



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

**Department of the Treasury
Division of Rate Counsel**

July 1, 2012 to June 30, 2014

**Stephen M. Eells
State Auditor**

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Enclosed is our report on the audit of the Department of the Treasury, Division of Rate Counsel for the period of July 1, 2012 to June 30, 2014. If you would like a personal briefing, please call me at (609) 847-3470.

A handwritten signature in black ink that reads "Stephen M. Eells".

Stephen M. Eells
State Auditor

December 23, 2014

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Scope

We have completed an audit of the Department of the Treasury, Division of Rate Counsel for the period July 1, 2012 to June 30, 2014. Our audit included financial activities accounted for in the state's General Fund.

Annual expenditures of the division averaged \$6.4 million during the audit period, excluding employee fringe benefits of \$1.3 million. The division is funded through an assessment levied on utility companies, which averaged \$7.3 million annually for the audit period. The division is statutorily required to represent New Jersey ratepayers when a utility company files a petition for a change of a rate, toll, fare, or charge of a product or service.

Objectives

The objectives of our audit were to determine whether financial transactions were related to the division's programs, were reasonable, and were recorded properly in the accounting system. An additional objective was to determine whether the division was making efficient use of outside consultants. We also tested for resolution of the significant conditions noted in our prior report dated October 24, 2006.

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. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In preparation for our testing, we studied legislation, the administrative code, circular letters promulgated by the Department of the Treasury, and policies of the division. Provisions we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our testing of financial transactions. We also read the budget messages, reviewed financial trends, and interviewed Department of the Treasury and division 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 on our audit objectives, as well as internal controls and compliance. Transactions were judgmentally selected for testing.

To ascertain the status of findings included in our prior report, we identified corrective action, if any, taken by the division and determined if the corrective action was effective.

Conclusions

We found the financial transactions included in our testing were related to the division's programs, were reasonable, and were recorded properly in the accounting system. Additionally, we found, that overall, the division is making efficient use of its consultants. In making these determinations, we noted internal weaknesses in the procurement process and matters of compliance meriting management's attention. We also found the division has resolved the significant issues noted in our prior report, except for matters related to clearly defining contracts with outside consultants. This issue has been updated and restated in this report.

Consultant Procurement Process

The consultant procurement process needs improvement.

New Jersey Statutes allow for professional consulting services to be utilized on a per case basis to assist the division in representing ratepayers on petitioned rate changes. Consultants accounted for over 70 percent of non-payroll expenditures during our audit period, therefore it is important the division makes efficient use of this resource. Utility assessments were increased by 15 percent to \$8.5 million in fiscal year 2015. The division had a carry-forward balance of over \$1 million on July 1, 2012 which decreased to \$400,000 by the end of fiscal year 2014. The additional assessment was necessary primarily because of the increasing costs for consultants in recent years.

Every two years, the division is granted a waiver of advertising for the acquisition of professional services under terms set forth in Department of the Treasury Circular Letter 11-21-DPP/OMB/OIT. During this process, a list of pre-qualified consultants and their hourly rates is approved. Both parties agree to a master consultant agreement which specifies general billing procedures and recognizes the division has the ability to contract with a vendor for specific petitioned case matters during the biennial period. According to the division, multiple consultants are needed on the list since all have strict specializations, although some larger consultants handle multiple specializations. When a Request For Proposal (RFP) is sent, selected consultants bid using their approved hourly rates. Consultants may bid and be contracted for unlimited cases.

RFPs sent to prospective consultants do not contain specific descriptions of work to be completed or a target time allotted. The consultants themselves provide this information when they bid on a case, with varying degrees of detail. By not providing specific descriptions of work or a target time allotment, the division's monitoring of contract progress is impeded.

The division may also issue separate contracts to different consultants for the same petitioned case under different specializations. This increases the risk that consultants perform duplicate tasks on the same case. If the RFPs were also sent to vendors that offer all specializations, a higher degree of efficiency may have been achieved. According to Department of the Treasury Circular Letter 11-14-DPP, waivers of advertising require documentation to substantiate vendor awards and retention. The division did not document bid evaluations to justify vendor selections or the need for separate vendors on the same cases.

