 31, 20\_\_, did any employee or board member of the Contractor hold any beneficial interest or financial interest in any lease or rental agreement involving the Contractor or the Contractor's affiliates, parents, subsidiaries, or related entities?

- Yes                       No

12. (b) If the answer to Question 12(a) is "yes," please complete the Supplemental Disclosure Form for Lease with Related Party.

13. (a) For the period of January 1, 20\_\_ through December 31, 20\_\_, did an immediate family member of any employee or board member of the Contractor hold any beneficial interest or financial interest in any lease or rental agreement involving the Contractor or the Contractor's affiliates, parents, subsidiaries, or related entities?

- Yes                       No

13. (b) If the answer to Question 13(a) is "yes," please complete the Supplemental Disclosure Form for Lease with Related Party.

**Supervision of Family Members**

14. (a) For the period of January 1, 20\_\_ through December 31, 20\_\_, have the Contractor or the Contractor's affiliates, parents, subsidiaries, or related entities employed any immediate family member of any employee or board member of the Contractor or the Contractor's affiliates, parents, subsidiaries, or related entities?

- Yes                       No

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14. (b) If the answer to Question 14(a) is “yes,” please provide details including (i) the employee or board member’s name and title; (ii) the family member’s name and title; (iii) total compensation amount by year for each person; (iv) name of the entity that employs each person; (v) all sources of the employee’s total compensation, whether from a City, State, federal or private source, and the dollar amount of compensation paid from each such source.

**Compliance with Employment Tax Obligations and Workers Compensation Requirements**

15. (a) For the period of January 1, 20\_\_ through December 31, 20\_\_, has the Contractor remained current with all federal, state, and local employment tax obligations and workers’ compensation requirements?

Yes                       No

15. (b) If the answer to Question 15(a) is “no,” please provide details of all instances in which the Contractor has not remained current with all federal, state and local employment tax obligations and workers’ compensation benefits.

I HEREBY CERTIFY THAT I HAVE READ AND UNDERSTAND THE ABOVE STATEMENT, THAT THE INFORMATION FURNISHED IN THIS REPORT HAS BEEN COMPLETED IN ITS ENTIRETY, AND IS IN ACCORDANCE WITH THE INSTRUCTIONS AND IS TRUE AND CORRECT TO THE BEST OF MY KNOWLEDGE. I FURTHER ATTEST TO THE FACT THAT THERE ARE RECORDS AND ALLOCATION WORKSHEETS TO SUPPORT ALL THE INFORMATION CONTAINED HEREIN, IN THE CUSTODY OF THE ABOVE NAMED SPONSORING AGENCY/CONTRACTOR. I ACKNOWLEDGE THAT THE CITY

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Not-for-Profit Human Services Contracts**

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OF NEW YORK, OR ANY OF ITS OFFICES OR DIVISIONS, MAY REJECT THIS REPORT IF IT HAS NOT BEEN FULLY, OR ACCURATELY COMPLETED.

I AM FURNISHING THIS INFORMATION FOR THE PURPOSE OF OBTAINING PAYMENTS FROM THE CITY OF NEW YORK.

Signature of Chief Executive Officer

Date

Name and Title

Telephone Number

E-mail Address

- Please check the box if the Chief Executive Officer changed from the prior reporting period.

## Appendix 2: Draft Procedures to Review Budgeted Occupancy Costs

Agency staff should follow the below procedures when reviewing budgets containing proposed occupancy expenses or amendments to already-approved occupancy expenses.

Following the below guidance may help your agency to mitigate the risks of noncompliance with its contracts and of corruption, waste, fraud, and abuse. It does not, nor is it intended to, supersede any other law, rule, or regulation.

### **1. Verify that occupancy expenses are reasonable.**

- a. Obtain and review a copy of any lease relating to rental expenses paid by the City.
- b. Determine whether the occupancy expenses are reasonable and consistent with prevailing market rates. Cost Manual, Section V.
- c. If the lease requires the contractor to pay expenses such as property tax, insurance, or maintenance, determine whether these costs are reported on the appropriate budget line.

