



**New Jersey State Legislature
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**Department of Labor and Workforce Development
Division of Vocational Rehabilitation Services**

July 1, 2012 to December 31, 2016

**Stephen M. Eells
State Auditor**

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Enclosed is our report on the audit of the Department of Labor and Workforce Development, Division of Vocational Rehabilitation Services for the period of July 1, 2012 to December 31, 2016. If you would like a personal briefing, please call me at (609) 847-3470.

A handwritten signature in black ink, appearing to read "Stephen M. Eells".

Stephen M. Eells
State Auditor
June 20, 2017

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Scope

We have completed an audit of the Department of Labor and Workforce Development (department), Division of Vocational Rehabilitation Services (division) for the period July 1, 2012 to December 31, 2016. Our audit included a review of vocational rehabilitation services provided to individuals with disabilities. The average annual cost of these services was \$25.8 million. We also reviewed the Extended Employment Program, administered by the division, with an average annual cost of \$27.9 million. Financial activities of the division were accounted for in the state's General Fund and the New Jersey Workforce Development Partnership Fund.

Pursuant to the Federal Rehabilitation Act of 1973, as amended by the Workforce Investment Act of 1998, which was subsequently amended by the Workforce Innovation and Opportunity Act, the division is the designated state entity responsible for the provision of vocational rehabilitation services to individuals with barriers to employment.

The mission of the division is to prepare and place in employment eligible persons with disabilities (clients) who would otherwise be unable to secure and/or maintain employment. The mission of the Extended Employment Program is to provide services through a network of community rehabilitation programs (CRPs) to individuals who are presently unable to work in the integrated labor market. A CRP is an entity engaged in production or service operations for the purpose of providing employment combined with rehabilitation services as an interim step in the rehabilitation process.

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 systems. Another objective was to assess the effectiveness of client case management. Our final objective was to assess the operations of CRPs participating in the Extended Employment Program.

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 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, the Federal Rehabilitation Act of 1973, the Workforce Investment Act of 1998, the Workforce Innovation

and Opportunity Act, Internal Revenue Service regulations, and policies of the department. Provisions we considered significant were documented and compliance with those requirements was verified by interview, observation, and testing. We also read the budget messages, reviewed financial trends, interviewed division personnel, and conducted a survey of individuals who had received, or were receiving, vocational rehabilitation services to obtain an understanding of the programs and the internal controls.

Statistical and nonstatistical sampling approaches were used. Our samples of financial transactions were designed to provide conclusions on our audit objectives, as well as internal controls and compliance. Sample populations were sorted and transactions were judgmentally and randomly selected for testing.

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 systems. However, in making this determination, we noted significant weaknesses in internal controls over the establishment and operation of a hydroponic farm resulting in overpayments. We also found CRPs participating in the Extended Employment Program were not properly withholding and remitting payroll taxes. In addition, we found that vocational rehabilitation cases were not closed timely by the division.

We also made observations regarding the level of client satisfaction with vocational rehabilitation services, the number of clients enrolled in CRPs that are placed in competitive integrated employment, and the attendance levels of CRPs compared to their contracted levels of capacity.

Hydroponic Farm

Federal and state funds totaling \$395,332 were invested in a hydroponic farm which has ceased operations, yet no funds were recovered.

In July 2012, a not-for-profit hydroponic farm was established in Monmouth County by Division of Vocational Rehabilitation Services (division) clients with the assistance of division counselors. The mission of the farm was to train and employ persons with disabilities in the hydroponic growth of vegetables, herbs, and fruits. The clients served as officers and employees of the farm, while the counselors participated as unpaid members of the farm's board of directors. The counselors also referred new clients to the farm for training and possible employment. A total of \$395,332 was invested in the farm which included \$230,332 of federal funds and \$165,000 from the New Jersey Workforce Development Partnership Fund. The farm officially opened to the public in September 2013 and ceased operations in February 2015.

The federal funds included a grant of \$150,000 that was utilized to pay for hydroponic equipment, attorney fees, and other start-up costs. However, according to division records, actual disbursements totaled \$153,850 including one overpayment of \$12,100 for hydroponic equipment. Additional federal funds totaling \$76,482 were expended. All of the federal funds were documented as payments for services rendered to specific clients. Funds designated to specific clients are typically disbursed for services that directly benefit those clients and help them to achieve an employment outcome. We estimated the value of services paid for with federal funds that directly benefited the clients was only \$13,192. Of the \$230,332 in federal funds expended, \$88,245 (38 percent) had no supporting documentation, and \$5,086 was paid for services rendered to a client whose case could not be found in the system.

