



STATE OF NEW YORK  
OFFICE OF THE STATE COMPTROLLER

July 15, 2010

Ms. Francine James  
Chief Deputy Director  
New York State Insurance Fund  
15 Computer Drive West  
Albany, NY 12205

Re: Report 2008-BSE-0294

Dear Ms. James:

Our Office examined select payments made by the New York State Insurance Fund (the Fund) from January 1, 2008 through December 31, 2008.<sup>1</sup> The objective of our examination was to determine if these payments and related contracts were processed in accordance with the New York State Constitution and New York State laws, rules and regulations governing the procurement and payment of commodities and services.

**A. Background and Methodology**

The Workers' Compensation Law establishes the New York State Insurance Fund (Fund) within the New York State Department of Labor. The Fund's mission is to guarantee the availability of workers' compensation protection to any employer seeking coverage in New York State (the State) at the lowest possible rates consistent with maintaining a solvent fund. The Fund also provides insurance for disability benefits. The Fund maintains the Workers' Compensation Fund and the Disability Benefits Fund. Fund revenues come from insurance premiums and the income generated from investing those premiums, which allows the Fund to be self-supporting.

The Fund competes with private insurers in the workers' compensation and disability benefits markets. As such, it functions much like a private insurance company in that it fixes and collects premiums, maintains a surplus and reserve, and its investments, reserves, etc. must be examined by the Insurance Department.

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<sup>1</sup> We performed our examination in accordance with the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution, as well as Article II, Section 8, and Article VII, Section 111 of the State Finance Law.

To carry out its mission, the Fund uses several bank accounts to make payments for such costs as medical and compensation claims, salaries, investments, and commodities and services. Our examination focused on the payments made from two accounts – the Treasury and Non-Treasury accounts. In 2008, the Fund spent almost \$222 million from these two accounts: \$138 million from the Treasury account and \$84 million from the Non-Treasury account. Based on long-standing practice, the Fund uses the Treasury account to pay for administrative expenses used in operating its business, and the Non-Treasury account for investments.

To accomplish our objective, we interviewed managers and staff at the Fund, reviewed relevant laws and procurement guidelines, and vendor invoices. We also obtained payment data from the Fund and the information maintained in the Fund's Oracle Financial Management System (Oracle). Among other functions, this system maintains historical vendor data, including aggregate spending with individual vendors, and contract information for each vendor.

We shared a draft copy of this report with Fund officials for their review and comment. We considered their comments in preparing this report and have included them as Appendix A. State Comptroller Comments on the Fund's response are attached as Appendix B.

## **B. Results of Examination**

Article 5 of the New York State Constitution (Constitution) and Section 111 of the New York State Finance Law (Section 111) require that all payments and refunds from the State be audited by the Comptroller prior to payment. The Comptroller audits and approves payments and refunds pursuant to his constitutional authority to prevent and detect fraud, waste, and improper spending.

The Office of the State Comptroller (OSC) recognizes the special needs of the Fund to conduct its insurance operations. This is reflected in the process followed by OSC auditors who are on-site at the Fund. Payments made from the Treasury account are contingent on the auditors' approval. Payments from the Non-Treasury account are not contingent on the auditors' approval.

However, after examining over half of the Non-Treasury account transactions for the period January 1, 2008 through December 31, 2008, we found the Fund has inappropriately processed through the Non-Treasury account administrative expenses, including payments for real estate expenses (e.g., leases, utilities, building improvements), legal services, certain claims-related administrative expenses, and other miscellaneous expenses. The Fund should have processed these payments through its Treasury account, thereby ensuring the Comptroller's prior audit and approval.

In their response, Fund officials argue that the Fund is not subject to the Comptroller's pre-audit authority. However, the Constitution clearly requires that any payment of money under the control of the Fund is subject to the Comptroller's prior audit and approval.

The Fund occasionally uses the Non-Treasury account to expedite payments to vendors it typically pays through the Treasury account. Fund officials agree to work with OSC and Treasury to implement agreed upon procedures to address these exceptions.

In addition, the New York State Finance Law (Section 112) requires the Fund to obtain prior approval by the Comptroller on all State contracts exceeding \$50,000. Comptroller approval of State contracts is essential to ensure that contracts are awarded to responsive and responsible bidders; are procured fairly and in the best interest of the State; and thus, are in compliance with the State's procurement laws, rules, and regulations. However, the Fund did not obtain Comptroller approval for 24 contracts that exceeded \$50,000 over a one-year period (as listed in Attachment A). These procurements totaled nearly \$12 million.

In their response, Fund officials disagree these contracts are subject to the Comptroller's approval under Section 112 because the contracts fall under an "insurance purposes" exception from a 1992 opinion of OSC. However, the exception was limited to contracts between the Fund and its insured (i.e., insurance policies). The contracts cited in this report are between the Fund and the various vendors it contracts with for real estate expenses (e.g., leases, utilities, building improvements), legal services, claims-related administrative expenses and other miscellaneous expenses. Therefore these contracts, and any such contracts that exceed the discretionary threshold of \$50,000, are subject to the Comptroller's approval.

Accordingly, the Fund should establish procedures and protocols to ensure that all payments, refunds, and contracts (except insurance policies) are contingent on the Comptroller's prior approval pursuant to the Constitution and State Finance Law.

### **Recommendations**

- 1) *Ensure all payments and refunds made from the Non-Treasury account are submitted to the Comptroller for audit and approval prior to payment, as required by the Constitution and State Finance Law. Consider closing the Non-Treasury account and processing all administrative expenses through the Treasury account.*
- 2) *Ensure that all contracts (except insurance policies) exceeding \$50,000 are submitted to the Comptroller for approval, as required by the State Finance Law.*

We would appreciate your response to this report by August 13, 2010, indicating any actions planned to address the recommendations in this report. We thank the management and staff of the New York State Insurance Fund for the courtesies and cooperation extended to our auditors.

Sincerely,

Bernard J. McHugh  
Director of State Expenditures

Encl: Attachment A  
Appendix A  
Appendix B

cc: Jean Woodard  
Susan Sharp  
Joseph Mullen  
Greg Allen  
Howard Feldman  
Ken Shulman

## Contracts Requiring Comptroller Approval

Vendors	Dollars Spent*
<b>Real Estate</b>	
103/105 Corporate Park Drive, LLC	\$985,767
Benderson-Rochester Associates, LLC	892,503
BTC Block 19 Partnership, LP	189,147
BTC Block 20, Inc.	378,079
BTC Building B Partnership	79,183
Carefree Security, Inc.	83,036
Galesi Management Corp.	433,885
GC Contractors, Inc.	409,429
Harvard Maintenance, Inc.	3,585,909
J. Luk Construction Co., LLC	807,919
Otis Elevator Company	240,902
Ruston Paving Company, Inc.	403,316
We're Associates, Inc.	2,300,787
Woodward Conner Gillies & Seleman Architects, PC	126,469
<b>Sub-Total</b>	<b>\$10,456,291</b>
<b>Legal</b>	
Abrams Garfinkel Margolis Bergson, LLP	\$96,020
Jan Ira Gellis, PC	541,780
Jasne & Florio, LLP	126,557
Joseph Gentile & Associates Ltd.	205,123
Julius Herling	110,551
Robert L. Cohen	74,987
<b>Sub-Total</b>	<b>\$1,154,998</b>
<b>Claims-Related</b>	
P2P Link, LLC	\$54,182
<b>Sub-Total</b>	<b>\$54,182</b>
<b>Other</b>	
FT Interactive Data	\$54,256
Image Data, Inc.	106,290
NCCI Holdings, Inc.	57,314
<b>Sub-Total</b>	<b>\$217,860</b>
<b>Grand Total</b>	<b><u>\$11,883,331</u></b>

\*net of any credit transactions



New York State Insurance Fund

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January 28, 2010

Bernard J. McHugh  
Director of State Expenditures  
Office of the State Comptroller  
110 State Street  
Albany, New York 12236

Dear Mr. McHugh:

This letter is in response to your Draft Report 2008-BSE-0294, addressed to Chief Deputy Director Francine James and dated December 29, 2009, regarding the examination of New York State Insurance Fund ("NYSIF") contracts and expenditures for the period January 1, 2008 through December 31, 2008. Inasmuch as the Draft Report asserts a number of legal conclusions, Ms. James has referred it to the NYSIF Legal Department for appropriate response.

