

# AUDIT REPORT



CITY OF NEW YORK  
OFFICE OF THE COMPTROLLER  
BUREAU OF FINANCIAL AUDIT  
**WILLIAM C. THOMPSON, JR., COMPTROLLER**

## **Audit Report on the Financial and Operating Practices of the United Probation Officers Association Welfare Fund**

*FL08-076A*

**June 30, 2009**



THE CITY OF NEW YORK  
OFFICE OF THE COMPTROLLER  
1 CENTRE STREET  
NEW YORK, N.Y. 10007-2341

WILLIAM C. THOMPSON, JR.  
COMPTROLLER

**To the Citizens of the City of New York**

Ladies and Gentlemen:

In accordance with the responsibilities of the Comptroller contained in Chapter 5, §93, of the New York City Charter, my office has examined the financial and operating practices of the United Probation Officers Association Welfare Fund (Active Fund) for the period July 1, 2005 through June 30, 2006.

Under the terms of its agreement with the City, the Active Fund receives City contributions and provides health and welfare benefits to eligible City employees, their spouses, and dependents. Audits such as this provide a means of ensuring that benefit funds are spending public monies in the best interest of their members and are complying with applicable City procedures and reporting requirements.

The results of our audit, which are presented in this report, have been discussed with Active Fund officials, and their comments have been considered in preparing this report.

I trust that this report contains information that is of interest to you. If you have any questions concerning this report, please contact my audit bureau at 212-669-3747 or e-mail us at [audit@Comptroller.nyc.gov](mailto:audit@Comptroller.nyc.gov).

Very truly yours,

A handwritten signature in black ink, appearing to read "William C. Thompson, Jr.", written over a horizontal line.

William C. Thompson, Jr.

WCT/fh

**Report: FL08-076A**  
**Filed: June 30, 2009**

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*The City of New York  
Office of the Comptroller  
Bureau of Financial Audit*

**Audit Report on the  
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United Probation Officers Association Welfare Fund**

**FL08-076A**

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**AUDIT REPORT IN BRIEF**

The United Probation Officers Association Welfare Fund (Active Fund) provides health and welfare benefits to eligible active City employees and their dependents. It receives contributions from the City of New York. The Active Fund is required to conform with Comptroller's Internal Control and Accountability Directive #12, "Employee Benefit Funds—Uniform Reporting and Auditing Requirements" (Comptroller's Directive #12), which sets forth accounting, auditing and financial guidelines for City welfare funds and their boards of trustees.

We performed an audit on the financial and operating practices of the Active Fund for Fiscal Year 2006. As of June 30, 2006, the Active Fund reported \$1,422,214 in City contributions and net assets of \$1,934,518.

**Audit Findings and Conclusions**

The audit found that the Trustees of the Active Fund may have breached their fiduciary responsibilities to the Active Fund and its members. For example, the Active Fund has spent a significantly larger percentage of its City contributions on administrative expenses—especially the high administrative fees totaling \$436,790 paid to its third-party administrator—when compared to other, similarly-sized funds, and has claimed to pay for capital equipment and other operating expenses of its third-party administrator, even though the Active Fund lists the equipment as fixed assets on its financial statements. Moreover, the Active Fund was not in compliance with the procedures and reporting requirements of Comptroller's Directive #12. Consequently, the Active Fund's financial statements and its Directive #12 filing were materially misstated. Specifically, the Active Fund:

- Materially misstated its City contributions, total assets, expenses, and Net Assets Available for Plan Benefits on its financial statements. (See Appendix I.)
- Misstated revenue, benefit and administrative expenses on its Directive #12 filing. (See Appendix I.)

- Spent a significantly larger percentage of its City contributions on administrative expenses when compared to other, similarly-sized funds.
- Paid for capital equipment and other operating expenses of its third-party administrator.
- Did not select a Certified Public Accountant who appears to be independent to audit its financial statements, as required by Directive #12.
- Paid \$10,652 for other questionable expenses.
- Reportedly paid \$181,626 for Health and Wellness benefits that may not exist.
- Paid \$10,995 for the Second Dental Opinion Program that does not exist.
- Has poor controls over payments to its third party administrator.
- Provided us minutes of Board of Trustee meetings that appear to be fictitious.
- Made improper benefit payments totaling \$6,180.
- Paid claims for dependents whose eligibility was not documented.
- Is owed \$34,850 by the Retiree Fund.

### **Audit Recommendations**

Generally, we would recommend a series of actions to the Active Fund designed to address the problems identified. However, the financial, managerial and operational problems are so prevalent and pervasive that they cannot be readily addressed by fine-tuning Active Fund financial and operating practices. Therefore, it is clear that the entire financial and operating systems of the Active Fund have to be overhauled. Consequently, we recommend that the Board of Trustees:

- Evaluate how the Active Fund resources could be used to reach its ultimate goal—providing maximum benefits to its members—while keeping administrative costs to a minimum.
- Consider replacing the Fund Manager based on the extensive problems cited in this report and for denying us access to important records and assets.
- Develop policies and procedures that would ensure that the Active Fund is achieving its ultimate goal and that it is in compliance with Comptroller’s Directive #12. These policies and procedures should include a system of internal controls addressing the issues cited in this report.
- Closely monitor Active Fund operations to ensure that the issues cited in this report have been eliminated, and address any new issues that arise in the future.

## INTRODUCTION

### **Background**

The United Probation Officers Association Welfare Fund was established on May 15, 1978, under the provisions of a Fund Agreement between the City of New York and the United Probation Officers Association (the Union) and a Declaration of Trust. The Active Fund provides health and welfare benefits to eligible City employees in various titles, including Probation Assistant, Probation Officer Trainee, Probation Officer, Senior Probation Officer, and Supervising Probation Officer. The Active Fund also provides benefits to members' spouses and dependents. The Active Fund received \$1,422,214 in City contributions for Fiscal Year 2006.

The Active Fund is required to conform to Comptroller's Directive #12, "Employee Benefit Funds—Uniform Reporting and Auditing Requirements," which sets forth accounting, auditing and financial guidelines for funds and their boards of trustees. Table I (on page 3) shows the benefits that were available to the 804 members of the Active Fund and the total amount reportedly paid for each type of benefit during Fiscal Year 2006.<sup>1</sup>

**Table I**

**Active Fund Benefits and Amounts Paid as Reported by the Active Fund**  
**Fiscal Year 2006**

| <b>Benefit</b>      | <b>Amount</b> | <b>Coverage</b>   |
|---------------------|---------------|---|
| Dental              | \$528,408     | Each member selects either a participating or non-participating dentist. If the member selects a participating dentist, members and eligible dependents are provided the services listed in the Schedule of Covered Dental Expenses without any out-of-pocket expense. If the member selects a non-participating dentist, the member is reimbursed by the Active Fund. These reimbursements are processed by the Active Fund's third-party administrator, KingCare, and are based on a Schedule of Covered Dental Expenses. Members and eligible dependents are entitled to a maximum benefit of \$3,000 per person per year. |
| Health and Wellness | \$181,626     | This benefit is not listed in the Active Fund's benefit book.   |
| Prescription Drug   | \$149,340     | Members and their eligible dependents are entitled to a maximum benefit of \$550 per family per year.   |

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<sup>1</sup> According to the Trustees' Management Letter, the Active Fund had 804 members during Fiscal Year 2006. The number of members varies during the year because of new hires, retirements, suspensions, etc.

| <b>Benefit</b>                         | <b>Amount</b> | <b>Coverage</b>   |
|--|---------------|---|
| Optical                                | \$124,427     | Members and eligible dependents are entitled to a maximum reimbursement of \$400 every two years for examinations, frames and lenses.   |
| Weekly Disability Income               | \$56,534      | Members are entitled to a weekly benefit of \$175 for a maximum of 26 weeks if they become totally disabled and unable to work because of a non-occupational accident or sickness not covered by Workers' Compensation.   |
| Comprehensive Medical Exam             | \$34,519      | Members and their spouses are entitled to a comprehensive medical examination every year. Each member selects a participating provider—Manhattan Internal Medicine Associates or Affiliated Physicians—or a non-participating medical facility or physician. If the member selects a participating provider, members and their spouses are provided a comprehensive medical examination without any out-of-pocket expense. If the member selects a non-participating medical facility or physician, the member is reimbursed by the Active Fund, up to a maximum of \$200. These reimbursements are processed by the Active Fund's third-party administrator, KingCare. |
| Life Insurance                         | \$30,000      | Beneficiaries receive \$10,000 on the death of an eligible member.  |
| 2 <sup>nd</sup> Dental Opinion Program | \$10,995      | This benefit is not listed in the Active Fund's benefit book.   |
| FICA Tax Expense                       | \$8,742       | This expense should be included in the Weekly Disability Income benefit.  |
| Mammography                            | \$5,110       | Members and their spouses are entitled to a mammography examination if authorized by their physician. Each member selects the participating provider—Daniel Maklansky, MD—or a non-participating physician, hospital, or medical center. If the member selects the participating provider, members and their spouses are provided mammography examinations without any out-of-pocket expense. If the member selects a non-participating provider, the member is reimbursed by the Active Fund, up to a maximum of \$70. These reimbursements are processed by the Active Fund's third-party administrator, KingCare.  |
| Podiatry                               | \$2,618       | Members and their eligible dependents are entitled to a maximum reimbursement of \$200 per year for visits to a podiatrist and any necessary x-rays.  |
| Hearing Aid                            | \$2,100       | Members and their eligible dependents are entitled to maximum reimbursement of \$700 towards the cost of a hearing exam and hearing aid every two years.  |



| <b>Benefit</b>        | <b>Amount</b>      | <b>Coverage</b>   |
|-----------------------|--------------------|---|
| In Hospital Indemnity | \$530              | Members are entitled to \$10 per day for a maximum 10-week period if the member is hospitalized or confined to a skilled nursing facility accredited by the Joint Commission on Accreditation of Hospitals. |
| Anesthesia            | \$494              | Members and eligible dependents are entitled to a maximum reimbursement of \$500 per year.  |
| Emergency Room        | \$250              | Members and their eligible dependents will be reimbursed a maximum of \$25 every six months.  |
| Prosthetic Appliance  | \$50               | Members and their spouses are entitled to a maximum lifetime reimbursement of \$2,500 for the purchase or rental of prosthetic devices.   |
| <b>Total</b>          | <b>\$1,135,743</b> |   |

During the audit period, Fiscal Year 2006, the Active Fund provided all benefits through its third-party administrator, KingCare, Inc. For Fiscal Year 2006, KingCare was paid \$436,790 to process benefit claims and provide administrative and bookkeeping services to the Active Fund.<sup>2</sup>

As of June 30, 2006, the Active Fund reported net assets of \$1,934,518. Table II, on the next page, summarizes the Active Fund's audited financial data, as reported by the Active Fund, for the years ending June 30, 2005, and June 30, 2006.

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<sup>2</sup> It should be noted that while the Active Fund paid \$436,790 to its third party administrator, KingCare, Inc., the Active Fund reported only \$123,200 in administrative fees to KingCare in its 2006 report to the New York City Comptroller's Office, which was submitted in accordance with Comptroller's Directive #12.

**Table II****Summary of the Active Fund's Reported  
Revenues and Expenses**

|                                     | <b>2005</b> | <b>% of Total<br/>Revenue</b> | <b>2006</b> | <b>% of Total<br/>Revenue</b> |
|-------------------------------------|-------------|-------------------------------|-------------|-------------------------------|
| City Contributions                  | \$1,243,993 | 95.12%                        | \$1,422,214 | 99.85%                        |
| Investment or Other<br>Income       | 63,715      | 4.87%                         | 2,110       | 0.15%                         |
| COBRA                               | 68          | 0.01%                         | 0           | 0%                            |
| Total Revenue                       | \$1,307,776 | 100.00%                       | \$1,424,324 | 100.00%                       |
| Benefit Expenses                    | \$1,196,102 | 91.46%                        | \$1,135,743 | 79.74%                        |
| Administrative<br>Expenses          | 256,355     | 19.60%                        | 265,522     | 18.64%                        |
| Total Expenses                      | \$1,452,457 | 111.06%                       | \$1,401,265 | 98.38%                        |
| Excess (Deficiency) of<br>Revenue   | (\$144,681) |                               | \$23,059    |                               |
|                                     |             |                               |             |                               |
| Fund Balance<br>(Beginning of Year) | \$2,056,140 |                               | \$1,911,459 |                               |
| Fund Balance<br>(End of Year)       | \$1,911,459 |                               | \$1,934,518 |                               |

We should note that we are also conducting a separate audit, Audit # FL08-077A, of the United Probation Officers Association Retirement Welfare Fund (Retiree Fund). The results of that audit will be covered in a separate report.

**Objective**

The objectives of the audit were to determine whether the Active Fund: complied with applicable procedures and requirements of Comptroller's Directive #12; had adequate and proper benefit-processing and accounting procedures and complied with them; and paid administrative expenses that were appropriate and reasonable.

## **Scope and Methodology**

To achieve our audit objectives, we reviewed the Active Fund's financial and operating practices for the period July 1, 2005, through June 30, 2006—the period covered by the most recent Directive #12 filing available when we began the audit. Directive #12 establishes uniform reporting and auditing requirements for City-funded employee benefit plans. We obtained the Active Fund's Directive #12 filings with the Comptroller's Office, which included its financial statements, federal tax return, and other required schedules. We determined whether the Active Fund complied with the significant terms and conditions of Directive #12 by checking its filings of:

- annual certified financial statements prepared in accordance with generally accepted accounting principles that were attested to by a Certified Public Accountant (CPA); and
- Internal Revenue Service Form 990.

We interviewed the Chairperson of the Board of Trustees and the President of Active Fund's third-party administrator—KingCare—and reviewed the Active Fund's Fund Agreement and Trust Agreement to gain an understanding of the contribution and benefit-processing procedures; and prepared flowcharts and memoranda outlining our understanding of these procedures and Active Fund internal controls.

To determine whether all revenues and expenses were properly recorded, we reconciled the Active Fund's certified financial statements with its trial balance, records of adjusting entries, cash receipts, disbursements journals, and other related documentation. Specifically, we traced revenue amounts for the audit period from the New York City payment vouchers and copies of canceled checks to the Active Fund's cash receipts journal and bank deposit slips. We also reviewed documentation related to the Active Fund's investments to determine the accuracy of the amounts reported in the financial statements.

We vouched all reported administrative expenses (\$265,522) from the Active Fund's cash disbursements journal to supporting documentation, which included expense allocation reports, and vendor invoices to determine whether reported administrative expenditures were properly recorded, reasonable, and appropriate.

We randomly sampled the records of 50 of the 791 City employees listed on the contribution reports received from the New York City Office of Labor Relations and compared the employment information contained in the reports to the Fund's membership records to ascertain whether all eligible employees were included on the Active Fund's membership records.

To determine the accuracy of the Active Fund's bank reconciliations and to account for all checks paid, outstanding, and voided, we reviewed Active Fund bank statements for the money market, expense, welfare, and dental accounts for Fiscal Year 2006.

In addition, we performed the following tests of the benefit payments to members to determine whether only eligible members and their dependents received benefits from the Active Fund:

## **Dental Benefit**

All 320 and 238 participants listed, respectively, on the Dental Benefit check register during February and May 2006 were traced to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's Payroll Management System (PMS).<sup>3</sup> We also determined whether the reimbursements were calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule. For instances in which a member's spouse or child received benefits, we checked whether proof of dependency (i.e., marriage certificate or child's birth certificate) was on file.

## **Health and Wellness**

We intended to trace a sample of participants who received the Health and Wellness benefit during Fiscal Year 2006 to information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. However, the Active Fund did not maintain a utilization report or any supporting documentation for this benefit. It should be noted that the Active Fund's third-party administrator prepared a utilization report for us upon our request. However, the utilization report only contained approximate numbers with no supporting documentation. Therefore, we were unable to conduct any eligibility tests on this benefit.

## **Prescription Drugs**

All 135 and 178 participants listed, respectively, on the Prescription Drug benefit check register during January and March 2006 were traced to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS.<sup>4</sup> We also determined whether the reimbursements were calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule. For instances in which a member's spouse or child received benefits, we checked whether proof of dependency (i.e., marriage certificate or child's birth certificate) was on file.

## **Optical Benefits**

All 57 and 57 participants listed, respectively, on the Optical benefit check register during October 2005 and March 2006 were traced to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports and in the

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<sup>3</sup> For our tests of dental benefit expenses, we judgmentally selected February and May 2006, based on the highest dollar amounts the Active Fund paid in dental claims during Fiscal Year 2006.

<sup>4</sup> For our tests of prescription drug benefit expenses, we judgmentally selected January and March 2006, based on the highest dollar amounts the Active Fund paid in prescription drug claims during Fiscal Year 2006.

City's PMS.<sup>5</sup> We also determined whether the reimbursements were calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule. For instances in which a member's spouse or child received benefits, we checked whether proof of dependency (i.e., marriage certificate or child's birth certificate) was on file.

### **Weekly Disability Income**

We traced all 40 members listed on the disability check register during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. We also reviewed the corresponding claims for clerical accuracy and compliance with the 26-week limit imposed by the Active Fund.

### **Comprehensive Medical Exam**

We traced all 151 participants listed on the Comprehensive Medical Exam benefit check register during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution report, and in the City's PMS. We also determined whether the reimbursements were calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule. For instances in which a member's spouse received benefits, we checked whether proof of dependency (marriage certificate) was on file.

### **Life Insurance**

We traced all three death claims processed during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. We also ascertained whether death certificates and designated beneficiary forms were on file to support the payments.