Recommendation

The division should develop RFPs containing specific scope of work detail or target time allotments rather than relying on the consultant to include this information in their bid. This will ensure the RFPs can be used as a tool to monitor contract objectives and track case progress. Additionally, the division should document vendor bid evaluations and their justification for issuing various specialized RFPs for the same contract.



Sole Source Vendors

The division should perform additional steps when selecting a sole source vendor.

Consulting services provided to the division are unique in nature, therefore only certain vendors are qualified for bidding. The division maintains 23 vendors on its current approved waiver list; however, during the audit period we noted 57 percent of consultant expenditures were paid to three vendors. During our testing, we sampled 34 contracts and found 28 had the RFP sent to only one vendor for the requested specialty, with sole source justification documented in only two instances. Although advertising had been waived, documentation should have justified the use of a sole source vendor according to New Jersey Administrative Code 17:12-1A.2. For 27 of the 28 contracts, the consultants' bid proposal was equal to the contract amount, indicating negotiation was not a part of the process. This increased the risk that work performed may have been in excess of what was needed. No analysis was performed by the division to determine the total amount spent on contracts. We analyzed the amount consultants were paid in relation to the original contract amount, and found payments were equal to or less than 75 percent of their spending authority for 7 of 14 closed cases, indicating there was room for negotiation. For example, in circumstances where a utility files for an annual increase and the consultant is retained from the previous year's petition, historical time records and billing data can serve as guidance when determining if current proposal amounts are adequate or may be excessive.

Recommendation

The division should document its justification for use of sole source vendors. Additionally, the division should use consultants' past billing history and bid proposals to determine the reasonableness of a vendor's bid.



Funding for Litigation

Funding contingent to litigation costs should be approved on an individual basis.

We found that for 16 of the 28 tested approved bid proposals, the consultant proposal listed two price quotes; a higher amount if the case goes to litigation. We found the quote, including the litigation amount, was always the amount approved. According to the division, only a small percentage of cases go to litigation. By approving the higher amount, there is increased risk that payments for services are made for which consultants did not seek spending authority. We found one instance where a non-litigated case was paid less than the contract maximum, but \$10,000 over the non-litigated quote given.

Recommendation

We recommend the division approve additional funds for consultants on an individual per case basis when litigation occurs.



Additional Funding Requests

The division should not grant additional funding unless contract changes have occurred.

Upon signing original contracts, both parties agree funds approved are not to exceed the agreed upon amount, although the master consultant agreements allow for such requests. We noted 12 of 34 contracts tested that had additional funding requests were all approved by the division. Consultants requested additional funds for various reasons. For five requests, the consultants requested additional time although no changes were made to the scope of work. We noted three of the requests appeared to have scope enhancements as documented by the consultant; however, the division's determination was not documented. Approving additional funds for work previously agreed upon may be the result of insufficient detail in the RFP.

We analyzed all contract payments made during our audit period and determined that, although only 28 of 349 (8%) of contracts signed had additional funding approved, the approvals increased consultants' spending authority by 31 percent, or \$2.2 million.

Recommendation

We recommend the division approve additional funding requests only when the scope of work changes and document the justification for the approval.



Generic Contracts

Work unrelated to original contracts should be competitively bid.

While reviewing contracts requesting additional funding, we found the division uses several generic contracts with various consultants where the contract scope and limitations initially agreed upon in the RFP differs from work being performed. The contract title and scope of work in the additional funding requests were related to work performed but not to the original RFP. The division granted approval for these additional funds. Additional work unrelated to the original contract should have been subject to the RFP process and competitively bid pursuant to the Department of the Treasury Circular Letter 11-14-DPP and the administrative code. The division could not provide documentation to substantiate the recurring nature of the additional funds awarded and why other vendors were unable to participate in a competitive bidding process. Although generic contracts are used for multiple utility cases, individual case data is not tracked. Only the original contract and description is entered into the division's internal tracking database. Consequently, this impedes the division's ability to monitor each contract.