### **2. If space is shared by more than one program or function, verify that occupancy costs are properly allocated among programs or functions.**

- a. Review the methodology for allocation (e.g., square footage or another method). Ensure that the methodology was applied correctly and consistently.
- b. Determine the extent to which the space will be used by the contracted program (including by visiting the site if warranted), and determine whether the allocation ratio is reasonable.
- c. Determine whether the allocation ratio is based on a generally accepted formula or method.

- d. Determine whether indirect rates have been fairly factored into the allocation plan. For example, if executive staff costs are charged to the indirect rate, their office space should also be charged to indirect.
  - e. Determine whether the cost allocation report is signed by the preparer and the manager assigned to supervise the program.
- 3. Verify that the occupancy costs being charged directly to the contract provide a direct benefit to the contract. Cost Manual, Section IV (V).**
- a. Verify that the space is necessary for the services required by the contract. Cost Manual Section III, B.
  - b. Disallow rental costs related to “idle facilities” as appropriate. Cost Manual, Section IV, O.
  - c. Disallow rental costs of real property and equipment of “home (residential) office Workspace.” Cost Manual, Section V.
  - d. Disallow rental costs of property and equipment owned by the provider itself or an affiliate organization, unless there are underlying expenses. Cost Manual, Section V.
  - e. Disallow cost increases not previously approved by the contracting agency.
- 4. Verify the facility complies with the contract.**
- a. Review whether the facility funded by the contract is in a condition suitable to provide services required by the contract. Standard Contract, Section 7.01.
    - This may include a review of the New York City Department of Buildings Building Information System to determine whether any outstanding building violations affect the suitability and safety of the facility for clients and staff.

- b. Review whether the contractor posted all signage required under the Human Services Standard Contract, including, but not limited to:
    - The program name, program activity, days and hours of operation, and the sponsorship of the agency. Standard Contract, Section 7.02.
    - Information about the contractor's obligations under the Equal Employment Opportunity Laws. Standard Contract, Section 7.02.
    - Information about the Whistleblower Protection Expansion Act, Standard Contract, Appendix A, Section 4.07.
  - c. Review whether the Contractor has an up-to-date site safety plan for staff and clients at the funded facility. Standard Contract, Section 7.03.
- 5. Determine whether leases and other similar transactions are with related parties and, if so, whether the related parties are being compensated excessively.**
- a. Review the Annual Conflicts of Interest Disclosure Form (Appendix 1) and Supplemental Disclosure Form for Lease from Related Party (Appendix 3) to identify any transactions involving related parties, such as organization executives or board members.
  - b. Review the organization's response to PASSPort (Section 7, Question 3) and IRS Form 990 (Question #28, Schedule L, and Schedule R) to identify any additional such transactions involving related parties.
  - c. With respect to any property not reported on the above-referenced forms, review the New York City Automated City Register Information System to identify the owner and determine whether there are any clear indications that the property is owned by a related party.

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- d. Where the building or property is owned by the Contractor or a related party, determine whether the lease is part of a “sale and leaseback” transaction. If so, proceed in accordance with Section V of the Cost Manual.
- e. Where the Contractor occupies property that it leases from a related party, take the following additional measures:
  - Ensure that the arrangement is reported to, and approved of in writing, by the Agency Chief Contracting Officer and General Counsel. The ACCO may re-evaluate the business integrity of the contractor.
  - Require the Contractor to provide an analysis as to why the expenses are fair and reasonable, as well as a certification that the transaction was approved by the board in compliance with Not-for-Profit Corporation Law § 715.
  - Disallow any expenses in excess of the costs to the related party landlord.
  - Disallow any expenses in connection with purchasing any interest in or improvement of real property (e.g., mortgage payments, deposits or down payments, closing costs, engineering costs, legal costs, building permits, and construction costs).
  - Determine whether depreciation is included, and the method for accounting for such depreciation.
- f. Determine whether the lease of this property is structured similarly to the Contractor's other lease engagements, if applicable. (e.g., triple-net leases).
- g. Confirm the board of directors approved the terms of the lease.

