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

Department of Law and Public Safety
Division of Criminal Justice
Office of the Insurance Fraud Prosecutor

July 1, 2002 to May 31, 2005

Richard L. Fair
State Auditor
The Honorable Richard J. Codey  
Acting Governor of New Jersey

The Honorable Richard J. Codey  
President of the Senate

The Honorable Albie Sires  
Speaker of the General Assembly

Mr. Albert Porroni  
Executive Director  
Office of Legislative Services

Enclosed is our report on the audit of the Department of Law and Public Safety, Division of Criminal Justice, Office of the Insurance Fraud Prosecutor for the period of July 1, 2002 to May 31, 2005. If you would like a personal briefing, please call me at (609) 292-3700.

Richard L. Fair  
State Auditor  
July 15, 2005
# Table of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scope</td>
<td>1</td>
</tr>
<tr>
<td>Objectives</td>
<td>1</td>
</tr>
<tr>
<td>Methodology</td>
<td>1</td>
</tr>
<tr>
<td>Background</td>
<td>2</td>
</tr>
<tr>
<td>Conclusions</td>
<td>2</td>
</tr>
<tr>
<td>Auditee's Response</td>
<td>7</td>
</tr>
</tbody>
</table>
Law and Public Safety  
Criminal Justice  
Office of the Insurance Fraud Prosecutor

**Scope**

We have completed an audit of the Department of Law and Public Safety, Division of Criminal Justice, Office of the Insurance Fraud Prosecutor for the period July 1, 2002 to May 31, 2005. Our audit included expenditure transactions accounted for in the state’s General Fund. Annual expenditures of the agency during fiscal years 2003 and 2004 were approximately $30 million. The Office of the Insurance Fraud Prosecutor (OIFP) is responsible for investigating and prosecuting insurance fraud and coordinating the conduct of all criminal, civil, and administrative matters involving insurance fraud. The OIFP is funded through an annual assessment imposed on all insurance carriers that write policies within the state. We did not review insurance fraud expenditures relating to the Department of Banking and Insurance and the state’s interdepartmental accounts which total $2 million annually.

**Objectives**

The objectives of our audit were to determine whether expenditure transactions incurred at the Department of Law and Public Safety and charged to the OIFP were related to the program and properly supported. This audit was conducted pursuant to the State Auditor’s responsibilities as set forth in Article VII, Section 1, 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, circular letters promulgated by the State Comptroller, and policies of the agency. Provisions that we considered significant were documented and compliance with those requirements was verified by interview,
observation, and through our samples of financial transactions. We also read the budget message, reviewed financial trends, and interviewed agency personnel to obtain an understanding of the program and the internal controls.

A nonstatistical sampling approach was used. Our samples of financial 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.

**Background**

In 1998, the New Jersey Office of the Insurance Fraud Prosecutor (OIFP) was created under the provisions of the Automobile Insurance Cost Reduction Act (AICRA) in an effort to contain the rising costs of automobile insurance premiums. The Governor’s Reorganization Plan No. 007-1998, which followed the enactment of AICRA, transferred statutory and regulatory authority and responsibilities for the OIFP from the Department of Banking and Insurance to the Department of Law and Public Safety (DLPS). In a subsequent agreement between these two agencies, it was stipulated that the DLPS would “assume full budget and fiscal responsibility for the OIFP... including procurement, payments, and accounting.” Accordingly, from the onset, all administrative and fiscal support for the OIFP was performed by the Division of Criminal Justice (DCJ) and provided through the DLPS’ existing administrative structure, while OIFP was left to focus on fulfilling the enforcement and programmatic functions. As head of the DLPS, the Attorney General is required by statute to annually certify to the State Treasurer an amount allocable to the expenses of the Insurance Fraud Prosecutor.

**Conclusions**

We found that of the $60 million charged by DLPS to the OIFP for fiscal years 2003 and 2004, $51 million was related to the program and properly supported. However, we identified $1 million of
questionable costs charged to the program and we were unable to determine the propriety of the remaining $8 million of expenditures because the division did not have adequate records to support certain salary charges.

