A REPORT BY THE NEW YORK STATE OFFICE OF THE STATE COMPTROLLER

Alan G. Hevesi
COMPTROLLER

RESEARCH FOUNDATION OF THE STATE UNIVERSITY OF NEW YORK

ADMINISTRATIVE AND DISCRETIONARY COSTS

2004-S-13

DIVISION OF STATE SERVICES

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Report 2004-S-13

Mr. John R. Ryan
Acting Chancellor
State University of New York
State University Plaza
Albany, New York 12246

Dear Mr. Ryan:

The following is our audit report addressing the administrative and discretionary costs of the Research Foundation of the State University of New York for the period July 1, 2001 through December 31, 2003.

This audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law. Major contributors to this report are listed in Appendix A.

Office of the State Comptroller
Division of State Services

June 9, 2005

EXECUTIVE SUMMARY

RESEARCH FOUNDATION OF THE STATE UNIVERSITY OF NEW YORK

ADMINISTRATIVE AND DISCRETIONARY COSTS

SCOPE OF AUDIT

The Research Foundation of the State University of New York (Foundation) was chartered in 1951 by the Board of Regents as a private, nonprofit educational corporation. The purpose of the Foundation is to expand the educational mission of the State University of New York (University) through fund raising, to administer gifts and grants, and to promote and administer externally sponsored research.

Foundation revenues come mainly from research grants and, to a lesser extent, from miscellaneous sources such as investment income. Furthermore, the Foundation recovers its indirect costs to administer and support grant programs and those of the University as well. During the two fiscal years ended June 30, 2003, grant revenues funded about $1.2 billion of sponsored program (research) and related expenses. For this same period, indirect cost recoveries and miscellaneous revenues provided about $247 million. Of this $247 million, we estimate that about $162 million was spent for the Foundation's administrative and support operations and the balance (about $85 million) was spent for discretionary initiatives. The Foundation's discretionary expenses are intended to support the overall mission of the University, and they are generally made at the direction of senior University officials.

On June 1, 1977, the Foundation and the University made a written agreement (in accordance with Chapter 50 of the Laws of 1977) to formalize their respective relationships, duties, and responsibilities. The agreement provides for the Foundation to make an annual payment to the University's Income Fund in an amount determined by the Foundation and the University. This amount is also subject to the approval of the State Director of the Budget, following consultation with the State Comptroller. The agreed to payment represents a portion of the indirect cost recoveries and miscellaneous revenues and represents amounts beyond that which are required to fund the Foundation's sponsored program administrative and support functions. In this way, some of the funding from indirect cost recoveries and intended for funding University program activities becomes subject to the State appropriation process and the attendant State rules, regulations and oversight.

Our audit addressed the following question relating to the Foundation's administrative and discretionary expenses, for the period July 1, 2001 through December 31, 2003:

- Do the expenditures comply with Foundation policies and procedures and do the discretionary expenditures support the University's mission?

AUDIT OBSERVATIONS AND CONCLUSIONS

We concluded that the expenditures we tested generally complied with established Foundation policies and procedures, and that the discretionary expenses were for program activities that generally supported the mission of the University. However, we identified exceptions, and in some cases it appeared that the Foundation was used to circumvent prescribed State policies and laws applicable to the University.

From our test of a judgmental sample of 576 payments, totaling $9.8 million from a universe of $170.1 million for the period July 1, 2001 through December 31, 2003, we determined that the Foundation awarded 11 contracts totaling about $2.4 million without following competitive procurement procedures. Six contracts, totaling about $1.1 million were awarded on a single source basis, but there was no documentation justifying that only a single source was available. One single source contract involved a lobbying firm that was paid $600,000 to $720,000 per year. For this contract, we found several monthly payments (ranging from $50,000 to $60,000) for which the invoices did not detail the specific services provided. Also, 11 other vendor payments totaling $160,982 were inconsistent with the University's policy and may not have supported the University's objectives. For example, $137,500 of discretionary payments provided two campus presidents with supplemental housing allowances. These supplements caused the University limits on housing allowances to be exceeded for both presidents. Our tests also identified questionable payroll practices, including two instances where employee salaries were supplemented in amounts beyond the limits allowed by State law. (See pp. 17-27)

We further noted that the provisions of the 1977 agreement, providing for the deposit of an agreed to amount of indirect cost recovery and miscellaneous revenues into the University's Income Fund, had not been utilized during our audit period. Instead, the Foundation directly allocated these funds to the University's campuses and System Administration. As a result, these surplus amounts were not subjected to the State's appropriation and oversight processes. In total, about $109 million could have been deposited into the Income Fund from July 1, 2001 through December 31, 2003.

Follow-up showed that the Income Fund provisions of the 1977 agreement were last utilized in the 1991-92 fiscal year. In that year, to help reduce total General Fund expenditures and personnel costs, the Executive Budget recommended

revamping the system of allocating the Foundation's revenues. Subsequently, the Legislature eliminated the payment for that year of $15.3 million of indirect cost recoveries into the Income Fund. This helped to offset the impact of a reduction in General Fund appropriations to the University. However, for the years after 1991-92, the Foundation was unable to provide supporting documentation that the Legislature agreed with the elimination of the deposit of revenues into the Income Fund. Similarly, there was no documentation that this decision was approved by the Director of the Budget after consultation with the State Comptroller. We believe the risk for exceptions, such as those that we identified from our sample of Foundation payments, is increased when agreed to amounts of indirect cost recoveries and miscellaneous revenues are not deposited into the Income Fund and are not subjected to the State's appropriation and oversight processes. We also believe the risk for exceptions could be decreased with improved monitoring of such expenditures through the Foundation's Internal Audit unit. (See pp. 13-15)

COMMENTS OF FOUNDATION OFFICIALS

Foundation officials generally disagreed with two of our six recommendations. For example, officials do not agree with our recommendation that they develop formal guidance and formalize limitations regarding how the indirect cost recoveries and miscellaneous revenues should be spent. They also do not agree that the provision of the 1977 agreement concerning the deposit of an agreed to amount of indirect cost recovery and miscellaneous revenue into the Income Fund should be complied with.

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INTRODUCTION

Background

The Research Foundation of the State University of New York (Foundation) was chartered in 1951 by the Board of Regents as a private, nonprofit educational corporation. The purpose of the Foundation is to expand the educational mission of the State University (University) through fund raising, to administer gifts and grants, and to promote and administer externally sponsored research. The mission of the Foundation is to serve and support the University and strengthen the economic impact of the University. The Foundation is governed by a Board of Directors that includes researchers and representatives from the campus and system administration, as well as representatives from private business and industry. The Chancellor of the University serves as chair of the board, ex officio.

Since its inception, the Foundation has facilitated research, education, and public service at its central office in Albany and at 30 State-operated University locations. The locations are responsible for the day-to-day administration of sponsored programs, including financial, human resources, procurement, and reporting. The Foundation's central office has established policies and procedures for the aforementioned activities. Each location must adhere to the central office's policies and procedures. Locations may have additional policies and procedures that are more restrictive or that apply to specific conditions at that location.

On May 14, 1964, the Board of Trustees of the University formally recognized and approved (through a resolution) the cooperative relationships and procedures developed by the University and the Foundation with respect to sponsored programs. Pursuant to the resolution, the Foundation became responsible for the fiscal administration of the University's sponsored research programs conducted on University premises under the direction of University faculty, with other than State-appropriated funding.

Foundation revenues come mainly from research grants (which include reimbursement for the direct and indirect costs associated with the grants) and, to a lesser extent, from miscellaneous sources such as investment income. Direct expenditures are program costs that are specifically identifiable to an individual project account. Indirect costs are charged (or allocated) to a program to cover administrative and facility costs that are not specifically identifiable to a project. Furthermore, the Foundation recovers both its own indirect costs to administer and support grant programs and those of the University as well. Consequently, the Foundation generates significantly more revenue than it needs to fund its grant administration and support functions.

During the two fiscal years ended June 30, 2003, revenues funded about $1.2 billion of sponsored program and related expenses. For this same period, indirect cost reimbursements and miscellaneous revenues provided about $247 million. Of this $247 million, we estimate that about $162 million was spent for the Foundation's administrative and support operations and the balance (about $85 million) was spent for discretionary expenses. The Foundation's discretionary expenses are intended to support the overall mission of the University, and they are generally made at the direction of senior University officials.