### **Second Dental Opinion Program**

We intended to trace a sample of participants who received the Second Dental Opinion benefit during Fiscal Year 2006 to the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. However, the Active Fund did not maintain a utilization report or any supporting documentation for this benefit. It should be noted that we traced all the payments recorded on the Active Fund's trial balance to their supporting documentation and found that these payments were made to two law firms for legal services.

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<sup>5</sup> For our tests of optical benefit expenses, we judgmentally selected October 2005 and March 2006, based on the highest dollar amounts the Active Fund paid in optical claims during Fiscal Year 2006.

### **Mammography**

We traced all 72 participants listed on the Mammography benefit check register during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. We also determined whether the reimbursements were calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule. For instances in which a member's spouse received benefits, we checked whether proof of dependency (marriage certificate) was on file.

### **Podiatry**

We traced all 19 participants listed on the Podiatry benefit check register during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. We also determined whether the reimbursements were calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule. For instances in which a member's spouse or child received benefits, we checked whether proof of dependency (i.e., marriage certificate or child's birth certificate) was on file.

### **Hearing Aid**

We traced all three participants listed on the Hearing Aid benefit check register during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. We also determined whether the reimbursements were calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule. For instances in which a member's spouse or child received benefits, we checked whether proof of dependency (i.e., marriage certificate or child's birth certificate) was on file.

### **In-Hospital Indemnity**

We traced all four members listed on the In-Hospital Indemnity benefit check register during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. We also determined whether the reimbursements were calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule.

### **Anesthesia**

We traced one participant listed on the Anesthesia benefit check register during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's

membership records, the City contribution reports, and in the City's PMS. We also determined whether the reimbursement was calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule.

### **Emergency Room**

We traced all five participants listed on the Emergency Room benefit check register during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. We also determined whether the reimbursements were calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule. For instances in which a member's spouse or child received benefits, we checked whether proof of dependency (i.e., marriage certificate or child's birth certificate) was on file.

### **Prosthetic Appliance**

We traced one participant listed on the Prosthetic Appliance benefit check register during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. We also determined whether the reimbursement was calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule.

The results of the above tests, which covered the sampled items totaling \$304,416 (about 27 percent of reported benefit expenses for Fiscal Year 2006), while not projectable to all benefit expenses for the audit period, provided a reasonable basis to assess the Active Fund's compliance with its benefit-processing guidelines.

### **Scope Limitations**

As mentioned earlier, we intended to review the use of the Active Fund's Health and Wellness benefit, totaling \$181,626. We requested a list of all individuals who received Health and Wellness benefits during Fiscal Year 2006. However, the Active Fund did not maintain a utilization report or any supporting documentation for this benefit. It should be noted that the Active Fund's third-party administrator prepared a utilization report for us upon our request. However, the report contained only approximate numbers and had no supporting documentation. Therefore, we were unable to conduct any eligibility tests on this benefit. At the exit conference, KingCare's attorney provided us with a list of names of people who purportedly attended seminars and health fairs. However, the list did not include any supporting documentation to identify these individuals as members or dependents, or to document when, where, and what seminars or health fairs they attended. Moreover, the list included an additional 142 individuals than previously reported.

In addition, we intended to review the use of the Active Fund's Second Dental Opinion program totaling \$10,995. Again, the Active Fund did not maintain a utilization report or any supporting documentation for this benefit. Therefore, we were unable to conduct eligibility tests on this benefit. It should be noted, that we traced all the payments recorded on the Active Fund's trial balance to the supporting documentation and found that these payments were made to two law firms for alleged legal services. At the exit conference, KingCare's attorney, who was a partner in one of the law firms that received payments, provided us a Claims History for one dental service provider. The Claims History lists all of this provider's services performed between April 2001 and November 2007 and the dollar amount the Active Fund paid for these services. Clearly, this is not a utilization report for a Second Dental Opinion benefit.

Finally, we intended to review the Active Fund's \$495,450 worth of computer equipment and software reported on the Active Fund's financial statements as fixed assets. We requested all the supporting bills and invoices for the computer equipment and software and access to inspect and assess the computer system. However, the President of Active Fund's third-party administrator—KingCare—and the Chairperson of the Board of Trustees denied these requests because the President of KingCare claimed that she owned the computer equipment and software. In fact, she told us that the Active Fund does not purchase and does not own computer equipment and software. She also claimed that the computer purchases were part of her administrative fee. In any case, we were unable to conduct testing to verify these purchases and to confirm the existence of the computer equipment and software.

**Fund Response:** “The Fund Trustees agree that the method of classifying computer-related costs and software should have been as an administrative expense. This was an accounting policy error which will be corrected going forward. Specifically, the Fund Trustees acknowledge that management is responsible for the selection and use of appropriate accounting policies. Previous accounting policy was to capitalize certain payments for administration fees as the purchase of certain software and computer costs and depreciate those amounts. The effect of this policy understated administrative fees but not necessarily administrative expenses in total, since depreciation is classified as an administrative expense.

“In consideration of the recognition of changes in estimated future benefits of the assets and consumption of such benefit, in complying with the U.S. generally accepted accounting principles (GAAP), management has decided to change this accounting policy.

“The effect of the change in accounting policy will result in the write down of the remaining book value of these assets as of July 1, 2007. As of July 1, 2007, the book value of these assets will be \$0, as would be the case whether they were expensed or capitalized.”

**Auditor Comment:** The Active Fund does not understand the issue related to the computer hardware and software. The issue is not whether computer equipment and software should be capitalized or expensed, but whether the Active Fund should be paying for capital equipment and operating expenses for its third-party administrator—



KingCare—and carrying the computer equipment and software that KingCare allegedly owns on the Active Fund’s financial statements as fixed assets. The Active and Retiree Funds paid \$776,365—\$495,450 from the Active Fund and \$280,915 from the Retiree Fund—for computer equipment and software between 2000 and 2006 that is reportedly owned by its third-party administrator. Moreover, \$776,365 seems to be an excessive amount of money for computer equipment and software to process reimbursement checks for two welfare funds of this size.

This audit was conducted in accordance with generally accepted government auditing standards (GAGAS) and included tests of the records and other auditing procedures considered necessary. The audit was performed in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

### **Discussion of Audit Results**

The matters covered in this report were discussed with Active Fund officials during and at the conclusion of this audit. A preliminary draft report was sent to Active Fund officials on May 9, 2008, and was discussed at an exit conference held on June 10, 2008. On September 22, 2008, we submitted this draft report to Active Fund officials with a request for comments. On September 26, 2008, the Active Fund’s attorney requested and received an extension to October 14, 2008.

In the Active Fund’s response, the Active Fund’s attorney generally disagreed with the audit’s findings and did not specifically address its recommendations. The Active Fund’s response stated, in part:

“Based on the general and specific responses to the Draft Report, it appears that the recommendations, while useful, are the product of misunderstandings by the auditors. These misunderstandings have been engendered to some extent by certain misclassifications, which the Trustees believe have been and will continue to be remedied, and by the auditors failing to review in detail the voluminous documentation provided with the responses to the Preliminary Draft Report.

“The concerns raised about the Fund Manager have, in the Trustees’ judgment, been demonstrated to have been based on misunderstandings by the auditors despite the detailed responses made to the Preliminary Draft Report and the thousands of pages of documents submitted in support of these responses.

“Finally, the Trustees will address the system of internal controls and will continue to strive to maximize the benefits to the Active Fund’s members and effect compliance with Directive #12.”

***Auditor Comment:*** We not only disagree with the Active Fund’s contention that these findings are a product of misunderstandings and misclassifications, we are mystified by the Trustees’ position concerning its third-party administrator, KingCare. According to the Chairperson of the Board of Trustees, KingCare is responsible for all aspects of the

Active and Retiree Funds. The Chairperson referred all requests and questions, including legal and accounting issues, to KingCare, even though his Union office is located within KingCare's offices.

Furthermore, contrary to the Active Fund's response, we did review in detail the voluminous documentation submitted by the Active Fund and made the necessary changes to the draft report. Most of the documentation—utilization reports, contribution reports, and claim forms with supporting documentation—was requested during the audit. However, the additional documentation provided by the Active Fund after the exit conference did not change the findings and conclusions of our initial report. There are extensive administrative, financial, and operational problems with the Active Fund. Given the degree of these problems and the Trustees' unwillingness to recognize and correct them, we have no choice but to refer this report to the New York City Department of Investigation and the New York State Attorney General for further action.

The specific comments raised by the Active Fund's attorney and our rebuttals are contained in the relevant sections of this report.

The full text of the Active Fund's response is included as an addendum to this report.

## FINDINGS

Due to the numerous fiscal irregularities we found, it appears that the Trustees of the Active Fund may have breached their fiduciary responsibilities to the Active Fund and its members. For example, the Active Fund has spent a significantly larger percentage of its City contributions on administrative expenses—especially the high administrative fees paid to its third-party administrator, totaling \$436,790—when compared to other, similarly-sized funds, and has claimed to pay for capital equipment and other operating expenses of its third-party administrator, even though the Active Fund lists the equipment as fixed assets on its financial statements. Moreover, the Active Fund was not in compliance with the procedures and reporting requirements of Comptroller's Directive #12. Consequently, the Active Fund's financial statements and its Directive #12 filing were materially misstated. Specifically, the Active Fund:

- *Materially misstated its City contributions, total assets, expenses, and Net Assets Available for Plan Benefits on its financial statements.* The Active Fund's financial statements included erroneous accounting entries in various accounts, which caused City contributions (revenue) to be overstated, total assets to be overstated, and expenses to be understated and applied incorrectly. At least one of these entries appears to represent a departure from generally accepted accounting principles (GAAP). Overall, these material misstatements allowed the Net Assets Available for Benefits (fund reserve) to be overstated by \$421,618—21.79 percent of the Active Fund's Net Assets Available for Plan Benefits (after our adjustments) on both the Statement of Net Assets Available for Plan Benefits (Balance Sheet) and Statement of Changes in Net Assets Available for Plan Benefits (Income Statement). See Appendix I.
- *Misstated revenue, benefit and administrative expenses on its Directive #12 filing.* As a result of the improper accounting transactions, the Active Fund's Directive #12 filing contained material misstatements. This allowed revenue to be overstated by 9.13 percent, administrative expenses to be understated by 74.47 percent, and benefit expenses to be overstated by 16.47 percent. It appears that the Active Fund is manipulating the expense accounts to hide its administrative expenses in benefit expenses and in loan receivables. See Appendix I.
- *Spent a significantly larger percentage of its City contributions on administrative expenses when compared to other, similarly-sized funds.* The Active Fund spent 35.85 percent of its City contributions on administrative expenses. In comparison, eight similarly-sized funds spent an average of 13.06 percent of their City contributions on administrative expenses.
- *Paid for capital equipment and other operating expenses of its third-party administrator.* The Active Fund paid \$498,656 for computer software and hardware and other operating expenses for its third-party administrator, in addition to the administrative fees. Specifically, the Active Fund purchased \$495,450 in computer equipment and software from Fiscal Year 2000 to Fiscal Year 2006 that is reportedly owned by its third-party administrator, as well as \$3,206 for Fiscal Year 2006 operating expenses, which included messenger services and telephones.

- *Did not select a Certified Public Accountant who appears to be independent to audit its financial statements as required by Directive #12.* The CPA who attested to the financial statements is an employee of Cohen Phillips & Seiden, LLP, the firm that was paid to “check the accuracy” of the Active Fund’s books and records and prepare the Active Fund’s financial statements including the trial balance and all the adjusting entries. The CPA who certified the Active Fund’s materially misstated financial statements, did not question the adjusting entries to the Active Fund’s trial balance and relied on schedules (Depreciation Schedule and Employers Contribution Receivable Schedule) that were reportedly approved and signed by the CPA more than two months *after* the issuance of his Independent Auditor’s Report. We were not able to determine when the schedules were prepared because they were not signed and dated by the preparer.
- *Paid \$10,652 for other questionable expenses.* These questionable expenses are in violation of Active Fund’s Trust Agreement, unrelated to the operations of the Active Fund, or do not have adequate supporting documentation. These expenses included compensation paid to Trustees, flowers, meals, telephone bills for the Chairperson’s home, long-distance phone bills for the Union and on Union courtesy cards.
- *Reportedly paid \$181,626 for Health and Wellness benefits that may not exist.* Only \$5,536 in invoices can be traced directly to the Health and Wellness benefit. The contract for this benefit contains vague and undefined services with no specific deliverables, time frames, schedules, or bench marks. In addition, the Active Fund does not maintain utilization reports for this benefit. In fact, this benefit is not even listed or defined in the Active Fund’s benefit book. The remaining \$176,090 was paid to King Care as an administrative fee or “On Account.”
- *Paid \$10,995 for the Second Dental Opinion Program that does not exist.* We traced these payments to their supporting documentation and found that these payments were made to two law firms for alleged legal services. Moreover, this benefit is not listed in the Active Fund’s benefit book, but has been included in its Directive #12 filing for the last four fiscal years—2003, 2004, 2005, and 2006.
- *Has poor controls over payments to its third-party administrator.* The Active Fund did not segregate responsibilities for approving invoices and for signing checks for payments to its third-party administrator. The president of KingCare submitted invoices for payment to the Active Fund, then approved the payments and co-signed the checks made out to her company. Good internal controls dictate that these responsibilities be segregated to ensure that all payments to its third-party administrator are reasonable and justifiable.
- *Minutes of Board of Trustee meetings appear to be fictitious.* The minutes of the 12 Board of Trustees meetings held from July 2005 to June 2006 appear to be fictitious. While the meetings purportedly lasted for seven and half hours, all the minutes of each meeting were very similar, very few issues were discussed, and no details of the

discussions were reported. In addition, the minutes were not signed by all the Trustees, and one set of minutes was signed only by the Chairperson of the Board of Trustees. Therefore, we question the veracity of the minutes of the Board of Trustees meetings. Since four Trustees are City employees, and these meetings are reportedly seven and a half hours long, we will refer the minutes and the names of the employees to the City's Department of Investigation for further investigation of possible theft of service and falsifying timesheets.

- *Made improper benefit payments totaling \$6,180.* Of the \$304,416 in claims we reviewed, \$6,180 (2 %) in payments were made to individuals who are not listed on the City contribution reports and made without supporting documentation.
- *Paid claims for dependents whose eligibility was not documented.* Of the 1,284 benefit claims reviewed, 398 claims were for services provided to individuals who were listed as dependents of eligible members. However, the Active Fund did not have documentation in its files (i.e., birth certificates, marriage licenses) showing that the individuals were in fact eligible dependents for 294 (74%) of the 398 claims.
- *Is owed \$34,850 by the Retiree Fund.* The \$34,850 is the balance of a \$42,000 loan that the Active Fund made to the Retiree Fund.

These issues are discussed in detail in the following sections of this report.

### **The Active Fund Materially Misstated Its Financial Statements**

The Active Fund's financial statements included: City contributions for a subsequent period (Fiscal Year 2007) credited as revenue in Fiscal Year 2006; a payment of the Fiscal Year 2006 fourth quarter administration fee to the third-party administrator disclosed as a prepaid expense instead of as an expense; and fixed assets of computer hardware and software that the Active Fund reportedly does not own and that therefore should not be included in its financial statements. (See Appendix I.) It should be noted that KingCare and the Chairperson of the Board of Trustees denied our request to review the supporting bills and invoices for the purchases of computers or software. They also denied us access to inspect and assess the computer equipment and software. Consequently, we could not verify the existence of these fixed assets.

Specifically, in Fiscal Year 2006:

- City contributions (revenue) were overstated by \$130,093—9.15 percent of the Active Fund's contributions (after our adjustment) which represented a departure from generally accepted accounting principles (GAAP);
- Prepaid expenses were overstated by \$70,500—96.77 percent of the Active Fund's total prepaid expenses (total expenses were understated, as discussed below);

- Fixed Assets were overstated by \$221,025; and
- Total Assets and Net Assets Available for Plan Benefits were overstated by \$421,618—21.79 percent of the Active Fund’s Net Assets Available for Plan Benefits (after our adjustments) on both the Statement of Net Assets Available for Plan Benefits (Balance Sheet) and Statement of Changes in Net Assets Available for Plan Benefits (Income Statement).

### **City Contributions**

Regarding the overstatement of revenue from City contributions, the Active Fund included as Fiscal Year 2006 revenue a receivable of \$130,093—a one-time payment of \$167 on behalf of each Active Fund member (779) who was receiving benefits on August 13, 2006—based on an Agreement that was signed on December 11, 2006 (Fiscal Year 2007). Since this receivable was for contributions in Fiscal Year 2007, it should not have been included as revenue from City contributions on the Fiscal Year 2006 financial statements and represents a departure from generally accepted accounting principles (GAAP). As a result, total revenue reported in Fiscal Year 2006 was overstated by \$130,093—9.13 percent of the Active Fund’s total revenue (after our adjustment). Moreover, the Active Fund should have reported an operating deficit of \$117,684 in Fiscal Year 2006 instead of its reported operating surplus of \$23,059—a difference of 610.36 percent. Even more disturbing is that the Schedule of Employee Contribution Receivable was reportedly approved and signed by the CPA more than two months after the CPA certified the Active Fund’s financial statements. We were unable to determine when the schedule was prepared because it was not signed and dated by the preparer.

**Fund Response:** “The Fund CPA included this number as a receivable for this period because, at the time he prepared the Fund’s certified audit statements, it was anticipated that the revenue received would be properly allocated. Only in retrospect did the Fund CPA become aware that the City revenue in question was not to be attributable as a receivable until August 2006. Thus, he did not apply this amount again as a receivable in the next fiscal period.”

**Auditor Comment:** We disagree with the Active Fund’s contention that the Active Fund and the CPA were unaware that this revenue was not attributable to Fiscal Year 2006. The CPA did not sign off on the accounting worksheets until December 2006, and the Active Fund did not submit its Directive #12 filings until July 7, 2007. Therefore, there was ample time for the CPA and the Active Fund to make the necessary adjustments.