**Non OIFP Salary Charges**

Our review found that the DCJ had not established an adequate cost allocation system to support the salary charges to the OIFP for work performed by employees outside of the office. The non-investigative division employees are not required to maintain time sheets reporting actual hours worked on OIFP related activities. Therefore, the division could not provide documentation for the methodology used in allocating these salary expenditures. As a result, the following salary costs could not be verified to determine if they were appropriate.

The DCJ provides administrative support services for OIFP such as budget and finance, human resources, administration, information and technology, and motor vehicles fleet management. The division could not support charging 100 percent of the salary expenditures for 21 employees in these units to OIFP. Clearly these employees provide services to the OIFP, but they also provide services to other bureaus within the division. Accordingly, only a portion of their salaries should have been allocated to the OIFP. For example, we found seven of nine employees’ salaries in the division’s Human Resource section were charged to OIFP even though the OIFP only represents 30 percent of the staff at DCJ. The total salaries and fringe benefits charged to OIFP for these 21 employees totaled $1.7 million for fiscal year 2003 and $1.9 million for fiscal year 2004.

In addition, we found 100 percent of the salaries for 23 employees in certain legal and investigative units were charged to OIFP even though OIFP only utilizes these services on occasion. It did not appear appropriate for the department to allocate these individuals’ entire salaries to the OIFP.
Salary and fringe benefit costs were $2.2 million in fiscal year 2003 and $2.4 million in fiscal year 2004 for these employees.

We further noted that 60 percent of the salaries and fringe benefits totaling $493,000 for 13 employees from the division’s Office of Public Information, Intelligence Database Initiative and other units were allocated to the OIFP. The division could not provide the methodology used in allocating these expenditures nor how salaries associated with the Intelligence Database Initiative related to insurance fraud activities.

The OIFP funded a unit of eight state troopers during our audit period. The expenditures for this unit were $868,000 in fiscal year 2003 and $951,000 in fiscal year 2004. In January 2005, the OIFP discontinued funding the State Police unit. After reviewing monthly activity reports provided to OIFP by the unit, we could not determine whether the troopers assigned to the unit worked solely on insurance fraud related matters. Our review of assignment records found discrepancies for one trooper funded by OIFP in fiscal year 2003. According to the records maintained by the Division of State Police (DSP), the trooper was assigned to different units at which time salary costs of $19,000 were not applicable to OIFP.

Additionally, the OIFP was charged $75,000 for the training costs of three troopers. Neither the DCJ nor the DSP could provide invoices for these expenditures. According to the DSP sources, the charges to the OIFP were a general cost of training a state police recruit at the academy and did not relate to any specific trooper assigned to the OIFP unit. These training costs should not have been reimbursed.
OIFP Salary Expenditures

OIFP employees in investigative titles are required to submit hourly time sheets accounting for time worked on the various cases. The division did not properly adjust salary expenditures for the hours worked on non-insurance fraud activities. Based on OIFP records, approximately 6300 hours in calendar year 2003 and 7500 hours in calendar year 2004 were related to work performed on non-insurance fraud matters and should not have been included as costs relating to insurance fraud activities. We estimated the salary overcharges to be $195,000 and $234,000 in calendar years 2003 and 2004, respectively.

Other Issues

In fiscal year 2004, the OIFP was charged for the delayed pension enrollment of a division employee. Since the individual was not enrolled timely into the pension system, the division was responsible for 50 percent of the pension contributions. Pension contributions from 1987 totaling $19,000 were improperly charged to the OIFP for this employee. The OIFP should not be responsible for the department’s omission.

State personnel procedures were often bypassed by the department using OIFP salary position numbers to fund positions when DCJ position numbers were not available. We identified cases where individuals who had not worked on insurance fraud related matters were moved on and off OIFP payrolls during various pay periods to accommodate promotions or other personnel actions. Salary adjustments were not made in certain cases resulting in individuals being improperly charged to the OIFP.