A New Jersey Workforce Development Partnership Fund grant was also awarded to the farm to provide training, placement, and retention services to clients. Of the \$165,000 paid, \$25,500 was for services to clients who, according to the division's case notes, never attended training as there were no records of the clients visiting the facility. One of these clients was identified as "Anticipated Participant" and two others were identified as "HS Student". We also found the division paid for the same services multiple times resulting in net overpayments totaling \$45,000.

Adequate review of invoices by the division, along with proper supporting documentation, would have prevented overpayments of both federal and state funds.

After the farm closed, all greenhouses, equipment, and materials were abandoned and left at the location. As of December 31, 2016, no funds or assets were recovered by the state or the federal government. There were 27 clients who either worked or attended training at the farm. As of January 31, 2017, none of these clients have found agriculture-related employment which was the primary objective of the farm.

Recommendation

We recommend the division pursue reimbursement for the overpayments and for the abandoned assets. In addition, the division should require proper supporting documentation before disbursing federal and state funds.



Extended Employment Program

The division should ensure adherence to tax codes and payroll withholdings from clients in the Extended Employment Program.

The Extended Employment Program provides services, through a network of community rehabilitation programs (CRPs), to individuals who are unable to work in the integrated labor market. The CRPs are entities engaged in production or service operations for the purpose of providing employment combined with rehabilitation services as an interim step in the rehabilitation process. The services available to these clients must include on-going evaluation, counseling, work adjustment, and job placement in a competitive work environment. In fiscal year 2016, the Division of Vocational Rehabilitation Services (division) contracted with 29 CRPs at a total cost of \$24 million.

For federal taxation purposes, pursuant to Revenue Ruling 65-165 from the Internal Revenue Service (IRS), there are two classifications of clients who perform services in a CRP. The first classification is for clients who have been enrolled in a CRP for an average of 16 weeks. These clients are considered to be in training and are not considered employees. The second classification is for clients who have completed the training period and are working in a CRP while awaiting job placement. These clients are classified as employees.

As of June 27, 2016, we noted 2,496 of the 2,748 clients were enrolled in a CRP for more than one year, and 1,112 of these were enrolled for more than ten years. These clients therefore should have been classified as employees.

In accordance with the Federal Insurance Contributions Act (FICA), a CRP is required to withhold Social Security and Medicare taxes from employees. The IRS requires CRPs to provide all employees with a Withholding Exemption Certificate (IRS Form W-4) to determine the amount of income tax to be withheld. However, pursuant to N.J.S.A. 43:21-19 and N.J.S.A. 43:21-25, CRP clients are exempt from Unemployment Insurance (UI) and Disability Insurance (DI) contributions, respectively.

We contacted all 29 CRPs and requested Wage and Tax Statements (IRS Form W-2), along with payroll registers, to determine which payroll taxes were being withheld from clients' wages. Based on inquiries with management, as well as the review of IRS Form W-2's and payroll registers from the 21 CRPs that responded, we noted the following:

- One CRP with 211 clients did not withhold any payroll taxes.
- Six CRPs inappropriately withheld UI and/or DI contributions.

By not properly withholding and remitting Social Security and Medicare taxes, the CRPs are placing the responsibility of paying these taxes on the clients. The retirement benefits of these clients could also be adversely affected. Furthermore, the CRPs are not paying the employer share of these taxes to the appropriate agencies. In addition, inappropriately withholding UI and DI contributions lowers the clients' net wages.

Recommendation

We recommend the division ensure proper withholding and remittance of taxes for Extended Employment Program clients by making it a requirement in the annual CRP contracts.



Open Cases

Cases should be closed timely.

The Division of Vocational Rehabilitation Services (division) utilizes the AWARE information system for client case management. The system is a comprehensive, web-based case management system used by vocational rehabilitation counselors to manage and document all aspects of the case process for clients of the program. According to the division, the total number of open cases per the AWARE system as of January 19, 2017 was 18,506.

Of the 18,466 cases open as of June 15, 2016, 14 had a closure date yet they remained open per the system. Of the 18,452 cases without closure dates, we selected three separate samples for testing. Our testing included a review of all case notes and system information to determine if the cases should be closed or remain open.

