The Honorable Donald T. DiFrancesco  
Acting Governor of New Jersey

The Honorable Donald T. DiFrancesco  
President of the Senate

The Honorable Jack Collins  
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 State, Selected Programs for the period July 1, 1999 to August 31, 2001.

If you would like a personal briefing, please call me at (609) 292-3700.

November 15, 2001
Table of Contents

Scope ........................................ 1
Objectives ................................. 1
Methodology ............................... 1
Conclusions ............................... 2

Findings and Recommendations

  Martin Luther King Grant Payments ........ 3
  Microfilm Revolving Fund ................ 4
  War Memorial - Revenue Enhancements .... 6
  Purchase Procedures ..................... 8
Department of State  
Selected Programs  

Scope  
We have completed an audit of the Department of State, Selected Programs for the period July 1, 1999 to August 31, 2001. The selected programs include Records Management, Office of the Secretary of State, Council on the Arts, Division of State Museum, and Historical Programs. Our audit included financial activities accounted for in the state’s General Fund; Jobs, Science and Technology Fund; Cultural Centers and Historic Preservation Fund; Jobs, Education, and Competitiveness Fund; and the New Jersey Cultural Trust.  

Annual expenditures are $43 million. The prime responsibilities of the Department of State, Selected Programs are to increase public participation in the arts, increase total artistic resources, collect fine art objects, promote an interest in and an appreciation of New Jersey history, maintain its official archives and a records management service for state and local government, and to provide access to these and other historical materials. Annual revenues are $4 million and the major component of revenue is fees charged to state and local government agencies by the micrographics unit.  

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

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 programs 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 stratified and large dollar transactions were chosen for testing. Other transactions were randomly selected.

Conclusions

We found that the financial transactions included in our testing were related to the agency's programs, were reasonable, and were recorded properly in the accounting systems. In making this determination, we noted certain internal control weaknesses and matters of compliance with laws and regulations merit management's attention.
Management has bypassed its controls for grant review, authorization and accountability.

**Martin Luther King Grant Payments**

Our review of grant administration noted that the controls are effective and in effect for all grant programs, except the newly established Martin Luther King Grant Program (MLKGP). Many of the controls used in other grant programs are not used in the MLKGP and those controls established were often bypassed by management.

In accordance with the agency’s control procedures, grant applications are required to be reviewed, scored and processed by committee members or review boards with subsequent approvals by the Director of Programs, her supervisor, and finally the fiscal office prior to being awarded. Our audit disclosed no evidence of this oversight for the grants we tested. Furthermore, the Director of Programs awarded grants and approved payments without other oversight. Grant documentation was lacking compared to other grant programs and management did not establish procedures to verify the expenditure of the grant funds as required of other grant programs. The commission’s policies cap MLKGP grant awards at $5,000. However, we noted one award in excess of $78,000 and two others that each exceeded the $5,000 maximum, both of which contained mathematical errors. The committee and board members we contacted said they did not have the opportunity to review these grants.

We expanded our audit scope to include an on-site review and in-depth analysis of the three grants. Our on-site review of the largest grant disclosed internal control weaknesses within the organization including cash payments to individuals which were not properly documented for tax purposes, undocumented cash expenses, presigned checks, and incomplete records. Cash receipts were not reconciled to tickets issued for events, and expenses and receipts from various events were co-mingled making the determination of profitability difficult. We also noted that despite requesting and receiving
100 percent of the grant funds in advance, not all vendors had been paid three months after the event.

After several months and many requests, both written and verbal, the other two grantees only partially supported their expenses. Documentation provided by the Director of Programs (actual receipts from the grant recipient) was incomplete but indicated that the grants were used for general expenses of the grantee in violation of the grant purpose. Attempts to conduct an on-site review were unsuccessful due to a lack of cooperation by the department and the grantee. Management has the responsibility to establish controls over the awarding of grants and the disbursement of funds and to ensure that controls are observed. This supervisory and fiscal oversight responsibility helps to ensure disbursements are properly supported, authorized and correct.

**Recommendation**

We recommend that the existing grant procedures for the awarding of grants and the disbursement of grant funds be followed. These procedures document the review, authorization and accountability processes by both supervisory and fiscal management. We also recommend that grants be limited to the maximum amounts set by agency policy. By doing this, the integrity of the award and disbursement process could be greatly enhanced.

**Auditee’s Response**

During the period reviewed, the NJ Department of State disbursed in excess of $41 million dollars in grant funding department-wide to selective organizations throughout the state. The program in question, the Martin Luther King Jr. Commission Grant Program, was instituted during this time period as an additional source of grants for our constituencies.

Your audit has questioned costs totaling less than $100,000 of this funding. The grants in question were directly authorized by the Secretary and were
made within the parameters of his discretion. The guidelines to which these grants were to be held accountable were not modified.

The Department has instituted tighter controls to be effective in the FY02 cycle which will include a more documented grant review process and sign off by all appropriate parties. These increased controls should provide the necessary corrective action to remedy this situation in future years.

Microfilm Revolving Fund

The Micrographics Unit provides source-document microfilm and imaging services for state, county, and local government agencies on a charge-back basis. The fund showed operating deficits of $62,000 in fiscal year 1999 and $146,000 in fiscal year 2000. Our review of fiscal year 2000 operations showed not all costs of the microfilm operation are reflected in the fund. Employee salaries totaling $200,000 were paid from other accounts. If these expenditures were charged, the deficit would be $350,000.

The charge-back basis of funding and accounting for microfilming and imaging services allows the costs to be appropriated and expended at the using agency. However, with the exception of the limited services to local governments, the services are for state agencies. Hence, the state must bill and collect from itself and, as noted above, the billing does not reflect all costs. Accounting for and controlling microfilm and imaging costs can be accomplished by other means, thus allowing resources to be directed toward production, rather than internal billing and collection.