## Appendix 3: Draft Supplemental Disclosure Form for Lease from Related Party

1. During the reporting period, did the Contractor or any of the Contractor's affiliates, parents, subsidiaries, or related entities make any payments to:
  - a. Any individuals associated with the Contractor (including employees and board members) with respect to the Contractor's lease, rental, purchase, or occupancy of property?  
 Yes                       No
  - b. Any immediate family member<sup>34</sup> of individuals associated with the Contractor (including employees and board members) with respect to the Contractor's lease, rental, purchase, or occupancy of property?  
 Yes                       No
  - c. Any entity holding any financial relationship with either any individual associated with the Contractor (including employees and board members) or any immediate family member of any individual associated with the Contractor (including employees and board members) with respect to the Contractor's lease, rental, purchase, or occupancy of property?  
 Yes                       No

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<sup>34</sup> For purposes of this questionnaire, "immediate family member" is defined in the same manner as in the New York City PASSPort "Beginner's Guide," and therefore includes "former or current husband(s), and or wife(ves), son(s), daughter(s), stepson(s), stepdaughter(s), adopted child(ren), grandchild(ren), parent(s), brother(s), sister(s), grandparent(s), mother(s)-in-law, father(s)-in-law, brother(s)-in-law and sister(s)-in-law." Vendor Enrollment: A Beginner's Guide to PASSPort (December 1, 2017) at page 65, available at [https://www1.nyc.gov/assets/mocs/passport-downloads/pdf/resources-for-vendors/UserManual-Vendors\\_Beginners\\_Guide\\_to\\_PASSPort.pdf](https://www1.nyc.gov/assets/mocs/passport-downloads/pdf/resources-for-vendors/UserManual-Vendors_Beginners_Guide_to_PASSPort.pdf).

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2. If the answer to Questions 1(a), 1(b), or 1(c) is “yes,” please provide the following information:
  - a. A description of each transaction.
  - b. The address of each property.
  - c. The name of each associated individual and entity as well as their relationship to the property at issue.
  - d. All sources of the payment(s), whether from a City, State, federal or private source, and the dollar amount paid from each such source.
  - e. Amount paid by Contractor during the reporting period for each transaction using New York City funds.
  - f. The amount of expenses incurred by the related individual/family member/or related entity in the reporting period:
    - i. Mortgage principal
    - ii. Mortgage interest
    - iii. Depreciation
    - iv. Property taxes
    - v. Insurance
    - vi. Other expenses (specify)

I HEREBY CERTIFY THAT I HAVE READ AND UNDERSTAND THE ABOVE STATEMENT, THAT THE INFORMATION FURNISHED IN THIS REPORT HAS BEEN COMPLETED IN ITS ENTIRETY, AND IS IN ACCORDANCE WITH THE INSTRUCTIONS AND IS TRUE AND CORRECT TO THE BEST OF MY KNOWLEDGE. I FURTHER ATTEST TO THE FACT THAT THERE ARE RECORDS AND ALLOCATION WORKSHEETS TO SUPPORT ALL THE INFORMATION CONTAINED HEREIN, IN THE CUSTODY OF THE ABOVE NAMED SPONSORING AGENCY/CONTRACTOR. I ACKNOWLEDGE THAT THE CITY OF NEW YORK, OR ANY OF ITS OFFICES OR DIVISIONS, MAY

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REJECT THIS REPORT IF IT HAS NOT BEEN FULLY, OR  
ACCURATELY COMPLETED.

I AM FURNISHING THIS INFORMATION FOR THE PURPOSE  
OF OBTAINING PAYMENTS FROM THE CITY OF NEW YORK.

Signature of Chief Executive Officer

Date

Name and Title

Telephone Number

E-mail Address

## Appendix 4: Draft Procedures to Review Budgeted Costs for Procurements of Goods or Services

Agency staff should follow the below procedures when reviewing budgets containing proposed contracted services costs or amendments to already-approved contracted services costs.

Following the below guidance may help your agency to mitigate the risks of noncompliance with its contracts and of corruption, waste, fraud, and abuse. It does not, nor is it intended to, supersede any other law, rule, or regulation.