In our first sample, we selected 31 of the 357 cases that had a closure outcome or reason, but no closure date, and determined that 28 of the 31 cases should have been closed. In addition, we selected a second sample of 30 of the 1,280 cases where the last case note or case status update was at least 731 days old, and we determined that all of these cases should have been closed. In our third sample, we randomly selected 10 of the 17,172 cases that were last updated within 730 days and found that 4 of these cases should have been closed.

Failure to close cases timely exaggerates the number of clients currently receiving services and understates the average cost per client as reported in the evaluation data in state budget documents. It may also make it difficult to manage counselor caseloads and focus on active cases.

Recommendation

We recommend the division establish a procedure for closing cases timely. Supervisors should perform random periodic case reviews.



Observations

Client Survey

We conducted an electronic survey of Division of Vocational Rehabilitation Services (division) clients who have received services after July 1, 2012. The objective of our survey was to obtain a measure of satisfaction with the division from the perspective of the clients receiving the services.

Of the 21,212 emailed surveys, 3,696 were returned as undeliverable indicating outdated contact information for these clients. We received survey responses from 1,344 clients indicating the following results:

- 70 percent were not currently employed.
- 32 percent did not feel the services helped to improve their skills, abilities, or prepared them for employment.
- 29 percent did not feel the services improved their quality of life.
- 29 percent were not satisfied with the services from the division or a vendor.
- 27 percent felt the overall process was difficult.

Community Rehabilitation Programs

Placements in Competitive Integrated Employment

The Division of Vocational Rehabilitation Services (division) is not properly enforcing the placement benchmark established for clients in community rehabilitation programs (CRPs). As a result, New Jersey may be at risk of violating the Americans with Disabilities Act of 1990 (ADA).

Pursuant to N.J.A.C. 12:51-8.1(j), each CRP is expected to place a percentage of its clients in competitive integrated employment each year. The U.S. Department of Labor defines competitive integrated employment as jobs held by people with the most significant disabilities in typical workplace settings where the majority of persons employed are not persons with

disabilities. In these jobs, the individuals with disabilities earn wages consistent with wages paid to workers without disabilities in the community performing the same or similar work. The individuals earn at least minimum wage, and they are paid directly by the employer. In addition to the administrative code, the contracts between the division and each CRP reaffirm the need to place a percentage of clients in competitive integrated employment each year. The contracts for fiscal year 2016 recommended this benchmark be at least ten percent.

In fiscal year 2015, the division contracted with 30 CRPs serving a total of 2,674 clients. Only 18 of these clients were placed in competitive integrated employment. In fiscal year 2016, the division contracted with 29 CRPs serving 2,637 clients. Only 85 of these clients were placed in competitive integrated employment. It should be noted that 52 of the 85 placements were clients of one CRP. This CRP was able to place 37 percent of its clients in competitive integrated employment, indicating that higher rates of placement are possible.

In June 2012, the United States Department of Justice found that the State of Oregon's Community Rehabilitation Programs, known as "sheltered workshops", failed to provide employment and vocational services in the most integrated setting appropriate to the clients' needs thereby violating the ADA. The investigation found that most clients whose employment or vocational services were funded by Oregon remained unnecessarily and indefinitely confined to segregated sheltered workshops. These clients had very little opportunity to interact with non-disabled individuals other than program staff. The investigation also found Oregon lacked a meaningful or financial incentive to encourage the movement of clients from sheltered workshops to a competitive integrated employment setting.

In January 2014, the United States Department of Justice also found the State of Rhode Island's sheltered workshop program was in violation of the ADA stating that thousands of individuals spend the majority of their daytime hours receiving employment and day services in segregated sheltered workshops even though they are capable of receiving employment in an integrated setting.

As of June 27, 2016, 40 percent of the division's clients enrolled in CRPs had been there for more than ten years. Similar to Oregon, the division lacks a meaningful or financial incentive to encourage the movement of clients from a CRP to a competitive integrated employment setting.

Contracted Level of Capacity for Community Rehabilitation Programs

The fiscal year 2016 contracts for CRPs included a commitment to achieve 90 percent of their level of capacity (LOC). The LOC is the average daily number of clients to whom a CRP is authorized to provide services multiplied by the number of days the clients are in paid attendance status during the contract period.

The division reserves the right to reduce or suspend monthly payments when a CRP fails to fulfill their contract commitment for the LOC in two or more consecutive months, or the total variance between the budgeted and actual LOC exceeds 10 percent during the entire contract period.