On June 1, 1977, the Foundation and the University made a written agreement (in accordance with Chapter 50 of the Laws of 1977) to formalize their respective relationships, duties, and responsibilities. According to the agreement, the Foundation is the fiscal administrator of all funds awarded by the federal government and other external sources for sponsored programs at University institutions. In addition, the agreement requires the Foundation to support sponsored programs through the employment of personnel, the purchase of equipment and supplies, and the receipt and disbursement of funds. Furthermore, the agreement requires the Foundation to submit to the University an annual financial plan which sets forth the funds awarded by sponsors and identifies the Foundation's income from the recovery of program costs and miscellaneous revenues (including interest income, technology licensing fees, and income from other sources).

The agreement also provides for the Foundation to make an annual payment to the University's Income Fund in an amount determined by the Foundation and the University. This amount

is subject to the approval of the State Director of the Budget, following consultation with the State Comptroller. The payment would be made from the indirect cost recoveries and miscellaneous revenues beyond the amounts required to fund the Foundation's sponsored program administrative and support functions. In this way, certain funding for program activities would become subject to the State appropriation process and the attendant State rules, regulations and oversight.

The agreement remains in effect unless and until terminated by the University or the Foundation by one year's prior written notice from one party to the other. If the agreement is terminated, no additional sponsored programs will be undertaken.

Audit Scope, Objective and Methodology

We audited the Foundation's controls over the expenditures from its indirect cost recoveries and miscellaneous income for the period July 1, 2001 through December 31, 2003. The objective of our performance audit was to determine if such expenditures complied with Foundation policies and procedures and that discretionary expenditures supported the University's mission.

To accomplish our objective, we reviewed Chapter 50 of the Laws of 1977 to familiarize ourselves with the relationships, duties, and responsibilities of both the Foundation and the University in regards to sponsored program activities of the University. We also reviewed the federal government's Circular A-21 (Cost Principles for Nonprofit Organizations), the cost accounting classifications as defined by the National Association of College and University Business Offices, the Foundation's financial statements, and the Foundation's policies and procedures for spending indirect cost monies. In addition, we reviewed the Foundation's indirect cost accounts to evaluate and assess their reasonableness. We met with Foundation officials to gain an understanding of the Foundation's responsibilities and policies and procedures in relation to the indirect costs. We selected and tested a sample of indirect cost payments, and conducted a payroll match of University and Foundation employees.

We conducted our audit in accordance with generally accepted government auditing standards. Such standards require that we

plan and perform our audit to adequately assess those operations of the Foundation which are included within our audit scope. Further, these standards require that we understand the Foundation's internal control structure and its compliance with those laws, rules and regulations that are relevant to the operations which are included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments and decisions made by management. We believe that our audit provides a reasonable basis for our findings, conclusions and recommendations.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State, several of which are performed by the Division of State Services. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions, and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these management functions do not affect our ability to conduct independent audits of program performance.

Response of Foundation Officials to Audit

We provided draft copies of this report to Foundation officials for their review and comment. Their comments were considered in preparing this report and have been included as Appendix B. Our rejoinders to the Foundation response are presented as State Comptroller's Notes, Appendix C.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Chancellor of the State University of New York shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons why.

FOUNDATION DEPOSITS TO THE UNIVERSITY INCOME FUND

Generally, external grants provide funding for the both the direct and indirect (facilities and administrative) costs of a sponsored project. According to the agreement of June 1, 1977, the Foundation is responsible for the recovery of indirect costs attributable to facilities and support services provided by the University, as well as its own grant administration functions. Moreover, the agreement requires the Foundation to try to obtain from sponsors the maximum possible reimbursement of indirect costs. In addition, the Foundation derives miscellaneous revenues from investments and other sources. Thus, the Foundation generates more funding than it needs for its own grant administration functions by virtue of it recovering not only its own indirect costs but also the indirect costs of the University's operations.

According to the agreement, the activities to be funded by indirect cost recoveries and miscellaneous revenues include (but are not limited to) the following: the operation of the Foundation's offices and other costs incurred to manage and administer sponsored programs; the maintenance of adequate working capital and appropriate reserves and contingency funds; the direct payment by the Foundation into the University's income fund of an annual sum, to be mutually agreed upon by the Foundation and the University, subject to the approval of the Division of the Budget following consultation with the State Comptroller; payments for local support services provided by the colleges and other institutions at which the sponsored programs are conducted; support of University governance programs; and support of University programs to enrich and supplement State-supported programs.

In accordance with the agreement, the Foundation deposited $1.5 million into the University's income fund for the 1977-78 fiscal year. Although documentation was not provided for the deposits, the Foundation stated that a mutually agreed upon sum was deposited into the University's income fund from the 1978-79 through the 1990-91 fiscal years. However, for the 1991-92 year, the State Legislature approved the elimination of that year's projected payment ($15.3 million) due to the need to

reduce State spending (including appropriations to the University) at that time, while maintaining the essential mission of the University. Moreover, for the 1992-93 fiscal year and every year thereafter, the Foundation has not made an annual payment to the University's income fund pursuant to the specific provisions prescribed by the agreement. Therefore, we conclude that the Foundation and the University have not complied with the 1977 agreement.

Furthermore, we requested the Foundation to provide us with the quantitative analysis to support the amount of funds paid into the Income Fund during the period when such payments were being made. However, the Foundation was unable to provide us with any analysis. We also requested the Foundation to provide us with an estimate of the funds available during our audit period for deposit into the University's Income Fund. However, the Foundation did not provide us with any such estimate. Consequently, based on our analysis of pertinent Foundation records and data, we estimated that as much as $109 million was available for deposit into the University's income fund during the period of our audit (July 1, 2001 through December 31, 2003).

Instead of making an annual payment as required by the 1977 agreement, the Foundation now allocates indirect cost recovery and miscellaneous revenue surpluses to each campus based on that campus' share of costs that generated the recoveries. However, Foundation officials were unable to provide us with any supporting documentation of the decision to redirect cost recoveries from the Income Fund directly to the campuses, nor any documentation that this decision was agreed to by the University and the Division of the Budget in consultation with the State Comptroller. It is important to note that funds paid into the University's Income Fund are subject to the State's standard review and approval procedures (including appropriation, budget and pre-audit) before they are spent. Because the amounts in question are no longer paid into the Income Fund, expenditures of these funds are no longer reviewed and approved by State oversight authorities prior to disbursement. As detailed subsequently in this report, we found that University officials used funds for expenditures that State oversight authorities might not have approved in certain instances.

In response to our preliminary audit findings, Foundation officials stated that they do not concur that the Foundation should consult with the State Comptroller regarding the amount

to be deposited into the University's Income Fund. Officials have taken the position that the Foundation is not currently required to make such deposits. Officials indicated that as a result of an agreement worked out between the Executive and Legislature while preparing the State's 1991-92 budget, the requirement was eliminated.

However, we believe that this agreement applies only to the 1991-92 fiscal year, and that there was no formal approval to eliminate the requirement in subsequent years. In addition, no modifications were proposed or made to the 1977 agreement to reflect elimination of provision for depositing amounts into the Income Fund. In reply to our request to provide us with a quantitative analysis to support the amount of funds previously paid into the University's Income Fund, officials stated that the basis is spelled out in the 1977 agreement: all funds not needed for the administration of the Foundation and for the fiscal management of the grants were available for deposit.

Recommendation

1. Comply with all provisions of the 1977 agreement regarding payment of monies to the University's Income Fund. To facilitate consultation with the State Comptroller, the Foundation should provide a formal analysis and justification of the amount to be deposited into the University's Income Fund each year.

   (In response to our draft report, Research Foundation Officials disagreed with our recommendation. They said that the Foundation is not currently required to make such deposits.)

   Auditor's Comments: Foundation officials were unable to provide us with any supporting documentation that the Legislature agreed to permanently end deposit of indirect cost recovery into the Income Fund.

EXPENDITURES FOR GOODS AND SERVICES

The Foundation has established policies and procedures regarding the use of funds obtained from indirect cost recoveries and miscellaneous revenues. As prescribed by a statement from the Foundation's Board of Directors in June 1991, these funds may be used to support three major functions of the University: instruction, organized research and other sponsored activities, and institutional activities. Moreover, the Foundation provides broad discretion to campus and University System Administration officials in their use of these funds. In general, allocations of surplus indirect cost recoveries and miscellaneous revenues can be spent (with few limitations) for any good or service that officials believe is consistent with the mission of the University.