We found eight generic contracts approved for 58 additional funding requests with total payments of approximately \$2.5 million, including over \$700,000 during the audit period. One of the contracts was awarded in 2006 for \$54,000 and has had twelve additional funding requests approved with payments totaling \$827,000. Another contract dates back to 1995. Although all vendors were on the approved vendor list, we could not determine if the contracts were ever competitively bid.

Recommendation

We recommend the division competitively bid additional work unrelated to the original contracts in order to comply with Department of the Treasury circular letters and the administrative code. In addition, the division should document contract objectives, monitor consultant progress, and ensure all case data is properly accumulated.



Encumbrances

Individual contract obligations are not entered into the state's accounting system.

When a consultant contract is signed, a purchase order should be established on the state's accounting system, creating a reserve for encumbrance. Executed contracts are not forwarded to the Department of the Treasury's centralized fiscal unit, which has the responsibility to create and approve accounting system transactions for the division. Although the unit creates a blanket purchase order to pay current year expenditures, this may not consider all potential contract obligations. Since the average contract length is eight months and can range over multiple years, obligations may exist at year end that are not being recorded. We calculated outstanding

contract obligations to be approximately \$1 million at June 30, 2014, an approximate \$150,000 increase over June 30, 2013. Due to the increasing nature of this obligation, a risk exists that contract funds become due without the division having spending authority to meet existing obligations.

Recommendation

We recommend all contracts be forwarded to the Department of the Treasury's centralized fiscal unit to obligate funds in an effort to reduce the risk that sufficient funds are not reserved to meet obligations.



Subcontractors

Consultants subcontract with vendors not registered by the state and pass on excess fees.

Two consultants used the work of subcontractors and did not forward proof of business registration certificates to the division. Per state statute and Department of the Treasury Circular Letter 11-14-DPP, the contractor must provide proof that any subcontractors utilized have a valid business registration certificate issued by the Division of Revenue and Enterprise Services (DORES). Additionally, the division did not seek written approval from the Director of the Division of Purchase and Property for the subcontractor use, a stipulation in the waiver terms and conditions agreement signed by each consultant. Consultant staff listings required by waiver procedures included contractors listed along with employees and were not clearly identified. These consultants billed the division \$465,000 for subcontractors during the audit period. Subcontractors billed the consultants for work at a lower rate than the consultants billed the division. These excess fees totaled \$91,000 for the audit period. Additionally, we noted that neither of the consultants included subcontractor bills when sending invoices seeking payment, hence the division could not determine if the hours paid were accurate.

Recommendation

The division should ensure all businesses are registered with DORES and obtain written approval for subcontractor use from the Division of Purchase and Property. Additionally, the division should discontinue paying in excess of consultant subcontractor fees and require consultants to forward subcontractor invoices when applicable.



Consultant Billing Process

The division needs written billing review procedures that verify all payments are allowable.

Contract progress should be effectively monitored as part of a billing review process by tracking well-defined objectives outlined in a detailed RFP. Since the consultants' work is done remotely and improvements are needed in the RFP process, the division's ability to effectively monitor is limited. However, staff should carefully examine all invoices for unallowable costs. We found no instances where bills were questioned or not approved. The division did not document this process, although they stated it did occur. Contract billing procedures require a specific description of the activity being submitted with the invoice. We found vendors submitted invoices with varying degrees of detail. Consultants may be working on multiple cases per month, and the division's contract billing procedures require the submission of a separate invoice for each case. However, there is no specific format required and the division does not maintain a log of the consultant's daily hours worked and billed for each case, increasing the risk the same hours may be billed on more than one case.

During the audit period, consultants were paid \$2.6 million annually. All invoices for the top three highest paid vendors for fiscal year 2013 were tested, representing 58 percent of consultant expenditures for the year. We found invoices were paid with a vague description of work completed, with mathematical errors, for expenses ineligible for reimbursement, and for work performed prior to contract approval.