To summarize the events of this examination, on January 20, 2009, the Office of the State Comptroller ("OSC") notified the NYSIF that it would be performing an examination of contracts and certain expenditures processed by the NYSIF for the period January 1, 2008 through December 31, 2008. The stated objective of the examination was to determine whether the aforementioned transactions were appropriate and complied with the State Finance Law ("SFL") and New York State procurement guidelines. An opening conference was held on January 28, 2009. On February 25, 2009, the NYSIF provided the OSC with requested documents including all relevant payments for the examination period. From April 15, 2009 to June 11, 2009, OSC auditors were periodically on-site and received the full cooperation and assistance of NYSIF personnel.

On August 28, 2009, the NYSIF received a notice of preliminary findings. On September 10, 2009, the NYSIF and OSC met and discussed the preliminary findings, audit methodology, reporting and audit procedures. On September 25, 2009, the NYSIF and OSC met again to discuss the methodology. At this meeting, the NYSIF expressed concerns regarding the audit methodology and preliminary findings. On October 1, 2009, the NYSIF and OSC met again to review disputed preliminary findings together with supporting documentation provided by the NYSIF. As follow-up to the October 1<sup>st</sup> meeting and in further support of its position regarding the disputed preliminary findings, the NYSIF provided additional documentation under cover of a letter dated October 9, 2009.

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By letter dated October 29, 2009, the OSC notified the NYSIF that it had reviewed the information supplied by the NYSIF and, further, that the OSC was preparing a draft report to which the NYSIF would have an opportunity to respond. On November 20, 2009, the NYSIF responded with a letter which, among other things, confirmed in substance that all NYSIF transactions reviewed by the OSC during this process were at all previous times available for viewing by the OSC's team of on-site auditors during the subject time period for both pre- and post-audit through the computerized NYSIF payment system.

**A: Background and Methodology:**

In 2003, the NYSIF implemented an Oracle Financial Management System ("Oracle"), an integrated, paperless financial system through which NYSIF payments are processed. The OSC participated in the system design and testing to ensure that workflow and access protocols met the OSC's needs. Oracle went live in January of 2004.

The OSC maintains (at NYSIF's expense) a staff of two (2) full-time auditors on-site at the NYSIF and two (2) full-time auditors at the OSC's Albany offices. Since 2004, the OSC's assigned auditors have had the ability to view through Oracle all transactions before payments are issued to vendors. This includes all contract payments processed through the NYSIF Treasury and Non-Treasury accounts which are the subject of the OSC Draft Report. It appears that, as a matter of day-to-day practice, the OSC on-site auditors do not distinguish between pre-audit and post-audit functions. By virtue of the real-time access provided by the NYSIF to the assigned OSC auditors, the OSC had full opportunity to review all of the payments discussed in the Draft Report prior to the making of each payment.

Pursuant to Workers' Compensation Law ("WCL") §85, the NYSIF makes payments through the State Treasurer's office, which involves weekly processing. As indicated in prior correspondence on this subject, the NYSIF occasionally encounters situations where payments ordinarily made from the Treasury account are required to be expedited in order to avoid service interruption or prevent interest charges. The results of this necessary accommodation between the NYSIF and State Treasurer were raised as an OSC concern, in that, some routine payments which were required to be remitted on an expedited basis were made through the Non-Treasury account and not reviewed in advance by the OSC. The NYSIF will work with the OSC and Treasury to develop and implement an agreed upon procedure to ensure that such future payments are made in a timely manner acceptable to the OSC. To address the situation in the meantime, the NYSIF has set up temporary procedures in cooperation with the on-site OSC auditors.

**B: Results of Examination:**

The Draft Report asserts that the "New York State Constitution and Finance Law require that all payments and refunds from the Fund be audited by the Comptroller prior to payment" and, further, that the "Finance Law requires all State Agencies to obtain prior approval by the Comptroller on all State Contracts exceeding \$50,000." As discussed below, the NYSIF believes

that these assertions are not supported by applicable statutory and case law and longstanding practice between the NYSIF and OSC.

Pursuant to § 76 of the WCL, the NYSIF is an agency established within the New York State Department of Labor. The NYSIF is administered by a Board of ten (10) Commissioners who are appointed by the Governor with the advice and consent of the Senate. In addition, the Commissioner of Labor serves as an *ex officio* member of the Board. WCL § 77.

The powers and duties of the Board of Commissioners are prescribed by statute, and are primarily contained in WCL § 82. The mission of the NYSIF is to provide workers' compensation insurance to employers within New York State at the lowest possible rates consistent with the maintenance of a solvent fund. *See* WCL §§ 76; 89. The Board is required to "consider at all times the condition of the Fund and examine into its reserves, investments and all other matters relating to its administration." WCL § 82 (3).

The NYSIF competes in a competitive marketplace with private insurance carriers, pays business franchise taxes and is regulated by the New York State Department of Insurance ("DOI"). The NYSIF is financially self-sustaining, receiving neither legislative appropriation nor other taxpayer funds. Its administrative costs and indemnity payments are funded from premium and investment earnings, (*see* WCL §§ 76 *et seq*). "The entire expense of administering the [NYSIF] shall be paid out of such fund which shall not be considered an agency or a fund of the state for the purposes of [§ 4 of the SFL]." WCL § 88. Further, the law provides that "[n]o payment, expenditure or refund shall be subject to pre-audit by the department of audit and control as provided by [§ 111 of the SFL]." *Id.*

#### Pre-Auditing:

Article V, § 1 of the New York State Constitution, which is the "wellspring of the Comptroller's authority" (*McCall v. Barrios-Paoli*, 93 N.Y.2d 99, 104 (1999)), provides in pertinent part, that:

[t]he comptroller shall be required: (1) to audit all vouchers before payment and all official accounts; (2) to audit the accrual and collection of all revenues and receipts; and (3) to prescribe such methods of accounting as are necessary for the performance of the foregoing duties . . . *In such respect the legislature shall define the powers and duties* [of the Comptroller] . . . *The legislature shall assign to him or her no administrative duties*, excepting such as may be incidental to the performance of these functions, any other provision of this constitution to the contrary notwithstanding. (Emphasis added).

Article V, § 1 of the State Constitution requires the Comptroller "to audit all vouchers before payment and all official accounts." This language suggests that the Comptroller's pre-audit functions are confined to those payments which are voucher based. The NYSIF does not make any payments by means of a voucher.

