



**New Jersey State Legislature  
Office of Legislative Services  
Office of the State Auditor**

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**New Jersey Commission on  
Science and Technology**

July 1, 2007 to December 31, 2008

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*New Jersey State Legislature*

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Governor of New Jersey

The Honorable Richard J. Codey  
President of the Senate

The Honorable Joseph J. Roberts, Jr.  
Speaker of the General Assembly

Mr. Albert Porroni  
Executive Director  
Office of Legislative Services

Enclosed is our report on the audit of the New Jersey Commission on Science and Technology for the period of July 1, 2007 to December 31, 2008. If you would like a personal briefing, please call me at (609) 292-3700.

A handwritten signature in cursive script that reads "Stephen M. Eells".

Stephen M. Eells  
Assistant State Auditor  
April 23, 2009

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## **New Jersey Commission on Science and Technology**

### ***Scope***

We have completed an audit of the New Jersey Commission on Science and Technology (NJCST) for the period July 1, 2007 to December 31, 2008. Our audit included a review of expenditures, payroll, and grants-in-aid which are accounted for in the state's General Fund.

Established in 1985 the commission's primary mission is to encourage economic development and job growth by promoting strong ties between industry and universities in order to accelerate commercialization of technology, supporting entrepreneurial technology businesses in areas of strategic importance to the state, and strengthening research collaborations among universities to create new potential for increased federal funding and private investment. Fiscal year 2008 expenditures of the commission were \$17.2 million which included grants-in-aid expenditures of \$16.7 million. A 16 member commission provides oversight to NJCST. An executive director and four staff conduct day-to-day operations.

### ***Objectives***

The objectives of our audit were to determine whether financial transactions were related to the commission's programs, were reasonable, and were recorded properly in the accounting system.

This audit was conducted pursuant to the State Auditor's responsibilities as set forth in Article VII, Section I, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

### ***Methodology***

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

In preparation for our testing, we studied legislation, administrative code, and policies of the commission. Provisions we considered significant were documented and compliance with those

requirements was verified by interview, observation, and through our sample testing of transactions. We also reviewed financial trends and interviewed agency personnel to obtain an understanding of the programs and the internal controls.

A nonstatistical sampling approach was used. Our samples of transactions were designed to provide conclusions about the validity of transactions as well as internal control and compliance attributes. Sample populations were sorted and transactions were judgmentally selected for testing.

***Conclusions***

We found that the financial transactions included in our testing were related to the commission's programs and were recorded properly in the accounting system. However, due to the lack of on-site visits by NJCST staff and final fiscal and programmatic reports not being submitted to NJCST by the grantees, we are not able to determine the reasonableness of the grant disbursements. In making this determination we noted that the same internal control weaknesses noted during our prior audit involving grant administration are still a concern. The corrective action plan to address these prior issues contained in our letter to management dated November 2004, have not been fully implemented by prior NJCST management. In addition, current management's grant administration procedures are not effective. These conditions are due to an ineffective control environment caused by management not monitoring the effectiveness of its grant administration process.

## Control Environment

**G**rant administration procedures need to be enhanced to ensure program effectiveness.

The prior management of the New Jersey Commission on Science and Technology (NJCST), in response to our November 2004 letter to management, formulated procedures for the Department of the Treasury, Division of Administration (DOA) to be responsible for many aspects of managing its grants. These responsibilities addressed the disbursement of funds and included the maintenance of the official grant checklist, official grant records database, and official files for audit purposes. NJCST was required to certify to the DOA the receipt of all grantee fiscal and performance reports required during the administration of the grant. In addition, prior to the execution of any subsequent grant payments, the DOA would ensure that the grantee had complied with any and all audit requirements it had with its cognizant state funding agency. The Department of the Treasury, Division of Administration management disclosed to us that they only agreed to provide support with the disbursing of grant funds and that there was no final agreement reached for DOA to ensure that the grantee has complied with any and all audit requirements prior to the execution of any subsequent grant funding. Our current audit disclosed that NJCST is not assuring the receipt of all grantee fiscal and performance reports and numerous grants remain open. This is due to management not monitoring the effectiveness of the grant administration process and making corrective actions. Our tests noted 24 grantees receiving grant funds while their prior grants remained open. Our current audit also disclosed that NJCST management has not established procedures to verify application and report data, and to monitor compliance with critical issues in the grants that would help management detect errors or irregularities. Examples of these compliance issues include determining the accuracy of financial information in applications and reports, residency requirements, receipt of goods/services, and

royalty income; performing on-site visits to assure satisfactory progress; and reviewing W-2 forms to vouch annual salaries.