We requested a computer file download of all indirect cost recovery and miscellaneous income expenditures for all 33 Foundation location codes for the period of July 1, 2001 through December 31, 2003. The download consisted of 174,060 payment invoices. We then judgmentally selected a sample of 576 payment invoices (totaling $9.8 million from a universe of $170.1 million) at nine Foundation locations to review. We chose transactions from the eight locations with the highest dollar value of expenditures, making up over 95 percent of the total amount of expenditures at all 33 campus location codes. In addition, we chose transactions to test from one location where a complaint was filed with our office. To arrive at our judgmental sample of 576 payment invoices, we selected 75 percent of the payment invoices at each of the nine locations from the following payment categories: miscellaneous payments, travel payments, unallowable payments, food and beverage payments, and consulting payments. In addition, the remaining 25 percent of the sample consisted of payment invoices in all categories of payment, including the categories previously mentioned. Our review focused on determining if Foundation expenditures complied with applicable policies and procedures and whether the expenditures in support of their sponsored programs were appropriate. We reviewed 226 payments at Stony Brook, 122 payments at the Foundation's central office, 58 payments at the University at Buffalo, 53

payments at Albany, 44 payments at the Sponsored Programs Office (SPO), 41 payments at Downstate Medical, 13 payments at Upstate Medical, 10 payments at Purchase and 9 payments at Buffalo State.

We concluded that expenditures of such funds generally supported University programs and were generally consistent with Foundation policies and procedures. Based on the specific transactions we tested, we did not identify any systemic non-compliance with Foundation policies and procedures. In addition, any grantee, such as the Foundation, that wishes to be reimbursed for organization-wide facilities and administrative costs associated with conducting federal research, needs to have negotiated an indirect cost proposal rate. We reviewed the process used by the Foundation to establish the indirect cost proposal rate. We found that the Foundation's process was adequate to ensure that only eligible costs are used in determining the rate.

However, based on our audit tests, we determined that competitive procurement procedures were not used for several large contracts, and the justifications for certain single source contracts were not documented. Further, we found that 14 invoices (for amounts ranging from $635 to $105,614) from a lobbyist did not detail the specific services rendered or extra expenses incurred. We also determined that the Foundation paid supplemental housing allowances (in addition to allowances paid by the University) to two campus presidents for amounts that significantly exceeded the prescribed State limits. In 11 instances, it appeared that the University used the Foundation to circumvent prescribed State policies and procedures. The absence of formal limitations on the use of surplus Foundation balances and limited monitoring by Foundation officials (including the Foundation's Internal Audit Unit) were major reasons for our findings.

Procurement

The Foundation's procurement policies and procedures require officials to obtain bids and proposals for certain contracts based on the total dollar amount of the purchase requisition. For purchase requisitions under $9,999, bids or proposals are not required; for purchase requisitions ranging from $10,000 to $25,000 a minimum of three written or verbal bids or proposals are required; and for purchase requisitions

greater than $25,000 a minimum of three written bids or proposals are required. The written policy includes two exceptions. First, a sole source justification may be used for purchasing from the only available supplier of the product or service. Second, in cases where there are limiting circumstances, a single source justification may be used for purchasing from a supplier who is chosen without soliciting the minimum number of bids or proposals, despite the fact that competition exists.

In accordance with Foundation policies and procedures, formal bidding was required for but not done for 71 of the 148 invoice payments that we tested. We found that these 148 invoice payments correspond to 68 contracts. From the 68 contracts tested, 57 of the contracts complied with the Foundation's procurement policies and procedures while the other 11 contracts (totaling about $2.4 million) did not for various reasons. (Six of these contracts, totaling about $1.1 million were awarded on a single source basis, but there was no documentation justifying that only a single source was available.) The 11 contracts pertained to the central office, the SPO, Stony Brook, and Downstate Medical. In these instances, we believe that since officials did not comply with procurement policies and procedures, the Foundation did not have adequate assurance that it obtained the best price consistent with quality specifications.

At the central office, two contracts were not properly procured. Both contracts were entered into with the same vendor, for two different years, without formal bids. This vendor provided a lobbying service for the Foundation in support of the University. For the first year, the contract payment was $600,000. The contract payment increased the second year to $720,000. We found that the contracts were vague regarding the specific deliverables to be provided to the Foundation, and that the Foundation's billing process did not require adequate documentation before invoice payments were made. In fact, we determined that from the 31 invoice payments already made to this vendor, 14 of the payments (for amounts ranging from $50,000 to $60,000) were made without the Foundation having documentation as to specific services rendered and incidental expenses (such as travel, phone calls and food) incurred. Foundation officials subsequently contacted the lobbying firm to request the back-up documentation to support these invoices. We did not review the additional documentation since the

invoice payments were made without existing documentation at the time of payment.

Foundation officials stated that they considered three firms in their search, two of which made presentations to Foundation officials. The other firm, based on past experience, was unacceptable since Foundation officials were unsatisfied with prior service provided. Foundation officials were unable to provide us with documentation related to one of the presentations or with cost proposals from either firm. Foundation officials were also unable to provide us with an analysis, prior to the selection and approval of the contract, documenting that a review was performed which compared the specific services to be provided in relationship to the desired goals and the dollar amount of the contract.

At Stony Brook, we found six contracts that were not properly procured for various reasons. These six contracts correspond to 37 of the invoice payments we tested and ranged in value from $12,039 to $650,000. For example, in one contract, valued at $650,000, a consulting firm was hired for the development of a PeopleSoft project. For this contract, Stony Brook officials accepted resumes and interviewed consultants. They chose a consultant based on whom they felt had the skills and experience needed, and subsequently negotiated a contract price with the consultant's firm. Although the contract was not competitively bid according to existing policies and procedures, Stony Brook officials believed the price was reasonable based on past experience with consulting firms performing similar work. A second contract for $265,000 was entered into with a consulting firm to create a capital plan for Stony Brook. This consulting firm had created a multi-year capital plan for the State University Construction Fund (SUCF) in the past, and Stony Brook officials felt that it was in the best interest of the University to use the same firm for the campus' capital plan. Officials considered both of these contracts as single source, but could not provide the required documentation justifying this.

At the SPO, two contracts were not properly procured for various reasons. These two contracts correspond to two of the payments we tested. The first contract for $72,000 was entered into with a consulting firm to assist the University in formalizing relationships between the University, the Board of Regents, Cornell University and any other areas as may be requested by the Chancellor. Also, the consultant was to help support and enhance the major research initiatives across the State

University system, including the Centers for Excellence. The contract, however, does not provide specific detail of the scope of the work to be performed. SPO did not competitively procure this contract. SPO officials considered this procurement as a single source vendor, but were unable to provide sufficient documentation to substantiate this. Officials stated that the consultant was selected because of his wide range of experience, his list of contacts and his reputation as a negotiator. Officials acknowledged that the contract file did not contain all the facts necessary to justify this transaction. Foundation officials indicated that they will take the necessary steps to ensure that in the future such documentation is prepared and kept on file.

The second contract at the SPO was entered into with a company to install wiring for Foundation leased buildings. The Foundation has used this company since the 1980s, and at the time, had done an analysis of this firm and other firms that could provide the same service. SPO officials felt that this company's rates were still competitive with those of other firms and therefore did not obtain any bids from other companies. This contract totaled $30,000.

At Downstate Medical, we found one contract that was not properly procured. This contract, which totaled $16,357, corresponded to one invoice payment that we tested. This contract was entered into with a technology financing firm to pay for technology services. Downstate Medical officials indicated that they did not bid out the contract because their purchasing agent determined that the rate paid to the vendor was competitive.

In response to our preliminary audit findings, Foundation officials indicated that Foundation policy specifically identifies instances (single source and sole source procurements) where bids and proposals are not necessary. However, they acknowledged that in a number of cases they could have done a better job documenting such decisions.

Expenditures that May Not Be in Support of the University

From our sample of 576 invoice payments, we identified 11 payments totaling $160,972 that may not have specifically supported the University. We found a $7,000 invoice payment made to a SUNY employee to pay for his child's college tuition costs to an out-of-state school. Documentation indicated that the employee can receive this payment for up to 4 years. Foundation officials stated that this payment was necessary to attract this individual to work at the University. Officials stated that this person is a top expert in his field and his decision to come to SUNY was a major coup for the University. In another instance we found a $3,500 invoice payment to an employee for reimbursement of travel expenses to Russia. Included in the $3,500 charge was $660 for expenses for University employees to attend the opera, ballet, circus and puppet show while in Moscow and St. Petersburg.