Chapter 635 of the Laws of 1996 ("Chapter 635") amended WCL § 88, which governs NYSIF finances. The amendments to WCL § 88 included: (i) removing the NYSIF from the legislative

appropriation process by exempting it from § 4 of the SFL; (ii) repealing the requirement that NYSIF submit its annual budget to the State Division of the Budget; and (iii) providing that NYSIF expenditures shall not be subject to pre-audit by the OSC.

The changes to WCL § 88 enacted by Chapter 635 were intended to make the NYSIF more competitive and its financial management more efficient by removing it from the strictures of the State budget process. These provisions allow the NYSIF the flexibility it requires to more quickly procure and fund its needs for personal services, equipment and facilities, thereby enabling it to better respond to the competitive insurance marketplace. In commenting on taking NYSIF off-budget, the Governor's Memorandum approving Chapter 635 stated that its purpose was "to enhance the Fund's ability to operate as an efficient business operation . . . [which will benefit] New York's employers in the form of better service and reduced premiums." Clearly, the same policy purpose applies to exempting the NYSIF from OSC pre-audit requirements.

The Legislature designated the Superintendent of Insurance as the examiner of the NYSIF's financial books and records, as the Superintendent does for private insurance companies. *See* Insurance Law §§ 302 and 2313. In compliance therewith, the NYSIF files its annual financial statements with the DOI. The financial statements filed by the NYSIF are fully-audited by independent outside auditors, in the same manner as the financial statements filed by private workers' compensation insurance carriers. *See* Insurance Law §§ 310 and 307; WCL § 99. Also, the Legislature has designated the Superintendent as the final reviewer and approver of NYSIF real estate, office maintenance and investment contracts. *See* WCL §§ 81 and 87.

*In Blue Cross & Blue Shield v. McCall*, 89 N.Y.2d 160, 168 (1996), the Court of Appeals held that the plain language and history of Article V, § 1 compelled the conclusion that the audit of not-for-profit health insurers was an "administrative" duty not incidental to the OSC's core functions. The Court recognized the State's long history of regulating the business of insurance through the DOI, which possesses broad regulatory and audit powers as well as specialized expertise in the insurance industry. Since the insurance audits challenged in *Blue Cross* were within the jurisdiction of the DOI, the Court reasoned that the same duties must be considered "administrative" when performed by the OSC.

By making the Superintendent responsible for examining the finances of the NYSIF (as he or she does for private carriers) and expressly excluding NYSIF payments, expenditures and refunds from the pre-audit authority of the Comptroller, the Legislature has made clear beyond peradventure that there exists no requirement for the OSC to pre-approve all NYSIF payments, expenditures or refunds.

* Comment 1
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#### Contract Approval:

The NYSIF understands from discussions with the OSC's Counsel's Office in connection with this audit that the OSC now construes § 112 of the SFL to apply to the NYSIF. As was indicated to OSC's Counsel in those discussions, the issue of whether SFL § 112 applies to NYSIF contracts, particularly contracts for legal services, has been addressed by the courts. For example, in *Royal Insurance Company of America*, 289 A.D.2d 807, 808 (2001) (citations omitted), the Appellate Division, Third Department stated that:

Both this Court and the Court of Appeals have recognized the uncertain status of the Fund, particularly in matters of litigation. As we stated in Matter of Carney v. Newburgh Park Motors [84 A.D.2d 599, 600 (1981)], “while the [SIF] is an agency of the State, its function is akin to that of a private insurance carrier and, especially in matters of litigation, it is considered to be an entity separate from the State itself.” Moreover, the revenues of the Fund are raised by premiums it charges for the policies it issues and investments made from these funds (*see*, Workers’ Compensation Law § 76 [1]) and these moneys may not be transferred to any other fund nor used for any purpose other than those of the Fund (*see*, Workers’ Compensation Law § 76 [5]). Given that the purpose of State Finance Law § 112 is to prevent the improvident expenditure of general State revenues, we are unpersuaded that the provisions of this statute apply to the expenditure by the Fund of its revenue for counsel fees incurred in the defense of one of its insureds, an expenditure it is obligated to make by the terms of the policy of insurance it issued.

The OSC has previously acknowledged, both in administrative practice and documentary form, that the NYSIF is treated by statute as a separate insurance entity and that, especially in litigations, it is considered to be separate from the State. In an April 9, 1992 OSC Memorandum, entitled “Subject: MA-1191/004-A State Insurance Fund Method of paying Temporary Service Agencies,” the OSC stated as follows:

Nonetheless, claims-related contracts may fall within the “insurance purposes” exception set forth in Methodist Hospital [64 N.Y.2d 365 (1985)], and Commissioners of the State Insurance Fund [3 N.Y.2d 590], *supra*. Specifically, contracts directly related to the payment of claims expenses, including the issuance of insurance policies and the establishment of their terms and conditions and the fixing of premium rates, may be considered as part of a separate insurance business and that the Fund, for such purposes, is considered to be an entity separate from the State itself. In said event, the Fund would not be considered a State agency for purposes of [SFL §112]. We believe this to be a reasonable interpretation of the statute.

In a Footnote 2 of the 1992 Memorandum, the OSC also stated that:

The exception relating to ‘insurance purposes’ is based upon the fact that ‘in fixing and collecting premiums, in maintaining surplus and reserve, and in the requirement that it be examined by the State superintendent of insurance (section 99) as to investments, reserves etc, the Fund is treated by the statute much like a private insurance company . . . From all this it appears that the Fund, while it is not a separate corporation and while it is an agency of the State in one sense, [the Fund] is nevertheless treated by

the statutes as a separate insurance business (see requirement that it pay franchise tax, Tax Law, § 187, subd.6) and that, especially in litigations, it is considered to be an entity separate from the State itself [*Commissioners of the State Insurance Fund v. Low*, 3 N.Y.2d 590, 170 N.Y.S. 795 (1958)].

Several types of NYSIF contracts are expressly governed by Article 6 of the WCL. For example, WCL § 81 authorizes the NYSIF Board of Commissioners, any law to the contrary notwithstanding, to: (i) maintain offices at such places within the State as may be required to properly and conveniently transact the business of the Fund; (ii) acquire real property and construct new buildings or reconstruct, operate and maintain existing buildings to provide suitable office space for the convenient transaction of the business of the Fund; and (iii) rent to private tenants or public entities any available space in such premises, buildings or property not required by the Fund, with or without leases, as the Commissioners deem to be in the best interests of the Fund. WCL § 84 authorizes the NYSIF General Attorney to secure outside counsel and provide for payment of such counsel's compensation, subject to the approval of the Board of Commissioners. WCL § 87 authorizes the Board of Commissioners to order investment of surplus or reserves in certain types of securities prescribed by law, subject to the approval of the Superintendent.

The NYSIF maintains internal policies designed to ensure that the procurement process is fair and transparent while protecting the interests of the NYSIF and its policyholders. NYSIF procurement methods involve, for example: (a) notice and publication; (b) competitive bidding; (c) use of standard State clauses; (d) vendor responsibility review; (e) encouragement of Minority and Women-Owned Business Enterprises ("MWBE"); and (f) utilization of preferred sources consistent with SFL § 162. NYSIF contracts are subject to direct oversight and approval by the NYSIF Board of Commissioners and, where required, the Superintendent. See WCL §§ 81 and 87. With few, if any, exceptions, these types of contracts have, historically, not been submitted to the OSC for approval. This is consistent with the "insurance purposes" exception discussed in the 1992 OSC Memorandum mentioned above.