### **Prepaid Expenses**

With respect to the incorrect accounting and reporting of prepaid expenses, the Active Fund reported the fourth quarter administrative fee (covering the period April 1, 2006, to June 30, 2006) totaling \$70,500, as a prepaid expense. Specifically, a member of Cohen, Phillips, and Seiden, LLP, made an adjusting entry to the Active Fund’s trial balance transferring this payment

from the administrative fees expense account to the prepaid expense account. However, according to the invoice, this payment was for the administrative fees for the fourth quarter of Fiscal Year 2006. As a result, prepaid expenses were overstated by \$70,500.

**Fund Response:** “The Fund Trustees disagree. See Fund CPA worksheets addressing this item. Such worksheets were provided to the auditors by the Fund CPA during the audit.

“New contracts were in place indicating that no expense overstatements occurred.”

**Auditor Comment:** We reviewed the CPA worksheets and found that prepaid expenses were overstated by \$70,500.

Contrary to the Active Fund’s contention, the auditors used the contract that was in effect during the audit period.

### **Fixed Assets**

The Active Fund included as fixed assets computer equipment and software that it reportedly does not own on its Fiscal Year 2006 financial statements. According to the Active Fund’s Statement of Net Assets, it has \$221,025 (\$495,450 less \$274,425 in accumulated depreciation) in total fixed assets. The Active Fund’s financial statements list the computer equipment and software as the only fixed assets that the Active Fund has. However, the President of the Active Fund’s third-party administrator—KingCare—and the Chairman of the Board of Trustees stated that the Active Fund did not purchase and does not own computer equipment or software. Further, the President of KingCare claims that the computer purchases are part of her administrative fee.

According to New York State Society of Certified Public Accountants, an asset is defined as: “Anything of value to which the firm has a legal claim. Any owned tangible or intangible object having economic value useful to the owner.”

Obviously, if the Active Fund has no legal claim to and is not the owner of the computer equipment and software, it should not be include the equipment and software on its financial statements as a fixed asset.

Even more disturbing, the depreciation schedule was also reportedly approved by the CPA more than two months after the CPA certified the Active Fund’s financial statements and issued its report. Again, we were unable to determine when the schedule was prepared because it was not signed and dated. The notes of the report do not identify any specific computer equipment or software programs owned by the Active Fund. The report reflects only that purchases were for computers or software, the years of the purchases, and their cost. KingCare and the Chairperson denied our request to review the supporting bills and invoices for the purchases of computers or

software. They also denied us access to inspect and assess the computer equipment and software. Consequently, we could not verify the existence of this equipment.

**Fund Response:** “The accounting policy with respect to computer costs and software expenses will be changed and replaced with a new and more appropriate policy going forward.

“The Trustees now believe that it appears that the equipment acquired by the TPA for the benefit of the Fund (principally, software that is used uniquely for UPOA Welfare Fund purposes) should not have been capitalized. Management is responsible for the selection and use of appropriate accounting policies, hence, the Trustees will adopt a new and more appropriate accounting policy with respect to such equipment.”

**Auditor Comment:** The Active Fund does not understand the issue related to the purchasing of the computer equipment and software. We are questioning the propriety of the Active Fund in purchasing equipment for KingCare and then carrying the value of the equipment they do not own on its financial statements as fixed assets. The Active and Retiree Funds paid \$776,365—\$495,450 from the Active Fund and \$280,915 from the Retiree Fund—for computer equipment and software between 2000 and 2006 that is reportedly owned by its third-party administrator. Moreover, \$776,365 seems to be an excessive amount of money for computer equipment and software to process reimbursement checks for two welfare funds of their size.

### **The Active Fund Misstated Benefit and Administrative Expenses, And City Contributions on Its Directive #12 Filing**

The Active Fund did not accurately report its benefit and administrative expenses, and City contributions on its Directive #12 filing. As a result, revenue was overstated by 9.13 percent (as discussed in the previous section), administrative expenses were understated by 74.47 percent, and benefit expenses were overstated by 16.47 percent. (See Appendix I.)

As a result of these misstatements, key financial ratios that are indicators used to assess aspects of the Active Fund’s operations and financial condition were incorrect. For example, based on the information submitted on its Directive #12 filing and on the Active Fund’s financial statements, the percentage of revenue spent on administration was 18.64 percent. However, it would have been 35.79 percent had the Active Fund appropriately classified its expenses. It is important that the Active Fund accurately report its expenses so that the City can properly assess the fund’s financial activities and monitor its degree of solvency. Of even greater concern, however, is that the Active Fund appears to be intentionally concealing as benefit expenses the dollar amount it spends on administrative expenses, particularly the total amount paid to its third-party administrator.

#### **Administrative Expenses**

Administrative expenses were understated by \$197,735—74.47 percent of the Active Fund’s total administrative costs (after our adjustment). According to the Schedule of



Administrative Expenses, KingCare was reportedly paid \$123,200 in administrative fees. However, according to the Active Fund's records, KingCare billed and was paid \$282,000 in administrative fees, \$83,750 "On Account," and two payments, totaling \$71,040, without any supporting documentation, for a total of \$436,790. Administrative expenses also included \$84,850 in depreciation expense for computer equipment and software that it reportedly does not own; our adjusted number does not include this amount.

It should be noted that one of the partners of the firm Cohen, Phillips, and Seiden, LLP, made three adjusting entries on the Active Fund's Trial Balance that total \$200,800, transferring \$158,800 from the administrative fees account to the Health and Wellness account (as a benefit expense), and to record a \$42,000 loan to the Retiree Fund. These transfers appear to be an attempt to conceal certain payments made to the Active Fund's third-party administrator for administrative expenses, as benefit expenses and a loan receivable. The \$42,000 loan to the Retiree Fund was not included in our adjustment to administrative expenses. Additionally, the Active Fund paid \$10,995 for the Second Dental Opinion program, reportedly a benefit expense. When we traced these payments from this benefit expense to their supporting documentation, we found that payments were made to two firms for alleged legal services. Therefore, the \$10,995 should be recorded as administrative expenses rather than benefit expenses.

**Fund Response:** "It is also important to note that a number of matters the auditors found as problematic were the results of misclassifications either by the auditors themselves or, in some cases, by Fund employees or consultants. The most significant of these—all of which will be addressed in the Trustees' detailed review of the auditors' findings—was the conclusion by the auditors that the "Wellness" benefit (in the amount of \$181,626) was a disguised administrative expense. This conclusion was based solely on the fact that the benefit was not listed in the SPD. The fact is, however, that this was a legitimate benefit, and it was reflected in announcement letters and other materials that are used when a new benefit is provided. All of these materials were provided to the Comptroller's office in conjunction with the response to the Preliminary Draft Report, and the Trustees had expected that the Draft Report would take this information into account. (A review of the Draft report reveals that extensive documentation provided by the UPOA on this and other matters, including five bound volumes of documents, was disregarded.)

"When such documentation is taken into account, this expenditure (like others referenced below) is readily recognizable as a benefit and not an administrative expense. Such recognition not only removes the single largest negative finding by the auditors, but also dramatically lowers the administrative fee calculation. To avoid such problems in the future, the SPD has been updated and it is on the UPOA website as of October 14, 2008. See [www.upoa.com](http://www.upoa.com)."

**Auditor Comment:** Contrary to the Active Fund's statement, our review of the information we received from the Active Fund in response to the preliminary draft report only provided further reason to doubt the existence of a Health and Wellness benefit (see page 29 of this report for specific details). We continue to question the existence of this benefit and maintain that the transfers from the administrative fees account to the Health

and Wellness account and loan receivable appear to be an attempt to conceal certain payments made to the Active Fund's third-party administrator for administrative expenses as benefit expenses and a loan receivable.

**Fund Response:** "There were, as reflected in the responses to specific matters set out below, some instances in which the auditors found errors of a minor nature when the Fund accountants had misclassified a benefit. Thus, for example, the 'Second Dental Opinion Program' was found by the auditors to reflect paid fees to two law firms for legal services. The fact is that benefits were properly paid for the UPOA's legal services benefit, but were misclassified as a 'Second Dental Opinion' benefit. This \$10,995 legitimate benefit was erroneously reclassified by the auditors as an administrative expense. The data provided by the Fund in response to the Preliminary Draft that clarified this misclassification was, apparently, not considered by the Comptroller's office in preparing the Draft Report."

**Auditor Comment:** Contrary to the Active Fund's response, the fund did not provide us with any evidence to substantiate the existence of a Second Dental Opinion benefit or a Legal benefit (see page 30 for specific details). Since these are not benefits that are directly used by members, these expenses should be reclassified as administrative expenses in accordance with Comptroller's Directive #12.

We also found that the practice of concealing administrative fees as benefit expenses has been going on for several years. The Active Fund's contract with its third-party administrator covering Fiscal Years 2004, 2005, and 2006, states that "the Trustees of the Fund agree to pay KingCare, Inc. the sum of (\$23,500.00) twenty- three thousand, five hundred dollars per month, said fees to be payable quarterly [\$70,500] during the period the services are being rendered [\$282,000 annually]." However, according to the Active Fund's Fiscal Year 2004, 2005, and 2006 Directive #12 filings, the Active Fund never reported more than \$162,000 in administrative fees to KingCare over the same period; it reported only \$161,250, \$162,000, and \$123,200 in Fiscal Years 2004, 2005, and 2006, respectively.

### **Benefit Expenses**

Benefit expenses were overstated by \$187,085—16.47 percent of the Active Fund's total benefits costs (after our adjustment). According to the Active Fund's Schedule of Benefits Paid for Participants, the Active Fund reportedly spent \$181,626 for its Health and Wellness benefit, a benefit not even listed in the Active Fund's benefit book. This is the second highest benefit in terms of dollars after its Dental benefit. However, according to the Active Fund's records, only \$5,536 was paid for this benefit as follows:

- \$2,243 to Oakstone Wellness for 1,500 "Top Health" newsletters and 1 newsletter logo on November 23, 2005;
- \$1,492 to KingCare from Outreach/Wellness Program, including materials for the Health Fair;
- \$1,400 to Registered Nurses;

- \$401 to 1-800 We Answer for 28 weeks of basic service.

The remaining \$176,090 was paid to King Care as an administrative fee or “On Account.”

As stated above, the Active Fund also paid \$10,995 for the Second Dental Opinion program, reportedly a benefit expense. When we traced these payments from this benefit expense to their supporting documentation, we found that payments were made to two law firms for alleged legal services. Therefore, the \$10,995 should be recorded as administrative expenses rather than benefit expenses. This benefit is also not listed in the Active Fund’s benefit book, but has been included in its Directive #12 filing for the last four fiscal years—2003, 2004, 2005, and 2006.

**The Active Fund Did Not Select a Certified Public Accountant  
Who Appears To Be Independent To Audit  
Its Financial Statements, as Required by Directive #12**

The Active Fund did not select a Certified Public Accountant, who appears to be independent to audit its financial statements as required by Directive #12. According to Directive #12, “Each year’s financial statements must be audited annually by *independent* Certified Public Accountants (CPA).” (Emphasis added.) However, the Active Fund hired a CPA to audit and certify its financial statements who was an employee of Cohen Phillips & Seiden, LLP—the firm that prepared the Active Fund’s financial statements, including the trial balance and all the adjusting entries.

According to the CPA’s contract dated July 1 2003, he agreed to audit the Active Fund’s financial statements for years ending June 30, 2004, June 30, 2005, and June 30, 2006. The contract further states: “Assistance to be supplied by our internal accounts, Cohen Phillips & Seiden LLP, including the preparation of schedules and analyses of accounts. The fees will be . . . \$15,000 for 6-30-06.” Cohen Phillips & Seiden, LLP, not the CPA, submitted an invoice dated July 1, 2005, for \$15,000 for accounting services for Fiscal Year 2006. The Active Fund then issued a check to Cohen Phillips & Seiden, LLP, for \$15,000 for these services.

Accordingly, the CPA does not appear to be independent from Cohen Phillips & Seiden, LLP; and we note that the CPA certified the Active Fund’s financial statements that contained material misstatements without questioning the adjusting entries to the Active Fund’s trial balance and relied on schedules (Depreciation Schedule and Employers Contribution Receivable Schedule) that were reportedly approved and signed by the CPA more than two months after the issuance of his Independent Auditor’s (CPA’s) Report. As previously stated, we were unable to determine when these schedules were prepared because they were not signed and dated by the preparer.

***Fund Response:*** “The Trustees further note that they are giving serious consideration to selecting a new firm of certified public accountants, even though they believe that their current CPA is sufficiently independent to meet the requisites of Directive 12. Additionally, the Fund has terminated the services of its legal counsel and it anticipates selecting new legal counsel in the near future.”

**Auditor Comment:** We continue to disagree that the current CPA is sufficiently independent to meet Directive #12 requirements.

**High Percentage of City Contributions  
Spent on Administrative Expenses**

The Active Fund spent a significantly larger percentage of its City contributions on administrative expenses when compared to those of other, similarly-sized funds, as shown in Table III, following.<sup>6</sup>

**Table III**  
**Comparison of Administrative Expenses**  
**Between the Fund and Other, Similarly-Sized Funds for Fiscal Year 2006**

| <b>Benefit Fund</b>                                    | <b>NYC<br/>Contributions</b> | <b>Total<br/>Admin.<br/>Exp.</b> | <b>Admin<br/>Exp/<br/>NYC Rev.</b> |
|--|------------------------------|----------------------------------|------------------------------------|
| United Probation Officers Association Welfare Fund     | \$1,292,121                  | \$463,257                        | 35.85%                             |
| Civil Service Bar Assoc WF                             | 1,505,075                    | 180,231                          | 11.97%                             |
| Correction Captains Association WF/CLRF                | 1,287,956                    | 114,622                          | 8.90%                              |
| Local 246 SEIU RWF                                     | 1,388,682                    | 117,360                          | 8.45%                              |
| Local 300 Civil Service Forum WF                       | 1,597,260                    | 171,548                          | 10.74%                             |
| Doctors Council WF                                     | 1,121,171                    | 298,507                          | 26.62%                             |
| Local 3 IBEW Electricians RWF                          | 814,304                      | 99,603                           | 12.23%                             |
| Local 300 Civil Service Forum RWF                      | 844,242                      | 112,973                          | 13.38%                             |
| NYC Municipal Plumbers & Pipefitters WF                | 926,056                      | 143,832                          | 15.53%                             |
| Total (Excluding United Probation Officers Assoc WF)   | 9,484,746                    | 1,238,676                        |                                    |
| Average (Excluding United Probation Officers Assoc WF) | \$1,185,593                  | \$154,835                        | 13.06%                             |

We based the total of \$463,257 in administrative expenses identified on Table III on the appropriate classification of expenses rather than on the \$265,522 reported in the Active Fund's certified financial statements.

As indicated above, the eight similarly-sized funds spent between 8.45 percent and 26.62 percent of their City contributions on administrative expenses. The United Probation Officers Association Welfare Fund had the highest percentage (35.85%) of City contributions spent on administrative expenses. Given the fact that the Active Fund's mission is to provide benefits for its members, the Fund should attempt to bring its administrative expenses more in line with those of funds of a similar size.

<sup>6</sup> The size of each fund was based on the amount of City contributions. As of December 31, 2006, eight other funds submitted financial statements to the New York City Comptroller's Office (in accordance with Comptroller's Directive #12) showing that they each received City revenue of between \$814,304 and \$1,597,260 in Fiscal Year 2006.

***Fund Response:*** “The Trustees are also concerned about the statistical comparisons made to other funds in the Draft Report. This concern arises from two perspectives: first, the other funds are not similarly-situated and, second, the comparison does not take into account the administrative requirements of this Fund as compared with the other funds. More importantly, the erroneous finding by the auditors that legitimate benefits were in fact disguised administrative expenses has resulted in the unwarranted conclusion that administrative expenses were \$463,257 when they were, in fact, only \$265,522. Thus, a proper allocation would leave administration expenses at 20.5% of total revenue, much more in line with other funds referenced.”

***Auditor Comment:*** Contrary to the Active Fund’s assertion, similarly-sized funds are comparable in terms of revenue. The mission of every fund is to provide the maximum amount of benefits to its members using its available resources—City contributions. Comparing similarly-sized funds in terms of revenue clearly demonstrates which funds are maximizing the amounts paid for the benefits they are providing to their members rather than maximizing the amounts paid to their third-party administrator. Clearly, these payments are administrative expenses rather than benefit expenses and, combined with our other audit adjustments, result in the Active Fund’s having the highest percentage (35.85%) of City contributions spent on administrative expenses.

#### **The Active Fund Paid for Capital Equipment and Other Operating Expenses of Its Third-Party Administrator**

The Active Fund allegedly paid \$498,656 for computer software and hardware and other operating expenses for its third-party administrator, in addition to administrative fees. KingCare and the Chairperson however, denied our request to review the supporting bills and invoices for the purchases of computers or software. They also denied us access to inspect and assess the computer equipment and software. Consequently, we could not verify the existence of this equipment. Specifically, the Active Fund paid:

- \$495,450 from Fiscal Year 2000 to Fiscal Year 2006 for computer hardware and software that is reportedly owned by its third-party administrator, KingCare;
- \$1,981 for messenger service between KingCare offices at 375 West Broadway, Manhattan, and 62 West Clinton Avenue, Westchester County; and
- \$1,225 for KingCare’s telephone expenses.

Since the Active Fund’s Trustees are paying its third-party administrator to manage the Active Fund, they should not be also paying for KingCare’s capital equipment and operating expenses.