We performed detailed testing in two phases. The first test phase was a review of the grant files maintained by NJCST. The second test phase were field visits to sampled grantee locations to determine if critical compliance issues not being addressed by NJCST were in fact complied with by the grantee. Our tests of grant files disclosed the following exceptions summarized by grant year.

Fiscal Year 2007 Grants

Final reports were not submitted to the commission for 49 of 58 grants tested. Five of the nine final reports received were not approved by the commission, and only three of these grants were reviewed and closed out by the executive director.

Fiscal Year 2006 Grants

Final reports were not submitted to the commission for 56 of 74 grants tested. The 18 final reports received were neither approved by the commission nor reviewed and closed out by the executive director.

Fiscal Year 2005 Grants

Final reports were not submitted to the commission for 18 of the 39 grants tested. The 21 final reports received were neither approved by the commission nor reviewed and closed out by the executive director.

We compiled lists of grant compliance issues not being verified by NJCST procedures and visited nine grantee locations to determine if grant compliance was achieved. The nine grantee locations chosen were judgmentally selected from various grant years. We found most of the grantees were complying with the conditions of the grant. One grantee was not in compliance with the residency requirements and we were not able to locate any personnel at one location after making several visits.

***Recommendation***

Management has not implemented procedures to address critical compliance issues of the various grants issued. This condition has caused an environment resulting in minimal verification or monitoring of the effectiveness in the administration of grant disbursements. At a minimum, management should ensure that all financial and performance reports are received and on-site reviews should be undertaken to ensure compliance with grant terms and that the project was completed.

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**State of New Jersey**  
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JON S. CORZINE  
Governor

PETER R. RECZEK, PH.D.  
Executive Director

April 20, 2009

Stephen M. Eells  
Assistant State Auditor  
Office of Legislative Services  
125 South Warren Street  
PO Box 067  
Trenton, NJ 08625

Dear Mr. Eells:

Pursuant to your standard procedure regarding agency audits, I am issuing the following comments to be included as part of the audit report.

We wish to thank the auditors for their excellent work during the audit of the New Jersey Commission on Science and Technology. We appreciated the attention that Mr. Hal Bauman and Ms. Petagay Johnson provided to every aspect of our operations and found them easily available for questions during the period of review. It was a joy for our staff to work with them.

The New Jersey Commission on Science and Technology was formed in 1985 to serve the citizens of New Jersey by promoting economic development and by keeping New Jersey at the forefront of scientific and technological advances. The Commission accomplishes this mission by *promoting* strong ties between industry and academic institutions in order to accelerate commercialization of new technologies; by *supporting* entrepreneurial technology businesses and incubation in areas of strategic importance; by *collaborating* with public and private organizations to create economic opportunities and advance job growth; and by *providing* the highest possible level of technical advice to State and local policy makers.

The Commission is composed of 16 members drawn from the academic, industrial and governmental sectors with particular attention to the technology community. Coupled with a full time staff of 5, the Commission administers 11 grant programs. During the 2008 fiscal year alone, the Commission awarded **59 grant awards** directly to **41** early-stage technology companies. Additional awards to Business Incubators and training programs assisted **over 300 companies**. These grants leveraged almost **2-fold additional** dollars in private investment and federal grant support. Finally, Commission activities resulted in the creation of over **2000 new, high-paying jobs**.

We are gratified to learn from the auditors that all procedures related to the grant application, review, and approval process were compliant with standards set by the State and that all financial transactions were reasonable and recorded properly in the accounting system.

However, we also acknowledge that those procedures associated with the final review and closing processes for grants have been inconsistently applied and that leads to an inability to assess effectiveness of grant disbursements.

It is important to point out that staff turnover and historically low staff number may have contributed to this finding. For example, during the last three years, the NJCST had had two full-time and one "acting" director. This turnover and reduced resources may have been responsible for some of the compliance issues raised in the report.

Nonetheless, the NJCST has begun working on procedures to insure future resolution of the deficiencies pointed out by the auditors. All funded grant applications from fiscal year 2004 on will be reviewed and visits scheduled to close grant files. In addition, an SOP for future agency visits to companies awarded funds is already in process. Finally, the Commission will work to change contractual wording on grants awarded in the future to contain language that requires final project reports be submitted and approved before award of the final grant funds. This step is necessary to improve receipt of final reports that have been historically difficult to obtain.

