The Honorable James E. McGreevey  
Governor of New Jersey

The Honorable John O. Bennett  
President of the Senate

The Honorable Richard J. Codey  
President of the Senate

The Honorable Albio 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 the Treasury, Office of Administrative Law for the period July 1, 2002 to June 30, 2003. If you would like a personal briefing, please call me at (609) 292-3700.

September 18, 2003
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Department of the Treasury
Office of Administrative Law

Scope

We have completed an audit of the Department of the Treasury, Office of Administrative Law (OAL) for the period July 1, 2002 to June 30, 2003. The OAL is considered in but not of the Department of the Treasury. Our audit included financial activities accounted for in the state’s General Fund.

Total annual expenditures of the agency are $9 million. The prime responsibility of the OAL is to develop and apply a fair, comprehensive, and uniform system of administrative practice and procedures governing the adjudication of contested matters and the promulgation of rules and regulations. Annual revenues of the agency are $4 million and the major components of revenue are billings and assessments for administrative hearings.

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 system.

The 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, 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 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. Transactions were judgmentally 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, matters of compliance with laws and regulations, and opportunities for cost savings meriting management’s attention.
The agency should monitor its computer systems contracts to ensure deliverables are received timely and are operating properly.

Case Tracking System

In 1994, the Office of Administrative Law (OAL) contracted with a vendor to design and implement an integrated case management tracking system. In July 1999, OAL procured services from this vendor through a waiver to re-engineer their existing Case Tracking System to be Y2K compliant along with increased capabilities. The new Case Tracking System should have been implemented in December 1999. The vendor assigned a third team to the project because the first two teams failed to deliver a sufficient product. The Office of Administrative Law’s project managers were not properly trained and were ineffective in keeping the contract on track with established goals and time frames, in particular with testing the new system. As a result, the project has yet to be satisfactorily completed.

OAL ran both the old system and the completed part of the new system parallel to one another until the old system crashed on June 16, 2003. This crash forced full use of the new system on June 23, 2003. The vendor was paid $473,000 for this project, with final payment of $95,000 still being withheld.

During our review, we found that the Case Tracking System is unreliable. It omits data from reports and does not generate required reports. During our revenue testing, we could not substantiate hours billed based on real time information from the Case Tracking System. Data relating to cases in or prior to 1999 was omitted from the requested reports. Prior to our discovery of this error, inaccurate bills may have been sent out as a result of the incomplete data.

The OAL did not fully assess their needs regarding the Case Tracking System. As a result, the system does not produce a report which calculates billable hours to third parties, thus requiring an OAL employee to manually enter all hours summarized through the Case Tracking System into an Excel spreadsheet. We further noted that an incorrect
formula had been entered in the Excel spreadsheet used to calculate the bills. As a result, a federal agency had been overbilled and had overpaid $190,000 for the first quarter and had been underbilled and had underpaid $43,000 for the second quarter of 2002.

Recommendation

We recommend that specific dates for deliverables in future contracts be enforced. OAL should ensure that vendors uphold contractual agreements. OAL project managers should have the necessary expertise to adequately supervise contracted projects. They should assess and incorporate the agency’s needs into new systems to eliminate unnecessary manual work. In addition, OAL should consult with the Office of Information Technology regarding new computer systems and assess the possibility of in-house development.

Temporary Administrative Law Judges

Administrative Law Judges (ALJs) are appointed by the governor to preside over contested cases concerning disputes arising from agency actions. In accordance with N.J.S.A. 52:14F-et.al., the director of the OAL has the authority to appoint additional administrative law judges on a temporary case basis to alleviate backlogs, provide expertise in a particular area, or when a conflict of interest arises within the OAL.

Our review noted the OAL has classified these individuals as professional consultants. The agency’s employment contract with these individuals stipulates that they be compensated at per diem rate of $300, plus travel in accordance with State procedure. If fewer than seven hours are worked on a particular day, compensation will be prorated based on a seven-hour day. In addition, the OAL limits temporary ALJs to receiving compensation, which
together with the judges pension or retirement allowance received from any State retirement system, does not exceed the highest salary payable in any given year to OAL non-supervisory judges.