### **The Active Fund Paid \$10,652 in Other Questionable Expenses**

The Active Fund paid \$10,652 for other questionable expenses. These expenses are in violation of the Trust Agreement, unrelated to the operations of the Active Fund, or lacking adequate supporting documentation. Specifically the Active Fund paid:

- \$4,575 to its Trustees—\$75 per month—in violation the Active Fund’s Trust Agreement. The Trust Agreement states that the Trustees are to serve without compensation.

***Fund Response:*** “This was not compensation paid to the Trustees but rather expense reimbursements.”

***Auditor Comment:*** The Active Fund did not submit any documentation—bills or invoices—to substantiate the legitimacy of these expenses.

- \$3,570 for 3,750 Union courtesy cards. We note that the Active Fund has approximately 800 members.
- \$1,798 for flowers for various individuals including Trustees and the Deputy Commissioner of the Department of Probation.
- \$495 for Trustee meeting meals based on questionable supporting documentation. The dates on the four receipts do not correspond to the dates listed on the minutes of the Board of Trustees meetings. In addition, three of the four invoice numbers are in sequential order even though the dates of the invoices are three months apart.
- \$179 for three telephone bills to the Chairperson’s residence in Long Island.
- \$35 in long distance calls that belong to the Union’s telephone.

### **The Active Fund Reportedly Paid \$181,626 for Health and Wellness Benefits That May Not Exist**

The Active Fund reportedly paid \$181,626 for a Health and Wellness benefits that may not exist. Only \$5,536 in invoices can be traced directly to the Health and Wellness benefit. In fact this benefit is not listed or defined in the Active Fund’s benefit book. Moreover, the contract for this benefit contains vague and undefined services with no specific deliverables, time frames, schedules, or bench marks. In addition, the Active Fund does not maintain utilization reports for this benefit. A utilization report was prepared for the audit after our request. However, the report contained only approximate statistics and figures and had no supporting documentation. As a result, we question the legitimacy of the administration of this benefit.

According to the Active Fund's Schedule of Benefits Paid for Participants, the Active Fund spent \$181,626 for its Health and Wellness benefit. However, we found just \$5,536 in invoices that can be traced back to this benefit as follows:

- \$2,243 to Oakstone Wellness for 1,500 "Top Health" newsletters and 1 newsletter logo on November 23, 2005;
- \$1,492 to KingCare from Outreach/Wellness Program, including materials for the Health Fair;
- \$1,400 to Registered Nurses; and
- \$401 to 1-800 We Answer for 28 weeks of basic service.

In addition, the Active Fund's Health and Wellness contract with its third-party administrator, KingCare, does not have any specific deliverables, time frames, schedules, or benchmarks for these benefits. For this benefit, the contract includes the following undefined and vague list of services: Preventive illness; Stress; Smoking Cessation; Advice on Health Care Proxies and Living Wills; Nutrition and Weight Management; and, Physical Activity.

The Active Fund does not maintain a utilization report on this benefit. The Active Fund's third-party administrator did prepare a utilization report for us after our request. However, the report contained only approximate numbers and had no supporting documentation for the following categories.

- Distribution of Wellness Information;
- Distribution of Health Care Proxy and Living Will;
- Seminar Attendance;
- Responses to Surveys; and
- Questions with regards to materials and other inquiries.

Even more disturbing is that in the minutes of Board of Trustees meetings held from November 2005 through June 2006 reflect that, "They [Board of Trustees] reviewed the new outreach program and were pleased with the progress so far." We question how the Trustees could have "reviewed" and been "pleased" with a program that has neither specific deliverables nor utilization reports to attest to membership activity in the program or the program's success.

As stated in a previous section, an individual of the firm Cohen Phillips & Seiden, LLP, made two adjusting entries on the Active Fund's Trial Balance transferring \$158,800 from the administrative fees account to the Health and Wellness account. This transfer appears to be an attempt to conceal payments made to the Active Fund's third-party administrator—KingCare—for administrative expenses in this questionable benefit. In any case, we seriously question the veracity of this benefit.

**Fund Response:** "It is also important to note that a number of matters the auditors found as problematic were the results of misclassifications either by the auditors

themselves or, in some cases, by Fund employees or consultants. The most significant of these—all of which will be addressed in the Trustees’ detailed review of the auditors’ findings—was the conclusion by the auditors that the “Wellness” benefit (in the amount of \$181,626) was a disguised administrative expense. This conclusion was based solely on the fact that the benefit was not listed in the SPD. The fact is, however, that this was a legitimate benefit, and it was reflected in announcement letters and other materials that are used when a new benefit is provided. All of these materials were provided to the Comptroller’s office in conjunction with the response to the Preliminary Draft Report, and the Trustees had expected that the Draft Report would take this information into account. (A review of the Draft report reveals that extensive documentation provided by the UPOA on this and other matters, including five bound volumes of documents, was disregarded).

“When such documentation is taken into account, this expenditure (like others referenced below) is readily recognizable as a benefit and not an administrative expense. Such recognition not only removes the single largest negative finding by the auditors, but also dramatically lowers the administrative fee calculation. To avoid such problems in the future, the SPD has been updated and it is on the UPOA website as of October 14, 2008. See [www.upoa.com](http://www.upoa.com).”

**Auditor Comment:** Contrary to the Active Fund’s response, our review of the information provided by the Active Fund in response to the preliminary draft report offered further reason to doubt the existence of a Health and Wellness benefit. Specifically, our review found that:

- The 28 seminars reportedly staffed by KingCare, were offered for *free* at the Winthrop University Hospital in Mineola, Long Island. KingCare’s seminars and speakers are exactly the same as those offered and staffed by Winthrop. This not only raises additional suspicions concerning the legitimacy of this “benefit” but may constitute fraud on the part of the Active Fund’s third-party administrator
- The twenty-four hour emergency line is nothing more than an answering service. According to officials at 1-800 We Answer, the “emergency line” is an answering service, not a crisis hotline, for which the Active and Retiree Funds—not KingCare—paid 28 weeks of basic service.
- Only two on-site visits were held during the audit period at which registered nurses screened for blood pressure, cholesterol, and sugar levels. The Active Fund, not KingCare, paid for the registered nurses. In addition, KingCare reportedly distributed claim forms, beneficiary cards, and information on health care proxy and living wills. These services are already included among KingCare’s duties as the Fund Manager.
- A second utilization report submitted to us in response to the preliminary draft report contradicts the initial utilization report prepared for us during the audit. The second utilization report shows 393 active members who attended Health and Wellness



seminars and health fairs compared to 251 individuals previously reported on the initial utilization report. While the second utilization report now lists names of specific individuals instead of the approximate numbers of individuals who reportedly received this benefit, the second utilization report did not include the services received, dates of service, etc.

- There is still no detailed description of this benefit defining the services, eligibility, and those requesting and receiving these services. According to the new on-line benefit book the following “benefits” are available:
  - “Post flyers to inform members of seminars.
  - Email notices of heanth [sic] and preventive illness information.
  - Monthly update on numerous materials.
  - Medical and Psychological benefit.
  - Information Line in all issues of living.
  - Seminars in health topics.”
- Only \$5,536 in invoices of the \$181,626 purportedly spent on this benefit can be traced back to this benefit.

Therefore, we continue to question the existence of this benefit and maintain that the transfers from the administrative fees account to the Health and Wellness account and loan receivable appear to be an attempt to conceal certain payments made to the Active Fund’s third-party administrator for administrative expenses as benefit expenses and a loan receivable.

### **The Active Fund Paid \$10, 995 for a Second Dental Opinion Program That Does Not Exist**

The Active Fund paid \$10,995 for the Second Dental Opinion Program that does not exist. We traced these payments to their supporting documentation and found that these payments were made to two law firms for legal services. This benefit is not listed in the Active Fund’s benefit book, but has been included in its Directive #12 filing for the last four fiscal years—2003, 2004, 2005, and 2006. Expenses for legal services should have been classified as an administrative expense instead of a benefit expense.

***Fund Response:*** “There were, as reflected in the responses to specific matters set out below, some instances in which the auditors found errors of a minor nature when the Fund accountants had misclassified a benefit. Thus, for example, the ‘Second Dental Opinion Program’ was found by the auditors to reflect paid fees to two law firms for legal services. The fact is that benefits were properly paid for the UPOA’s legal services benefit, but were misclassified as a ‘Second Dental Opinion’ benefit. This \$10,995 legitimate benefit was erroneously reclassified by the auditors as an administrative expense. The data provided by the Fund in response to the Preliminary Draft that

clarified this misclassification was, apparently, not considered by the Comptroller's office in preparing the Draft Report."

**Auditor Comment:** Contrary to the Active Fund's statement, the fund did not provide us with any evidence to substantiate the existence of a Second Dental Opinion benefit or a Legal benefit. Instead of utilization reports, KingCare provided us with a list of dental procedures for which the Active Fund paid one dentist who was purportedly being investigated by the Active Fund for improper billing. With regard to the alleged Legal benefit, payments to the law firm were for legal services to represent the Active Fund and its Trustees rather than for the provision of benefits to its members. It should be noted that one of the partners of this firm represented KingCare, not the Active Fund, at the exit conference. Clearly, these are not benefits that are directly used by members and should be reclassified in accordance with Comptroller's Directive #12.

### **The Active Fund Has Poor Controls over Payments to Its Third-Party Administrator**

The Active Fund did not segregate the responsibilities for approving invoices and for signing checks for payments to its third-party administrator. The president of KingCare submitted invoices for payment to the Active Fund, approved payments, and co-signed Active Fund checks made out to her company. Good internal controls dictate that these responsibilities be segregated to ensure that all payments to the third-party administrator are reasonable and justifiable.

**Fund Response:** "Significantly, the erroneous reclassification by the auditors of legitimate benefit payments to administrative expenses was apparently the genesis of a further criticism that there were poor controls over the payments made to the Third-Party Administrator ('TPA'). Thus, the improper reclassification of legitimate benefits to administrative expenses (admittedly due—in part—to errors by the Fund's accountants), was the source of at least three of the major criticisms made by the Comptroller's Office.

**Auditor Comment:** Contrary to the Active Fund's response, all reclassifications are in accordance with Comptroller's Directive #12. As stated above, poor controls exist over payments made to the third-party administrator, KingCare. The President of KingCare is submitting invoices for payment to the Active Fund, approving the payments to her company from the Active Fund, and then co-signing Active Fund checks made payable to her company. This process violates good internal controls, which require that these functions be segregated. This payment process is an even more egregiously bad practice since the President of KingCare is approving and making payment to her own company on behalf of the Active Fund.

### **The Active Fund Minutes of Board of Trustee Meetings Appear To Be Fictitious**

The minutes of the 12 Board of Trustees meetings held from July 2005 to June 2006 appear to be fictitious and manufactured for this audit. Minutes are the record of all business transacted at Board of Trustees meetings including, but not limited to, decisions on administration, benefits provided, eligibility requirements, and the hiring of consultants. Even though the meetings reportedly lasted seven and half hours, all the minutes of each meeting were very similar, very few issues were discussed, and no details of the discussion were reflected in the minutes. In addition, the minutes were not signed by all the Trustees, and one of the sets of minutes was signed only by the Chairperson of the Board of Trustees. Therefore, we question the veracity of the minutes of the Board of Trustees meetings we were given to review.

For example, the minutes include only two or three paragraphs of new business and usually include the following citations:

“The Board of Trustees reviewed operating procedures of the Fund. They discussed the services being provided by the Fund Manager’s Office and were pleased to find there were no complaints and that the Fund is running well.

“They reviewed the new outreach program and were pleased with the progress so far.”

Further, these meetings are reportedly seven and half hours long, beginning at 9:00 a.m. and ending at 5:30 p.m. Since according to the Union President/Chairperson of the Board of Trustees he is the only person that is allowed release time from his City job, we are concerned that the four Trustees who are active City employees are attending Trustee meetings on City time. We have reviewed the City’s PMS system and found that in many cases the four Trustees took no leave time to attend these meetings. Therefore, these Trustees may be submitting fraudulent timesheets resulting in theft of service. This issue will be submitted to the City’s Department of Investigation for further investigation.

In addition, while all seven trustees are listed on the minutes, only four to five Trustees sign the minutes; one Trustee never signed the minutes. Also, the minutes for the Board of Trustees meeting on March 21, 2006, were signed by only the Chairperson.

We requested to attend one of these Board of Trustees meetings to observe how the Trustees are reviewing the Active Fund’s operating procedures and the performance of its third-party administrator. However, the Chairperson and the Board of Trustees denied us access to any of the Board of Trustees meetings. Therefore, we question the veracity of the minutes of the Board of Trustees meetings. Without accurate minutes of Board of Trustee meetings, there is no record or accountability for the decisions made by the Board of Trustees when directing Active Fund policy.

***Fund Response:*** “With respect to Trustees’ meetings, the Trustees vigorously object to the notion that meetings reflected in the Board Minutes did not occur. The Trustees concur, however, that the Minutes could be more complete. Accordingly, the Trustees will take steps to ensure that this occurs in the future.”

### **Improper Benefit Payments**

The Active Fund made improper benefit payments totaling \$6,180. Of the \$304,416 in claims we reviewed, \$6,180 (2 %) in payments were made to ineligible individuals and made without supporting documentation. Specifically, the Active Fund:

- Paid \$2,700 for two ineligible individuals for disability benefit.
- Paid \$2,224 for 19 claims on behalf of ineligible individuals. The benefits were paid for individuals who were not listed on the City contribution reports. In some cases, these individuals were not even listed on the City database of present or former City employees.
- Paid \$715 for 8 claims for which no medical receipts was on file.
- Paid \$541 in Prescription Drugs benefits for 12 claims with inadequate documentation.

### **Claims Paid for Dependents Whose Eligibility Was Not Documented**

Of the 1,284 benefit claims we reviewed, 398 claims, totaling \$56,146, were for services provided to individuals who were listed as dependents of eligible members. However, the Active Fund did not have documentation (i.e., birth certificates, marriage licenses) in its files for 294 (74%) of the 398 claims showing that the individuals were in fact eligible dependents.

### **The Retiree Fund Owes the Active Fund \$34,850**

The Retiree Fund owes the Active Fund \$34,850. The \$34,850 is the balance of a \$42,000 loan that the Active Fund made to the Retiree Fund.

## RECOMMENDATIONS

Generally, we would recommend a series of actions to the Active Fund designed to address the problems identified. However, the financial, managerial and operational problems are so prevalent and pervasive that they cannot be readily addressed by fine-tuning Active Fund financial and operating practices. Therefore, it is clear that the entire financial and operating systems of the Active Fund have to be overhauled. Consequently, we recommend that the Board of Trustees:

1. Evaluate how the Active Fund resources could be used to reach its ultimate goal—providing maximum benefits to its members—while keeping administrative costs to a minimum.
2. Consider replacing the Fund Manager based on the extensive problems cited in this report and for denying us access to important records and assets.
3. Develop policies and procedures that would ensure that the Active Fund is achieving its ultimate goal and that it is in compliance with Comptroller's Directive #12. These policies and procedures should include a system of internal controls addressing the issues cited in this report.
4. Closely monitor Active Fund operations to ensure that the issues cited in this report have been eliminated, and address any new issues that arise in the future.

**Fund Response:** “Based on the general and specific responses to the Draft Report, it appears that the recommendations, while useful, are the product of misunderstandings by the auditors. These misunderstandings have been engendered to some extent by certain misclassifications, which the Trustees believe have been and will continue to be remedied, and by the auditors failing to review in detail the voluminous documentation provided with the responses to the Preliminary Draft Report.

“The concerns raised about the Fund Manager have, in the Trustees’ judgment, been demonstrated to have been based on misunderstandings by the auditors despite the detailed responses made to the Preliminary Draft Report and the thousands of pages of documents submitted in support of these responses.

“Finally, the Trustees will address the system of internal controls and will continue to strive to maximize the benefits to the Active Fund’s members and effect compliance with Directive #12.”

**Auditor Comment:** We not only disagree with the Active Fund’s contention that these findings are a product of misunderstandings and misclassifications, we are mystified by the Trustees’ position concerning its third-party administrator, KingCare. According to the Chairperson of the Board of Trustees, KingCare is responsible for all aspects of the Active and Retiree Funds. The Chairperson referred all requests and questions, including legal and accounting issues, to KingCare, even though his Union office is located within KingCare’s offices.

Furthermore, contrary to the Active Fund's response, we did review in detail the voluminous documentation submitted by the Active Fund and made the necessary changes to the draft report. Most of the documentation—utilization reports, contribution reports, and claim forms with supporting documentation—was requested during the audit. However, the additional documentation provided by the Active Fund after the exit conference did not change the findings and conclusions of our initial report. There are extensive administrative, financial, and operational problems with the Active Fund. Given the degree of these problems and the Trustees' unwillingness to recognize and correct them, we have no choice but to refer this report to the New York City Department of Investigation and the New York State Attorney General for further action.

**WORMSER, KIELY, GALEF & JACOBS LLP**

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**John T. Morin**

October 14, 2008

Direct Dial No. 1(212) 573-0635  
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**BY HAND**

John Graham  
Deputy Comptroller  
Audits, Accounting & Contracts  
Office of the Comptroller  
Executive Office  
1 Centre Street  
New York, New York 10007-2341

Re: Audit Report on the Financial and Operating Practices  
of the United Probation Officers Association Welfare Fund  
FL08-076A

Audit Report on the Financial and Operating Practices  
of the United Probation Officers Association  
Retirement Welfare Fund  
FL08-077A

Dear Mr. Graham:

On behalf of the two above-referenced Welfare Funds, we are pleased to submit two copies of their Responses to the Draft Reports which were sent to Mr. Dominic Coluccio, the Fund's Chairperson, under cover of your letter to him dated September 22, 2008.