We also found multiple payments, under one invoice, made to a college president for his housing allowance. The housing allowance totaled $46,500 and ranged from $4,750 per month to $6,000 per month. This allowance was in addition to the $37,500 the University was allowed to pay him under the University's Salary Plan for a president of a specialized or comprehensive college. In addition, we found five invoice payments, totaling $51,000, made to another college president for a housing allowance. This employee was also reimbursed $14,412 under one invoice for moving expenses, even though a New York State employee is limited to $3,000 for reimbursement from the State. Foundation officials believe that the additional housing payments and moving expense reimbursement allows the University to provide a more competitive compensation package when searching for the best candidate to fill vacant campus president positions and to retain them once hired.

We also found a $1,000 invoice payment to a charity on behalf of an Office of Children and Family Services employee in lieu of a retirement gift for this employee. Foundation officials stated that making contributions to charities is part of their normal business operations. Lastly, we found a $6,091 invoice payment to a hotel for a conference. The Foundation overbooked the hotel, and was obligated to pay for the overbooked rooms amounting to $3,410 of this bill. Foundation

officials admitted this was a mistake and that such an occurrence has not happened again.

In response to our preliminary audit findings, Foundation officials replied that they believe that existing controls are adequate to ensure that the Foundation's indirect cost recoveries are expended in a manner that specifically supports the University and its programs. However, we believe that the instances we cite show the need for improvement.

Travel

The Foundation has established travel policies and procedures which conform to the U.S. General Services Administration per diem rates. Using these rates as criteria for our travel review, we found that the Foundation was generally in compliance with the travel policies and procedures. We identified only 2 payments from the 86 travel invoice payments we tested where the Foundation paid New York State sales tax and did not file a tax-exempt form with the hotel where staff were staying.

Recommendations

2. As prescribed in the Foundation's procurement policies and procedures, require the central office and the campuses to obtain a minimum of three written or verbal bids or proposals for purchase requisitions ranging from $10,000 to $25,000 and a minimum of three written bids or proposals for purchase requisitions greater than $25,000. Adequately document the justification for using single and sole source contracts.

   (The Foundation agreed with the recommendation.)

3. Before paying invoices, require the vendor to provide adequate supporting documentation of the products and services provided.

   (The Foundation agreed with the recommendation.)

Recommendation (Cont'd)

4. Develop formal guidance and formalize limitations regarding how the Foundation's indirect cost recoveries and miscellaneous revenues should be spent, and perform periodic tests of transactions to ensure these policies are followed. For instance, limitations on expenditures should include, but not be limited to, restrictions of payments to employees for their child's tuition costs and restrictions of payments to employees for personal entertainment.

   (In response to our draft report, Foundation officials disagreed with our recommendation. They said that they believe that existing controls are adequate to assure that Foundation resources are expended in a manner that specifically supports the University and its programs.)

   Auditors' Comments: Our audit identified some transactions where the benefit to the University was not clear and which appear to circumvent established SUNY policy. Therefore, we maintain that our recommendation is appropriate.

PAYROLL COSTS

Under certain conditions, University employees may appear on the Foundation payroll, and Foundation employees may appear on the University payroll. For instance, professors at the University who perform research related activities are compensated by the University during the academic months and by the Foundation during the summer months. Also, a number of University employees participate in coordinating events for research-related activities, such as award ceremonies for inventors, during nights and weekends where they are compensated by the Foundation. There are also instances where an employee may have specific job duties that benefit either the University or the Foundation, and because of such, the employee is compensated by the University and the Foundation for the percentage of time in which the employee performed the specific duties for each paying entity.

The Foundation has established a policy for summer-only assignments to recognize the academic work schedule of colleges and universities. The Foundation has also established a policy for University employees who perform work on the Foundation-administered sponsored projects. These policies provide for the compensation of employees who perform work for both organizations and help ensure that the associated costs are properly assigned to each entity. However, we found instances where employee compensation arrangements were inconsistent with established policies. Specifically, we found two Foundation employees whose job duties are solely Foundation-related but were paid on the University's payroll and not by the Foundation. The Foundation reimbursed the University for both the salaries and fringe benefits for the two employees. According to Foundation officials, both employees are former State employees who did not want to withdraw from the State payroll system and forfeit some of their vested State benefits, such as participation in the State Employees' Retirement System. In acknowledgement of this situation, the Foundation arranged to have the University maintain both these employees on the State payroll system and have the Foundation reimburse the University for both the salaries and fringe benefits associated with them. After our audit scope

period, one of the employees resigned from the University and is now maintained entirely on the Foundation's payroll.

According to Foundation officials, it is not a widespread occurrence that former State employees who are currently performing Foundation-related activities are maintained on the University's payroll system to maintain their vested State benefits. However, it appears that this arrangement was not made in accordance with any Foundation or University policies and that it exists solely to benefit the individuals who remain on the State payroll system. Officials replied that the employee in question who remains on the University's payroll is wholly engaged in advancing the research activity at the University. They further stated that this practice has no cost to the State or the University as the Foundation reimburses the entire cost of the employee, including all fringe benefits and retirement costs. Furthermore, such an arrangement, on behalf of the University, enables the Foundation to avail itself of the specialized services and skills of individuals who happen to be State employees. Officials agree that there is no formal policy that governs this practice and they will rectify that situation as soon as possible.

We also found one University employee, whose job duties are solely University-related, is compensated by both the University and the Foundation. The University compensates this employee for the allowable salary a person in this University title may receive. The Foundation supplements this employee's salary because the employee was unable to attain a higher salary grade through the University. According to human resource files for this individual, this was a temporary arrangement until the employee was able to pass the required exam for promotion. This supplemental payment has continued for the last 16 years as the situation has remained unchanged. When this arrangement was first entered into on June 20, 1988, the Foundation compensated this employee for 6 percent of the employee's then University salary. Over the past 16 years of this arrangement, the Foundation has continually provided percentage increases to this employee's salary. As of December 31, 2003, the percentage supplemented by the Foundation has increased from 6 percent to 15.3 percent of the employee's current University salary. By allowing this University employee to be paid a supplemental income by the Foundation, the University is using the Foundation to circumvent the State system by allowing a State employee to earn a greater income than what is permitted under that employee's salary and title plan and has violated the Retirement and Social Security Law.

Officials agreed with our conclusions and took immediate action to remove the individual from the Foundation payroll.

We also identified another University employee (who was retired from the Division of the State Police) to whom the Foundation paid supplemental salary amounts, above the prescribed limit for full-time State employment. Sections 211 and 212 of the Retirement and Social Security Law establish the maximum amount that a retired State employee can earn by returning to work for a public employer. Retired State employees who return to work for a public employer may not earn a salary that exceeds the maximum annual compensation pursuant to a formula prescribed by the Retirement and Social Security Law.

This employee's standard work schedule was 30 hours per week (80 percent of a standard 37.5 hour full-time work week). According to available records, the University paid 60 percent of the employee's total base salary, and the Foundation paid the remaining 40 percent. Thus, the University paid this employee an annual State salary of $36,000 (the maximum amount allowed by the Law), and the Foundation paid the employee $28,280 annually, to perform no additional work beyond his standard University obligation.

Based on our review of available records and discussions with Foundation officials, we concluded that University and Foundation officials agreed to compensate the employee at a salary that exceeded the amount allowed by the Retirement and Social Security Law. Therefore, we conclude that University officials consciously used the Foundation to circumvent the Law, as it relates to limitations on State salary payments to people who previously retired from State service.

Recommendations

5. Discontinue the arrangement with the one employee who remains on the University's payroll while performing only Foundation-related activities.

   (Foundation officials did not specifically respond to this recommendation.)

Recommendations (Cont'd)

6. Discontinue paying salary and/or wage supplements to University employees (including the employee who failed to pass promotional exams and the retired State Trooper, as detailed in this report) unless such payments are for hours of service beyond the employees' standard work schedules for which the University pays them.

   (Foundation officials partially concur with this recommendation. They indicate that the individual who failed to pass the promotional exam has been removed from the Research Foundation payroll. With regard to the retired State Trooper, this individual was paid an annual salary of $36,000 by SUNY, the maximum amount to be paid a retired State employee. The balance of this individual's salary, $28,280, was paid by the Foundation for his involvement in Foundation-related activities.)