Our review of these contractual expenditures found that retired ALJs were being rehired by the OAL to serve as temporary ALJs. The OAL’s position is that the temporary ALJ position is not covered by a state pension system and thus the pension enrollment requirements would not apply. This action circumvents the Division of Pensions and Benefits’ controls regarding salary re-enrollment thresholds for retired government personnel.

OAL’s position is based on N.J.S.A. 43:6a-13 for the Judiciary’s recall judges. However, this legislation is only applicable to those judges who retired from the Judicial Retirement System (JRS), and is not applicable to those members who retired from the Public Employees’ Retirement System (PERS) or the Teachers’ Pension and Annuity Fund (TPAF). Those members who retired from PERS and TPAF are limited to annual post-retirement earnings of $15,000 and $500, respectively.

The earning thresholds established by pension regulations apply to seven of the ten temporary ALJs. Our review of these contractual expenditures for calendar years 1998 through 2002 found that five of these seven temporary ALJs exceeded the earnings threshold for their pension system and should have been re-enrolled in the pension system. These retirees could be responsible for the repayment of all pension benefits paid after the effective date of re-enrollment.

We have concluded that the temporary ALJs are employees and not independent contractors. We found that two other temporary ALJs, based upon their earnings and years of service, should have been enrolled in the state’s pension system. Paying employees as consultants is in violation of the
Department of the Treasury Circular Letter 97-18 OMB and to federal and state income tax, unemployment, and disability tax regulations. As such, the state may be subject to penalties and fines.

**Recommendations**

We recommend that OAL seek a change in legislation regarding post-retirement employment of temporary ALJs as the Judiciary has done for recall judges. This includes compensating temporary ALJs through the state payroll system.

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**Royalty Revenues and Complimentary Subscriptions**

A primary responsibility of the OAL is to oversee the rulemaking process in the state including the filing and review of administrative rules and publication of the New Jersey Register and the New Jersey Administrative Code. During 1995, the OAL contracted with a vendor to publish, market, and distribute these publications. The contractual arrangements require that the vendor pay an annual license fee to the OAL to cover the OAL Rules and Publications Unit salaries and expenditures. In addition, the vendor is required to pay a five percent royalty fee on gross sales of all OAL publications in all media. The contract also provides for free and discounted subscription for state agencies.

In fiscal years 2001 and 2002 the OAL received $143,000 and $126,000 in royalties, respectively. According to royalty statements submitted with the semi-annual royalty payments, the calculations were computed on net sales and not gross sales as required by the contract. Net sales represent gross sales less returns, discounts, transportation and handling, and any applicable bad debt. We can not determine the underpayment or the amount due the OAL without requesting an audit of the vendor’s financial records.
The contract indicates that the state would have access to the gross sales generated from products in the contract. In addition, the contract has an audit provision that permits the state to full access of financial records that pertain to all of the vendor’s services performed and determination of amounts payable under the contract. The OAL has never exercised that option within the duration of the contract.

In addition, other state agencies were not aware of the provisions for additional free or discounted subscriptions to the Administrative Code and New Jersey Register that were to be made available by the publisher. The OAL did not exercise the options for additional free subscriptions nor did they notify other state agencies of the potential savings. We estimate the cost savings to have been $600,000 over the course of the contract.

**Recommendation**

We recommend the OAL exercise its audit option with regards to the contract and request the vendor certify its gross sales and recalculate the amounts due during the duration of the contract.

In addition, the agency should exercise the provisions of the contract and notify other state agencies of the complimentary and discounted subscriptions available, rather than paying for these subscriptions.

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**Legal Research Services**

In 1999, the Department of the Treasury, Purchase Bureau procured a contract with vendors to purchase automated legal research services for use by various state agencies. In May 2002, the OAL amended the terms of the contract without notification and proper authorization from the Purchase Bureau. The vendors are required to submit requests in writing to the Purchase Bureau to amend any existing contracts.
As a result of the contract amendments, we could not trace charges appearing on the vendor’s invoice to the state.