- 1. Review any procurements reported by the Contractor that benefit a related party or were negotiated at less than arms-length.**
  - a. Review the *Annual Conflict of Interest Disclosure Form* (Appendix 1) to identify any transactions involving related parties, such as organization executives or board members.
  - b. Review the Contractor's response to questions about potential related party transactions on IRS Form 990 (Section IV, Question 28, Schedule L, and Schedule R).
  - c. Review the contracted service provider's responses to PASSPort questionnaires (including Principal Questionnaire Section 3, Question 1) to identify any additional such transactions involving related parties.
  - d. Where the Contractor obtains contracted goods or services from a potentially related or interested party, take the following additional measures:
    - Ensure that the arrangement is reported to, and approved of in writing, by the Agency Chief Contracting Officer and General Counsel. The ACCO may re-evaluate the business integrity of the contractor.

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- Require the Contractor to provide an analysis as to why the expenses are justified, fair, and reasonable, as well as a certification that the transaction was approved by the board in compliance with Not-for-Profit Corporation Law § 715.

**2. Determine whether Contractor followed procurement requirements.**

- a. Where the annual cost of the goods or services is budgeted to be more than \$25,000, verify that the Contractor obtained at least three bids (or, alternatively, that services were procured through the City's group purchasing contract) and made its selection following a bona fide competitive bidding process.
- b. Where the annual cost of the goods or services is between \$5,000 and \$25,000, verify that the Contractor conducted sufficient market research and/or competition to support its determination that the price is reasonable (or, alternatively, that services were procured through the City's group purchasing contract).
- c. If the contractor is a designated subrecipient, verify the contractor complied with 2 CFR § 200.320. *See* Standard Contract, Section 4.05(c).

**3. Verify that every proposed subcontract has been reported by the contractor in the Payee Information Portal (PIP), and approved by the City agency if the annual subcontract exceeds \$20,000.**

- a. Verify that written requests included the name and address of the proposed subcontractor, portion of the work and materials that it is to perform and furnish, a description of the work, and the estimated cost of the subcontract. (PPB Rules, 4-13, (d)(1), Standard Contract Appendix A, Article 3).

**4. If the annual subcontracts exceed \$20,000, verify that proposed subcontractors have been prequalified in HHS Accelerator. Cost Manual, VI (H).**

**5. Verify that the subcontractor has completed PASSPort disclosures.**

- a. If the value of the subcontract plus the value in the PASSPort field "12 Month Aggregate Amount" exceeds \$250,000, subcontractors must enter disclosures in PASSPort. (PPB Rules 2-08 (e)(i)).

**6. Conduct a basic integrity review of the subcontractor.**

- a. Review all PASSPort disclosures for the entity and its principals.
- b. Conduct internet research of the entity and its principals.

**7. If the contract exceeds \$20,000, verify the written subcontract agreement has been uploaded to the budget. (Cost Manual, VI (H)).**

- a. Verify the value of the subcontract matches the amount budgeted.

**8. Verify any written subcontract complies with requirements set forth in the Human Services Standard Contract.**

- a. Confirm the work performed by the subcontractor is in accordance with the terms of the Agreement between the City and the Contractor. (Standard Contract Appendix A 3.02 (B)(1)).
- b. Confirm compliance with any contractual insurance requirements. (Standard Contract Appendix A, Article 7).
- c. If the subcontract or annual purchase value is in excess of \$100,000:
  - i. Confirm the subcontractor agrees to be bound by Standard Contract Appendix A 4.05(D) (Equal Opportunity Employment), and specifically agrees that the City may enforce such provisions directly against the subcontractor as if the City were a party to the subcontract.

- ii. Confirm the subcontractor agrees to be bound by Standard Contract Appendix A 4.07 (Whistleblower Protection Expansion Act).
- 9. If the cost of procured goods or services is shared by more than one program or function, verify that the costs are properly allocated among programs or functions.**
  - a. Obtain and review a cost allocation plan.
  - b. Review the methodology for allocation (time and effort study, number of clients, hours of operation, etc.). Ensure the method was applied correctly and consistently.
  - c. Determine the extent to which the service will be used by the contracted program, and determine whether the ratio of expense is reasonable.
  - d. Determine whether the allocation ratio is based on a generally accepted formula or method.
  - e. Determine whether indirect costs have been fairly factored into the allocation plan.
  - f. Determine whether the cost allocation report is signed by the preparer and the manager assigned to supervise the program.
- 10. If warranted under the circumstances, review the proposed subcontractors' HHS Accelerator application for prequalification to ensure the capacity exists to perform the contracted services and consider the following procedures:**
  - a. Verify that the proposed subcontractor has the necessary facilities, skill, integrity, past experience and financial resources to perform the required work, including by comparing the portion of work and materials that it is to perform. (PPB 4-13(d)(3)).
  - b. Call the proposed subcontractor's references and verify capacity. (PPB 4-13(d)(3)).