We believe that these steps will allow for the efficient closing of files in compliance with the auditors findings and will streamline some of the Commissions own activities. Hopefully, these steps will allow the NJCST to monitor the effectiveness of its programs making it easier to design instruments that address conditions as they exist in the start-up company.

Thank you,

A handwritten signature in black ink, appearing to read 'Peter R. Reczek', with a long horizontal flourish extending to the right.

Peter R. Reczek, PhD  
Executive Director



## State of New Jersey

DEPARTMENT OF THE TREASURY  
DIVISION OF ADMINISTRATION  
P.O. BOX 211  
TRENTON, NJ 08625-0211

JON S. CORZINE  
*Governor*

R. DAVID ROUSSEAU  
*State Treasurer*

April 22, 2009

**MEMORANDUM TO:** Stephen Eells  
Assistant State Auditor  
Office of the State Auditor

**FROM:** David Ridolfini  
Director & Chief Financial Officer

**SUBJECT: COMMISSION ON SCIENCE & TECHNOLOGY:  
AUDIT REPORT ON GRANTS PROGRAM**

The Department of the Treasury is in receipt of your office's March 31, 2009 audit report for the New Jersey Commission on Science and Technology and the request for written comments contained therein. Thank you for opportunity to provide comments on the audit, specifically on the Treasury's auxiliary role in the Commission grant program.

Although Treasury was aware of the Commission's response to the 2004 audit, effective control of the grants administration process continued to rest with the Commission. Since the last audit, Treasury continued to serve as the Commission's paying agent for its grants program. Effectively, Treasury's role was limited to issuing grant payments in accordance with the NJCFS protocols and the respective payment terms of the executed grant agreements. Treasury's only other grant's administrative role was the proofing of new grant agreements prior to release for compliance with Circular #07-05. Even in this capacity Treasury's role was purely consultative. Often Treasury would recommend via email more frequent reporting on the part of the grantee and limitations on the advanced payment of grant funds.

The Department of the Treasury is in agreement with most of the findings and comments contained in the audit. Specifically, though the financial transactions were recorded properly in the state accounting system, the same internal control weaknesses in grants administration that existed at the time of your office's last audit in 2004 are still present today.

The Commission's response to the earlier audit was that the Division of Administration in Treasury would be given increased responsibility for ensuring the effective management of the grant's administration process. However as indicated in the March 31, 2009 audit, the shift in responsibility never transpired and to the best of our knowledge was not officially adopted by the Commission.

Stephen Eells  
April 22, 2009  
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Throughout its relationship with the Commission, Treasury has always been as supportive as the Commission would permit. Whether it was technical issues involving agency grant funding or operational funding, Treasury has always worked with the Commission and the appropriate oversight agency (e.g. OMB, EDA, Purchase Bureau, and Governor's Office) to resolve such matters.

Even as the deficiencies of this audit became known, Treasury continued to support the Commission providing guidance and assistance with previous audit requirements. For example, the attached narrative was prepared by our Grant Office outlining how the Commission could strengthen its management of its grant programs.

I thank you again for sharing your concerns with our office before releasing your report. Please do not hesitate to contact me at (609) 633-2825 if you require any further information.

## **DUE DILIGENCE PROCEDURES**

### **Part I -Components of the Grant Agreement**

The majority of the grant agreement is comprised of boiler plate components that appears in State of New Jersey grant agreements as required by Circular Letter #07-05 OMB. This core agreement allows the grantor some flexibility particularly with regard to reporting requirements and payment terms. It is incumbent upon the grantor to outline the reporting requirements and payment terms in a manner that it can ensure the grantee has the capacity to achieve the intent of the grant and is actually achieving this intent.

The reporting requirements and payment terms are normally outlined in Attachment A of the standard State grant agreement. Attachment A is titled Additional Grant Provisions. Below are some suggestions on how to utilize the grant agreement to improve overall grantee reporting.