**Recommendation**

In the future, the OAL should submit all contracts, amendments, and any changes in pricing of existing statewide contracts to the Purchase Bureau for approval. Additionally, the OAL should request the Department of the Treasury, Purchase Bureau’s contract compliance unit to perform a statewide review of this contract.
RESPONSE TO AUDIT REPORT FOR THE OFFICE OF ADMINISTRATIVE LAW

Case Tracking System

The OAL worked with OIT in the early 1990s and in 1999 to design the case tracking system and software application. A team composed of staff members from OAL, the Office of Management and Budget, and the Office of Telecommunications and Information Systems (OTIS, currently OIT) worked together for over a year to develop an OAL case management and office automation plan. An RFP was issued based on the team’s recommendations. OIT (or OTIS) was instrumental in developing this project and determined that an outside vendor was necessary to develop the software. The untimely implementation of this upgrade is a result of problems with the vendor, a lack of technological expertise at the OAL, and insufficient staff to devote to the testing of the software. It must also be noted that the program, although small by today’s standards, is very complex in handling the 120 data entry screens necessary to provide a viable case tracking system.

Fortunately, some of these issues are currently resolved. The current team from the outside vendor has a greater understanding of the project and has moved the project to near completion. The new case tracking system is in place and when deficiencies are identified, the team responds to them quickly. In addition, since December 2002, OAL has an employee with technological expertise who can solve problems that arise, knows the appropriate questions to ask the outside vendor, and has continuous communication with various staff members of OIT. This has significantly improved OAL’s ability to monitor this project.

The unreliable data that the auditor’s report refers to was limited to a specific circumstance and corrected immediately. As was noted, the OAL ran parallel systems for a significant period of time. The vendor was required to convert the data that was input into the old system to the new system periodically because the billing and judicial evaluation functions were done solely on the new system. Unfortunately, the auditor requested data the day after a data conversion in which an error occurred when the data was migrated from one operating system to the other. OAL had already reported another problem that identified the error and the vendor made the necessary correction immediately, but not before the auditor received the incorrect data. It is important to note that the data produced by the case tracking system at the time of the revenue calculation was in fact correct.

The OAL Case Tracking System (CTS) application includes various reports and system level programs and scripts. The data repository for the CTS application utilizes Oracle 8 Enterprise Edition and the reporting component is Crystal Reports 7.01. Crystal Reports has the capacity to allow OAL staff to export the generated report into an Excel spreadsheet. This function will reduce the potential for errors and allow OAL staff to efficiently generate tables where formulas are necessary to complete the reporting process. In addition, ad hoc reports can be prepared using Access. This report flexibility is a significant benefit under the new system.
The over and under billing to a federal agency is currently under discussion with the affected State agency and will be resolved.

**Temporary Administrative Law Judges**

OAL is seeking legislation to resolve these issues. While awaiting legislation, OAL is working with the Division of Pensions and Office of the Attorney General on an appropriate way to continue using temporary administrative law judges since this is a vital function.

**Royalty Revenues and Complimentary Subscriptions**

By letter dated August 22, 2003, the vendor replied to a May 22, 2003 letter from an Assistant State Auditor concerning the "Net Sales"/"Gross Sales" royalties disparity. The vendor advised that the "Net Sales" heading and the legend defining the term "Net Sales" in the semi-annual tabular royalties statements from the vendor to the OAL appear due to the use of a standard company form for reporting of royalties to all customers. The vendor further explained, "the figures under this heading actually represent 'Gross Sales' as defined as gross sales less returns and discounts; and does not include a deduction for Bad Debt." In addition, the vendor related that, beginning in 2001, shipping and handling charges were rolled into the sales price of products, rather than being a separate charge, and have since constituted a separate adjustment to the "Gross Sales" figure.

The vendor's explanation of the depiction of "gross sales" in its royalties reporting resolves the apparent discrepancy between the contract's royalties' basis and the schedules supporting the royalties actually paid. Beyond this issue, the OAL has had no reason to question the accuracy of royalties payments made under the contract, and, therefore, the need for an audit has not been previously considered. Whether to proceed with an audit at this time must be based on consideration of possible gain from royalties not paid versus the cost to the State of performing the audit and possible loss due to royalties overpaid. When requested, the vendor has been forthcoming with financial information related to the contract, in accordance with contract Section 6.8. Further consideration is necessary to determine whether an audit is necessary at this time.