- We found 132 of 454 invoices (29%) contained questionable items totaling \$105,000. Exceptions included payments over \$25,000 for items with a vague description of "Case Analysis" only, more than \$20,000 of invoices with signatures certifying services were rendered prior to the required approval by the supervising attorney, \$19,000 where an invoice could not be provided, \$2,300 in vendor calculation errors, \$4,500 of possible duplicate hours or line items billed, and \$4,600 billed for employees not on approved staff listings. Also, one vendor billed \$2,700 for cases after the closing date on file at the BPU. Contracts allow for reimbursement of economy air travel and for charging an hourly rate for time worked but exclude time spent traveling. We noted \$14,000 for time spent traveling. Additionally, a consultant was reimbursed \$2,500 for an upgraded travel class airfare.
- During the fiscal year 2012/13 waiver period, a vendor increased hourly rates multiple times without prior approval. In the waiver period 2014/15, language was placed in the master consultant agreements making any rate increases unallowable; however, we noted this vendor was approved to make changes after the contract was signed.

- We found instances where requests for additional funding were made for work already commenced or completed. These are instances where the vendor spent more than the current approved contract amount; however, the requests for additional funding were approved before payment was issued. For the three vendors, work performed prior to approval totaled \$241,000 during the audit period and an additional \$127,000 was worked prior to the audit period for these same contracts.

Recommendation

We recommend the division document its billing review procedures to include guidance for comparing bills to case objectives and progress, to request additional information when receiving vague descriptions of work performed, to disallow non-reimbursable costs, and to disallow payment for work performed prior to additional funding approval.

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December 17, 2014

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Re: OLS Audit Response - Division of the Rate Counsel

Dear Mr. Pica:

The Division of Rate Counsel is in receipt of the November 28, 2014 audit report from the Office of Legislative Services – Office of the State Auditor. As the audit findings make clear, overall Rate Counsel’s financial transactions were found to be reasonable and recorded properly in the accounting system. Moreover, we were found to be making efficient use of our consultants. The audit findings did however reveal areas of internal control weaknesses. Rate Counsel has taken and will take corrective measures to ensure that those weaknesses are remedied. Rate Counsel’s specific responses to the audit recommendations are as follows:

Consultant Procurement Process

The audit report recommends greater specificity in the Division’s Requests for Proposals (RFPs) regarding the scope of work and target time allotments, so that the RFPs can be used more effectively to monitor contract objectives and track case progress. Rate Counsel recognizes the value of this proposal and therefore accepts the recommendations contained in the audit report as it relates to the procurement process. Going forward, Rate Counsel will modify the RFPs so that the scope of work requested is more specific and time estimates for specific stages of the case are provided. In addition, Rate Counsel shall create bid evaluation forms for each case to document the justification for the award of contracts for services. Rate Counsel will also use the RFP responses to track the consultants’ conformance with the bids.

Sole Source Vendors

The audit report recommends that the Division document its justification for use of sole source vendors and use consultants' past billing to evaluate the reasonableness of bids. Rate Counsel accepts the recommendations contained in the audit report as it relates to sole source vendors. In fact, management had already begun requiring the professional staff to document sole source justifications for each case matter where a sole source vendor was utilized. This process shall continue going forward. In addition, the professional staff at Rate Counsel will begin to review the past billing history and bid proposal of each vendor to evaluate the reasonableness of the vendor's bid, particularly where a sole source contract is awarded.

Funding for Litigation

The audit report recommends that the Division approve additional funds when "litigation occurs." While Rate Counsel acknowledges that most of its cases settle before hearing, nearly all of its cases involve litigation. Rate Counsel will assume for the purposes of this response that the audit's reference to a matter "go[ing] to litigation" refers to matters that are fully litigated through hearings. As the audit acknowledges, Rate Counsel does request vendors to provide two price quotes: one for a matter fully litigated through hearings and one for a matter that settles before trial. Rate Counsel uses these two quotes to evaluate the bids and takes into account the likelihood that a particular case will settle before hearings. However, the audit appears to recommend that the Division award a contract based on the lower quote for a matter that will settle before hearings and then approve an additional funding request if the case then goes to hearings. Rate Counsel believes the recommendation offered is not operationally feasible.