In sum, there is ample support for the long-held position of the NYSIF that SFL § 112 is inapplicable to NYSIF procurements made in connection with its litigation or "insurance purposes."

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Comment
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**Recommendations:**

It is the policy of the NYSIF to procure goods and services consistent with the procurement guidelines, SFL and other relevant laws. However, the NYSIF does not concur with the OSC's recent conclusion that the law requires all NYSIF payments and refunds to be subject to pre-audit by the OSC. Nor does the NYSIF agree that all of its contracts in excess of the SFL discretionary threshold are subject to pre-approval by the OSC.

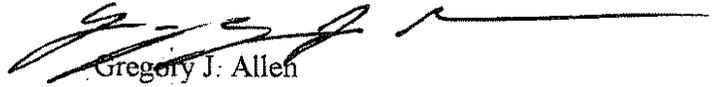
In addition to the legal authority cited above, there exists considerable other such authority supporting the conclusion that NYSIF has a unique legal status. In light of the foregoing, the NYSIF believes that the draft recommendations proposed by the OSC: (i) lack support in the law; (ii) contradict years of established practice; and (iii) would, if implemented, impair the NYSIF's ability to fulfill its mission of providing low-cost workers' compensation and disability

benefits insurance to employers within the State. Therefore, it is respectfully requested that the OSC reassess its conclusions and modify its recommendations accordingly.

As has been the case throughout this process, NYSIF legal and professional staff stands ready to work with the OSC to achieve mutual understanding and resolution of these issues.

Thank you for your consideration in this matter.

Sincerely,



Gregory J. Allen  
General Attorney

cc: Francine James  
John Dalton  
Jean Woodard  
Howard Feldman  
Susan Sharp  
Joseph Mullen  
Ken Shulman

Note: Attachment "A" to this letter contains NYSIF comments regarding some particular payments listed under the heading "Other" in the OSC Draft Report.

**Attachment A:**

Comments on "Other" payments:

**FT Interactive Data, Image Data Inc., and NCCI Holdings Inc.** – For payments related to these three (3) vendors, as previously indicated in our response to the preliminary findings, NYSIF did not expect to exceed the discretionary threshold and, in fact, did not do so until final payments were made.

Please note that SFL § 163 (6-b) states "for determination of threshold amount purposes of determining whether a purchase is within the discretionary thresholds established by subdivision six of this section, the commissioner and state agencies shall consider *the reasonably expected* aggregate amount of all purchases of the same commodities or services to be made within the twelve-month period commencing on the date of purchase." (Emphasis added). With respect to each of these three (3) vendors, NYSIF did not, and could not reasonably foresee exceeding the discretionary threshold. Based on 2008 expenditures for FT Interactive and NCCI Holding Inc., NYSIF has since implemented additional procurement protocols. There is no longer a need for the services provided by Image Data. Please note, OSC on-site auditors reviewed and approved all payments to the three (3) vendors noted above.

**Oracle USA Inc.** – Attachment A indicates that payments to this vendor totaled \$56,965. This payment amount is incorrect. The OSC did not take into account the reversed distributions and, therefore, payments to Oracle USA Inc. on Attachment A are overstated by \$3,997.

OSC's conclusion that payment amounts for Oracle USA Inc. exceeded the discretionary threshold is incorrect. SFL § 163 (6-b) provides that a discretionary threshold is determined by the "... aggregate amount of all purchases of the *same* commodities or services." (Emphasis added). In the case of payments made to Oracle, there were two (2) separate and distinct purchases: one for training in the amount of \$3,000; and one for the purchase of unrelated software and maintenance in the amount of \$49,968. For the software and maintenance purchase, NYSIF received from the OSC an exemption from any requirement to advertise and made this purchase for an amount below the discretionary threshold, consistent with the procurement guidelines. Each of these two (2) payments was made consistent with the SFL and procurement guidelines.

Attachment A indicates that there were eight hundred sixty-two (862) payments issued to the twenty-five (25) vendors referenced. We would like to clarify that there were three hundred sixty two (362) checks or payments issued to vendors for the related expenses noted on Attachment A. The "862 # of payments" denoted on Attachment A refers to line items posted to respective purchase orders. However, all line items with a negative amount were not taken into account when the transactions were reviewed. As stated above, by not taking into account postings with negative amounts, expenditures and the number of payments on the draft report are overstated.

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Comment
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## State Comptroller Comments on Auditee Response

1. In their response, Fund officials argue that the Fund is not subject to the Comptroller's constitutionally required pre-audit duties because: (i) it is a unique legal entity; (ii) it does not make payments pursuant to vouchers; and (iii) it is exempted from the Comptroller's pre-audit by Section 88 of the Workers Compensation Law. Article V, Section I of the New York State Constitution requires the Comptroller "...to (1) audit all vouchers before payment and all official accounts. . . The payment of any money of the state, or of any money under its control, or the refund of any money paid to the state, except upon audit by the comptroller, shall be void . . ." Since the Fund is an agency of the State<sup>2</sup>, the plain language of the Constitution makes it clear that any payment of money under the control of the Fund is subject to the Comptroller's pre-audit, regardless of whether such payment is pursuant to a voucher or otherwise. Furthermore, it is well established that the Constitution takes precedence over legislative action and the Legislature may not, by statute, grant an exemption from a constitutional requirement.
2. In their response, the Fund cites OSC Memorandum MA-1191/004-A, dated April 9, 1992, to support their position that the contracts in question are not subject to the Comptroller's approval under Section 112 of the State Finance Law because said contracts fall under an "insurance purposes" exception. However, as we note below, the contracts in question clearly fall outside the exception recognized in our memorandum. Moreover, we are currently reviewing whether this Office continues to recognize the exception at all.

In the memorandum, OSC counsel indicated that claims related expenses might fall within an "insurance purposes" exception to the general rule that contracts entered into by the Fund are subject to Section 112 of the State Finance Law. The memorandum went on to state:

Specifically, contracts directly related to the payment of claims expenses, including the issuance of insurance policies and the establishment of their terms and conditions and the fixing of premium rates, may be considered as part of an insurance business and that the Fund, for such purposes, is considered to be an entity separate from the State itself. In said event, the Fund would not be considered a State agency for purposes of State Finance Law § 112. [Emphasis supplied]

We interpret any exception recognized in that memorandum to be limited to contracts between the Fund and its insured. The contracts in question in the audit are for:

- ***Real Estate Expenses*** (e.g.; expenses for acquiring, managing and maintaining business properties to conduct the Fund's business)

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<sup>1</sup> New York Workers' Compensation Law Section 76. *Methodist Hospital of Brooklyn v. State Ins. Fund*, 64 NY2d 365 (1985).

- *Legal Services* (e.g.; legal fees to recover outstanding claims)
- *Claims-Related Expenditures* (e.g.; payments for EDI transaction fees)
- *Miscellaneous Expenditures* (e.g.; other costs of doing business, including janitorial services, temporary services, postage, etc.)

Therefore, this exception has no application to any of the contracts in question and any such contracts that exceed the \$50,000 threshold are subject to the Comptroller's approval.

3. Fund officials responded that credit transactions were not included when OSC determined the amount that the Fund paid to certain vendors. However, the credit transactions for the vendors listed in Attachment A total only \$19,663 and do not have a material impact on the amount spent by the Fund on payments to those vendors. Attachment A has been updated to account for the credit transactions; but also indicates that these adjustments do not cause the aggregate amount paid to any individual vendor to fall below the \$50,000 threshold for contract approval by the Comptroller. As such, the Fund did not obtain the statutorily required Comptroller approval for various contracts that, in the aggregate, totaled nearly \$12 million.

