



Office of Mental Health

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GUIDANCE MEMORANDUM

TO: Office of Mental Health Licensed and/or Funded Providers (collectively, "**Providers**") and Chairpersons of Providers' Boards of Directors ("**Boards**")

FROM: Robert Myers, PhD., Senior Deputy Commissioner, Director of Adult Services, State Psychiatric Centers and Managed Care 

DATE: March 5, 2015

RE: Prohibited Related-Party Transactions, Self-Dealing, and Waste of State Funds

This Memorandum addresses two important financial management issues for all Providers of mental health services, their employees, including directors and officers, ("Employees") and Board members: (1) the need to follow certain requirements for "related-party transactions" in order to avoid improper self-dealing; and (2) the prohibition on the misuse of State funds, particularly for improper executive compensation.

Related-Party Transactions

Related-party transactions are financial arrangements between Board members and Providers and/or their Employees where there is a special connection between the parties (e.g., a blood relative or business relationship). For example, when a Provider enters into a contract with a Board member for legal services with that Board member's law firm that is a related party-transaction.

Acceptable Related-Party Transactions

Related-party transactions, while generally discouraged by OMH, may be allowed when it is in the best interest of the Provider.

Contracts with Related Parties

A Board member or Employee may direct Provider business to an individual or company with which that Board member or Employee has a personal connection if the Provider's best interests are taken into consideration. For example, a Board may authorize a Provider to lease property from a company owned by a relative of the Board member because the property addresses the programmatic goals of the Provider better than all available and comparable properties and the lease terms are at fair market. Even though this type of contract is not always prohibited, licensed Providers must still obtain approval of a majority of non-interested Board members and disclose such arrangements to the OMH Commissioner and to the director of community services of each local governmental unit that has, at the time of such disclosure, a State aid contract with the Provider for services (see MHL Section 31.31(c)). OMH-funded Providers, whether licensed or not, are also subject to OMH contract provisions that affect their ability to enter into such transactions. Providers are urged to review their OMH contracts in order to make sure that the requirements are being followed before entering into any related-party transactions.

Loans to Employees

Loans to Employees of Providers are discouraged, and in the case of Employees making more than \$30,000, are prohibited except under severely limited circumstances. Specifically, a Board may authorize a Provider to make a loan to an Employee who receives an annual salary of greater than \$30,000 only if it is an emergency loan intended to help the health and welfare of the Employee. No other type of loan for such an Employee is allowed. The Commissioner of OMH and any director of community services of a local governmental unit that contracts with the Provider must be notified in writing of the Board's authorization (MHL Section 31.31(b)).

Providers are reminded that related-party transactions must be reported on the Consolidated Fiscal Report ("CFR") submitted annually to OMH.

Unacceptable related-party transactions and potential consequences

Self-dealing is a type of improper related-party transaction. Generally, self-dealing occurs where an Employee or Board member takes advantage of his or her position and fails to act in the best interests of the Provider, often in a way related to finances. Here is an illustration:

Board member X of a large Provider is the president of a well-known and successful construction firm. The Provider needs major work done on its licensed community residence, with an actual estimated cost of \$150,000. The funding for the work is being provided pursuant to a contract with OMH. The Provider enters into a contract for the renovation with Board member X's construction firm at a price of \$200,000, well in excess of the fair market price of the renovation. The Board member also fails to report the transaction on the CFR. Both the lack of reporting and the excessive price paid under the contract make this transaction improper.

OMH reminds Providers that it has the authority to examine their financial transactions through auditing. The serious potential consequences for Providers, Board members and Employees who engage in improper self-dealing include:

1. criminal prosecution of Board members or Employees and/or personal civil liability;
2. revocation or limitation of an OMH operating certificate or cancellation of an OMH contract;
3. a determination that expenditures claimed for reimbursement under OMH contracts are ineligible for reimbursement (OMH Spending Plan Guidelines and MHL Section 41.18(f)); and/or
4. actions brought by other State agencies, including the Office of the Medicaid Inspector General or the Office of the Attorney General.

The New York Non-Profit Revitalization Act of 2013 (the "Act")

The Act, which overhauled the Not for Profit Corporations law ("NPC") and amended other State laws, contains several provisions regarding related-party transactions that are effective as of July 1, 2014.

Boards are required to perform an independent review of proposed transactions between Providers and related parties and make an affirmative determination that the transaction is fair, reasonable and, as already discussed, in the Provider's best interest. Specifically, a Board must consider alternative transactions before pursuing the related-party transaction, approve the related-party transaction by at least a majority vote of non-interested Board members and document in writing its reasons for approving the transaction. Any Employee who has an interest in a related-party transaction must disclose the material facts of the transaction to the Board. A Provider's certificate of incorporation, by-laws or an adopted policy may impose additional restrictions and procedures regarding related-party transactions. (See Section 74 of the Act, amending NPC Section 715.)

In addition, the Act gives the Office of the Attorney General specific powers in regard to related-party transactions. The Attorney General may bring an action to enjoin, void or rescind any related-party transaction or proposed related-party transaction that violates any provision of the Act or that was unreasonable or not in the best interests of the Provider. The Attorney General can also seek restitution and the removal of Employees. Employees may be required to pay profits from related party transactions to the Provider, pay for the value of use of any Provider assets used in the transaction, and/or return or replace assets. In the case of willful and intentional conduct, Employees may be required to pay an amount up to double of any benefit obtained. (See Section 74 of the Act, amending NPC Section 715.)

Please note that the Act's provisions are in addition to the requirements set forth elsewhere in this memorandum. Providers still must comply with applicable provisions of the MHL and contractual obligations.

Waste of State Funds

Providers should have fiscal practices, including proper bidding procedures, in place that safeguard against unnecessary expenses. OMH recommends that Board members and Employees receive appropriate training about their responsibilities and develop policies to guard against carelessness and wastefulness. The New York State Office of the Attorney General, Charities Bureau has prepared useful publications regarding the responsibilities of Boards and general financial practices of not-for-profit corporations. (<http://www.charitiesnys.com/home.jsp>.)

One form of waste is excessive or inappropriate compensation for executive Employees. Compensation to executive Employees must be reasonable and must comply with Executive Order No. 38 ("EO 38"). Among other restrictions, EO 38 prohibits public funds from being used for excessive executive compensation and/or administrative costs (see <http://ExecutiveOrder38.ny.gov> and http://www.omh.ny.gov/omhweb/policy_and_regulations/Adoption/Part_513_text_final_20130514). Boards and Providers should develop best practices with respect to executive compensation, including the formation of compensation committees and the implementation of policies for both establishing and reviewing executive compensation on a regular basis. Particular attention should be paid to non-monetary compensation such as car allowances, payments for daily commuting costs, and memberships to clubs.

Further Guidance

This memorandum is intended for general guidance only. It does not cover all aspects of Provider and Board financial transactions nor does it cover all of the provisions of the Act. Providers and Boards should consult with their legal counsel and other professionals about the issues raised in this memorandum and other applicable requirements. Providers or Boards who are concerned that their financial practices may not be in compliance with applicable requirements should contact their OMH Field Office assigned staff member.

cc: OMH Field Office Directors
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