- More frequent interim reporting. Many types of grants awarded by the Commission do not require an interim report. All grants greater than \$25,000 should be required to submit interim reports every six months. This will provide the Commission with ample opportunity to determine if the grantee is not adhering to the terms of the agreement, and is otherwise not achieving the goals of the grant. If the grantee has a poor track record or is otherwise considered “high risk” with the Commission, quarterly reports can be required.
- Pay more grants on an installment or reimbursement basis. When the full grant award is advanced to the grantee at the onset of the grant, the grantor loses much of its leverage in compelling compliance with the reporting requirements of the grant as well as with all the terms of the agreement. By delaying payment or more importantly linking payment to the reporting requirements, grantees have more incentive to submit reports in a timely manner and to provide all the materials the Commission is requiring in the reports. High risk grantees should be paid 100% on a reimbursement basis.

### **Part II - Post Award Review of Grants for Compliance**

Depending on the actual findings of the OLS audit, the Commission may want to revisit the types of materials that it is requesting from grantees for use in determining that they are complying with the terms and conditions of the grant agreement. Typically such materials are provided with interim and final reports. Below are some suggestions for strengthening the reporting requirements for grantees.

#### Interim Reports

- Expenses (and accompanying documentation) to date are reviewed for consistency with the approved grant budget. Any expenses that are inconsistent

are denied unless grantee can substantiate the relationship of said expenses to intent of the grant. The type of documentation required varies from grant to grant. Normally it would include copies of invoices, payroll runs, form 1099, W2 forms, cancelled checks and payment vouchers.

- Annual audits are utilized to determine if the grantees have the proper financial reporting systems and guidelines that are required under the provisions of Circular #07-05. The more comprehensive A-133 audits will help substantiate how much of a particular grant award was accrued and expended during the fiscal year. Unfortunately, only those grant recipients that expend more than \$500,000 in government funding are required to submit an A-133 audit per Circular #04-04.
- Grantees should be compelled to provide a written update on the overall status of the grant project. The Commission can review this narrative and determine if the grant will be completed on time or if a grant extension or budget modification is required. If the Commission concurs with the grantee's assessment that a modification or an extension is warranted, an approval letter is sent to the grantee. This letter then serves as an addendum to the fully executed grant agreement.
- When the Commission feels that the submitted report is deficient, it should advise the grantee in writing as to what materials need to be provided or clarified in order for the Commission to proceed with the next funding installment. If deficient materials are minor, the grantee can be advised to remediate in its next report submission.
- The use of all these materials, the update, the audit and the budget expenditures can all be used as tools for the Commission to assess the overall conviction of the grantee to achieve the intent of the grant. Specifically, when succeeding reports indicate no real progress on the grant project and no real progress in addressing the issues that are causing the delays, the Commission may want to reconsider its commitment to funding the project.

### Final Reports

- Final reports should require an update to all the information normally provided with the interim report.
- Section II of the standard grant agreement requires compliance with various existing federal and state laws. These laws cover a variety of subjects including anti discrimination issues, competitive purchasing for public entities and contributions by private contractors to public entities. The Commission should require a statement from either the grantee's CFO or CEO verifying compliance with these laws.
- The standard grant agreement requires that all grantees adhere to the audit requirements stipulated in Circular #04-04. In instances where a grantee's annual expenditures of government funding are below the \$500,000 threshold and an A-133 audit is not required to be provided, the CFO should provide a statement verifying this and that the grantee is otherwise in compliance with the provisions of the Circular.
- All grantee's that used a portion of the grant for salary expenses must also provide a certification from the CFO that all appropriate wages taxes were remitted to the

proper taxing authorities. Audits, even non A-133 audits, will further corroborate that wage taxes are being remitted properly. To further substantiate that the grantee is complying with state and federal payroll tax requirements, copies of payroll runs, w2's and 1099's can be requested.

- All grantee's that are for-profit entities should be requested to have the CFO provide a statement verifying that the organization is in compliance with all pertinent state and federal business tax requirements. To further substantiate that the grantee is not running afoul of any tax laws, copies of tax filings for the period of the use of grant funding can be requested.

### Other Monitoring and Enforcement Activities

With regard to grantee requests for budget modification or grant extension, all warranted requests should be approved via a brief memo to the grantee that serves as an addendum to the grant agreement. Questionable requests should be followed –up with either a site visit or a meeting with the grantee to better understand the circumstances involved with the grant. If the Commission still has concerns, that the grantee is unable to allay, the Commission should consider soliciting guidance from its assigned Deputy Attorney General or advise from other granting agencies.

Also, audits are rarely available at the time the Final Report is due. Federal requirements permit grant recipients up to nine full months from the end of their fiscal year to provide funding agencies with a copy of the audit. Because of this time lag, the Commission will need to follow-up with written reminders to grantees advising them to submit their audits.