   Auditors' Comments: With respect to the retired State Trooper; Foundation funds were used to compensate a State employee for services performed during the employee's normal State work schedule. Consequently, the Foundation was used to circumvent prescribed State limitations on compensation.

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January 24, 2005

Mr. Steven Sossei
Audit Director
Office of the State Comptroller
110 State Street
Albany, NY 12236

Dear Steve:

I would like to extend my personal appreciation to you and your staff for the audit recently completed at The Research Foundation (2004-S-13). Although I suspect that we will continue to disagree on some minor points, I am gratified at your auditors' conclusion that the expenditures they tested generally complied with the RF's policies and procedures. This finding is entirely consistent with those made by the external auditors who review our operations each year.

As an aside, I would like to note that your letter transmitting the draft audit was addressed to Robert L. King, the chancellor of the State University of New York. As you know, section 170 of the Executive Law requires you to transmit draft copies of your audit reports to the head of the organization being audited. While we could debate the applicability of the Executive Law to a non-governmental entity, the fact is that Mr. King, while serving as chair (ex officio) of the RF Board of Directors, is, in fact, neither an officer nor has any management role in the corporation. Consequently, the draft report was sent to the wrong person at the wrong address, resulting in a significant delay in our receiving it. For the record, the chief executive officer and head of the RF is our president, Mr. John J. O'Connor, while I am the executive vice president and chief operating officer. All future correspondence should be directed to his or my attention at our corporate address, at the left.

* Note 1

Our formal response to the exception findings noted in the draft report is contained in the enclosed document entitled "Research Foundation Response to OSC Draft Report 2004-S-13 Recommendations – Report Dated 12/21/04." Thank you for the opportunity to comment.

Finally, I request that you remove the last sentence in the section entitled "Audit Observations and Conclusions." The clear implication is that in some way the Internal Audit staff at the RF are not or have not been fulfilling their responsibilities, a finding that is entirely inconsistent with the general findings of this very audit, not to mention the findings of innumerable previous audits by external auditors. It is gratuitous, inaccurate, unprofessional and unsupported by your own findings.

* Note 2

*See State Comptroller's Notes, page 43

My staff and I are available to discuss any further questions or issues that you may have.

Sincerely yours,

Timothy P. Murphy

Cc: John J. O'Connor, RF President
Bonny G. Boice, RF Treasurer
James R. Dennehey, RF General Counsel
Frank Zuraf, RF Vice President for Internal Audit

THE RESEARCH FOUNDATION
The State University of New York

Research Foundation Response to OSC Draft Report 2004-S-13
Recommendations – Report Dated 12-21-04

Following are the Research Foundation's (RF's) responses to each of the recommendations and related findings contained in your report. The responses are followed by general comments related to factual matters in the report that we believe require clarification.

Foundation Deposits to the University Income Fund

Recommendation (page 12 of report)

1. Comply with all provisions of the 1977 agreement including consultation with the State Comptroller regarding payment of monies to the University's Income Fund. To facilitate consultation with the State Comptroller, the Foundation should provide a formal analysis and justification of the amount to be deposited into the University's Income Fund each year.

Corporate Response:

We do not concur with your recommendation that the RF consult with the Comptroller regarding the amount to be deposited in the University's income fund each year. The RF is not currently required to make such deposits and it was never required to consult with the Comptroller regarding such payments. As a result of an agreement between the Governor and Legislature as part of the State's 1991-92 budget, the requirement that the RF deposit monies in the SUNY income fund was eliminated in exchange for an equal reduction in base State operating aid provided to SUNY. You indicate in your draft finding that officials at the RF have taken the position that the RF is not currently required to make such deposits. The RF has not taken a "position" on this issue. The RF Board of Directors adopted a resolution allocating the funds to the campus that earned them. This resolution was adopted in response to a request from University officials following the budget action described above. This resolution has been in effect since the 1991-92 fiscal year.

* Note 3

We further note that the language in the 1977 agreement concerning "consultation" refers specifically to consultation between SUNY, the State Director of the Budget and the Comptroller. The RF was not a party to this and is not in a position to direct such a consultation. In any event, the 1991-92 budget actions described above and following make such consultation meaningless.

We also do not concur with the conclusion in your report that the elimination of the payment of monies by the RF into the SUNY Income Fund in 1991-92 was a one-time

*See State Comptroller's Notes, page 43

event. The plan to continue the elimination of this payment is supported by language contained in the 1991-92 Executive Budget enacted by the State Legislature. Pursuant to Chapter 50 of the Laws of 1991, the University's appropriation for Graduate Education and Research was reduced by $15.3 million. According to the budget, this reduction was made "to restructure state support for state university research activities." Use of the term "restructure," in our opinion, indicates permanent change to structure or organization, rather than the temporary, one-year change suggested by your audit. Moreover, there are additional statements in the Governor's 1991-92 Executive Budget that further demonstrate the intent to permanently change or restructure the system of allocating research income. For example:

* Note 4

The budget document discusses the need to:

> "Promote research productivity and competitiveness by revamping the system of allocating research income."

When discussing opportunities to achieve savings the budget calls for:

> "...Redirecting Research Foundation reimbursements formerly recovered by the State to encourage greater research productivity and permit the University to support its research programs without additional State funding..."

Finally, the section of the budget covering the Research Foundation contains the following comments:

> "*The 1991-92 budget proposes to discontinue the annual payments which have been made by the Foundation to the State University Income Fund as partial reimbursement for overhead costs borne by the State (emphasis added).* This will provide a funding structure conducive to research productivity...Decentralization efforts within the Research Foundation will also be continued with the goal of maximizing administrative efficiency by redistributing contract management and technology transfer functions from Central Office to the large research campuses."

It is important to note that the 1992-93 Executive Budget does not contain a restoration of the $15.3 million payment, nor does it indicate a corresponding increase in the recommended income fund offset, again consistent with the intent of a permanent restructuring. We believe that a review of the Governor's 1991-92 Executive Budget supports the fact that the elimination of the annual Income Fund payment that first occurred in the 1991-92 fiscal year was intended to be a permanent restructuring of the system. As noted in the budget narrative, this change was made to encourage greater research productivity and competitiveness and to allow SUNY to support its own research programs without the need for additional State funding.

* Notes 3,4

We would note also that because of the growth of RF funded activity since 1991-92, it is highly unlikely that there would be significant funds available to make payments into the SUNY Income Fund, even if this requirement were still in effect. The 1977 agreement provides that activities to be funded by RF indirect cost revenues include the operation of the central office, the administration of sponsored programs (amounts we currently allocate

*See State Comptroller's Notes, page 43

to campuses), the maintenance of adequate working capital and appropriate reserves and contingency funds. Growth in RF activity since 1991-92 has significantly increased the need for working capital and for funds to cover contingencies. This growth can best be illustrated by recent experiences administering programs funded by New York State. Because the State has not been able to provide immediate funding for projects contracted with SUNY, the RF has used its working capital fund balances to get these important training projects off the ground. As a result of such arrangements, at 6/30/03 accounts receivable balances with New York State totaled $73 million. The RF's ability to use working capital funds to support these activities allows it to continue to grow SUNY's research enterprise as well as to allow for unforeseen contingencies.

*
Note
5

We also have the following comments regarding other sections of the draft report:

- You allege that the RF cannot provide the basis used in the past to determine the monies available for deposit into the SUNY income fund. This is not correct. The basis was quite simple and as you indicate in your draft report it is spelled out in the 1977 agreement: all funds not needed for the administration of the corporation and the fiscal management of grants were available for such deposits.

*
Note
6

- You allege that the RF cannot provide a methodology to reasonably estimate what monies currently would be available for deposit into the SUNY income fund. Under other circumstances, the methodology would be exactly the same as existed prior to the 1991-92 State fiscal year. As explained in our response to your recommendation above, the RF currently returns funds that would have been deposited into the income fund directly to the campuses that earned them. The RF has been doing this since the 1991-92 budget year.