The department has a responsibility to the insurance industry to ensure the accurate accounting of operating costs for the OFIP since these activities are funded by the industry. Pursuant to N.J.S.A. 17:33A-30, “the Attorney
General shall annually, on or before October 1, certify to the State Treasurer an amount allocable to the expenses of the Office of the Insurance Fraud Prosecutor for the preceding fiscal year...” Our review found that there was no certification of expenditures by the department. A fiscal manager at the division level reports the expenditure amounts relating to the OIFP to the Department of Banking and Insurance.

**Recommendation**

We recommend the department implement a comprehensive cost allocation system which includes the documentation of the appropriate methodology to support the charges to the OIFP. These allocations should be based on such factors as a time reporting system or analysis of services provided to the OIFP. In addition, the Insurance Fraud Prosecutor should be responsible for fiscal oversight of operations of the OIFP. Current operations would be enhanced if the Insurance Fraud Prosecutor was informed of determinations regarding the appropriate allocation of administrative costs.
July 14, 2005

Mr. Richard L. Fair  
State Auditor  
Office of the State Auditor  
P.O. Box 067  
Trenton, NJ 08625-0067

Re: Audit of the Office of Insurance Fraud Prosecutor  
July 1, 2002 to May 31, 2005

Dear Mr. Fair:

As requested by your office, enclosed is the Department of Law and Public Safety’s response to the audit report in the above matter dated July 11, 2005.

I would like to compliment your audit staff on the high degree of professionalism it displayed during the course of this audit. My staff remains available to you should you have any question regarding the enclosed response.

Very truly yours,

[Signature]

Thomas J. O’Reilly  
Administrator

As was discussed at the exit conference, the Department of Law & Public Safety (LPS) and the Division of Criminal Justice (DCJ) established the Office of Insurance Fraud Prosecutor (OIFP) from its inception in 1998 under both the direction of the enabling legislation and pragmatic advice surrounding the guidance of the State Treasurer and the Office of Management and Budget (OMB). The goal has always been and continues to be to create a system of accounting and accountability that provides a complete, equitable recovery of State costs from the insurance industry with the ability to provide records supporting such costs when requested. Unfortunately, there are intersecting State and LPS procedures and requirements which render certain costs, particularly shared support services, difficult to document on a direct charge back basis. The State accounting system is not a true “cost accounting” system as is maintained in the private sector. As such, in particular, salary and wage costs must be charged to one funding element and then subsidiary records must support partial assignments. As OIFP represents anywhere from 30 to 33 % of the DCJ operations, its need for support of central services is significant. Fiscal, procurement, personnel, payroll, logistics, central supply, information technology, operational support from other units, management oversight, etc are not practical for the direct charge method for the reasons discussed in the following. In the beginning, cost allocation methods to properly reflect these costs were discussed with OMB which determined that adding a number of OIFP positions to the overall central support of DCJ was a more advisable solution.

The statute created OIFP within DCJ for many reasons not the least of which was the ability for DCJ and LPS to provide administrative, operational and executive support and guidance. This arrangement benefits both DCJ and OIFP through economies of scale and provides OIFP with greater resources than if it stood alone. This approach to administrative efficiency was recently re-emphasized in the adoption of the FY06 appropriations law which directs specific economies to the LPS and DCJ in the area of administration to consolidate services.

As part of DCJ, OIFP is staffed by attorneys and State Investigators who have a specific statutory law enforcement status. The Department believes that activities integral to that law enforcement status is an appropriate charge to the insurance industry for the use of DCJ State Investigators. Activities such as firearms qualification, in-service training, which may include limited assignments in areas outside OIFP to broaden investigative experience, and the incidental exercise of law enforcement authority other than insurance fraud is part of the cost of using a DCJ State Investigator. A large amount of the $1 million in “questionable costs” in the audit report is represented by salary expenditures for investigative staff which were not adjusted for investigative hours devoted to non-insurance fraud investigative activities. This result was a product of the routine practice in the Division of Criminal Justice (DCJ) to utilize the investigative resources of the entire Division for intense investigative activity such as wiretaps and surveillance which benefits the entire State as a whole. In the context of the explanation
given at the beginning of this paragraph, the Department accepts the finding with respect to the salary expenditures for non-OIFP matters. The Division will implement a procedure to track non-insurance fraud activity by OIFP investigative personnel that would not be appropriate to charge to the insurance industry and salary adjustments will be made if necessary, keeping in mind that sensitive substantive investigative information is not shared outside of the investigating unit in order to protect the integrity of the investigation.