In addition to the aforementioned reasons, the Commission is concerned to see if the auditor in his/her unqualified opinion feels that the grantee has no material weaknesses. Any weaknesses noted by the auditor should be noted by the Commission. Any action taken by Commission at this juncture depends entirely on the seriousness of the identified weaknesses and how it directly relates to the grant project. In most instances, the Commission will simply compel the grantee to provide additional documentation that will serve to demonstrate that grant monies were utilized in an appropriate manner. Often the findings may not directly relate to the grant project but may be cause for concern with regard to future commission funding. If this is the case, future grant agreement should be executed with more stringent reporting and grant payment requirements. With serious weaknesses that directly impact the grant project, the Attorney General's Office should be consulted.

### **Part III - Enhanced Reporting Requirements Associated with Intangible Property Revenue**

Section XXXIV of the standard grant agreement for research and development grants requires the grantee to return to the Commission, 1% of the proceeds on intangible property directly related to the grant agreement or created there-under. Section XXXIV goes on to cap the 1% figure at 10 times the amount of the grant award and the

requirement to remit these receipts expires 10 years after the completion of the funding period. Section XXXV outlines definitions of net income from such property.

Section XXXIII requires that any and all intangible property be reported annually and be certified by the grantee's Chief Executive Officers. Section XIV defines intangible property as "patents, patent applications, trade names, trademarks, services marks, copyrights, mask works, trades secrets, and similar types of intangible assets."

Attachment E (final report requirements) specifies that the net income of products identified in section XXIV and XXXV be reported. Furthermore it requires that all such reports be filed for 5 years following the period of funding. This is inconsistent with the requirements of Section XXXIV which requires receipt remittance for 10 subsequent years.

For the most part the aforementioned sections of the grant agreement outline the requirements of grantees with regard to income derived from intangible properties. Below are some suggestions on how the Commission may want to clarify them in an effort to obtain better compliance on reporting and ultimately better compliance with the actual remittance of funding.

- Amend Section XXXIII to require that revenues derived from intangible property be reported.
- Amend Section XXXIII to require that the amount due and payable to the Commission from these revenues be reported.
- Amend Section XXXIII to require that both the Chief Executive Officer and the Chief Financial Officer certify the "accuracy and completeness of the report." This would compel, the grantee to develop some internal checks and balances with regard to the revenues derived from the grant funding.
- Amend Attachment E that performance reports must include the "amount of net income of products identified in the proposal as defined in Sections XXIV, XXXIV and XXXV of the Contract." Please note the verbiage with regard to intangible properties is very broad based in Section XXIV and much more specific in Section XXXIV.
- Amend Attachment E to specifically require that the amount due and payable to Commission should be remitted with each report in a check payable to Treasurer, State of New Jersey.
- Amend either Attachment E or Section XXXIV to ensure that both sections are consistent with the "sunset" requirement to remit the 1% of revenue derived from intangible properties.

The major problem for the Commission with regard to intangible property is the issue of creative accounting that may result in reduced amounts of revenue from intangible properties being reported. In an effort to mitigate this concern, the Commission may want to explore the potential for having information on intangible properties be disclosed in the grantee audits. The benefit of such an approach is that an independent 3<sup>rd</sup> party is certifying the accuracy of revenues being reported by the grantee.

Such an approach may only be legally possible with grantee's who are expending in excess of \$500,000 in government funding annually. By law, these grantees must provide a comprehensive audit and asking for audit schedules that detail revenues from the intangible properties would not be too much of an additional burden. Nonetheless, the Commission should consult with its Deputy Attorney General prior to instituting such requirements.

Unfortunately, grantees who expend below the \$500,000 threshold annually are not required to provide comprehensive audits. The rationale for this is that the cost for such an audit is prohibitive relative to the minimal amount of government funding. To require these grantees to provide detailed audit schedules on intangible properties is simply not plausible.

As discussed, the Commission may want to seek guidance from other public and quasi-public agencies with experience in awarding grants that are used in the development of intangible properties. Their experiences may further help the Commission in its ongoing efforts to achieve the aims of its grant programs and recoup some of the costs for funding these programs.

Finally, any and all changes to the standard grant agreement for the Commission on Science and Technology should be reviewed by its assigned Deputy Attorney General prior to implementation.