This review also noted that, on average, billings are six months behind the date services are provided. In addition, the person responsible for the billing of microfilm services also maintains the receivable
records, adjusts billings and posts receipts. No mail-log is maintained. Strong internal controls necessitate a separation of duties over the billing and receipt functions. Finally, we noted that deposits to the bank are often one to two weeks late. Treasury Circular 94-24-OMB requires bank deposits to be made on a daily basis.

**Recommendation**

We recommend that appropriations be made directly to the micrographics unit rather than channeled through using agencies; this allows for the refocusing of resources from accounting to production. As part of its oversight responsibility, management should determine if operating costs are reasonable and competitive with the private sector.

The use of a mail-log by an employee independent of billing and collections and the separation of duties over the billing and receipt functions will strengthen internal controls. Treasury Circular Letter 94-24-OMB should be followed regarding timeliness of deposits.

**Auditee’s Response**

The Department of State agrees with the audit finding and has begun the necessary steps to provide a more efficient and accurate accounting of microfilm revenues. In FY01, the Department began the solicitation process for the upgrade of the existing Wang system at the Division of Archives and Records Management. The Department has secured $300,000 of capital funding to replace and upgrade the existing system, with particular attention to the accounting software which will account for the invoicing of work and the resultant revenues.

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**War Memorial - Revenue Enhancements**

The War Memorial consists of a theater, a ballroom, conference rooms and administrative offices. It is funded by state appropriations for the majority of its operating costs. To defray those costs, the state
Additional revenue sources are needed to meet management’s objectives.

Additional revenue sources are needed to meet management’s objectives. Discussions with the management of the facility noted that their goals are to increase revenues, expand operations and reduce their reliance on state appropriations. Our review of the rental operation for the theater noted that because of its status as a state organization, the facility is not eligible to receive funding from private sources which support the arts like the Dodge Foundation. We noted that two peer theater facilities we contacted receive between 20 and 40 percent of their funding from donations from government, private organizations and citizens that support the arts. Establishing a “Friends of the War Memorial” fund could provide management the means to meet its objectives.

In calendar year 2000, the War Memorial collected $277,000 in rental revenue for its theater and $78,000 for its other rental facilities. We are aware that the facilities are used without charge by many civic/non-profit organizations and that the overriding purpose of the War Memorial, its dedication to the memory of our veterans, must not be overshadowed. However, our review of the utilization of the rental units at the War Memorial noted that the theater was rented only 72 times, the ballroom was rented 30 times, the board room was rented 3 times, the exhibition room was rented 13 times, the late comers room was rented 17 times, and the other spaces were rented 8 times.

We could not conclude whether the cause of the underutilization was price, lack of demand, lack of advertising, or a combination of the above. The cost of operating the War Memorial is fixed with only minimal additional costs when the facilities are rented. Hence, it is financially advantageous for management to determine the cause and take corrective action to maximize rentals and increase revenues.
In our discussions with department management, they were receptive to our suggestions on how to increase revenues, however reluctant to make changes citing a contract being negotiated with the Marriot Corporation for the use of the War Memorial. At present, no contract exists.

**Recommendation**

The creation of a “Friends of the War Memorial” fund to receive and channel donations from private organizations and citizens that support the arts could increase funding. Management should determine the causes of the underutilization of the facilities and take corrective action. These actions should take into consideration risk and the dedicated nature of the facility.

**Auditee’s Response**

The War Memorial is in a state of transition, moving from a rental facility to a performing theater. As such, its focus is changing to meet its new mission. In addition, the future utilization of the War Memorial, including its Patriot’s Theater and its George Washington Ballroom, will be directly impacted by negotiations with Marriot, Inc., the occupant of the new hotel and conference center being erected next to the War Memorial facility.

The Department does not disagree that the “Friends of the War Memorial” could be a viable solution to part of the War Memorial’s budgetary needs. However, the Department also takes the position that more effective utilization of the War Memorial as a performing theater will generate increased revenues to make the complex more self-sustaining for future budget cycles.

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**Purchase Procedures**

The agency ordered 15 computers and monitors in June 2000 at a cost of $19,000. Since purchased, the equipment has remained in the storeroom and as of May 24, 2001 this equipment had still not been
Unnecessary computer equipment was purchased in order to reduce the year-end surplus of funds.

In addition, the agency purchased a video editing package costing in excess of $18,000. Management could not support its sole source reason for not soliciting competitive bids in accordance with OMB regulations. We also noted the agency bypassed procurement regulations by accepting a $13,200 bid from a non-contract t-shirts vendor when the item was available through DEPTCOR.

**Recommendation**

We recommend that management assess the need for computer equipment throughout the department and limit its purchases to match those needs and keep inventory at an absolute minimum. The agency should follow OMB procurement policies to ensure competitive pricing alternatives are considered.

**Auditee’s Response**

The Department notes that the audit questions costs approximating $50,000 out of a $53 million budget, which, by some standards, may be considered immaterial as to the totality of the finding. Computers in question are currently being stored but will be shortly deployed as the Department upgrades to Windows 2000 office products. Further, the Department did provide a sole source statement supporting the purchase of video editing equipment which we believed was accepted by the audit team. Insofar as the third component of this finding, corrective action has been taken to purchase materials from DEPTCOR, which at the time of purchase, the Department was not aware of their availability.
In general, the Department contends that the need for computer purchases and the timing of their deployment are a management decision and that the Department does follow OMB procurement policies and ensures competitive pricing alternatives where availability of products or services is known.