As a preliminary matter we wish to thank you for affording both Funds additional time to respond to the Draft Reports. Such additional time permitted the Funds the opportunity to make complete and detailed Responses.

John Graham  
Deputy Comptroller  
Audits, Accounting & Contracts  
Office of the Comptroller  
October 14, 2008  
Page 2

As you will note, the Funds' Responses are parallel in most respects. This was to be expected, of course, given the similarities in the benefits provided by, and the administration of, both.

Despite the fact that the Responses are as detailed as the Funds think necessary, appropriate people will be available for further discussion should your office believe further discussion to be useful. Our belief that a better understanding of the Responses may result from meetings and/or telephone conversations is predicated to some extent on the Funds' perception that, despite the voluminous documentation provided to your office in response to the Preliminary Draft Reports, the Draft Reports appear not to have taken such documentation into account. The Funds have, once again, referred to the documents provided with the Preliminary Draft Reports, and we hope they -- along with the Responses to the Draft Reports -- will be assessed by your office before the Final Reports are issued.

To the extent a Final Report is issued for publication, it is the Funds' hope that their comments with respect to any criticisms that remain in the Final Reports after your office reviews and assesses the Funds' Responses to the Draft Reports will be published in full.

The Funds further believe, and on their behalf we formally request, that they be afforded the opportunity to review what your office considers its Final Reports at least two weeks in advance of any publication. That would be fair given the efforts made by the Funds to be as



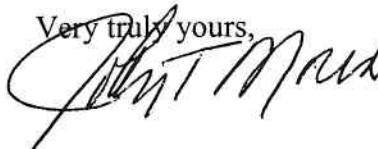
WORMSER, KIELY, GALEF & JACOBS LLP

John Graham  
Deputy Comptroller  
Audits, Accounting & Contracts  
Office of the Comptroller  
October 14, 2008  
Page 3

responsive as possible to those comments and criticisms made in the Draft Reports that are countered in the Funds' Responses.

We thank you for your anticipated attention to the Responses that are enclosed, and we trust that your Final Reports will be informed by the Responses and documentation provided by the Funds.

You may, of course, address any further comments or concerns to Mr. Dominic Coluccio, the Chairperson of both Funds, or you may communicate directly with me.

Very truly yours,  


JTM:kp

cc: ✓ Ms. Irene Lam (by hand w/o encl.)  
Mr. Dominic Coluccio (via first class mail w/ encl.)

# AUDIT REPORT

CITY OF NEW YORK  
OFFICE OF THE COMPTROLLER  
BUREAU OF FINANCIAL AUDIT  
**WILLIAM C. THOMPSON, JR.,  
COMPTROLLER**

## **Audit Report on the Financial and Operating Practices of the United Probation Officers Association Welfare Fund**

*FLO8-076A*

September 22, 2008

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*The City of New York  
Office of the Comptroller  
Bureau of Financial Audit*

**Audit Report on the  
Financial and Operating Practices of the  
United Probation Officers Association Welfare Fund**

FLO8-076A

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**AUDIT REPORT IN BRIEF**

The United Probation Officers Association Welfare Fund (Active Fund) provides health and welfare benefits to eligible active City employees and their dependents. It receives contributions from the City of New York. The Active Fund is required to conform with Comptroller's Internal Control and Accountability Directive #12, "Employee Benefit Funds—Uniform Reporting and Auditing Requirements" (Comptroller's Directive #12), which sets forth accounting, auditing and financial guidelines for City welfare funds and their boards of trustees.

We performed an audit on the financial and operating practices of the Active Fund for Fiscal Year 2006. As of June 30, 2006, the Active Fund reported \$1,422,214 in City contributions and net assets of \$1,934,518.

**Audit Findings and Conclusions**

The audit found that the Trustees of the Active Fund may have breached their fiduciary responsibilities to the Active Fund and its members. For example, the Active Fund has spent a significantly larger percentage of its City contributions on administrative expenses—especially the high administrative fees totaling \$436,790 paid to its third-party administrator—when compared to other, similarly-sized funds, and has claimed to pay for capital equipment and other operating expenses of its third-party administrator, even though the Active Fund lists the equipment as fixed assets on its financial statements. Moreover, the Active Fund was not in compliance with the procedures and reporting requirements of Comptroller's Directive #12. Consequently, the Active Fund's financial statements and its Directive #12 filing were materially misstated. Specifically, the Active Fund:

- Materially misstated its City contributions, total assets, expenses, and Net Assets Available for Plan Benefits on its financial statements (See Appendix I).
- Misstated revenue, benefit and administrative expenses on its Directive #12 filing (See Appendix I).



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- Spent a significantly larger percentage of its City contributions on administrative expenses when compared to other, similarly-sized funds.
- Paid for capital equipment and other operating expenses of its third-party administrator.
- Did not select a Certified Public Accountant who appears to be independent to audit its financial statements, as required by Directive #12.
- Paid \$10,527 for other questionable expenses.
- Reportedly paid \$181,626 for Health and Wellness benefits that may not exist
- Paid \$10,995 for the Second Dental Opinion Program that does not exist.
- Paid \$34,519 for the Comprehensive Medical Examination Benefits, which is covered by all of the City's major medical plans with a co-payment of between \$0 and \$20.
- Has poor controls over payments to its third party administrator.
- Provided us minutes of Board of Trustee meetings that appear to be fictitious.
- Made improper benefit payments totaling \$6,180.
- Paid claims for dependents whose eligibility was not documented.
- Is owed \$34,850 by the Retiree Fund.

**Audit Recommendations**

Generally, we would recommend a series of actions to the Active Fund designed to address the problems identified. However, the financial, managerial and operational problems are so prevalent and pervasive that they cannot be readily addressed by fine-tuning Active Fund financial and operating practices. Therefore, it is clear that the entire financial and operating systems of the Active Fund have to be overhauled. Consequently, we recommend that the Board of Trustees:

- Evaluate how the Active Fund resources could be used to reach its ultimate goal—providing maximum benefits to its members—while keeping administrative costs to a minimum.
- Consider replacing the Fund Manager based on the extensive problems cited in this report and for denying us access to important records and assets.
- Develop policies and procedures that would ensure that the Active Fund is achieving its ultimate goal and that it is in compliance with Comptroller's Directive #12. These policies and procedures should include a system of internal controls addressing the issues cited in this report.
- Closely monitor Active Fund operations to ensure that the issues cited in this report have been eliminated, and address any new issues that arise in the future.

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### **INTRODUCTION**

The Trustees of the United Probation Officers Association Welfare Fund ("UPOA") ("Active Fund" or "Fund") submit their response ("Response") to the Draft Audit Report ("Draft Report") provided by the Office of the Comptroller of the City of New York ("Comptroller's Office") under cover of a September 22, 2008 letter to Mr. Dominic Coluccio, the Chairperson of the UPOA Welfare Fund, from Mr. John Graham.

As a preliminary matter, the Trustees wish to thank the Comptroller's Office for affording them the opportunity to respond to the Draft Report. Indeed, the Trustees appreciate the efforts made by the Comptroller's office staff in pointing out what it perceived to be matters of concern during the course of their audit work.

While the Trustees' Response to the Draft Report will demonstrate what they believe to be errors in the Draft Report, they appreciate the concerns raised in that Report, and will undertake certain procedural and substantive management and accounting policy changes as a result.

In framing their Response, the Trustees have assessed and analyzed the Draft Report and are providing an overview in the form of a narrative explaining (i) the manner in which the Draft Report unfairly criticizes the Trustees, the Fund Manager, and the handling of the Fund itself, and (ii) acknowledging those matters where -- for reasons of misclassification or otherwise -- errors were in fact made by the Fund.

Additionally, the Response will address some specific actions the Trustees will undertake based on their review and analysis of the Draft Report. It will also address specific criticisms made by the auditors.

### **OVERVIEW**

#### Audit Findings and Conclusions

As a further preliminary matter, the Trustees want to make clear that, for reasons detailed below in response to specific matters addressed by the Draft Report, every effort was made to comply with Directive 12. Thus, to the extent any discrepancy exists with respect to the receipt of City contributions (and, therefore the Fund's assets), such discrepancy was the result of work done by the UPOA's accountants in a good faith effort to categorize contributions expected from the City which were received later than the accountants anticipated.

The Trustees note, at the outset, that the Draft Report fails to recognize or even refer to the range and quality of the benefits provided by the Fund. While this omission may not be surprising in an "audit" report, such recognition would be useful in assessing the Fund's overall performance.

Similarly, the Trustees believe it important to note that, in preparing the Draft Report (as was also the case in the Preliminary Draft Report), the auditors have referenced the obligations imposed by Directive 12, but have omitted the obligations imposed by -- among other things --



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the Fund's (i) Constitution, (ii) By-Laws, and (iii) Collective Bargaining Agreement, as well as (iv) relevant Codes and Statutes. Striking such a balance is crucial in assessing the performance by the Trustees as well as the Third-Party Administrator and other professionals whose work was being audited.

The Trustees are also concerned about the statistical comparisons made to other funds in the Draft Report. This concern arises from two perspectives: first, the other funds are not similarly-situated and, second, the comparison does not take into account the administrative requirements of this Fund as compared with the other funds. More importantly, the erroneous finding by the auditors that legitimate benefits were in fact disguised administrative expenses has resulted in the unwarranted conclusion that administrative expenses were \$463,257 when they were, in fact, only \$265,522. Thus, a proper allocation would leave administration expenses at 20.5% of total revenue, much more in line with other funds referenced.

It is also important to note that a number of matters the auditors found as problematic were the results of misclassifications either by the auditors themselves or, in some cases, by Fund employees or consultants. The most significant of these -- all of which will be addressed in the Trustees' detailed review of the auditors' findings -- was the conclusion by the auditors that the "Wellness" benefit (in the amount of \$181,626) was a disguised administrative expense. This conclusion was based solely on the fact that the benefit was not listed in the SPD. The fact is, however, that this was a legitimate benefit, and it was reflected in announcement letters and other materials that are used when a new benefit is provided. All of these materials were provided to the Comptroller's office in conjunction with the response to the Preliminary Draft Report, and the Trustees had expected that the Draft Report would take this information into account. (A review of the Draft Report reveals that extensive documentation provided by the UPOA on this and other matters, including five bound volumes of documents, was disregarded).

When such documentation is taken into account, this expenditure (like others referenced below) is readily recognizable as a benefit and not an administrative expense. Such recognition not only removes the single largest negative finding by the auditors, but also dramatically lowers the administrative fee calculation. To avoid such problems in the future, the SPD has been updated and it is on the UPOA website as of October 14, 2008. See [www.upoa.com](http://www.upoa.com).

There were, as reflected in the responses to specific matters set out below, some instances in which the auditors found errors of a minor nature when the Fund accountants had misclassified a benefit. Thus, for example, the "Second Dental Opinion Program" was found by the auditors to reflect paid fees to two law firms for legal services. The fact is that benefits were properly paid for the UPOA's legal services benefit, but were misclassified as a "Second Dental Opinion" benefit. This \$10,995 legitimate benefit was erroneously reclassified by the auditors as an administrative expense. The data provided by the Fund in response to the Preliminary Draft that clarified this misclassification was, apparently, not considered by the Comptroller's office in preparing the Draft Report.

Significantly, the erroneous reclassification by the auditors of legitimate benefit payments to administrative expenses was apparently the genesis of a further criticism that there were poor controls over the payments made to the Third-Party Administrator ("TPA"). Thus, the improper reclassification of legitimate benefits to administrative expenses (admittedly due -- in



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part -- to errors by the Fund's accountants), was the source of at least three of the major criticisms made by the Comptroller's Office.

The Trustees further note that they are giving serious consideration to selecting a new firm of certified public accountants, even though they believe that their current CPA is sufficiently independent to meet the requisites of Directive 12. Additionally, the Fund has terminated the services of its legal counsel and it anticipates selecting new legal counsel in the near future.

The Trustees now believe that it appears that the equipment acquired by the TPA for the benefit of the Fund (principally, software that is used uniquely for UPOA Welfare Fund purposes) should not have been capitalized. Management is responsible for the selection and use of appropriate accounting policies, hence, the Trustees will adopt a new and more appropriate accounting policy with respect to such equipment.

With respect to Trustees' meetings, the Trustees vigorously object to the notion that meetings reflected in the Board Minutes did not occur. The Trustees concur, however, that the Minutes could be more complete. Accordingly, the Trustees will take steps to ensure that this occurs in the future.

Finally, the Trustees wish to point out to the Comptroller's Office that the IRS conducted an audit of the Fund's financial statements for tax year 2005, in large part to verify the correctness of income or gross receipts, deductions and credits. As a result of the audit, the IRS issued a "no change" letter to the Fund.

### Response To Audit Recommendations

Based on the general and specific responses to the Draft Report, it appears that the recommendations, while useful, are the product of misunderstandings by the auditors. These misunderstandings have been engendered to some extent by certain misclassifications, which the Trustees believe have been and will continue to be remedied, and by the auditors failing to review in detail the voluminous documentation provided with the responses to the Preliminary Draft Report.

The concerns raised about the Fund Manager have, in the Trustees' judgment, been demonstrated to have been based on misunderstandings by the auditors despite the detailed responses made to the Preliminary Draft Report and the thousands of pages of documents submitted in support of these responses.

Finally, the Trustees will address the system of internal controls and will continue to strive to maximize the benefits to the Active Fund's members and effect compliance with Directive #12.

### **Background**

The United Probation Officers Association Welfare Fund was established on May 15, 1978, under the provisions of a Fund Agreement between the City of New York and the United Probation Officers Association (the Union) and a Declaration of Trust. The Active Fund provides

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health and welfare benefits to eligible City employees in various titles, including Probation Assistant, Probation Officer Trainee, Probation Officer, Senior Probation Officer, and Supervising Probation Officer. The Active Fund also provides benefits to members' spouses and dependents. The Active Fund received \$1,422,214 in City contributions for Fiscal Year 2006.

The Active Fund is required to conform to Comptroller's Directive #12, "Employee Benefit Funds—Uniform Reporting and Auditing Requirements," which sets forth accounting, auditing and financial guidelines for funds and their boards of trustees. Table I (on page 2) shows the benefits that were available to the 804 members of the Active Fund and the total amount reportedly paid for each type of benefit during Fiscal Year 2006.<sup>1</sup>

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<sup>1</sup> According to the Trustees' Management Letter, the Active fund had 804 members during Fiscal Year 2006. The number of members varies during the year because of new hires, retirements, suspensions, etc.



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Table I

Active Fund Benefits and Amounts Paid as Reported by the Active Fund  
Fiscal Year 2006

| Benefit                    | Amount    | Coverage  |
|----------------------------|-----------|---|
| Dental                     | \$528,408 | Each member selects either a participating or non-participating dentist. If the member selects a participating dentist, members and eligible dependents are provided the services listed in the Schedule of Covered Dental Expenses without any out-of-pocket expense. If the member selects a non-participating dentist, the member is reimbursed by the Active fund. These reimbursements are processed by the Active fund's third-party administrator, KingCare, and are based on a Schedule of Covered Dental Expenses. Members and eligible dependents are entitled to a maximum benefit of \$3,000 per person per year.   |
| Health and Wellness        | \$181,626 | This benefit is not listed in the Active Fund's benefit book.<br><br><i>Comment: Copies of a flowchart describing the benefit along with copies of announcement letters and numerous other documents were reviewed by the auditors. There is no question that this benefit exists and was properly treated in the Fund's financial statements.</i>  |
| Prescription Drug          | \$149,340 | Members and their eligible dependents are entitled to a maximum benefit of \$550 per family per year.   |
| Optical                    | \$124,427 | Members and eligible dependents are entitled to a maximum reimbursement of \$400 every two years for examinations, frames and lenses.   |
| Weekly Disability Income   | \$56,534  | Members are entitled to a weekly benefit of \$175 for a maximum of 26 weeks if they become totally disabled and unable to work because of a non-occupational accident or sickness not covered by Workers' Compensation.   |
| Comprehensive Medical Exam | \$34,519  | Members and their spouses are entitled to a comprehensive medical examination every year. Each member selects a participating provider—Manhattan Internal Medicine Associates or Affiliated Physicians—or a non-participating medical facility or physician. If the member selects a participating provider, members and their spouses are provided a comprehensive medical examination without any out-of-pocket expense. If the member selects a non-participating medical facility or physician, the member is reimbursed by the Active Fund, up to a maximum of \$200. These reimbursements are processed by the Active Fund's third-party administrator, KingCare. |
| Life Insurance             | \$30,000  | Beneficiaries receive \$10,000 on the death of an eligible member.  |

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| <b>Benefit</b>             | <b>Amount</b>      | <b>Coverage</b>  |
|----------------------------|--------------------|--|
| 2nd Dental Opinion Program | \$10,995           | This benefit is not listed in the Active Fund's benefit book.<br><br><i>Comment: While there is a Second Dental Opinion Program, no funds were expended for this benefit during the audit period. Instead, this is a legal services benefit for which documentation was provided to the auditors. There is no question that this benefit exists. The Fund Trustees acknowledge that this benefit was inadvertently mislabeled.</i>   |
| FICA Tax Expense           | \$8,742            | This expense should be included in the Weekly Disability Income benefit.   |
| Mammography                | \$5,110            | Members and their spouses are entitled to a mammography examination if authorized by their physician. Each member selects the participating provider—Daniel Maklansky, MD—or a non-participating physician, hospital, or medical center. If the member selects the participating provider, members and their spouses are provided mammography examinations without any out-of-pocket expense. If the member selects a non-participating provider, the member is reimbursed by the Active Fund, up to a maximum of \$70. These reimbursements are processed by the Active Fund's third-party administrator, KingCare. |
| Podiatry                   | \$2,618            | Members and their eligible dependents are entitled to a maximum reimbursement of \$200 per year for visits to a podiatrist and any necessary x-rays.   |
| Hearing Aid                | \$2,100            | Members and their eligible dependents are entitled to maximum reimbursement of \$700 towards the cost of a hearing exam and hearing aid every two years.   |
| In Hospital Indemnity      | \$530              | Members are entitled to \$10 per day for a maximum 10-week period if the member is hospitalized or confined to a skilled nursing facility accredited by the Joint Commission on Accreditation of Hospitals.  |
| Anesthesia                 | \$494              | Members and eligible dependents are entitled to a maximum reimbursement of \$500 per year.   |
| Emergency Room             | \$250              | Members and their eligible dependents will be reimbursed a maximum of \$25 every six months.   |
| Prosthetic Appliance       | \$50               | Members and their spouses are entitled to a maximum lifetime reimbursement of \$2,500 for the purchase or rental of prosthetic devices.  |
| <b>Total</b>               | <b>\$1,135,743</b> |  |

During the audit period, Fiscal Year 2006, the Active Fund provided all benefits through its third-party administrator, KingCare, Inc. For Fiscal Year 2006, KingCare was paid \$436,790 to process benefit claims and provide administrative and bookkeeping services to the Active Fund. (fn2)

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Comment: The Fund Trustees do not agree with the auditors' computation for administrative payment expenses made to KingCare LLC. Once the Health and Wellness benefit and legal services benefit are correctly classified, the administrative expense amounts will decrease to be in a comparable range with similarly-situated small fund administrative expense amounts.