*
Note
6

- You assert in your draft report that by not subjecting the monies in question to the State budget process and the State approval process, certain expenditures were made that would otherwise not have been approved by State authorities. We do not agree with this assertion. First, these are not State funds and need not, therefore, be managed according to State rules. Second, the RF maintains its own rules and regulations concerning how these funds may be spent and they require that it be for the benefit of the University. Third, there is nothing that would lead us to believe that the control processes in place in the RF are not adequate. Indeed, given the long series of clean audit opinions that the RF has received and the faith and trust placed in the RF every day by sponsors who have sent the RF literally billions of dollars over the years, we believe that the controls in place at the RF ensure the integrity of financial records and compliance with appropriate policies and regulations.

*
Note
7

*
Notes
2,8

- Finally, we would also note that the purpose for which RF funds can be expended are clearly spelled out in the 1977 Agreement and in RF's policy and procedures manuals. The latter provides that these funds may be used to support three major functions of each campus: instruction, organized research and other sponsored activities, and institutional activities. We are confident that RF funds have been spent within these guidelines. In addition, your current audit, covering a two and a half year period, concluded that expenditures you tested generally complied with established

*See State Comptroller's Notes, pages 43 - 44

Foundation policies and procedures and that discretionary expenses were made for activities that supported the SUNY mission.

Expenditures for Goods and Services

Recommendations (page 19 of report)

2. As prescribed in the Foundation's procurement policies and procedures, require the central office and the campuses to obtain a minimum of three written or verbal bids or proposals for purchase requisitions ranging from $10,000 to $25,000 and a minimum of three written bids or proposals for purchase requisitions greater than $25, 000. Adequately document the justification for using single and sole source contracts.

3. Before paying invoices, require the vendor to provide adequate supporting documentation of the products and services provided.

4. Develop formal guidance and formalize limitations regarding how the Foundation's indirect cost recoveries and miscellaneous revenues should be spent, and perform periodic tests of transactions to ensure these policies are followed. For instance, limitations on expenditures should include, but not limited to, restrictions of payments to employees for their child's tuition costs and restrictions of payments to employees for personal entertainment.

Corporate Response:

Procurement

We concur that all sole or single source contracts should be adequately justified and documented in the files and that the RF should obtain written or verbal bids where appropriate. We also concur in general that vendors should provide adequate supporting documentation related to services or products provided before the RF pays for them. We may disagree, however, as to how much documentation is "adequate." Finally, we do not concur that additional guidance or limitations are required regarding how the RF's indirect cost recoveries are spent. Additional comments regarding each of these areas are provided below.

We are pleased but not at all surprised that the Comptroller's staff found that expenditures for goods and services generally supported University programs and were generally consistent with Foundation policies and procedures. For the most part, the exceptions noted related to single or sole source transactions that do not require verbal or written bids based on Research Foundation policies and procedures. Again, we concur with your finding that the RF should provide more complete written justifications in the files supporting sole or single source purchases. We will take the necessary steps to instruct all RF employees involved in such procurements of the necessity to document all decisions made when making purchases that are subject to RF policies in this area.

We are also pleased that the review of transactions by the Comptroller's office did not identify any transaction in which goods or services were not received. In addition, there was no evidence that the Research Foundation overpaid for the goods or services it procured. With regard to the exceptions noted by the auditors there are a number of areas where we believe clarification is needed and some where we disagree with the conclusions reached. Our comments are presented in the following paragraphs.

The report identifies a central office finding that involves a contract with a lobbying firm that you assert did not contain specific detail regarding the scope of work to be performed. We disagree with this observation. The letter announcing SUNY's intention to contract with this firm and its attachment, copies of which were provided to you, discuss specific goals to be accomplished. Most of these goals involve activities that raise the State University's profile at the federal level. This includes scheduling meetings for State University officials to brief Members of Congress and Executive Branch officials, identifying opportunities for University officials to testify before Congress, and seeking to have State University representatives serve on Congressional panels, advisory boards and commissions. RF and SUNY staff have been monitoring the performance of the lobbying firm related to these objectives listed and have been pleased with their performance.

* Note 9

We might add that, as noted above, the main objective of the contract was to raise the State University's profile at the federal level. It was expected that a by-product of meeting the objectives of the contract would be increased opportunities for SUNY campuses to compete for certain grants and contracts. We have been monitoring this area and we previously provided you with data that shows a significant increase in the amount of "earmarked" funds (i.e., Congressionally-directed grants) provided to SUNY campuses after this contract began. We believe there is a direct relationship between this increase and the work of our consultant in Washington. We also provided you with comments by various campus presidents that discuss the benefits that have accrued to their campuses as a result of this contract.

Your draft report cited six contracts at Stony Brook with procurement problems. The report stated the following "At Stony Brook, we found six contracts that were not properly procured for various reasons. These six contracts correspond to 37 of the invoice payments we tested and ranged in value from $12,039 to $650,000." This statement is misleading. It suggests that the Foundation's procurement policies were disregarded in all these cases when, in fact, they were not. Most of these cases, including the two detailed in the draft report, were processed as single or sole source procurements, which is allowable under the RF's "Bids and Proposals Policy." In the cases detailed in the audit report, the procurement documentation provided to the auditors included written justifications identifying limiting circumstances that led to the selection of the consulting firms. Required documentation was provided, however, the Comptroller's staff concluded that the written justifications provided were not sufficient. Furthermore, the report states that in one contract, valued at $650,000, Stony Brook officials chose a consultant based on whom they felt had the skills and experience needed, and subsequently negotiated a contract price with the consultant's firm. The report also states that the contract was not competitively bid according to existing policies and procedures, and that Stony Brook officials believed the price was reasonable based on past experience with this firm. This statement is incorrect and should be clarified. First, the contract was not competitively bid because it was processed as a single source procurement, which is allowable under the Research Foundation "Bids and Proposals

* Note 10

*See State Comptroller's Notes, page 44

Policy." Second, officials determined the reasonableness of price based on past experience with consulting firms performing similar work.

* Note 11

The report also states that a second contract for $265,000 was entered into with a consulting firm to create a capital plan for Stony Brook. The report further states that this consulting firm had created a multi-year capital plan for the State University Construction Fund in the past, and "...Stony Brook officials felt that it was in their best interests to use the same firm for the campus' capital plan." This statement is incorrect and should be clarified. Officials felt that it was in the best interest of the University to use the same firm for the campus capital plan.

* Note 12

Finally, regarding the above two contracts, OSC stated "Officials considered both of these contracts as single source, but could not provide the required documentation justifying this." This statement should be clarified. The Foundation's "Bids and Proposals Policy" states: "a single source procurement is a purchase from a supplier who is chosen without soliciting the minimum number of bids or proposals, despite the fact that competition exists, because of limiting circumstances (e.g., experience or service of the supplier or product quality)." The Foundation's "Documentation Guidelines for Purchasing and Payment Activities" state that the purchasing documentation should, where relevant, include a single/sole source justification. In the cases detailed in the audit report, the procurement documentation provided to the auditors included written justifications identifying limiting circumstances that led to the selection of the consulting firms. Required documentation was provided, however the Comptroller's staff concluded that the written justifications provided were not sufficient.

* Note 10

Your finding includes two purchases at the Sponsored Program Office (SPO) that you indicate had bidding problems. As noted in the report, one of these contracts totaling $72,000 involved a consulting firm engaged to assist SUNY in establishing key business relationships. In addition, the consultant was to help support and enhance major research initiatives across the State University system. In addition to bidding problems you indicate that the contract did not have specific detail or quantifiable measures that would allow us to determine if the intended results were achieved. We do not agree that bids were required on this contract. This contract was entered into under the Single Source provisions of our procurement policies. This policy provides that a supplier can be chosen without soliciting bids or proposals, despite the fact that competition exists, because of limiting circumstances such as the experience of the provider. The consultant was selected in this case because of his range of experience, his list of contacts and his sterling reputation as a negotiator. His experience includes stints in State agencies and the State Legislature, as counsel to the State Comptroller, as secretary to the governor, head of the Lower Manhattan Redevelopment Corporation, and as a lawyer in private practice and a lobbyist. We do acknowledge that these facts which we believe justify the single source transaction were not maintained in the contract file as prescribed by RF policies. However, they were held in other files maintained by the RF. We will take the necessary steps to ensure that in the future such documentation is prepared and kept in the appropriate file.