August 11, 2010

Bernard J. McHugh  
Director of State Expenditures  
Office of the State Comptroller  
110 State Street  
Albany, New York 12236

Re: Report 2008-BSE-0294

Dear Mr. McHugh:

I write in response to the Office of the State Comptroller ("OSC") Report 2008-BSE-0294 ("Report"), addressed to Chief Deputy Executive Director Francine James and dated July 15, 2010, regarding the examination of New York State Insurance Fund ("NYSIF" or "Fund") contracts and payments for the period January 1, 2008 through December 31, 2008. By letter to you dated January 28, 2010 (attached), I previously commented on Draft Report 2008-BSE-0294. Rather than my repeating all of the points made therein, please refer to that letter for its comprehensive response to the recommendations contained in the Report, particularly as the recommendations do not significantly differ from those proposed in the Draft Report.

As acknowledged in the Report, NYSIF is operating a competitive business enterprise to provide low-cost workers' compensation and disability benefits insurance to employers within New York State. NYSIF is financially self-sustaining, receiving neither legislative appropriation nor any other taxpayer funds, with its administrative costs and indemnity payments funded exclusively by policyholder premium payments and earnings on investments. NYSIF provides timely and appropriate indemnity and medical payments to injured workers and their family members in accordance with its policies of insurance and pursuant to the Workers' Compensation Law ("WCL").

The Report recognizes "the special needs of the Fund to conduct its insurance operations" and NYSIF's "longstanding practice" of utilizing a separate Non-Treasury account to make certain payments related to its insurance operations. The Report makes no finding of impropriety of any sort with respect to NYSIF payments or contracts. Yet, the Report recommends the imposition of a cumbersome new process that would jeopardize the ability of NYSIF to effectively compete in the private insurance marketplace and provide statutorily mandated, affordable workers' compensation insurance to New York employers.

The Legislature has assigned the Superintendent of Insurance (“Superintendent” or “Insurance Department”) to examine the financial books and records of the Fund, as the Superintendent does for private insurance companies. See Insurance Law §§ 302 and 2313. Insurance Department examiners periodically conduct full examinations of all aspects of NYSIF finances. Thus, the Fund’s annual financial statements (which are also audited by independent outside auditors) are submitted to the Superintendent in the same manner as the financial statements of private insurance carriers. See Insurance Law §§ 310 and 307; WCL § 99. In addition, the Legislature has designated the Superintendent to review and approve NYSIF real estate, office maintenance and investment contracts. See WCL §§ 81 and 87.

The recommendations contained in the Report would have the OSC engaging in redundant review of transactions that are already subject to review and approval by the Superintendent and the Fund’s independent outside auditors. Inasmuch as these matters have been legislatively delegated to the Insurance Department, functions performed by the OSC relative thereto would be purely “administrative” in nature and, hence, outside of the Comptroller’s constitutional authority. See *Blue Cross & Blue Shield v. McCall*, 89 N.Y.2d 160 (1996). Also, adding additional, unnecessary layers of review could increase costs to NYSIF policyholders and taxpayers.

The Report selectively cites portions of Article V of the State Constitution for the proposition that all NYSIF payments and refunds are subject to prior audit and approval by the OSC. However, the Report omits reference to the provisions of Article V, § 1 which expressly authorize the Legislature to define the powers and duties of the Comptroller. The Report also fails to address a significant limitation imposed on the Comptroller pursuant to Article V, § 1. Under this section, the powers of the Comptroller are limited to auditing payment “vouchers.” Indeed, none of the subject NYSIF payments are made by means of a voucher.

The Legislature has exercised its constitutional authority to expressly define and limit the powers of the Comptroller with regard to NYSIF. Specifically, Chapter 635 of the Laws of 1996 amended WCL § 88 to, *inter alia*, expressly exempt all NYSIF payments, expenditures and refunds from the pre-audit authority of the Comptroller. Chapter 635 was intended to enable NYSIF to operate more competitively and efficiently by removing it from these strictures of OSC review and from the State budgeting process.

The 1992 OSC Memorandum, Subject MA-1191/004-A, states that SFL § 112 may be inapplicable to NYSIF procurements made in connection with its litigation or for “insurance purposes.” Further, Article 6 of the WCL expressly authorizes NYSIF to enter into various types of contracts related to its insurance business. Thus, as a matter of long-standing practice between the NYSIF and OSC, these types of contracts have not been submitted to the OSC for approval.

Notwithstanding any contrary provision of law, WCL § 81 authorizes the NYSIF Board of Commissioners, to: (i) maintain offices at such places within the State as may be required to properly and conveniently transact the business of the Fund; (ii) acquire real property and construct new buildings or reconstruct, operate and maintain existing buildings to provide suitable office space for the convenient transaction of the business of the Fund; and (iii) rent to private tenants or public entities

any available space in such premises, buildings or property not required by the Fund, with or without leases, as the Commissioners deem to be in the best interests of the Fund. WCL § 84 authorizes the NYSIF General Attorney to secure outside counsel and provide for payment of such counsel's compensation, subject to the approval of the Board of Commissioners. WCL § 87 authorizes the Board of Commissioners to order investment of surplus or reserves in certain types of securities prescribed by law, subject to the approval of the Superintendent.

While the Fund is a State agency, "its function is akin to that of a private insurance carrier and, especially in matters of litigation, it is considered to be an entity separate from the State itself." *Matter of Carney v. Newburgh Park Motors*, 84 A.D.2d 599, 600 (1981). This unique status must be considered to fully understand the flawed nature of the recommendations of the Report. For example, the recommendations, if implemented would enable the Comptroller to exercise control over contracts and payments for legal services provided to an adverse party in litigation (*ie.*, a NYSIF policyholder). Such a case can arise from NYSIF's non-State status in litigation and the fact that NYSIF must retain counsel and fund lawsuits to which NYSIF and/or its policyholders are parties.

Any exercise of control by OSC over payments for legal services retained by NYSIF, when NYSIF acts in a private capacity or on behalf of private parties in litigation, would clearly frustrate the intent of the Legislature to establish NYSIF as an independent insurance entity. Such interference could violate the legal rights of NYSIF, its policyholders and other parties in litigation, frustrate orders of the courts, and create legal conflicts of interest for the OSC. For reasons like these, *inter alia*, the courts have rejected the argument that State Finance Law ("SFL") §112 applies to NYSIF contracts or payments for legal services. *Royal Insurance Company of America*, 289 A.D.2d 807 (2001).

In response to the Report's assertion that OSC review is necessary to ensure compliance with State procurement laws: NYSIF already maintains internal policies to ensure consistency with applicable laws, rules and regulations and follows a procurement process which is fair and transparent while at the same time protecting the interests of the NYSIF and its policyholders. NYSIF procurement methods typically involve, for example: (a) notice and publication; (b) competitive bidding; (c) use of standard State clauses; (d) vendor responsibility review; (e) encouragement of Minority and Women-Owned Business Enterprises; and (f) utilization of preferred sources consistent with SFL § 162. NYSIF contracts are subject to oversight by its Board of Commissioners and, where required, the Superintendent. *See* WCL §§ 81 and 87.