Frequently, Rate Counsel does not know whether a matter will settle or go to hearing until immediately before the hearing is held. Indeed, cases are often settled during the hearings. Consultants often must prepare for hearings even while settlement discussions are ongoing. It is not generally possible to determine the moment in time when a case goes from being one that may settle to one that may try. It would hinder the Division's ability to prepare adequately for hearings if its consultants were not assured of being paid as they are approaching the hearing. Rate Counsel believes that by requiring consultants to estimate their fees for different stages of litigation, and tracking their billing against those estimates as agreed to above, the concern that this recommendation is aimed at alleviating will be addressed in a manner more consistent with the operational needs of the Division.

Additional Funding Request

The audit recommends that requests from vendors for additional funding under a contract not be granted unless the scope of work has changed and that if additional funding is approved, that the justification for it be documented. Rate Counsel accepts the recommendations contained in the audit report as it relates to additional funding requests. In fact, the Division Director already advised the professional staff in F.Y. 2014 that Rate Counsel will only approve requests for additional funds to a vendor contract when the scope of work changes. Rate Counsel will ensure

going forward that any such requests be in writing with a justification submitted by the professional staff for the Director's review and approval.

Generic Contracts

The audit recommends that work unrelated to the original scope of a generic contract not be added to that contract without a competitive process or sole source justification. The audit also recommends that the Division should monitor generic contracts to ensure they are appropriately used for ongoing and recurring work. Rate Counsel accepts the recommendations contained in the audit report as it relates to generic contracts. Going forward, Rate Counsel shall competitively bid or justify a sole source contract for additional work unrelated to the original contract, and will re-bid generic contracts on a bi-annual basis. Rate Counsel will also establish specific guidelines that require its professional staff to "document contract objectives, monitor consultant progress, and ensure all case data is properly accumulated" under generic contracts as the audit report recommends.

Encumbrances

The audit recommends that all contracts be forwarded to Treasury's centralized fiscal unit to obligate funds. Rate Counsel accepts the recommendation contained in the audit report as it relates to encumbrances. The Chief of Staff for Rate Counsel shall work with the fiscal staff at the Department of the Treasury to make sure that all contracts have been submitted to make sure that Rate Counsel has sufficient funds to meet its obligations.

Subcontractors

The audit recommends that all subcontractors be registered with DORES and be approved by the Division of Purchase and Property. The audit also recommends that the Division require consultants to forward invoices from subcontractors and not pay more than what the subcontractor is charging. Rate Counsel accepts the recommendations contained in the audit report as it relates to subcontractors. Rate Counsel did receive approval from the Department of the Treasury, Division of Purchase and Property to utilize subcontractors. Going forward, Rate Counsel shall follow the directives outlined in the Treasury Circular Letter 11-14-DPP for contractors and subcontractors. Moreover, Rate Counsel shall require all of its vendors to specifically list any subcontractors that may be utilized for a particular case matter and forward their invoices. Furthermore, all contracts will specifically include language that informs the vendor that Rate Counsel shall not pay more for a subcontractor than the vendor is billed on a particular case matter.

Consultant Billing Process

The audit recommends that the Division institute and document billing review procedures. Rate Counsel accepts the recommendations contained in the audit report as it relates to the consultant billing process. To help implement the recommendations in this area, Rate Counsel has recently

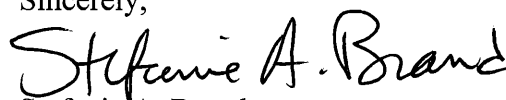
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hired a fiscal person to work with the professional staff in the areas of documentation review, billing procedures, detailed vendor work descriptions and additional funding requests.

In closing, I would like to thank your audit staff for their diligence, professionalism and constructive suggestions. If you need additional information, please do not hesitate to contact me.

Sincerely,



Stefanie A. Brand
Director

Enclosure

c: Daniel Povia, Office of the State Treasurer
Thomas Solecki, Dept. of Treasury
Mona Cartwright, Dept. of Treasury
Kimberly Holmes, Esq., Rate Counsel Chief of Staff