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New Jersey Office of Legislative Services
Office of the State Auditor

2011
Annual Report

Improving the accountability of public funds and strengthening the operations of government.

Stephen M. Eells, State Auditor

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Message from the State Auditor

The Honorable Members of the Senate and General Assembly

Mr. Albert Porroni, Executive Director
Office of Legislative Services

I am pleased to present to you the *Annual Report of the New Jersey Office of Legislative Services, Office of the State Auditor* for calendar year 2011. In conformance with our responsibilities to perform financial, performance, and compliance audits, all state agencies are audited periodically using a risk-based approach. We issued 24 reports during 2011 which identified $99.6 million in potential cost savings/revenue enhancements. In addition, the state continues to save substantial dollars as a result of the resolution of issues previously reported by the Office of the State Auditor. If you or members of your staff would like additional information or a personal briefing, please contact me.

Our mission is to improve the accountability for public funds and to improve the operations of state government. We serve the public interest by providing members of the Legislature and other policymakers with unbiased, accurate information and objective recommendations on how to better use public resources. In addition to fulfilling our audit mission, we have focused on maximizing the quality of our services and maintaining communication with the Legislature and the agencies that we audit. We are committed to providing high quality audit reports. You may be assured that we will continue our efforts to improve state government accountability to the Legislature through an effective and constructive audit process.

Stephen M. Eells
State Auditor
March 20, 2012

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INTRODUCTION

BACKGROUND

The Office of the State Auditor, which is in the legislative branch of government, was originally established in 1934 pursuant to P.L. 1933, c.295. A number of statutory amendments dealing with the powers and duties of the State Auditor have been enacted in the ensuing years. The Office of the State Auditor is within the Office of Legislative Services under the provisions of the Legislative Services Act.

The State Auditor is a constitutional officer appointed by the Legislature for a term of five years and until a successor shall be appointed and qualified. On February 11, 2010, Stephen M. Eells, CPA, was confirmed by a joint session of the Legislature as the State Auditor.

The organization of the office within the legislative branch permits the State Auditor to be independent of the executive and judicial branches of government. This independence is critical in terms of meeting professional standards and in providing fair and objective reviews and audits of governmental operations.

Under the provisions of Article VII, Section I, Paragraph 6 of the State Constitution and N.J.S.A. 52:24-1 et seq., the Office of the State Auditor is required to conduct post-audits of all transactions and accounts kept by or for all departments, offices, and agencies of state government. Reports are submitted to the Legislature, the Governor, and the Executive Director of the Office of Legislative Services.

The Public Laws of 2006, Chapter 82 authorized the State Auditor to conduct a performance review of any program of any accounting agency, any independent authority, or any public entity or grantee that receives state funds. The law also requires the State Auditor to conduct a follow-up review to determine agency compliance with our audit recommendations. In addition, at the request of the legislative leadership or the Legislative Services Commission, the State Auditor conducts studies on the operation of state and state-supported agencies with respect to their efficiency, internal management control, and compliance with applicable laws and regulations.

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INTRODUCTION

MISSION STATEMENT

The State Auditor provides independent, unbiased, timely, and relevant information to the Legislature, agency management, and the citizens of New Jersey that can be used to improve the operations and accountability of public entities.

VISION STATEMENT

The State Auditor and his staff will approach all work in an independent, unbiased, and open-minded manner.

The State Auditor will provide timely reporting to the Legislature, agency management, and the citizens of New Jersey.

Reporting will be in clear and concise language so it is understood by all users of the report.

Reporting will include recommendations on how to improve the workings of government and how to strengthen agency internal controls.

The State Auditor and his staff will perform all work in a professional manner utilizing appropriate standards.

ACCOMPLISHMENTS

During calendar year 2011 we identified $99.6 million in new cost savings or revenue enhancements. The schedule of cost savings and revenue enhancements is presented on page 4. The office provided additional cost savings of $29,000 by providing the required NJ Law and Ethics Course to 147 state employee certified public accountants free of charge. In addition, the office provided training through audio conferences in various topics at no charge. Our compliance review on findings related to audit reports issued during the fiscal year ended June 30, 2010 disclosed that 75 percent of the recommendations have been complied with or management has taken steps to achieve compliance.

The office performs the annual financial audit of the state's Comprehensive Annual Financial Report (CAFR). The CAFR engagement includes the audit of 144 funds and component units which had a total asset value of $169 billion at June 30, 2011 based on full accrual accounting.