The second contract questioned at SPO involved a vendor that we believe to be a sole source provider. The contractor in this case was not a maintenance company as indicated in your report. It was a firm that specializes in installing telephone systems and wiring infrastructure for IT purposes. Also the wiring was installed in RF leased buildings, not

* See State Comptroller's Notes, page 44

University buildings as stated in your finding. Your finding indicates that we should have obtained bids for the work involved in this contract. We do not agree and continue to believe that this is a sole source situation. The paperwork supporting the sole source procurement with this vendor was prepared in the 1980's. The vendor in question is classified as a Small Business entity, therefore meeting the sole source procurement mandates. In addition, in the 1980's there were verbal bids that were obtained from three vendors and these were documented. The selected vendor proposed an hourly rate of $50.00; a second vendor proposed an hourly rate of $140.00 while a third proposed an hourly rate of $85.00. We selected the lowest bidder. Due to the ongoing relationship that was developed over the years with this vendor, the chosen vendor also afforded us additional discounts, better service and other enhancements such as knowing the buildings inside and out, thereby saving labor hours, resulting in additional savings. Today, the selected vendor's hourly rate is $60.00; still considerably lower than the other vendors' initial rates back in the 1980's.

* Notes 12, 13

Expenditures that may not be in support of the University

Your draft report also contains a section that refers to items of expenditure that may not be in support of SUNY. It indicates that there were 11 expenditures totaling $169,503 that you believe did not support SUNY. First of all, we believe the total that you are reporting in this finding is overstated. For example, you include in this total an invoice related to a trip to Russia for $3,500. The report finding indicates that $660 of the total may be questionable. Yet the entire $3,500 is included in the questioned amount. Also, you questioned $14,412 in moving expenses for a campus president because this amount exceeded the State limit of $3,000. In our opinion, if any amount were questioned (and we do not agree that any should) it should have been $11,412, the amount claimed in excess of the limit. Finally, the total questioned included a $6,091 payment to a hotel for a conference. The expense was questioned because a mistake led to overbooking of rooms for which we were charged. But as you indicate in your finding the amount related to the overbooked rooms was $3,410, not $6,091 that was included in the total questioned.

* Note 14

We address other issues related to each of the 11 items in the following paragraphs:

- Your finding includes a $7,000 payment made to a SUNY employee to cover his daughter's college tuition costs. We disagree with your conclusion that this expenditure did not support SUNY. The employee was recently hired by SUNY and part of his employment package included the added benefit of tuition costs for his daughter. This was a benefit the employee had at his previous place of employment and enabling him to not suffer such a loss helped attract this employee to work for SUNY. He is considered a top expert in his field and his decision to come to SUNY was a major coup for the university. We believe the tuition payment was money well spent. We would also note that our policies do not preclude the expenditure of RF funds for this purpose.

* Note 15

- Your finding indicated that $3,500 was paid to an employee for travel expenses to Russia. You note that included in this amount were expenses for representatives of the University and their Russian guests to attend the circus,

* See State Comptroller's Notes, pages 44-45

ballet, and other social and cultural events. The total cost of attendance at the events in question that might be considered entertainment was $660. We would note that the University employees who traveled to Moscow did so as a delegation representing SUNY. The costs incurred were to cover attendance at the ballet and a circus, important cultural events in Russia that the SUNY delegation attended with their Russian hosts. Engaging in such reciprocal events is an important part of the relationship-building effort between SUNY and Moscow State University.

* Note 16

- The largest exception included in this section of your finding was for $137,500 in housing allowances provided to two campus presidents. You question payments made to the campus presidents in excess of $37,500 per year, which is the maximum amount of State funds allowed to be paid for a housing allowance under the current salary plan for a University president. We do not concur with your general position that amounts paid by the RF to campus presidents for a housing allowance may not have specifically supported SUNY. (This was the only reason provided in your written finding for questioning these payments.) The additional housing allowance paid with RF, not State, funds allows SUNY to provide a more competitive compensation package when searching for the best candidate to fill vacant campus president positions and to retain them once hired. We believe that helping SUNY to attract and retain high quality presidential talent is clearly in support of the University's mission.

* Note 17

- Your finding also questioned a payment of $14,412 for moving expenses for a SUNY employee because this payment exceeded the State limit of $3,000 for this purpose. We do not concur that such payments do not support the University. The amount of moving expenses that we paid was reasonable and allowable in accordance with RF policy and supported the University's mission. RF funds, not State funds, were used to pay this expenditure. The limitation you cite is a limitation on the expenditure of State funds, not RF funds.

* Note 18

- The finding questions payments of $7,091 that you indicate do not support the University. Of this amount, $6, 091 was paid to the Marriott Hotel for hotel rooms for honorees attending SUNY recognition dinners and programs for researchers. The amount shown as questionable costs in the schedule you presented to us totals only $3,739.23. Of this amount, $3,409.92 was paid to the hotel for overbooked rooms. The overbooking occurred during the first awards dinner, when staff were inexperienced in making such arrangements for rooms and in negotiating with hotels. It was an honest mistake (that did not recur) and a cost of doing this type of business. While the overbooking was regrettable, it does not rise to the level of a questionable cost as it was clearly made in support of the University.

* Note 19

With regard to the recommendation that we develop more formal guidance on how indirect cost recoveries should be spent, we believe that existing controls are adequate to assure that the Foundation's resources are expended in a manner that specifically supports the University and its programs. We believe that our position is supported by the findings of your audit, that expenditures were made in general compliance with RF policies and

* Note 20

* See State Comptroller's Notes, page 45

procedures. With regard to the relatively small number of exceptions that were found we do concur that we should take steps to ensure that existing procurement policies are closely followed. We have already undertaken such steps.

Payroll Costs

Recommendation (page 23 of report)

5. Discontinue the arrangement with the one employee who remains on the University's payroll while performing only Foundation related activities.

6. Discontinue paying salary and/or wage supplements to University employees (including the employee who failed to pass promotional exams and the retired state trooper, as detailed in this report) unless such payments are for hours of service beyond employees' standard work schedules for which the University pays them.

Corporate Response:

We partially concur with this recommendation. The campus removed the individual who failed to pass the promotional exam from the Research Foundation payroll effective September 3, 2004. With regard to the retired state trooper, this individual was paid an annual salary of $36,000 by SUNY—the maximum amount to be paid a retired state employee as allowed by the Retirement and Social Security law. The balance of this individual's salary, $28,280 was paid by the RF and reflected his activity in support of the Chancellor in his role as Chairman of the RF Board. This would include his involvement in all RF related activities. Because the RF is a private, not-for-profit entity and did not use State funds to pay its portion of this individual's salary, and because the Retirement and Social Security law does not limit state retiree earnings from private employers, we do not believe this is a valid finding.

* Note 21

General Comments:

We also have the following general comments regarding specific sections of the draft report.

p. 6 You indicate in the last sentence of the second paragraph that, "It is the discretion of each location whether to adopt the central office's policies and procedures or to establish its own;..." This statement is incorrect. All locations must adopt the RF's policies and procedures when conducting RF business. Locations may have additional policies and procedures that are more restrictive or that apply to specific conditions at that location, but all must adhere to RF policies and procedures.

* Note 12

p. 7 The last sentence in the first paragraph states that "Consequently, the Foundation generates significantly more revenue than it needs to fund its grant and administration and support functions." This statement is incorrect. When we recover funds from sponsors of grants and contracts we are basically charging them for the actual direct and indirect costs we

*See State Comptroller's Notes, pages 44,45

incur both at central office and at SUNY locations. We are not generating significantly more revenue than expenses. In fact, because certain Federal and State programs have instituted artificially low caps on the amount of facilities and administration costs that can be recovered, we sometimes receive less revenues than required to cover the related costs involved.

* Note 22

p. 10 The last sentence in the first paragraph states, "Thus, the Foundation generates more funding than it needs for its own grant administration functions by virtue of it recovering not only its own indirect costs but also the indirect costs of the University's operations." This statement is misleading. Although we recover indirect costs related to campus activities, such funds are returned to the campuses on the basis that they were earned. We provided the auditors with a copy of the allocation plan that showed how these funds were distributed to each campus. Further, and importantly, the RF does not generate these funds. They are received as a part of individual grants and awards. The RF merely administers them.

* Note 22

p. 11 Second paragraph, last sentence, we do not know how the auditors calculated the estimate of $109 million that they say was available for deposit into the University's income fund. Therefore, we are unable to verify the accuracy of this estimate.