As of June 30, 2006, the Active Fund reported net assets of \$1,934,518. Table II, on the next page, summarizes the Active Fund's audited financial data, as reported by the Active Fund, for the years ending June 30, 2005, and June 30, 2006.



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**Table II**

**Summary of the Active Fund's Reported  
Revenues and Expenses**

|                                     | <b>2005</b> | <b>% of Total<br/>Revenue</b> | <b>2006</b> | <b>% of Total<br/>Revenue</b> |
|-------------------------------------|-------------|-------------------------------|-------------|-------------------------------|
| City Contributions                  | \$1,243,993 | 95.12%                        | \$1,422,214 | 99.85%                        |
| Investment or Other<br>Income       | 63,715      | 4.87%                         | 2,110       | 0.15%                         |
| COBRA                               | 68          | 0.01%                         | 0           | 0%                            |
| Total Revenue                       | \$1,307,776 | 100.00%                       | \$1,424,324 | 100.00%                       |
| Benefit Expenses                    | \$1,196,102 | 91.46%                        | 1,135,743   | 79.74%                        |
| Administrative<br>Expenses          | \$256,335   | 19.60%                        | 265,522     | 18.64%                        |
| Total Expenses                      | \$1,452,457 | 111.06%                       | 1,401,265   | 98.38%                        |
| Excess (Deficiency) of<br>Revenue   | (\$144,681) |                               | \$23,059    |                               |
| Fund Balance<br>(Beginning of Year) | \$2,056,140 |                               | \$1,911,459 |                               |
| Fund Balance<br>(End of year)       | \$1,911,459 |                               | \$1,934,518 |                               |

We should note that we are also conducting a separate audit, Audit # FLO8-077A, of the United Probation Officers Association Retirement Welfare Fund (Retiree Fund). The results of that audit will be covered in a separate report.

**Objective**

The objectives of the audit were to determine whether the Active Fund: complied with applicable procedures and requirements of Comptroller's Directive #12; had adequate and proper benefit-processing and accounting procedures and complied with them; and paid administrative expenses that were appropriate and reasonable.

**Scope and Methodology**

To achieve our audit objectives, we reviewed the Active Fund's financial and operating practices for the period July 1, 2005, through June 30, 2006—the period covered by the most recent Directive #12 filing available when we began the audit. Directive #12 establishes uniform reporting and auditing requirements for City-funded employee benefit plans. We obtained the Active Fund's Directive #12 filings with the Comptroller's Office, which included its financial statements, federal tax return, and other required schedules. We determined whether the Active Fund complied with the significant terms and conditions of Directive #12 by checking its filings of:

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- annual certified financial statements prepared in accordance with generally accepted accounting principles that were attested to by a Certified Public Accountant (CPA); and
- Internal Revenue Service Form 990.

We interviewed the Chairperson of the Board of Trustees and the President of Active Fund's third-party administrator—KingCare—and reviewed the Active Fund's Fund Agreement and Trust Agreement to gain an understanding of the contribution and benefit-processing procedures; and prepared flowcharts and memoranda outlining our understanding of these procedures and Active Fund internal controls.

**Comment: The Third Party Administrator is the Fund Manager, not President.**

To determine whether all revenues and expenses were properly recorded, we reconciled the Active Fund's certified financial statements with its trial balance, records of adjusting entries, cash receipts, disbursements journals, and other related documentation. Specifically, we traced revenue amounts for the audit period from the New York City payment vouchers and copies of canceled checks to the Active Fund's cash receipts journal and bank deposit slips. We also reviewed documentation related to the Active Fund's investments to determine the accuracy of the amounts reported in the financial statements.

We vouched all reported administrative expenses (\$265,522) from the Active Fund's cash disbursements journal to supporting documentation, which included expense allocation reports, and vendor invoices to determine whether reported administrative expenditures were properly recorded, reasonable, and appropriate.

We randomly sampled the records of 50 of the 804 City employees listed on the contribution reports received from the New York City Office of Labor Relations and compared the employment information contained in the reports to the Fund's membership records to ascertain whether all eligible employees were included on the Active Fund's membership records.

To determine the accuracy of the Active Fund's bank reconciliations and to account for all checks paid, outstanding, and voided, we reviewed Active Fund bank statements for the money market, expense, welfare, and dental accounts for Fiscal Year 2006.

In addition, we performed the following tests of the benefit payments to members to determine whether only eligible members and their dependents received benefits from the Active Fund:

**Dental Benefit**

All 320 and 238 participants listed, respectively, on the Dental Benefit check register during February and May 2006 were traced to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's Payroll Management System (PMS)<sup>2</sup>. We also determined whether the reimbursements were calculated correctly, supported with proper documentation, and did not exceed the amounts

<sup>2</sup> For our tests of dental benefit expenses, we judgmentally selected February and May 2006, based on the highest dollar amounts the Active Fund paid in dental claims during Fiscal Year 2006.



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specified in the Active Fund's fee schedule. For instances in which a member's spouse or child received benefits, we checked whether proof of dependency (i.e., marriage certificate or child's birth certificate) was on file.

### **Health and Wellness**

We intended to trace a sample of participants who received the Health and Wellness benefit during Fiscal Year 2006 to information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. However, the Active Fund did not maintain a utilization report or any supporting documentation for this benefit. It should be noted that the Active Fund's third-party administrator prepared a utilization report for us upon our request. However, the utilization report only contained approximate numbers with no supporting documentation. Therefore, we were unable to conduct any eligibility tests on this benefit.

**Comment:** The Fund Trustees disagree with the auditors' above characterization. See previous comments addressing the Health and Wellness benefit. Note, also, that the documentation supplied with the UPOA's Response to the Preliminary Draft Report helped clarify this matter.

### **Prescription Drugs**

All 135 and 178 participants listed, respectively, on the Prescription Drug benefit check register during January and March 2006 were traced to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS<sup>3</sup>. We also determined whether the reimbursements were calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule. For instances in which a member's spouse or child received benefits, we checked whether proof of dependency (i.e., marriage certificate or child's birth certificate) was on file.

### **Optical Benefits**

All 57 and 57 participants listed, respectively, on the Optical benefit check register during October 2005 and March 2006 were traced to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports and in the City's PMS<sup>4</sup>. We also determined whether the reimbursements were calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule. For instances in which a member's spouse or child received benefits, we checked whether proof of dependency (i.e., marriage certificate or child's birth certificate) was on file.

### **Weekly Disability Income**

We traced all 40 members listed on the disability check register during Fiscal Year 2006 to

<sup>3</sup> For our tests of prescription drug benefit expenses, we judgmentally selected January and March 2006, based on the highest dollar amounts the Active Fund paid in prescription drug claims during Fiscal year 2006.

<sup>4</sup> For our tests of optical benefit expenses, we judgmentally selected October 2005 and March 2006, based on the highest dollar amounts the Active Fund paid in optical claims during Fiscal Year 2006.

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the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. We also reviewed the corresponding claims for clerical accuracy and compliance with the 26-week limit imposed by the Active Fund.

### **Comprehensive Medical Exam**

We traced all 151 participants listed on the Comprehensive Medical Exam benefit check register during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution report, and in the City's PMS. We also determined whether the reimbursements were calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule. For instances in which a member's spouse received benefits, we checked whether proof of dependency (marriage certificate) was on file.

### **Life Insurance**

We traced all three death claims processed during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. We also ascertained whether death certificates and designated beneficiary forms were on file to support the payments.

### **Second Dental Opinion Program**

We intended to trace a sample of participants who received the Second Dental Opinion benefit during Fiscal Year 2006 to the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. However, the Active Fund did not maintain a utilization report or any supporting documentation for this benefit. It should be noted that we traced all the payments recorded on the Active Fund's trial balance to their supporting documentation and found that these payments were made to two law firms for legal services.

**Comment: The Fund Trustees disagree. See previous comments addressing the Second Dental Opinion Program and legal services benefit.**

### **Mammography**

We traced all 72 participants listed on the Mammography benefit check register during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. We also determined whether the reimbursements were calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule. For instances in which a member's spouse received benefits, we checked whether proof of dependency (marriage certificate) was on file.

### **Podiatry**

We traced all 19 participants listed on the Podiatry benefit check register during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. We also



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determined whether the reimbursements were calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule. For instances in which a member's spouse or child received benefits, we checked whether proof of dependency (i.e., marriage certificate or child's birth certificate) was on file.

**Hearing Aid**

We traced all three participants listed on the Hearing Aid benefit check register during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. We also determined whether the reimbursements were calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule. For instances in which a member's spouse or child received benefits, we checked whether proof of dependency (i.e., marriage certificate or child's birth certificate) was on file.

**In-Hospital Indemnity**

We traced all four members listed on the In-Hospital Indemnity benefit check register during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. We also determined whether the reimbursements were calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule.

**Anesthesia**

We traced one participant listed on the Anesthesia benefit check register during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. We also determined whether the reimbursement was calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule.

**Emergency Room**

We traced all five participants listed on the Emergency Room benefit check register during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. We also determined whether the reimbursements were calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule. For instances in which a member's spouse or child received benefits, we checked whether proof of dependency (i.e., marriage certificate or child's birth certificate) was on file.

**Prosthetic Appliance**

We traced one participant listed on the Prosthetic Appliance benefit check register during Fiscal Year 2006 to the cash disbursement journal, the general ledger, and the information on the Active Fund's membership records, the City contribution reports, and in the City's PMS. We also determined whether the reimbursement was calculated correctly, supported with proper documentation, and did not exceed the amounts specified in the Active Fund's fee schedule.



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The results of the above tests, which covered the sampled items totaling \$304,416 (about 27 percent of reported benefit expenses for Fiscal Year 2006), while not projectable to all benefit expenses for the audit period, provided a reasonable basis to assess the Active Fund's compliance with its benefit-processing guidelines.

**Scope Limitations**

As mentioned earlier, we intended to review the use of the Active Fund's Health and Wellness benefit, totaling \$181,626. We requested a list of all individuals who received Health and Wellness benefits during Fiscal Year 2006. However, the Active Fund did not maintain a utilization report or any supporting documentation for this benefit. It should be noted that the Active Fund's third-party administrator prepared a utilization report for us upon our request. However, the report contained only approximate numbers and had no supporting documentation. Therefore, we were unable to conduct any eligibility tests on this benefit. At the exit conference, KingCare's attorney provided us with a list of names of people that purportedly attended seminars and health fairs. However, the list did not include any supporting documentation to identify these individuals as members or dependents, or to document when, where, and what seminars or health fairs were attended. Moreover, the list included an additional 140 individuals than was previously reported.

**Comment:** Legal counsel referred to is the Fund's counsel and not that of KingCare LLC. The Fund Trustees disagree with the auditors' above characterization. See previous comments addressing the Health and Wellness benefit.

In addition, we intended to review the use of the Active Fund's Second Dental Opinion program totaling \$10,995. Again, the Active Fund did not maintain a utilization report or any supporting documentation for this benefit. Therefore, we were unable to conduct eligibility tests on this benefit. It should be noted, that we traced all the payments recorded on the Active Fund's trial balance to the supporting documentation and found that these payments were made to two law firms for alleged legal services. At the exit conference, KingCare's attorney, who was a partner in one of the law firms that received payments, provided us a Claims History for one dental service provider. The Claims History lists all of this provider's services performed between April 2001, and November 2007 and the dollar amount the Active Fund paid for these services. Clearly, this is not a utilization report for a second dental opinion benefit.

**Comment:** The Fund Trustees disagree with the auditors' above characterization. See previous comments addressing the Second Dental Opinion Program and legal services benefit.

Finally, we intended to review the Active Fund's \$495,450 worth of computer equipment and software reported on the Active Fund's financial statements as fixed assets. We requested all the supporting bills and invoices for the computer equipment and software and access to inspect and assess the computer system. However, the President of Active Fund's third-party administrator KingCare—and the Chairperson of the Board of Trustees denied these requests because the President of KingCare claimed that she owned the computer equipment and software. In fact, she told us that the Active Fund does not purchase and does not own computer equipment and software. She also claimed that the computer purchases were part of her administrative fee. In any case, we were unable to conduct testing to verify these purchases and to confirm the existence



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of the computer equipment and software.

Comment: The Fund Trustees agree that the method of classifying computer-related costs and software should have been as an administrative expense. This was an accounting policy error which will be corrected going forward. Specifically, the Fund Trustees acknowledge that management is responsible for the selection and use of appropriate accounting policies. Previous accounting policy was to capitalize certain payments for administration fees as the purchase of certain software and computer costs and depreciate those amounts. The effect of this policy understated administrative fees but not necessarily administrative expenses in total, since depreciation is classified as an administrative expense.

In consideration of the recognition of changes in estimated future benefits of the assets and consumption of such benefit, in complying with U.S. generally accepted accounting principles (GAAP), management has decided to change this accounting policy.

The effect of the change in accounting policy will result in the write down of the remaining book value of these assets as of July 1, 2007. As of July 1, 2007, the book value of these assets will be \$0, as would be the case whether they were expensed or capitalized.

This audit was conducted in accordance with generally accepted government auditing standards (GAGAS) and included tests of the records and other auditing procedures considered necessary. The audit was performed in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

### **Discussion of Audit Results**

The matters covered in this report were discussed with Active Fund officials during and at the conclusion of this audit. A preliminary draft report was sent to Active Fund officials on May 9, 2008, and was discussed at an exit conference held on June 10, 2008. On September 22, 2008, we submitted this draft report to Active Fund officials with a request for comments. Their comments will be included in the final version of this report.

## FINDINGS

Due to the numerous fiscal irregularities we found, it appears that the Trustees of the Active Fund may have breached their fiduciary responsibilities to the Active Fund and its members. For example, the Active Fund has spent a significantly larger percentage of its City contributions on administrative expenses—especially the high administrative fees paid to its third-party administrator, totaling \$436,790—when compared to other, similarly-sized funds, and has claimed to pay for capital equipment and other operating expenses of its third-party administrator, even though the Active Fund lists the equipment as fixed assets on its financial statements. Moreover, the Active Fund was not in compliance with the procedures and reporting requirements of Comptroller's Directive #12. Consequently, the Active Fund's financial statements and its Directive #12 filing were materially misstated. Specifically, the Active Fund:

Comment: See previous comments addressing administrative fee payments, computer costs and software expenses and alleged possible breach of fiduciary duties. The Fund Trustees vigorously deny any alleged possible breach of fiduciary duties and any material

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misstatements in the Fund's financial statements.

- *Materially misstated its City contributions, total assets, expenses, and Net Assets Available for Plan Benefits on its financial statements.* The Active Fund's financial statements included erroneous accounting entries in various accounts, which caused City contributions (revenue) to be overstated, total assets to be overstated, and expenses to be understated and applied incorrectly. At least one of these entries appears to represent a departure from generally accepted accounting principles (GAAP). Overall, these material misstatements allowed the Net Assets Available for Benefits (fund reserve) to be overstated by \$421,618-21.79 percent of the Active Fund's Net Assets Available for Plan Benefits (after our adjustments) on both the Statement of Net Assets Available for Plan Benefits (Balance Sheet) and Statement of Changes in Net Assets Available for Plan Benefits (Income Statement). See Appendix I.

Comment: The Fund Trustees disagree. See previous comments denying any material misstatements as to revenue, assets and expenses.

- *Misstated revenue, benefit and administrative expenses on its Directive #12 filing.* As a result of the improper accounting transactions, the Active Fund's Directive #12 filing contained material misstatements. This allowed revenue to be overstated by 9.13 percent, administrative expenses to be understated by 74.47 percent, and benefit expenses to be overstated by 16.47 percent. It appears that the Active Fund is manipulating the expense accounts to hide its administrative expenses in benefit expenses and in loan receivables. See Appendix I.

Comment: There are no loans involved as set forth in documents previously on file with the City of New York and audited by the Comptroller's Office. Moreover, any alleged material misstatements and manipulation of expense accounts are vehemently denied by the Fund Trustees. See previous comments addressing these alleged issues.

- *Spent a significantly larger percentage of its City contributions on administrative expenses when compared to other, similarly-sized funds.* The Active Fund spent 35.85 percent of its City contributions on administrative expenses. In comparison, eight similarly-sized funds spent an average of 13.48 percent of their City contributions on administrative expenses.