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- c. Verify the subcontractor is appropriately licensed to provide specific services. (PPB 4-13(d)(3)).

## Appendix 5: Draft Certification of Audit Compliance by Board of Not-for-Profits Subject to Independent Annual Audit Requirement

1. Did the board of directors or the board's audit committee consider the independence and performance of the independent auditor pursuant to New York Not-for-Profit Corporation Law § 712-a(b)(3)?

Yes  No

2. Did the board of directors or the board's audit committee review the results of the audit performed by the independent auditor and discuss with the independent auditor the following issues:

- Any material risks and weaknesses in internal controls identified by the auditor;
- Any restrictions on the scope of the auditor's activities or access to requested information;
- Any significant disagreements between the auditor and management; and
- The adequacy of the corporation's accounting and financial reporting processes;

as set forth in New York Not-for-Profit Corporation Law § 712-a(b)(2)?

Yes  No

3. Did only independent directors, as defined by New York Not-for-Profit Corporation Law § 102(21), participate in any board or committee deliberations and/or voting relating to activities disclosed above?

Yes  No

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4. Is the Certified Public Accountant who completed the audit listed on the New York City Comptroller's Prequalified List, and/or or enrolled in the American Institute of CPAs Peer Review Program?

- Yes                       No

I HEREBY CERTIFY THAT I HAVE READ AND UNDERSTAND THE ABOVE STATEMENT, THAT THE INFORMATION FURNISHED IN THIS REPORT HAS BEEN COMPLETED IN ITS ENTIRETY, AND IS IN ACCORDANCE WITH THE INSTRUCTIONS AND IS TRUE AND CORRECT TO THE BEST OF MY KNOWLEDGE. I FURTHER ATTEST TO THE FACT THAT THERE ARE RECORDS TO SUPPORT ALL THE INFORMATION CONTAINED HEREIN, IN THE CUSTODY OF THE ABOVE NAMED SPONSORING ORGANIZATION. I ACKNOWLEDGE THAT THE CITY OF NEW YORK, OR ANY OF ITS OFFICES OR DIVISIONS, MAY REJECT THIS REPORT IF IT HAS NOT BEEN FULLY, OR ACCURATELY COMPLETED.

I AM FURNISHING THIS INFORMATION FOR THE PURPOSE OF OBTAINING PAYMENTS FROM THE CITY OF NEW YORK.

**Signature of Board Chair or Chair of the Audit Committee**

Date

Name and Title

Telephone Number

E-mail Address

- Please check the box if the certifying Board Member changed from the prior reporting period.

## Appendix 6: Draft Guidance for Responsibility Determinations – Not-for-Profit Contracts

The Department of Investigation has developed the following non-exclusive list of recommended best practices for City agency staff in performing responsibility determinations of significant not-for-profit contracts.

Following the below guidance may help your agency to mitigate the risks of noncompliance with its contracts and of corruption, waste, fraud, and abuse. It does not, nor is it intended to, supersede any portion of the Procurement Policy Board Rules or any other law, rule, or regulation.

### Review Information Relating to Overall Capacity of the Organization

1. Confirm that addresses provided for the organization's service locations are real, physical locations and that addresses submitted on official records match the PASSPort record, if applicable. *Review:* Prequalification Application, IRS Form 990, (C).
2. Review the resumes of key personnel, including Chief Executive Officer and Chief Financial Officer, to ensure that they have adequate experience to oversee the City contract.
3. Determine whether the officers and directors reported on the IRS Form 990 and New York CHAR 500 are consistent with those reported on the organization's Prequalification Application and in PASSPort.
4. Identify the personnel overseeing the services provided by the organization, as well as where the program fits into the organization's management structure. *Review:* Organizational chart.
5. In cases of new programs, assess whether the organization reports that it has sufficient staff to provide the contracted services and existing services. *Review:* IRS Form 990, Part I (5).