We examined the division's fiscal year 2016 attendance records for the 29 CRPs and compared them to the LOC for each CRP. We found certain CRPs did not achieve the 90 percent LOC commitment as follows:

- 14, or 48 percent, did not meet their LOC commitment in at least two consecutive months.
- 3, or 10 percent, did not meet their LOC commitment in any of the 12 months.
- 3, or 10 percent, did not meet their LOC commitment in 10 of the 12 months.
- 6, or 21 percent, fell below the 10 percent tolerable variance during the entire contract period.

The division does not reduce or suspend monthly payments when a CRP fails to meet its LOC commitment. However, the division may lower their LOC in future months.





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June 16, 2017

Stephen Eells, State Auditor
Office of Legislative Services
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Trenton, New Jersey 08625

Dear Mr. Eells:

Please accept this letter on behalf of the New Jersey Department of Labor and Workforce Development (LWD) in response to your Agency's draft report on the Division of Vocational Rehabilitation Services (DVRS). The Department continually welcomes reports that assist us in our efforts to improve operations for the people we serve.

The report raised a concern about a 2012 grant awarded by DVRS for the development of a social enterprise program in Neptune, NJ to train and employ individuals with disabilities. This investment in a hydroponic farm was one of five grants awarded by DVRS in 2012 to support the implementation and development of new, innovative approaches to prepare individuals with disabilities for competitive, integrated employment. Title IV of the Workforce Investment Act (WIA) (replaced by the federal Workforce Innovation and Opportunity Act (WIOA)) requires that states use a portion of DVRS funds to support innovative programs. Innovative approaches were particularly needed in 2012, with New Jersey and the nation at the height of the Great Recession. It was in this spirit that the social enterprise program in Neptune was funded.

During the course of the Neptune program, 28 DVRS clients benefitted from on-the-job training and experience and these individuals gained business and technical skills useful in a wide variety of jobs. For a variety of reasons, DVRS determined that any continued investment of resources would be better utilized in other ventures. In 2014 and in response to the experience with this particular grant, DVRS determined that future innovation and expansion grants, previously managed by local DVRS offices, would be managed through its central office to strengthen management and oversight practices.

With regard to questioned costs of \$5,086.07 for a client whose case could not be found in the system, LWD has identified documentation indicating this client was a DVRS client and was involved in the hydroponic farm. LWD is currently in the process of securing copies of the hydroponic farm's bank records to determine total reimbursed expenditures and will take appropriate action at the conclusion of this investigation.

The report also found that a small number of organizations engaged in the Extended Employment Program did not ensure the appropriate payroll withholding for consumers. DVRS is developing a new protocol to better ensure that all organizations engaged in the Extended Employment Program are aware of, and are complying with, the federal income tax withholding requirement. This new protocol, which will be implemented immediately, will include the following:

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- (1) Letters detailing the federal income tax withholding requirement will be sent to all organizations engaged in the Extended Employment Program.
- (2) All future contracts between LWD and organizations engaged in the Extended Employment Program will have specific, prominent language outlining the federal income tax withholding requirement and that non-compliance with the requirement results in violation of such contract.
- (3) LWD's audit protocol of organizations engaged in the Extended Employment Program will require review of such organizations' payroll register to ensure adherence to the federal income tax withholding requirement.

Finally, the report concluded that DVRS cases should be closed timely. It is important to recognize that the primary indicators of success for DVRS programs are the number of consumers who obtain integrated, competitive employment and the number of consumers who become ready for integrated, competitive employment. In federal fiscal year 2016, 3,922 consumers were placed in integrated, competitive employment and 1,536 consumers became job ready. While the number of active cases is not a critical metric of success, the Division is currently developing an operational protocol for managing and closing cases that will balance the need to support the long-term delivery of services with the need to close the cases of consumers who will not receive additional services.

The Department of Labor and Workforce Development works to ensure that we provide the best services possible to the public and to protect taxpayer dollars. We thank you for your recommendations to help us to achieve these goals.

If you have any questions, please contact Jerry Calamia, Director of Internal Audit at (609) 292-1885.

Sincerely,



Aaron R. Fichtner, Ph.D.
Commissioner

c: Catherine Starghill
Robert F. Voorhees
Patricia Moran
Jerry Calamia
Alice Hunnicutt