Comment: The Fund Trustees disagree. See previous comments addressing administrative expenses and similarly-situated small funds.

- *Paid for capital equipment and other operating expenses of its third-party administrator.* The Active Fund paid \$498,656 for computer software and hardware and other operating expenses for its third-party administrator, in addition to the administrative fees. Specifically, the Active Fund purchased \$495,450 in computer equipment and software from Fiscal Year 2000 to Fiscal Year 2006 that is reportedly owned by its third-party administrator, as well as \$3,206 for Fiscal Year 2006 operating expenses, which included messenger services, telephones, and storage.

Comment: The Fund Trustees disagree. See previous comments addressing computer costs and software expenses.



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- *Did not select a Certified Public Accountant who appears to be independent to audit its financial statements as required by Directive #12.* The CPA who attested to the financial statements is an employee of Cohen Phillips & Seiden, LLP, the firm that was paid to "check the accuracy" of the Active Fund's books and records and prepare the Active Fund's financial statements including the trial balance and all the adjusting entries. The CPA who certified the Active Fund's materially misstated financial statements, did not question the adjusting entries to the Active Fund's trial balance and relied on schedules (Depreciation Schedule and Employers Contribution Receivable Schedule) that were reportedly approved and signed by the CPA more than two months after the issuance of his Independent Auditor's Report. We were not able to determine when the schedules were prepared because they were not signed and dated by the preparer.

*Comment: The Fund Trustees believe that their current CPA is sufficiently independent to meet the requisites of Directive 12. However, they note that they are going to give serious consideration to selecting a new firm of certified public accountants.*

- *Paid \$10,527 for other questionable expenses.* These questionable expenses are in violation of Active Fund's Trust Agreement, unrelated to the operations of the Active Fund, or do not have adequate supporting documentation. These expenses included compensation paid to Trustees, flowers, meals, telephone bills for the Chairperson's home, long-distance phone bills for the Union and on Union courtesy cards.

*Comment: The Fund Trustees deny that they were reimbursed for any questionable expenses. Ample documentation reflecting same was provided to the auditors.*

- *Reportedly paid \$181,626 for Health and Wellness benefits that may not exist.* Only \$5,536 in invoices can be traced directly to the Health and Wellness benefit. The contract for this benefit contains vague and undefined services with no specific deliverables, time frames, schedules, or bench marks. In addition, the Active Fund does not maintain utilization reports for this benefit. In fact, this benefit *is* not even listed or defined in the Active Fund's benefit book. The remaining \$176,090 was paid to King Care as an administrative fee or "On Account."

*Comment: The Fund Trustees disagree. See previous comments addressing the Health and Wellness benefit.*

- *Paid \$10,995 for the Second Dental Opinion Program that does not exist.* We traced these payments to their supporting documentation and found that these payments were made to two law firms for alleged legal services. Moreover, this benefit is not listed in the Active Fund's benefit book, but has been included in its Directive #12 filing for the last four fiscal years-- 2003, 2004, 2005, and 2006.

*Comment: The Fund Trustees disagree. See previous comments addressing the Second Dental Opinion Program and legal services benefit.*

- *Paid \$34,519, for the Comprehensive Medical Examination Benefits, which is covered by all of the City's major medical plans with a co-payment of between \$0 and \$20.* Since this benefit is already covered by the City's major medical plans, we question the need for this benefit.

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Comment: The Fund Trustees will examine possible policy changes regarding this benefit going forward.

- *Has poor controls over payments to its third-party administrator.* The Active Fund did not segregate responsibilities for approving invoices and for signing checks for payments to its third-party administrator. The president of KingCare submitted invoices for payment to the Active Fund, then approved the payments and co-signed the checks made out to her company. Good internal controls dictate that these responsibilities be segregated to ensure that all payments to its third-party administrator are reasonable and justifiable.

Comment: Payments are made to the TPA in compliance with the contract between the Fund Trustees and the TPA. The Fund Trustees deny that internal accounting controls are inadequate and that there is any evidence of same from the audit.

- *Minutes of Board of Trustee meetings appear to be fictitious.* The minutes of the 12 Board of Trustees meetings held from July 2005 to June 2006 appear to be fictitious. While the meetings purportedly lasted for seven and half hours, all the minutes of each meeting were very similar, very few issues were discussed, and no details of the discussions were reported. In addition, the minutes were not signed by all the Trustees, and one set of minutes was signed only by the Chairperson of the Board of Trustees. Therefore, we question the veracity of the minutes of the Board of Trustees meetings. Since four Trustees are City employees, and these meetings are reportedly seven and a half hours long, we will refer the minutes and the names of the employees to the City's Department of Investigation for further investigation of possible theft of service and falsifying timesheets.

Comment: The Fund Trustees vigorously deny that meetings reflected in the Board Minutes did not occur. However, the Trustees concur that the Minutes could be more complete. The Trustees will take steps to ensure that this happens going forward. The Fund Trustees note that they have terminated the services of their legal counsel and they anticipate hiring new legal counsel in the near future.

- *Made improper benefit payments totaling \$6,180.* Of the \$304,416 in claims we reviewed, \$6,180 (2 %) in payments were made to individuals who are not listed on the City contribution reports and made without supporting documentation.

Comment: The Fund Trustees deny that improper benefit payments were made and that the auditors uncovered any evidence of same.

- *Paid claims for dependents whose eligibility was not documented.* Of the 1,284 benefit claims reviewed, 398 claims were for services provided to individuals who were listed as dependents of eligible members. However, the Active Fund did not have documentation in its files (i.e., birth certificates, marriage licenses) showing that the individuals were in fact eligible dependents for 294 (74%) of the 398 claims.

Comment: The Fund Trustees deny that undocumented dependent benefit payments were made and that the auditors uncovered any evidence of same.



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- *Is owed \$34,850 by the Retiree Fund.* The \$34,850 is the balance of a \$42,000 loan that the Active Fund made to the Retiree Fund.

*Comment: No loans between funds exist.*

These issues are discussed in detail in the following sections of this report.

**The Active Fund Materially Misstated  
Its Financial Statements**

The Active Fund's financial statements included: City contributions for a subsequent period (Fiscal Year 2007) credited as revenue in Fiscal Year 2006; a payment of the Fiscal Year 2006 fourth quarter administration fee to the third-party administrator disclosed as a prepaid expense instead of as an expense; and fixed assets of computer hardware and software that the Active Fund reportedly does not own and that therefore should not be included in its financial statements (See Appendix I). It should be noted that KingCare and the Chairperson of the Board of Trustees denied our request to review the supporting bills and invoices for the purchases of computers or software. They also denied us access to inspect and assess the computer equipment and software. Consequently, we could not verify the existence of these fixed assets.

*Comment: The Fund Trustees disagree. See previous comments addressing computer costs and software expenses and those below as to the other items mentioned immediately above.*

Specifically, in Fiscal Year 2006:

- City contributions (revenue) were overstated by \$130,093-9.15 percent of the Active Fund's contributions (after our adjustment) which represented a departure from generally accepted accounting principles (GAAP);

*Comment: The Fund CPA included this number as a receivable for this period because, at the time he prepared the Fund's certified audit statements, it was anticipated that the revenue received would be properly allocated. Only in retrospect did the Fund CPA become aware that the City revenue in question was not to be attributable as a receivable until August 2006. Thus, he did not apply this amount again as a receivable in the next fiscal period.*

- Prepaid expenses were overstated by \$70,500-96.77 percent of the Active Fund's total prepaid expenses (total expenses were understated, as discussed below);

*Comment: New contracts were in place indicating that no expense overstatements occurred.*

- Fixed Assets were overstated by \$221,025; and

*Comment: The Fund Trustees disagree. See previous comments addressing computer costs and software expenses.*

- Total Assets and Net Assets Available for Plan Benefits were overstated by \$421,61821.79 percent of the Active Fund's Net Assets Available for Plan Benefits (after our adjustments) on both

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the Statement of Net Assets Available for Plan Benefits (Balance Sheet) and Statement of Changes in Net Assets Available for Plan Benefits (Income Statement).

**Comment:** The accounting policy with respect to computer costs and software expenses will be changed and replaced with a new and more appropriate policy going forward.

### City Contributions

Regarding the overstatement of revenue from City contributions, the Active Fund included *as* Fiscal Year 2006 revenue a receivable of \$130,093—a one-time payment of \$167 on behalf of each Active Fund member (779) who was receiving benefits on August 13, 2006—based on an Agreement that was signed on December 11, 2006 (Fiscal Year 2007). Since this receivable was for contributions in Fiscal Year 2007, it should not have been included as revenue from City contributions on the Fiscal Year 2006 financial statements and represents a departure from generally accepted accounting principles (GAAP). As a result, total revenue reported in Fiscal Year 2006 was overstated by \$130,093-9.13 percent of the Active Fund's total revenue (after our adjustment). Moreover, the Active Fund should have reported an operating deficit of \$117,684 in Fiscal Year 2006 instead of its reported operating surplus of \$23,059—a difference of 610.36 percent. Even more disturbing is that the Schedule of Employee Contribution Receivable was reportedly approved and signed by the CPA more than two months after the CPA certified the Active Fund's financial statements. We were unable to determine when the schedule was prepared because it was not signed and dated by the preparer.

**Comment:** The Fund Trustees disagree. See previous comments addressing City contributions.

### Prepaid Expenses

With respect to the incorrect accounting and reporting of prepaid expenses, the Active Fund reported the fourth quarter administrative fee (covering the period April 1, 2006, to June 30, 2006) totaling \$70,500, as a prepaid expense. Specifically, a member of Cohen, Phillips, and Seiden, UP, made an adjusting entry to the Active Fund's trial balance transferring this payment from the administrative fees expense account to the prepaid expense account. However, according to the invoice, this payment was for the administrative fees for the fourth quarter of Fiscal Year 2006. As a result, prepaid expenses were overstated by \$70,500.

**Comment:** The Fund Trustees disagree. See Fund CPA worksheets addressing this item. Such worksheets were provided to the auditors by the Fund CPA during the audit.

### Fixed Assets

The Active Fund included *as* fixed assets computer equipment and software that it reportedly does not own on its Fiscal Year 2006 financial statements. According to the Active Fund's Statement of Net Assets, it has \$221,025 (\$495,450 less \$274,425 in accumulated depreciation) in total fixed assets. The Active Fund's financial statements list the computer equipment and software as the only fixed assets that the Active Fund has. However, the President of the Active Fund's third-party administrator—KingCare—and the Chairman of the Board of Trustees stated that the Active Fund did not purchase and does not



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own computer equipment or software. Further, the President of KingCare claims that the computer purchases are part of her administrative fee.

According to New York State Society of Certified Public Accountants, an asset is defined as: "Anything of value to which the firm has a legal claim. Any owned tangible or intangible object having economic value useful to the owner."

Obviously, if the Active Fund has no legal claim to and is not the owner of the computer equipment and software, it should not be including the equipment and software on its financial statements as a fixed asset.

Even more disturbing, the depreciation schedule was also reportedly approved by the CPA more than two months after the CPA certified the Active Fund's financial statements and issued its report. Again, we were unable to determine when the schedule was prepared because it was not signed and dated. The notes of the report do not identify any specific computer equipment or software programs owned by the Active Fund. The report reflects only that purchases were for computers or software, the years of the purchases, and their cost. KingCare and the Chairperson denied our request to review the supporting bills and invoices for the purchases of computers or software. They also denied us access to inspect and assess the computer equipment and software. Consequently, we could not verify the existence of this equipment.

**Comment: The Fund Trustees disagree. See previous comments addressing computer costs and software expenses.**

### **The Active Fund Misstated Benefit and Administrative Expenses, And City Contributions on Its Directive #12 Filing**

The Active Fund did not accurately report its benefit and administrative expenses, and City contributions on its Directive #12 filing. As a result, revenue was overstated by 9.13 percent (as discussed in the previous section), administrative expenses were understated by 74.47 percent, and benefit expenses were overstated by 16.47 percent (See Appendix 1).

As a result of these misstatements, key financial ratios that are indicators used to assess aspects of the Active Fund's operations and financial condition were incorrect. For example, based on the information submitted on its Directive #12 filing and on the Active Fund's financial statements, the percentage of revenue spent on administration was 18.64 percent. However, it would have been 35.85 percent had the Active Fund appropriately classified its expenses. It is important that the Active Fund accurately report its expenses so that the City can properly assess the fund's financial activities and monitor its degree of solvency. Of even greater concern, however, is that the Active Fund appears to be intentionally concealing as benefit expenses the dollar amount it spends on administrative expenses, particularly the total amount paid to its third-party administrator.

**Comment: The Fund Trustees vigorously deny allegations of concealment of expense amounts. See previous comments addressing alleged revenue overstatements and administrative expense understatements and those addressing computer costs and software expenses.**



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### **Administrative Expenses**

Administrative expenses were understated by \$197,735-74.47 percent of the Active Fund's total administrative costs (after our adjustment). According to the Schedule of Administrative Expenses, KingCare was reportedly paid \$123,200 in administrative fees. However, according to the Active Fund's records, KingCare billed and was paid \$282,000 in administrative fees, \$83,750 "On Account," and two payments, totaling \$71,040, without any supporting documentation, for a total of \$436,790. Administrative expenses also included \$84,850 in depreciation expense for computer equipment and software that it reportedly does not own; our adjusted number does not include this amount.

**Comment:** The Fund Trustees disagree. See previous comments addressing the Health and Wellness benefit, computer costs and software expenses and allegations of "loan payments."

It should be noted that one of the partners of the firm Cohen, Phillips, and Seiden, LLP, made three adjusting entries on the Active Fund's Trial Balance that total \$200,800, transferring \$158,800 from the administrative fees account to the Health and Wellness account (as a benefit expense), and to record a \$42,000 loan to the Retiree Fund. These transfers appear to be an attempt to conceal certain payments made to the Active Fund's third-party administrator for administrative expenses as benefit expenses and a loan receivable. The \$42,000 loan to the Retiree Fund was not included in our adjustment to administrative expenses. Additionally, the Active Fund paid \$10,995 for the Second Dental Opinion program, reportedly a benefit expense. When we traced these payments from this benefit expense to their supporting documentation, we found that payments were made to two firms for alleged legal services. Therefore, the \$10,995 should be recorded as administrative expenses rather than benefit expenses.

**Comment:** The Fund Trustees vigorously deny any alleged concealment of expenses. See previous comments addressing the Health and Wellness benefit, the Second Dental Opinion Program, legal services benefit and "loan payments."

We also found that the practice of concealing administrative fees as benefit expenses has been going on for several years. The Active Fund's contract with its third-party administrator covering Fiscal Years 2004, 2005, and 2006, states that "the Trustees of the Fund agree to pay KingCare, Inc. the sum of (\$23,500.00) twenty- three thousand, five hundred dollars per month, said fees to be payable quarterly [\$70,500] during the period the services are being rendered [\$282,000 annually]." However, according to the Active Fund's Fiscal Year 2004, 2005, and 2006 Directive #12 filings, the Active Fund never reported more than \$162,000 in administrative fees to KingCare over the same period; it reported only \$161,250, \$162,000, and \$123,200 in Fiscal Years 2004, 2005, and 2006, respectively.

**Comment:** The Fund Trustees deny any alleged concealment of fees and expenses. See documents previously submitted with the response to the Preliminary Draft Report.

### **Benefit Expenses**

Benefit expenses were overstated by \$187,085-16.47 percent of the Active Fund's total benefits costs (after our adjustment). According to the Active Fund's Schedule of Benefits Paid for Participants, the Active Fund reportedly spent \$181,626 for its Health and Wellness benefit, a

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benefit not even listed in the Active Fund's benefit book. This is the second highest benefit in terms of dollars after *its* Dental benefit. However, according to the Active Fund's records, only \$5,536 was paid for this benefit as follows:

- \$2,243 to Oakstone Wellness for 1,500 "Top Health" newsletters and 1 newsletter logo on November 23, 2005;
- \$1,492 to KingCare from Outreach/Wellness Program, including materials for the Health Fair;
- \$1,400 to Registered Nurses;
- \$401 to 1-800 We Answer for 28 weeks of basic service.

The remaining \$176,090 was paid to King Care as an administrative fee or "On Account"

**Comment: The Fund Trustees disagree. See previous comments addressing the Health and Wellness benefit.**

As stated above, the Active Fund also paid \$10,995 for the Second Dental Opinion program, reportedly a benefit expense. When we traced these payments from this benefit expense to their supporting documentation, we found that payments were made to two law firms for alleged legal services. Therefore, the \$10,995 should be recorded *as* administrative expenses rather than benefit expenses. This benefit is also not listed in the Active Fund's benefit book, but has been included in its Directive #12 filing for the last four fiscal years-2003, 2004, 2005, and 2006.

**Comment: The Fund Trustees disagree. See previous comments addressing the Second Dental Opinion Program and legal services benefit.**

### **The Active Fund Did Not Select a Certified Public Accountant Who Appears To Be Independent To Audit Its Financial Statements, as Required by Directive #12**

The Active Fund did not select a Certified Public Accountant, who appears to be independent to audit its financial statements as required by Directive #12. According to Directive #12, "Each year's financial statements must be audited annually by *independent* Certified Public Accountants (CPA)." (Emphasis added.) However, the Active Fund hired a CPA to audit and certify its financial statements who was an employee of Cohen Phillips & Seiden, LLP—the firm that prepared the Active Fund's financial statements, including the trial balance and all the adjusting entries.