Complimentary subscriptions to the Code and Register are required under *N.J.S.A. 52:14B-7(d)* to "the Governor, the head of each principal department, the Office of Legislative Services, [and] the State Library"; additional complimentary subscription may be made to "such other State agencies and public officials and the [OAL] director may designate." In the 25 years of the Code and Register prior to their 1995 publication under the contract, the number of complimentary subscriptions grew into the hundreds (for example, in 1994, the Department of Education alone received 34 complimentary Register subscriptions). In developing Part VII of the contract concerning complimentary subscriptions and agency discounts, a policy determination was made by the OAL that complimentary subscriptions would be issued in such number as to satisfy statutory requirements and to ensure that staff of other agencies regularly
involved in rulemaking would have free access to the Code and Register necessary to facilitate their rulemaking responsibilities. The contract RFP therefore required the provision of complimentary copies as follows, with an exhibit list providing name, title and/or organization particulars:

OAL

20 Full Registers
20 Full Code Sets

AGENCIES

67 Full Registers
19 Full Code Sets

GOVERNOR'S OFFICE AND COUNSEL

3 Full Registers
2 Full Code Sets

STATE LIBRARY

68 Full Registers (of which 65 are required to satisfy statutory obligations that require the filing of documents with depository libraries throughout the State)
1 Full Code Set

LEGISLATIVE SERVICES

7 Full Registers
1 Full Code Set

MAILING CONTROL

2 Full Registers

In addition to the 167 Register subscriptions and 43 full Code sets above, the OAL utilized the database access provision under Part II of the contract to provide free Internet access to the Code and Register via the vendor’s website to the rulemaking components of 64 State agencies.

In its response to the RFP, now forming part of the contract, the vendor agreed to provide the complimentary Code and Register subscriptions listed in the RFP, and to otherwise provide a 50 percent discount to State agencies off regular prices for the Code and Register. In addition,
the vendor agreed to provide 100 additional Register subscriptions, 100 additional Code full set subscriptions, 250 additional Code odd title subscriptions, and 100 Code CD-Rom subscriptions at no charge.

As the contract was being implemented in 1995, the various rulemaking State agencies were advised of the alterations to their complimentary subscriptions, if any, and the 50 percent discount on subscriptions, through communication with each agency's Administrative Practice Officer. The OAL is currently in discussion with the vendor concerning revision of the latter's customer service protocols so that subscription inquiries/orders would clearly reveal State agency status, and, thus, entitlement to the discount. In addition, the OAL will direct correspondence to the various State agencies reminding them of the discount.

Concerning complimentary Code and Register subscriptions, in the initial implementation of the contract by the OAL, those made additionally available by the vendor were considered as providing room to expand the complimentary program in response to growth in the number of rulemaking agencies and/or the need for such complimentary subscriptions. No program was created to assess agency Code and Register needs in relation to the number of complimentary subscriptions available. The OAL will obtain information from State agencies concerning the nature of their current Code and Register subscriptions, with a view towards fairly distributing the additional complimentary subscriptions.

As to the estimate of $600,000 in costs savings had the complimentary subscriptions been utilized over the course of the contract, the OAL cannot substantively comment absent knowledge of the estimate methodology. While State agency Register subscriptions over the course of the contract would have readily absorbed the 100 complimentary subscriptions available, the OAL is not sure that State agency Code subscriptions were so extensive as to have entailed the 100 full Code sets, 250 Code odd titles, and 100 CD-ROM full Code sets available.

Legal Research Services

The OAL believed that it was offered a reduced price that was within the parameters of the State contract and was able to generate a Purchase Order through the MACSE System with no warning otherwise. The bills received from the vendor are confusing and often inaccurate and therefore require and receive extensive review by a member of OAL staff. The OAL has informed the Purchase Bureau that there is a problem and asked to participate in the development of the new contract.