* Note 23

p. 11 Last sentence on this page, "As detailed subsequently in this report, we found that University officials used funds for expenditures that State oversight authorities might not have approved in certain instances." The auditors use this statement to support their contention that indirect cost recoveries should be deposited into the Income Fund. However, the findings they are alluding to were insignificant and do not support their sweeping conclusion that funds would have been more properly monitored had they been deposited in the Income Fund. The overall conclusion of the report is that such funds were expended in general compliance with RF policies and procedures.

p. 13 First paragraph, last sentence. We object to the use of the term "Surplus indirect cost recoveries." The indirect cost recoveries are not surplus. Indirect cost recoveries are supported by actual direct and indirect costs incurred in support of research activities.

* Note 22

p. 13 Second paragraph. The report indicates that transactions were tested at one location where a complaint was filed. We believe it is unfair to mention the fact that someone filed a complaint without some resolution of the issue. The reader is left with a negative impression that goes unresolved in the report.

p. 15 Last sentence. The auditors state that they did not review additional documentation since the invoice payments were made without existing documentation at the time of payment. It is disappointing that the auditors were not interested in reviewing the documentation that supports the payments made to this contractor. We basically disagree with the auditors as to the amount of detail that should have been included with the submission of invoices. We believe the invoices submitted by this law firm, when viewed in conjunction with the contract requirement and specs, were sufficient.

* Note 24

* See State Comptroller's Notes, page 46

State Comptroller's Notes

1. Because the Chancellor of SUNY is the chair of the Board of Directors of the Research Foundation, we believe that it is appropriate for the audit report to be addressed to him. Moreover, the Office of the State Comptroller also sent copies of the draft audit report to the President, Executive Vice President, Senior Vice President and Treasurer, and Vice President for Internal Audit of the Research Foundation. Consequently, the Foundation's claim that sending the report to the Chancellor delayed the Foundation's receipt is unfounded.

2. Officials from the Foundation's Internal Audit unit acknowledged that they did not formally examine expenditures of the discretionary funds cited in our report because their audit efforts were primarily focused on other types of Foundation expenditures. Given the magnitude of discretionary expenditures (about $109 million from July 1, 2001 through December 31, 2003) made by the Foundation and the findings detailed in our report, we encourage the Foundation's Internal Audit unit to examine the propriety of discretionary expenditures and compliance with related Foundation guidance in the future.

3. The Foundation has not provided support that the Legislature agreed to suspend the deposit into the Income Fund beyond the 1991-92 budget. As our report points out, required approvals to modify the 1977 agreement for changes, such as termination of deposits to the Income Fund, were not made. Further, we believe that the resolution by the Board of Directors to allocate funds to the campuses that earned them constitutes taking a position on this matter. We recognize that the Foundation may not be a direct party to consultation with the State Comptroller concerning the agreed to amount for deposit into the Income Fund. We have adjusted our recommendation number 1 accordingly.

4. Although the Executive Budget for 1991-92 proposed a discontinuation of the annual payment to the SUNY Income Fund, Chapter 50 of the Laws of 1991 contains no specific provision for the permanent termination of the payment. Consequently, the State Legislature did not approve a permanent restructuring of the allocation of residual Foundation indirect cost recovery and miscellaneous revenues. Moreover, in the absence of a statutory change, we maintain that the provisions of the 1977 agreement remain in force, and consequently, a payment should have been made to the Income Fund, unless the Legislature explicitly approved the suspension of the payment (either for the year in question or permanently). Also, as noted in the audit report, there has been no amendment to the 1977 agreement terminating the annual payment to the Income Fund. Any amendment to the 1977 agreement would have to be approved by the Office of the State Comptroller.

5. As our report points out, about $109 million could have been deposited into the Income Fund from July 1, 2001 through December 31, 2003.

6. We agree with the Foundation that the general basis for determining the amount of the Foundation's payment to the Income Fund is included in the 1977 agreement. However, a formal detailed methodology is needed to determine the dollar amount of the payment for a particular period. The Foundation was unable to provide us with a detailed methodology to determine the amount ($15.3 million) that the Foundation was to have paid into the Income Fund for the 1991-92 year or for amounts paid prior to the 1991-92 year. Also, the Foundation did not provide us with a detailed methodology to determine the amount of funds that could have been paid into the Income Fund at the time of our audit fieldwork.

7. Our report indicates that State oversight officials might not have approved certain expenditures of discretionary funds had these funds been deposited into the Income Fund. For example, State oversight authorities might not have approved about $1.3 million in payments to a lobbyist or housing allowances that significantly exceeded prescribed State limitations.

8. The audits referenced by the Foundation generally do not include detailed reviews of discretionary expenditures of residual indirect cost recovery and miscellaneous revenues.

9. The letter in question addressed general goals and objectives of the lobbyist, but did not detail the specific deliverables the lobbyist would provide. Moreover, as our report states, the actual contract with the lobbyist was vague with respect to the specific deliverables the Foundation would receive in relation to each scheduled monthly payment.

10. Foundation officials provided auditors with written explanations for the single/sole source contracts in question after the auditors identified these matters to Foundation and SUNY officials during the course of the audit. The documentation in question provided by the Foundation was not prepared contemporaneously with the contracts or the related payments.

11. We made a technical correction to our report to note Stony Brook officials' determination of reasonableness of price based on past experience with other firms performing similar work (rather than the contractor in question). However, because Stony Brook officials apparently did not have prior experience with the contractor in question (based on the Foundation's response), we are now more concerned about the lack of contemporaneous documentation to support the selection of the single source vendor costing $650,000.

12. We have made technical corrections to our report, as appropriate.

13. The fact remains that the Foundation relied primarily on verbal rate quotes from the 1980s in its award of a no-bid contract.

14. We have adjusted the total amount of the expenditures in question in the report to $160,982 to account for the portions (amounting to $8,521) of the payments (that totaled $169,503) that we did not question.

15. We agree that the Foundation's policies do not specifically preclude this type of expenditure of discretionary funds. However, we continue to question whether payments to a State employee for his/her child's college education in an out-of-state school is in SUNY's best interest.

16. We adjusted the amount of the questionable expense related to this issue to $660. Moreover, we would note that there was no supporting documentation with this transaction to indicate the specific benefits that SUNY officials obtained from attending at Foundation expense the circus and ballet with officials from the Moscow State University.

17. The Foundation provided no supporting documentation to specifically indicate why the Foundation-paid housing allowances (totaling $86,500 during our audit period) were necessary to fill the position taken by the employee in question and to retain him. Moreover, the employee resided in housing provided by the University already and therefore needed no supplemental housing allowances. He resigned from the position (for which the allowance was paid) effective February, 2005.

18. We maintain that Foundation funds should not be used to circumvent prescribed State policy. The Foundation provided no supporting documentation to specifically indicate why the extra reimbursement for moving expenses was necessary to fill the position taken by the employee in question.

19. We have adjusted the amount of the questioned cost, as appropriate.

20. As noted in our report, there are virtually no formal limitations placed on the expenditure of discretionary Foundation funds, so long as they in some way support University functions. We maintain that certain limitations are needed to preclude the use of the Foundation to circumvent prescribed State policies and procedures designed to ensure that public funds are spent appropriately.

21. The fact remains that Foundation funds were used to compensate a State employee for services performed during the employee's normal State work schedule, and consequently, the Foundation was used to circumvent prescribed State limitations on compensation.

22. The Foundation's comment is misleading. As noted in the report, the Foundation collects indirect cost recovery revenues for the costs it incurs as well as those incurred by SUNY in support of sponsored programs. Consequently, the Foundation receives significantly more indirect cost recovery revenue than it needs to pay the costs of the Foundation's core grant administration functions. As noted in our report, we estimated that $109 million in residual (or surplus) indirect cost recovery and miscellaneous revenues were administered by the Foundation during our audit period.

23. We used a methodology developed with the input of Foundation officials, and the methodology includes the cost accounting classifications as defined by the National Association of College and University Business Officials. Foundation officials did not dispute our estimate (of $109 million) as presented to them in a preliminary finding we provided to them in July 2004. Moreover, in their response to the draft audit report, officials do not note an amount different from the estimate made by the auditors.

24. The documentation in question was not contemporaneous with the transactions we reviewed and generally was prepared after auditors brought matters to the attention of Foundation and SUNY officials. In some instances, the supporting documentation was prepared more than a year after claims were submitted by vendors and paid by the Foundation. Consequently, we questioned the validity of such documentation. We recommended that the Foundation require vendors to provide adequate supporting documentation prior to paying invoices.