The Department disagrees with the audit finding regarding $8 million dollars in what is called non-OIFP salary charges. The background set forth at the outset of this response explains the Department’s disagreement.

When the OIFP was instituted, a deliberate decision was made to organize the OIFP to function within the traditional structure of DCJ rather than function as a stand alone operation. This decision follows the policy of not only LPS but also OMB. The purpose of this decision was to avoid duplicating functions and to achieve economies of scale for both DCJ and OIFP. In this way, OIFP would not have to re-create central administrative, operational and legal support services or specialized units, such as, Appeals, Records and Identification, State Grand Jury, to name a few, which already existed in DCJ. However, since OIFP would be using at least 30% of these services, it is fitting that OIFP absorb its share of the costs.

When the additional staffing needs generated by the creation of OIFP were determined, the positions created for OIFP were assigned to a dedicated funding account. This system by and large worked adequately with OIFP program staff. However, this system causes complications with what the audit report calls non-OIFP support staff and specialized units. By definition, none of these personnel will be working 100% on OIFP business, yet, the position numbers available for functions provided by such personnel are in a dedicated account. By structure, employees who perform OIFP activities and also perform non-OIFP services must be put in positions where their full salaries are charged to OIFP. Guidance from OMB instructed the Department to address this issue on a full-time equivalent basis rather than individual charges by employee. By way of illustration, if one-third of the time of ten employees was devoted to OIFP, the advice that the Department received from OMB was to charge three employees to OIFP rather than to charge back 70% of three salaries to DCJ and 30% of seven individual salaries to OIFP, an achievable but labor intensive endeavor.

The Department acknowledges that, due to physical moves and changes in management staff, documentation for charges of personnel to OIFP were unavailable to audit staff. However, management did explain the methodology of the full-time equivalent basis for charging salary costs and offered the availability of employees previously responsible for charges to OIFP for interview. The full-time equivalent salary charge made the dedicated position numbers a medium of exchange to reflect OIFP’s share of DCJ’s, and the Department’s, costs. In addition, any State government fiscal manager knows that, due to operational need, position numbers might have to be borrowed. Position numbers are not instantaneously created or moved in the
State system synchronized to operational demands. Positions are occasionally borrowed and adjustments made to salary charges. Therefore, it is not particularly remarkable in the State system that a random name might appear for a limited period on an apparently unrelated payroll. Under a full-time equivalent basis of cost allocation, what is important is that the aggregate charges at the end of the fiscal year are appropriate. It should also be clear that, under this system, there are employees performing OIFP related work who are not charged to OIFP in any way. The Department has reviewed its charges during the course of this audit and remains confidant that the aggregate charges to the insurance industry fall below what could have been charged and certainly fall below what the costs would be had OIFP operated as a stand alone entity.

The Department appreciates the differing view of the audit, which is a departure from prior advice to the Department from OMB, to track charges on the basis of actual hours worked or an analysis of services performed. Such a cost allocation system is unworkable under the current arrangement of dedicated position numbers. The Department will conduct a time and activity study regarding the services provided by the greater DCJ and LPS to OIFP. This study will be used to create a cost allocation plan along the lines suggested in the audit report. The Department will then propose to OMB, relying on the audit recommendation, that the proposed cost allocation plan be used as a basis to charge the industry and that position numbers associated with the OIFP be put into a less restrictive category to allow more flexibility in their allocation. The proposed cost allocation plan would include the concept of periodic review and revision. The Department will also explore with OMB the future possibility of Circular Letter guidance to be used in areas supported by a non-State funding source where mixed services are performed.