The OSC maintains (at NYSIF's expense) a staff of two (2) full-time auditors on-site at the NYSIF and two (2) full-time auditors at the OSC's Albany offices. Since 2004, the OSC's assigned auditors have had the ability to view through Oracle all transactions before payments are issued to vendors. This includes all contract payments processed through the NYSIF Treasury and Non-Treasury accounts which are the subject of the Report. It appears that, as a matter of day-to-day practice, the OSC on-site auditors do not distinguish between pre-audit and post-audit functions. By virtue of the real-time access provided by the NYSIF to the assigned OSC auditors, the OSC had full opportunity to review all of the payments discussed in the Report prior to the making of each payment.

While NYSIF contracts necessary for insurance purposes, including contracts relating to: (i) insurance policies; (ii) reinsurance; (iii) investments; (iv) real estate (a type of investment); (v) outside counsel; and (vi) claims administration, are not considered subject to SFL § 112, NYSIF administrative contracts for other purposes are submitted to the OSC for approval. This dichotomy has been recognized by the OSC since at least 1992 when it stated that “the State Insurance Fund is a state agency except for ‘insurance purposes’.” See 1992 OSC Memorandum, *supra*, p. 4, citing *Methodist Hospital of Brooklyn v. SIF*, 64 N.Y.2d 365 (1985). In recognizing the exception, the OSC noted the following:

The exception relating to “insurance purposes” is based upon the fact that “in fixing and collecting premiums, in maintaining surplus and reserve, and in the requirement that it be examined by the State superintendent of insurance (section 99) as to investments, reserves etc, the Fund is treated by the statute much like a private insurance company . . . From all of this it appears that the Fund, while it is not a separate corporation and while it is an agency of the State in one sense, is nevertheless treated by the statutes as a separate insurance business . . . and that, especially in litigations, it is considered to be an entity separate from the State itself” [*Commissioners of the State Insurance Fund v. Low*, 3 N.Y.2d 590, 170 N.Y.S.2d 795 (1958)].

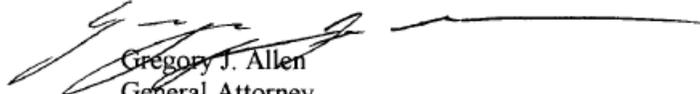
1992 OSC Memorandum, *supra*, Footnote 2.

In the past, the OSC has recognized the Fund’s unique status, acknowledging that NYSIF is an insurance business that is separate from the State for many purposes. Indeed, in 2002, OSC auditors were intimately involved with designing the protocols and workflows that are currently implemented through the Fund’s Oracle Financial Management System. These auditors explicitly approved the current payment workflow, which process allows for OSC pre-approval of Treasury account payments and post-audit review of Non-Treasury account payments. OSC now seeks to reverse course by expanding its pre-audit function, even in the face of the increased independence provided to the Fund by the Legislature and its express exemption of NYSIF payments from OSC pre-audit authority as provided in WCL §88. Such a shift in policy would be ill-advised and result in negative consequences for the business community and workers throughout the State.

In light of the above, it is submitted that the recommendations contained in the Report: (i) lack support in the law; (ii) disregard the clear intent of the Legislature; (iii) if implemented, would impair the Fund’s ability to fulfill its mission of providing low-cost workers’ compensation and disability benefits insurance to employers within the State; and (iv) contradict years of established practice previously accepted by OSC. Therefore, it is respectfully requested that the OSC reconsider its recommendations. As has been the case throughout this process, NYSIF legal and professional staff stands ready to work with the OSC to achieve a mutual understanding and resolution of these issues.

Thank you for your consideration in this matter.

Sincerely,



Gregory J. Allen  
General Attorney

cc: Francine James  
John Dalton  
Jean Woodard  
Howard Feldman  
Susan Sharp  
Joseph Mullen  
Ken Shulman

January 28, 2010

Bernard J. McHugh  
Director of State Expenditures  
Office of the State Comptroller  
110 State Street  
Albany, New York 12236

Dear Mr. McHugh:

This letter is in response to your Draft Report 2008-BSE-0294, addressed to Chief Deputy Director Francine James and dated December 29, 2009, regarding the examination of New York State Insurance Fund ("NYSIF") contracts and expenditures for the period January 1, 2008 through December 31, 2008. Inasmuch as the Draft Report asserts a number of legal conclusions, Ms. James has referred it to the NYSIF Legal Department for appropriate response.

To summarize the events of this examination, on January 20, 2009, the Office of the State Comptroller ("OSC") notified the NYSIF that it would be performing an examination of contracts and certain expenditures processed by the NYSIF for the period January 1, 2008 through December 31, 2008. The stated objective of the examination was to determine whether the aforementioned transactions were appropriate and complied with the State Finance Law ("SFL") and New York State procurement guidelines. An opening conference was held on January 28, 2009. On February 25, 2009, the NYSIF provided the OSC with requested documents including all relevant payments for the examination period. From April 15, 2009 to June 11, 2009, OSC auditors were periodically on-site and received the full cooperation and assistance of NYSIF personnel.

On August 28, 2009, the NYSIF received a notice of preliminary findings. On September 10, 2009, the NYSIF and OSC met and discussed the preliminary findings, audit methodology, reporting and audit procedures. On September 25, 2009, the NYSIF and OSC met again to discuss the methodology. At this meeting, the NYSIF expressed concerns regarding the audit methodology and preliminary findings. On October 1, 2009, the NYSIF and OSC met again to review disputed preliminary findings together with supporting documentation provided by the NYSIF. As follow-up to the October 1<sup>st</sup> meeting and in further support of its position regarding the disputed preliminary findings, the NYSIF provided additional documentation under cover of a letter dated October 9, 2009.

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By letter dated October 29, 2009, the OSC notified the NYSIF that it had reviewed the information supplied by the NYSIF and, further, that the OSC was preparing a draft report to which the NYSIF would have an opportunity to respond. On November 20, 2009, the NYSIF responded with a letter which, among other things, confirmed in substance that all NYSIF transactions reviewed by the OSC during this process were at all previous times available for viewing by the OSC's team of on-site auditors during the subject time period for both pre- and post-audit through the computerized NYSIF payment system.

**A: Background and Methodology:**

In 2003, the NYSIF implemented an Oracle Financial Management System ("Oracle"), an integrated, paperless financial system through which NYSIF payments are processed. The OSC participated in the system design and testing to ensure that workflow and access protocols met the OSC's needs. Oracle went live in January of 2004.

The OSC maintains (at NYSIF's expense) a staff of two (2) full-time auditors on-site at the NYSIF and two (2) full-time auditors at the OSC's Albany offices. Since 2004, the OSC's assigned auditors have had the ability to view through Oracle all transactions before payments are issued to vendors. This includes all contract payments processed through the NYSIF Treasury and Non-Treasury accounts which are the subject of the OSC Draft Report. It appears that, as a matter of day-to-day practice, the OSC on-site auditors do not distinguish between pre-audit and post-audit functions. By virtue of the real-time access provided by the NYSIF to the assigned OSC auditors, the OSC had full opportunity to review all of the payments discussed in the Draft Report prior to the making of each payment.