6. Confirm that the organization has appropriate conflict of interest and whistleblower policies in place in accordance with New York Not-for-Profit Corporation Law §§715-a, 715-b. *Review:* Conflict of interest and whistleblower policies uploaded by provider.

### **Review Information Relating to Financial Capacity of the Organization**

7. Assess the organization's financial management capacity, including the years and experience of the CFO, and the number of employees working in the finance area, as compared to the revenue size of the organization and complexity of its operations. *Review:* CFO's resume and the organizational chart.
8. Assess whether the prospective contractor has sufficient net assets or a line of credit to operate. *Review:* Audited financial statements (sections concerning unrestricted net assets and notes).
9. Note any material weaknesses, compliance weaknesses, or significant deficiencies in internal controls; and assess risk that City funds may be impacted. *Review:* Single Audit A-133 audit schedules.
10. Assess whether the organization's board of directors is appropriately involved in overseeing its finances and the integrity of its accounting system, including whether the board or audit committee has operated in accordance with New York Not-for-Profit Corporation Law § 712-a. *Review:* Certification of Audit Compliance (Appendix 5).
11. In cases where a contract is reimbursement-based, assess whether the organization's financial controls are sufficient to comply with the agency's fiscal manual. *Review:* Prequalification Application ("Policies Section"), vendor financial policies and procedures (by request if not already loaded into HHS Accelerator).
12. Review notes of audited financial statements to identify any major financial obligations that may affect the contract and

whether the auditor has written any notes as to whether the organization is a going concern.

**Review Submissions and Other Information for Potential Compliance Concerns**

13. Perform “open source” or other database searches related to the name of the organization and its principals.
14. Review names of key individuals to identify any information indicating that employees supervise individuals with whom they share a familial relationship, in violation of Human Services Standard Contract Section 6.05 (C). *Review:* Annual Conflicts of Interest Disclosure Form and Certification (Appendix 1).
15. Note any reporting of loans involving related parties, as well as other related party transactions, in order to flag any evidence of conflicts of interest or self-dealing that may reflect on the organization’s overall responsibility. *Review:* IRS Form 990 Schedule L, notes of audited financial statements. *Review:* Annual Conflicts of Interest Disclosure Form and Certification (Appendix 1).
16. Identify major subcontractors and expenses and confirm whether those costs were included in the contract budget and properly disclosed to the agency. *Review:* Annual Conflicts of Interest Disclosure Form and Certification (Appendix 1) and IRS Form 990, Part VII, Section B, Line(s) 1.
17. Note executive compensation, as well as whether the board of directors reports independently approving such compensation based on comparable research. *Review:* IRS Form 990, Part VII, Section A, and Schedule O; Prequalification Application (“Board Section, Duties”); and Annual Conflicts of Interest Disclosure Form and Certification (Appendix 1).
18. Note any disclosures that buildings used to provide services under the contract are owned by related parties (e.g., board members, executive staff). If any such disclosures are made, determine whether these ownership relationships were properly

## Report on Corruption Vulnerabilities in the City's Oversight and Administration of Not-for-Profit Human Services Contracts

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disclosed in PASSPort, and whether the relationships raise conflicts of interest that bear on the responsibility determination. *Review:* IRS Form 990, Schedule L, Part IV, Annual Conflicts of Interest Disclosure Form and Certification (Appendix 1), and Supplemental Disclosure Form for Lease from Related Party (Appendix 3).

19. Review composition of the board of directors to ensure compliance with the terms of the Human Services Standard Contract and the Not-for-Profit Corporation Law, including the requirement that the board include at least five members if the contract exceeds \$1 million. *See, e.g.,* Human Services Standard Contract, Section 6.05 (A)-(D). *Review:* Board List.
20. Ensure that required PASSPort disclosures were submitted, including on behalf of the CEO, CFO, and board chair (or equivalent of each such position). *Review:* PASSPort Principal Disclosures.