According to the CPA's contract dated July 1 2003, he agreed to audit the Active Fund's financial statements for years ending June 30, 2004, June 30, 2005, and June 30, 2006. The contract further states: "Assistance to be supplied by our internal accounts, Cohen Phillips & Seiden LLP, including the preparation of schedules and analyses of accounts. The fees will be ... \$15,000 for 6-30-06." Cohen Phillips & Seiden, LLP, not the CPA, submitted an invoice dated July 1, 2005, for \$15,000 for accounting services for Fiscal Year 2006. The Active Fund then issued a check to Cohen Phillips & Seiden, LLP, for \$15,000 for these services.



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Accordingly, the CPA does not appear to be independent from Cohen Phillips & Seiden, LLP; and we note that the CPA certified the Active Fund's financial statements that contained material misstatements without questioning the adjusting entries to the Active Fund's trial balance and relied on schedules (Depreciation Schedule and Employers Contribution Receivable Schedule) that were reportedly approved and signed by the CPA more than two months after the issuance of his Independent Auditor's (CPA's) Report. As previously stated, we were unable to determine when these schedules were prepared because they were not signed and dated by the preparer.

Comment: The Fund Trustees disagree. See previous comments addressing the independent auditor issue.

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**High Percentage of City Contributions  
Spent on Administrative Expenses**

The Active Fund spent a significantly larger percentage of its City contributions on administrative expenses when compared to those of other, similarly-sized funds, as shown in Table III below.<sup>5</sup>

**Table III**  
Comparison of Administrative Expenses  
Between the Fund and Other, Similarly-Sized Funds for Fiscal Year 2006

| Benefit Fund   | NYC Contributions | Total Admin. Exp. | Admin Exp/ NYC Rev. |
|--|-------------------|-------------------|---------------------|
| United Probation Officers Association Welfare Fund     | \$1,292,121       | \$463,257         | 35.85%              |
| Civil Service Bar Assoc WF                             | 1,505,075         | \$180,231         | 11.97%              |
| Correction Captains Association WF/CLRF                | 1,287,956         | \$114,622         | 8.90%               |
| Local 246 SEIU RWF                                     | 1,388,682         | \$117,360         | 8.45%               |
| Local 300 Civil Service Forum WF                       | 1,597,260         | \$171,548         | 10.74%              |
| Doctors Council WF                                     | 1,121,171         | \$298,507         | 26.62%              |
| Local 3 MEW Electricians RWF                           | 814,304           | \$99,603          | 12.23%              |
| Local 300 Civil Service Forum RWF                      | 844,242           | \$112,973         | 13.38%              |
| NYC Municipal Plumbers & Pipefitters WF                | 926,056           | \$143,832         | 15.53%              |
| Total Excluding United Probation Officers Assoc        | 9,484,746         | \$1,238,676       |                     |
| Average (Excluding United Probation Officers Assoc WF) | \$1,185,593       | \$154,835         | 13.06%              |

We based the total of \$463,257 in administrative expenses identified on Table III on the appropriate classification of expenses rather than on the \$265,522 reported in the Active Fund's certified financial statements.

**Comment:** An incorrect allocation as shown previously. A proper allocation would result in a ratio of 20.5%.

As indicated above, the eight similarly-sized funds spent between 8.45 percent and 26.62 percent of their City contributions on administrative expenses. The United Probation Officers Association Welfare Fund had the highest percentage (35.85%) of City contributions spent on administrative expenses. Given the fact that the Active Fund's mission is to provide benefits for its members, the Fund should attempt to bring its administrative expenses more in line with those of funds of a similar size.

**Comment:** The other funds are not similarly-situated and the comparison does not take into

<sup>5</sup> The size of each fund was based on the amount of City contributions. As of December 31, 2006, eight other funds submitted financial statements to the New York City Comptroller's office (in accordance with Comptroller's Directive #12) showing that they each received City revenue of between \$814,304 and \$1,597,260 in Fiscal Year 2006.

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account the administrative requirements of this Fund as compared with the other funds. See previous comments addressing the Health and Wellness benefit and the legal services benefit. When properly calculated the ratio is 20.5%.

### **The Active Fund Paid for Capital Equipment and Other Operating Expenses of Its Third-Party Administrator**

The Active Fund paid \$498,656 for computer software and hardware and other operating expenses for its third-party administrator, in addition to administrative fees. KingCare and the Chairperson denied our request to review the supporting bills and invoices for the purchases of computers or software. They also denied us access to inspect and assess the computer equipment and software. Consequently, we could not verify the existence of these fixed assets. Specifically, the Active Fund paid:

- \$495,450 from Fiscal Year 2000 to Fiscal Year 2006 for computer hardware and software that is reportedly owned by its third-party administrator, KingCare;
- \$1,981 for messenger service between KingCare offices at 375 West Broadway, Manhattan, and 62 West Clinton Avenue, Westchester County, and
- \$1,225 for KingCare's telephone expenses.

Since the Active Fund's Trustees are paying its third-party administrator to manage the Active Fund, they should not be also paying for KingCare's capital equipment and operating expenses.

Comment: The Fund Trustees disagree. See previous comments addressing computer costs and software expenses.

### **The Active Fund Paid \$10,527 in Other Questionable Expenses**

The Active Fund paid \$10,527 for other questionable expenses. These expenses are in violation of the Trust Agreement, unrelated to the operations of the Active Fund, or lacking adequate supporting documentation. Specifically the Active Fund paid:

- \$4,575 to its Trustees—\$75 per month—in violation of the Active Fund's Trust Agreement. The Trust Agreement states that the Trustees are to serve without compensation.

Comment: This was not compensation paid to the Trustees but rather expense reimbursements.

- \$3,570 for 3,750 Union courtesy cards. We note that the Active Fund has approximately 800 members.
- \$1,673 for flowers for various individuals including Trustees and the Deputy Commissioner of the Department of Probation.



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- \$495 for Trustee meeting meals based on questionable supporting documentation. The dates on the four receipts do not correspond to the dates listed on the minutes of the Board of Trustees meetings. In addition, three of the four invoice numbers are in sequential order even though the dates of the invoices are three months apart.
- \$179 for three telephone bills to the Chairperson's residence in Long Island.
- \$35 in long distance calls that belong to the Union's telephone.

Comment: The Fund Trustees deny allegations of questionable expense payments to them. See documentation previously provided with the Response to the Preliminary Draft Report.

**The Active Fund Reportedly Paid \$181,626 for Health and Wellness Benefits That May Not Exist**

The Active Fund reportedly paid \$181,626 for Health and Wellness benefits that may not exist. Only \$5,536 in invoices can be traced directly to the Health and Wellness benefit. In fact this benefit is not listed or defined in the Active Fund's benefit book. Moreover, the contract for this benefit contains vague and undefined services with no specific deliverables, time frames, schedules, or bench marks. In addition, the Active Fund does not maintain utilization reports for this benefit. A utilization report was prepared for the audit after our request. However, the report contained only approximate statistics and figures and had no supporting documentation. As a result, we question the legitimacy of the administration of this benefit.

According to the Active Fund's Schedule of Benefits Paid for Participants, the Active Fund spent \$181,626 for its Health and Wellness benefit. However, we found just \$5,536 in invoices that can be traced back to this benefit as follows:

- \$2,243 to Oakstone Wellness for 1,500 "Top Health" newsletters and 1 newsletter logo on November 23, 2005;
- \$1,492 to KingCare from Outreach/Wellness Program, including materials for the Health Fair;
- \$1,400 to Registered Nurses; and
- \$401 to 1-800 We Answer for 28 weeks of basic service.

In addition, the Active Fund's Health and Wellness contract with its third-party administrator, KingCare, does not have any specific deliverables, time frames, schedules, or bench marks for these benefits. For this benefit, the contract includes the following undefined and vague list of services: Preventive illness; Stress; Smoking Cessation; Advice on Health Care Proxies and Living Wills; Nutrition and Weight Management; and, Physical Activity.

The Active Fund does not maintain a utilization report on this benefit. The Active Fund's third-party administrator did prepare a utilization report for us after our request. However, the report contained only approximate numbers and had no supporting documentation for the following

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categories.

- Distribution of Wellness Information;
- Distribution of Health Care Proxy and Living Will;
- Seminar Attendance;
- Responses to Surveys; and
- Questions with regards to materials and other inquiries.

Even more disturbing is that in the minutes of Board of Trustees meetings held from November 2005 through June 2006 reflect that, "They [Board of Trustees] reviewed the new outreach program and were pleased with the progress so far." We question how the Trustees could have "reviewed" and been "pleased" with a program that has neither specific deliverables nor utilization reports to attest to membership activity in the program or the program's success.

As stated in a previous section, an individual of the firm Cohen Phillips & Seiden, L.L.P., made two adjusting entries on the Active Fund's Trial Balance transferring \$158,800 from the administrative fees account to the Health and Wellness account. This transfer appears to be an attempt to conceal payments made to the Active Fund's third-party administrator—KingCare—for administrative expenses in this questionable benefit. In any case, we seriously question the veracity of this benefit.

*Comment: The Fund Trustees disagree. See previous comments addressing the Health and Wellness benefit.*

### **The Active Fund Paid \$10,995 for a Second Dental Opinion Program That Does Not Exist**

The Active Fund paid \$10,995 for the Second Dental Opinion Program that does not exist. We traced these payments to their supporting documentation and found that these payments were made to two law firms for legal services. This benefit is not listed in the Active Fund's benefit book, but has been included in its Directive #12 filing for the last four fiscal years-2003, 2004, 2005, and 2006. Expenses for legal services should have been classified as an administrative expense instead of a benefit expense.

*Comment: The Fund Trustees disagree. See previous comments addressing the Second Dental Opinion Program and legal services benefit.*

### **The Active Fund Paid \$34,519 for a Comprehensive Medical Examination Benefit That Is Already Covered by All the City's Major Medical Plans**

The Active Fund paid \$34,519 on the Comprehensive Medical Examination Benefit, which is already covered by all of the City's major medical plans with a co-payment of between \$0 and \$20. However, the Active Fund paid \$34,040 for medical exams for 148 members or their spouses (\$230 per exam) by the Active Fund's participating benefit provider. In addition, the Active Fund reimbursed \$479, an average of \$160, to three members who selected a non-participating provider. Since this benefit is already covered by the City's major medical plans, we question the need for this benefit.



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Comment: The Fund Trustees disagree. See previous comments addressing this item.

**The Active Fund Has Poor Controls over Payments to Its Third-Party Administrator**

The Active Fund did not segregate the responsibilities for approving invoices and for signing checks for payments to its third-party administrator. The president of KingCare submitted invoices for payment to the Active Fund, approved payments, and co-signed Active Fund checks made out to her company. Good internal controls dictate that these responsibilities be segregated to ensure that all payments to the third-party administrator are reasonable and justifiable.

Comment: The Fund Trustees disagree. See previous comments addressing this item.

**The Active Fund Minutes of Board of Trustee Meetings Appear To Be Fictitious**

The minutes of the 12 Board of Trustees meetings held from July 2005 to June 2006 appear to be fictitious and manufactured for this audit. Minutes are the record of all business transacted at Board of Trustees meetings including, but not limited to, decisions on administration, benefits provided, eligibility requirements, and the hiring of consultants. Even though the meetings reportedly lasted seven and half hours, all the minutes of each meeting were very similar, very few issues were discussed, and no details of the discussion were reflected in the minutes. In addition, the minutes were not signed by all the Trustees, and one of the sets of minutes was signed only by the Chairperson of the Board of Trustees. Therefore, we question the veracity of the minutes of the Board of Trustees meetings we were given to review.

For example, the minutes include only two or three paragraphs of new business and usually include the following citations:

"The Board of Trustees reviewed operating procedures of the Fund. They discussed the services being provided by the Fund Manager's Office and were pleased to find there were no complaints and that the Fund is running well.

"They reviewed the new outreach program and were pleased with the progress so far."

Further, these meetings are reportedly seven and half hours long, beginning at 9:00 a.m. and ending at 5:30 p.m. Since according to the Union President/Chairperson of the Board of Trustees he is the only person that is allowed release time from his City job, we are concerned that the four Trustees who are active City employees are attending Trustee meetings on City time. We have reviewed the City's PMS system and found that in many cases the four Trustees took no leave time to attend these meetings. Therefore, these Trustees may be submitting fraudulent timesheets resulting in theft of service. This issue will be submitted to the City's Department of Investigation for further investigation.

In addition, while all seven trustees are listed on the minutes, only four to five Trustees sign the minutes; one Trustee never signed the minutes. Also, the minutes for the Board of Trustees meeting on March 21, 2006, were signed by only the Chairperson.



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We requested to attend one of these Board of Trustees meetings to observe how the Trustees are reviewing the Active Fund's operating procedures and the performance of its third-party administrator. However, the Chairperson and the Board of Trustees denied us access to any of the Board of Trustees meetings. Therefore, we question the veracity of the minutes of the Board of Trustees meetings. Without accurate minutes of Board of Trustee meetings, there is no record or accountability for the decisions made by the Board of Trustees when directing Active Fund policy.

*Comment: The Fund Trustees disagree. See previous comments addressing this issue.*

**Improper Benefit Payments**

The Active Fund made improper benefit payments totaling \$6,180. Of the \$304,416 in claims we reviewed, \$6,180 (2%) in payments were made to ineligible individuals and made without supporting documentation. Specifically, the Active Fund:

- Paid \$2,700 for two ineligible individuals for disability benefit.

Paid \$2,224 for 19 claims on behalf of ineligible individuals. The benefits were paid for individuals who were not listed on the City contribution reports. In some cases, these individuals were not even listed on the City database of present or former City employees.

- Paid \$715 for 8 claims for which no medical receipts was on file.
- Paid \$541 in Prescription Drugs benefits for 12 claims with inadequate documentation.

*Comment: The Fund Trustees disagree. See previous comments addressing this item.*

**Claims Paid for Dependents Whose Eligibility Was Not Documented**

Of the 1,284 benefit claims we reviewed, 398 claims, totaling \$56,146, were for services provided to individuals who were listed as dependents of eligible members. However, the Active Fund did not have documentation (i.e., birth certificates, marriage licenses) in its files for 294 (74%) of the 398 claims showing that the individuals were in fact eligible dependents.

*Comment: The Fund Trustees disagree. See previous comments addressing this item.*

**The Retiree Fund Owes the Active Fund \$34,850**

The Retiree Fund owes the Active Fund \$34,850. The \$34,850 is the balance of a \$42,000 loan that the Active Fund made to the Retiree Fund.

*Comment: The Fund Trustees disagree. See previous comments addressing this item.*

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### RECOMMENDATIONS

Generally, we would recommend a series of actions to the Active Fund designed to address the problems identified. However, the financial, managerial and operational problems are so prevalent and pervasive that they cannot be readily addressed by fine-tuning Active Fund financial and operating practices. Therefore, it is clear that the entire financial and operating systems of the Active Fund have to be overhauled. Consequently, we recommend that the Board of Trustees:

1. Evaluate how the Active Fund resources could be used to reach its ultimate goal—providing maximum benefits to its member-while keeping administrative costs to a minimum.
2. Consider replacing the Fund Manager based on the extensive problems cited in this report and for denying us access to important records and assets.
3. Develop policies and procedures that would ensure that the Active Fund is achieving its ultimate goal and that it is in compliance with Comptroller's Directive #12. These policies and procedures should include a system of internal controls addressing the issues cited in this report.
4. Closely monitor Active Fund operations to ensure that the issues cited in this report have been eliminated, and address any new issues that arise in the future.

The Fund Trustees note that they have acted and will continue to act in accordance with their responsibilities and duties as trustees, following Directive 12 guidelines and all applicable laws and regulations. The Fund Trustees further note that the concerns raised about the Fund Manager have, in their judgment, been based upon misunderstandings by the auditors despite the detailed documentation and responses provided to them. In considering a number of the accounting policy items relating to computer costs and software, the Fund Trustees will see that a change in accounting policy will be effectuated to address this issue going forward. In any event, as of July 1, 2007, the book value of these computer and software assets will be \$0, as would be the case whether they were expensed or capitalized.

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**Appendix I**

**Summary of the Active Fund's Reported Revenues and Expenses and  
Auditors' Restated Revenues and Expenses for Fiscal Year 2006**

|  | <b>2006</b> | <b>% of<br/>Total<br/>Revenue</b> | <b>Auditors<br/>Restatement</b> | <b>% of<br/>Total<br/>Revenue</b> | <b>Overstatement /<br/>(Understatement)</b> |
|--|-------------|-----------------------------------|---------------------------------|-----------------------------------|---|
| City Contributions                     | \$1,422,214 | 99.85%                            | \$1,292,121                     | 99.84%                            | 9.15%                                       |
| Investment or Other<br>Income          | \$2,110     | 0.15%                             | \$2,110                         | 0.16%                             | 0.00%                                       |
| COBRA                                  | 0           | 0%                                | 0                               | 0%                                | 0.00%                                       |
| Total Revenue                          | \$1,424,324 | 100.00%                           | \$1,294,231                     | 100.00%                           | 9.13%                                       |
| Benefit Expenses                       | \$1,135,743 | 79.74%                            | \$948,658                       | 73.30%                            | 16.47%                                      |
| Administrative<br>Expenses             | 265,522     | 18.64%                            | \$463,257                       | 35.79%                            | (74.47%)                                    |
| Total Expenses                         | 1,401,265   | 93.38%                            | \$1,411,915                     |                                   | (0.76%)                                     |
| Excess (Deficiency)<br>of Revenue      | \$23,059    |                                   | (\$117,684)                     |                                   | 610.36%                                     |
|  |             |                                   |                                 |                                   |   |
| Fund Balance<br>(Beginning of<br>Year) | \$1,911,459 |                                   | \$1,630,584                     |                                   | 14.69%                                      |
| Fund Balance<br>(End of Year)          | \$1,934,518 |                                   | \$1,512,900                     |                                   | 21.79%                                      |