Pursuant to Workers' Compensation Law ("WCL") §85, the NYSIF makes payments through the State Treasurer's office, which involves weekly processing. As indicated in prior correspondence on this subject, the NYSIF occasionally encounters situations where payments ordinarily made from the Treasury account are required to be expedited in order to avoid service interruption or prevent interest charges. The results of this necessary accommodation between the NYSIF and State Treasurer were raised as an OSC concern, in that, some routine payments which were required to be remitted on an expedited basis were made through the Non-Treasury account and not reviewed in advance by the OSC. The NYSIF will work with the OSC and Treasury to develop and implement an agreed upon procedure to ensure that such future payments are made in a timely manner acceptable to the OSC. To address the situation in the meantime, the NYSIF has set up temporary procedures in cooperation with the on-site OSC auditors.

**B: Results of Examination:**

The Draft Report asserts that the "New York State Constitution and Finance Law require that all payments and refunds from the Fund be audited by the Comptroller prior to payment" and, further, that the "Finance Law requires all State Agencies to obtain prior approval by the Comptroller on all State Contracts exceeding \$50,000." As discussed below, the NYSIF believes

that these assertions are not supported by applicable statutory and case law and longstanding practice between the NYSIF and OSC.

Pursuant to § 76 of the WCL, the NYSIF is an agency established within the New York State Department of Labor. The NYSIF is administered by a Board of ten (10) Commissioners who are appointed by the Governor with the advice and consent of the Senate. In addition, the Commissioner of Labor serves as an *ex officio* member of the Board. WCL § 77.

The powers and duties of the Board of Commissioners are prescribed by statute, and are primarily contained in WCL § 82. The mission of the NYSIF is to provide workers' compensation insurance to employers within New York State at the lowest possible rates consistent with the maintenance of a solvent fund. *See* WCL §§ 76; 89. The Board is required to "consider at all times the condition of the Fund and examine into its reserves, investments and all other matters relating to its administration." WCL § 82 (3).

The NYSIF competes in a competitive marketplace with private insurance carriers, pays business franchise taxes and is regulated by the New York State Department of Insurance ("DOI"). The NYSIF is financially self-sustaining, receiving neither legislative appropriation nor other taxpayer funds. Its administrative costs and indemnity payments are funded from premium and investment earnings, (*see* WCL §§ 76 *et seq.*). "The entire expense of administering the [NYSIF] shall be paid out of such fund which shall not be considered an agency or a fund of the state for the purposes of [§ 4 of the SFL]." WCL § 88. Further, the law provides that "[n]o payment, expenditure or refund shall be subject to pre-audit by the department of audit and control as provided by [§ 111 of the SFL]." *Id.*

#### Pre-Auditing:

Article V, § 1 of the New York State Constitution, which is the "wellspring of the Comptroller's authority" (*McCall v. Barrios-Paoli*, 93 N.Y.2d 99, 104 (1999)), provides in pertinent part, that:

[t]he comptroller shall be required: (1) to audit all vouchers before payment and all official accounts; (2) to audit the accrual and collection of all revenues and receipts; and (3) to prescribe such methods of accounting as are necessary for the performance of the foregoing duties . . . *In such respect the legislature shall define the powers and duties* [of the Comptroller] . . . *The legislature shall assign to him or her no administrative duties*, excepting such as may be incidental to the performance of these functions, any other provision of this constitution to the contrary notwithstanding. (Emphasis added).

Article V, § 1 of the State Constitution requires the Comptroller "to audit all vouchers before payment and all official accounts." This language suggests that the Comptroller's pre-audit functions are confined to those payments which are voucher based. The NYSIF does not make any payments by means of a voucher.

Chapter 635 of the Laws of 1996 ("Chapter 635") amended WCL § 88, which governs NYSIF finances. The amendments to WCL § 88 included: (i) removing the NYSIF from the legislative

appropriation process by exempting it from § 4 of the SFL; (ii) repealing the requirement that NYSIF submit its annual budget to the State Division of the Budget; and (iii) providing that NYSIF expenditures shall not be subject to pre-audit by the OSC.

The changes to WCL § 88 enacted by Chapter 635 were intended to make the NYSIF more competitive and its financial management more efficient by removing it from the strictures of the State budget process. These provisions allow the NYSIF the flexibility it requires to more quickly procure and fund its needs for personal services, equipment and facilities, thereby enabling it to better respond to the competitive insurance marketplace. In commenting on taking NYSIF off-budget, the Governor's Memorandum approving Chapter 635 stated that its purpose was "to enhance the Fund's ability to operate as an efficient business operation . . . [which will benefit] New York's employers in the form of better service and reduced premiums." Clearly, the same policy purpose applies to exempting the NYSIF from OSC pre-audit requirements.

The Legislature designated the Superintendent of Insurance as the examiner of the NYSIF's financial books and records, as the Superintendent does for private insurance companies. See Insurance Law §§ 302 and 2313. In compliance therewith, the NYSIF files its annual financial statements with the DOI. The financial statements filed by the NYSIF are fully-audited by independent outside auditors, in the same manner as the financial statements filed by private workers' compensation insurance carriers. See Insurance Law §§ 310 and 307; WCL § 99. Also, the Legislature has designated the Superintendent as the final reviewer and approver of NYSIF real estate, office maintenance and investment contracts. See WCL §§ 81 and 87.

In *Blue Cross & Blue Shield v. McCall*, 89 N.Y.2d 160, 168 (1996), the Court of Appeals held that the plain language and history of Article V, § 1 compelled the conclusion that the audit of not-for-profit health insurers was an "administrative" duty not incidental to the OSC's core functions. The Court recognized the State's long history of regulating the business of insurance through the DOI, which possesses broad regulatory and audit powers as well as specialized expertise in the insurance industry. Since the insurance audits challenged in *Blue Cross* were within the jurisdiction of the DOI, the Court reasoned that the same duties must be considered "administrative" when performed by the OSC.

By making the Superintendent responsible for examining the finances of the NYSIF (as he or she does for private carriers) and expressly excluding NYSIF payments, expenditures and refunds from the pre-audit authority of the Comptroller, the Legislature has made clear beyond peradventure that there exists no requirement for the OSC to pre-approve all NYSIF payments, expenditures or refunds.

#### Contract Approval:

The NYSIF understands from discussions with the OSC's Counsel's Office in connection with this audit that the OSC now construes § 112 of the SFL to apply to the NYSIF. As was indicated to OSC's Counsel in those discussions, the issue of whether SFL § 112 applies to NYSIF contracts, particularly contracts for legal services, has been addressed by the courts. For example, in *Royal Insurance Company of America*, 289 A.D.2d 807, 808 (2001) (citations omitted), the Appellate Division, Third Department stated that:

Both this Court and the Court of Appeals have recognized the uncertain status of the Fund, particularly in matters of litigation. As we stated in Matter of Carney v. Newburgh Park Motors [84 A.D.2d 599, 600 (1981)], “while the [SIF] is an agency of the State, its function is akin to that of a private insurance carrier and, especially in matters of litigation, it is considered to be an entity separate from the State itself.” Moreover, the revenues of the Fund are raised by premiums it charges for the policies it issues and investments made from these funds (*see*, Workers’ Compensation Law § 76 [1]) and these moneys may not be transferred to any other fund nor used for any purpose other than those of the Fund (*see*, Workers’ Compensation Law § 76 [5]). Given that the purpose of State Finance Law § 112 is to prevent the improvident expenditure of general State revenues, we are unpersuaded that the provisions of this statute apply to the expenditure by the Fund of its revenue for counsel fees incurred in the defense of one of its insureds, an expenditure it is obligated to make by the terms of the policy of insurance it issued.

The OSC has previously acknowledged, both in administrative practice and documentary form, that the NYSIF is treated by statute as a separate insurance entity and that, especially in litigations, it is considered to be separate from the State. In an April 9, 1992 OSC Memorandum, entitled “Subject: MA-1191/004-A State Insurance Fund Method of paying Temporary Service Agencies,” the OSC stated as follows:

Nonetheless, claims-related contracts may fall within the “insurance purposes” exception set forth in Methodist Hospital [64 N.Y.2d 365 (1985)], and Commissioners of the State Insurance Fund [3 N.Y.2d 590], *supra*. Specifically, contracts directly related to the payment of claims expenses, including the issuance of insurance policies and the establishment of their terms and conditions and the fixing of premium rates, may be considered as part of a separate insurance business and that the Fund, for such purposes, is considered to be an entity separate from the State itself. In said event, the Fund would not be considered a State agency for purposes of [SFL §112]. We believe this to be a reasonable interpretation of the statute.

In a Footnote 2 of the 1992 Memorandum, the OSC also stated that:

The exception relating to ‘insurance purposes’ is based upon the fact that ‘in fixing and collecting premiums, in maintaining surplus and reserve, and in the requirement that it be examined by the State superintendent of insurance (section 99) as to investments, reserves etc, the Fund is treated by the statute much like a private insurance company . . . From all this it appears that the Fund, while it is not a separate corporation and while it is an agency of the State in one sense, [the Fund] is nevertheless treated by

the statutes as a separate insurance business (see requirement that it pay franchise tax, Tax Law, § 187, subd.6) and that, especially in litigations, it is considered to be an entity separate from the State itself [*Commissioners of the State Insurance Fund v. Low*, 3 N.Y.2d 590, 170 N.Y.S. 795 (1958)].

Several types of NYSIF contracts are expressly governed by Article 6 of the WCL. For example, WCL § 81 authorizes the NYSIF Board of Commissioners, any law to the contrary notwithstanding, to: (i) maintain offices at such places within the State as may be required to properly and conveniently transact the business of the Fund; (ii) acquire real property and construct new buildings or reconstruct, operate and maintain existing buildings to provide suitable office space for the convenient transaction of the business of the Fund; and (iii) rent to private tenants or public entities any available space in such premises, buildings or property not required by the Fund, with or without leases, as the Commissioners deem to be in the best interests of the Fund. WCL § 84 authorizes the NYSIF General Attorney to secure outside counsel and provide for payment of such counsel's compensation, subject to the approval of the Board of Commissioners. WCL § 87 authorizes the Board of Commissioners to order investment of surplus or reserves in certain types of securities prescribed by law, subject to the approval of the Superintendent.

The NYSIF maintains internal policies designed to ensure that the procurement process is fair and transparent while protecting the interests of the NYSIF and its policyholders. NYSIF procurement methods involve, for example: (a) notice and publication; (b) competitive bidding; (c) use of standard State clauses; (d) vendor responsibility review; (e) encouragement of Minority and Women-Owned Business Enterprises ("MWBE"); and (f) utilization of preferred sources consistent with SFL § 162. NYSIF contracts are subject to direct oversight and approval by the NYSIF Board of Commissioners and, where required, the Superintendent. See WCL §§ 81 and 87. With few, if any, exceptions, these types of contracts have, historically, not been submitted to the OSC for approval. This is consistent with the "insurance purposes" exception discussed in the 1992 OSC Memorandum mentioned above.

In sum, there is ample support for the long-held position of the NYSIF that SFL § 112 is inapplicable to NYSIF procurements made in connection with its litigation or "insurance purposes."

**Recommendations:**

It is the policy of the NYSIF to procure goods and services consistent with the procurement guidelines, SFL and other relevant laws. However, the NYSIF does not concur with the OSC's recent conclusion that the law requires all NYSIF payments and refunds to be subject to pre-audit by the OSC. Nor does the NYSIF agree that all of its contracts in excess of the SFL discretionary threshold are subject to pre-approval by the OSC.

In addition to the legal authority cited above, there exists considerable other such authority supporting the conclusion that NYSIF has a unique legal status. In light of the foregoing, the NYSIF believes that the draft recommendations proposed by the OSC: (i) lack support in the law; (ii) contradict years of established practice; and (iii) would, if implemented, impair the NYSIF's ability to fulfill its mission of providing low-cost workers' compensation and disability

benefits insurance to employers within the State. Therefore, it is respectfully requested that the OSC reassess its conclusions and modify its recommendations accordingly.

As has been the case throughout this process, NYSIF legal and professional staff stands ready to work with the OSC to achieve mutual understanding and resolution of these issues.

Thank you for your consideration in this matter.

Sincerely,



Gregory J. Allen  
General Attorney

cc: Francine James  
John Dalton  
Jean Woodard  
Howard Feldman  
Susan Sharp  
Joseph Mullen  
Ken Shulman

Note: Attachment "A" to this letter contains NYSIF comments regarding some particular payments listed under the heading "Other" in the OSC Draft Report.

**Attachment A:**

Comments on "Other" payments:

**FT Interactive Data, Image Data Inc., and NCCI Holdings Inc.** – For payments related to these three (3) vendors, as previously indicated in our response to the preliminary findings, NYSIF did not expect to exceed the discretionary threshold and, in fact, did not do so until final payments were made.

Please note that SFL § 163 (6-b) states "for determination of threshold amount purposes of determining whether a purchase is within the discretionary thresholds established by subdivision six of this section, the commissioner and state agencies shall consider *the reasonably expected* aggregate amount of all purchases of the same commodities or services to be made within the twelve-month period commencing on the date of purchase." (Emphasis added). With respect to each of these three (3) vendors, NYSIF did not, and could not reasonably foresee exceeding the discretionary threshold. Based on 2008 expenditures for FT Interactive and NCCI Holding Inc., NYSIF has since implemented additional procurement protocols. There is no longer a need for the services provided by Image Data. Please note, OSC on-site auditors reviewed and approved all payments to the three (3) vendors noted above.

**Oracle USA Inc.** – Attachment A indicates that payments to this vendor totaled \$56,965. This payment amount is incorrect. The OSC did not take into account the reversed distributions and, therefore, payments to Oracle USA Inc. on Attachment A are overstated by \$3,997.

OSC's conclusion that payment amounts for Oracle USA Inc. exceeded the discretionary threshold is incorrect. SFL§ 163 (6-b) provides that a discretionary threshold is determined by the "...aggregate amount of all purchases of the *same* commodities or services." (Emphasis added). In the case of payments made to Oracle, there were two (2) separate and distinct purchases: one for training in the amount of \$3,000; and one for the purchase of unrelated software and maintenance in the amount of \$49,968. For the software and maintenance purchase, NYSIF received from the OSC an exemption from any requirement to advertise and made this purchase for an amount below the discretionary threshold, consistent with the procurement guidelines. Each of these two (2) payments was made consistent with the SFL and procurement guidelines.

Attachment A indicates that there were eight hundred sixty-two (862) payments issued to the twenty-five (25) vendors referenced. We would like to clarify that there were three hundred sixty two (362) checks or payments issued to vendors for the related expenses noted on Attachment A. The "862 # of payments" denoted on Attachment A refers to line items posted to respective purchase orders. However, all line items with a negative amount were not taken into account when the transactions were reviewed. As stated above, by not taking into account postings with negative amounts, expenditures and the number of payments on the draft report are overstated.