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INTRODUCTION

PROFESSIONAL STANDARDS

The Office of the State Auditor's audits are performed in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. These standards require that our operations be reviewed every three years. In 2011, the National State Auditors Association conducted a review of our system of quality control. The unqualified report received from this review is presented on page 5.

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OFFICE OF LEGISLATIVE SERVICES
OFFICE OF THE STATE AUDITOR
SCHEDULE OF COST SAVINGS AND REVENUE ENHANCEMENTS
REPORTS ISSUED DURING CALENDAR YEAR 2011

REPORT	COST SAVINGS/ REVENUE ENHANCEMENTS (In Thousands)
Asbury Park School District	$202
Department of Community Affairs	
American Recovery and Reinvestment Act Weatherization Assistance Program, Grant to New Jersey Community Action Association	58
Department of Corrections	
Albert C. Wagner Youth Correctional Facility	482
South Woods State Prison	15
Southern State Correctional Facility	151
Department of Education	
Division of Early Childhood Education, Preschool Education Aid	50,000
State Aid	18,400
Department of Human Services	
Division of Developmental Disabilities, Hunterdon Developmental Center	211
Division of Medical Assistance and Health Services Medicaid Provider Enrollment, Hearing Aid Services, and Drug Screenings	28,422
Department of State	302
Department of the Treasury	
Division of Pensions and Benefits College, University, Authority, and Commission Participation in the State Health Benefits Program	213
Office of Management and Budget Selected Programs	1,100
Total Cost Savings and Revenue Enhancements	$99,556

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National State Auditors Association

June 10, 2011

Mr. Stephen Eells
New Jersey State Auditor
New Jersey Office of the Auditor
125 South Warren Street
P.O. Box 067
Trenton, NJ 08625-0067

Dear Mr Eells:

We have reviewed the system of quality control of New Jersey Office of the State Auditor (the office) in effect for the period May 1, 2010 through April 30, 2011. A system of quality control encompasses the office's organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of conforming with government auditing standards. The design of the system and compliance with it are the responsibility of the office. Our responsibility is to express an opinion on the design of the system, and the office's compliance with the system based on our review.

We conducted our review in accordance with the policies and procedures for external peer reviews established by the National State Auditors Association (NSAA). In performing our review, we obtained an understanding of the office's system of quality control for engagements conducted in accordance with government auditing standards. In addition, we tested compliance with the office's quality control policies and procedures to the extent we considered appropriate. These tests covered the application of the office's policies and procedures on selected engagements. The engagements selected represented a reasonable cross-section of the office's engagements conducted in accordance with government auditing standards. We believe that the procedures we performed provide a reasonable basis for our opinion.

Our review was based on selective tests; therefore it would not necessarily disclose all weaknesses in the system of quality control or all instances of lack of compliance with it. Also, there are inherent limitations in the effectiveness of any system of quality control; therefore, noncompliance with the system of quality control may occur and not be detected. Projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions, or because the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the system of quality control of the New Jersey Office of the State Auditor in effect for the period May 1, 2010 through April 30, 2011 has been suitably designed and was complied with during the period to provide reasonable assurance of conforming with government auditing standards.

As is customary in a peer review, we have issued a letter under this date that sets forth comments that were not considered to be of sufficient significance to affect the opinion expressed in this report.

Tracey Moore

Tracey Moore, CPA, Team Leader
National State Auditors Association
External Peer Review Team

Neal Weatherspoon, CPA, CISSP, CISA, Concurring Reviewer
National State Auditors Association
External Peer Review Team

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www.nasact.org

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AUDIT REPORTS

TYPES OF AUDITS PERFORMED

Financial Audits

Financial audits are designed to provide reasonable assurance about whether the financial statements of an audited entity are fairly presented in conformity with generally accepted accounting principles. The primary annual financial audit conducted by the office is the opinion on the state's Comprehensive Annual Financial Report (CAFR) which is published by the Department of the Treasury. Two other financial audits were issued in calendar year 2011.

Agency Audits

The objectives of this type of audit are to determine whether financial transactions are related to an agency's programs, are reasonable, and are recorded properly in the accounting systems. This type of audit may also focus on specific performance issues. Where appropriate, these engagements may also provide economy and efficiency comments. Audits are selected using a risk-based approach. Larger departments are audited on a divisional, agency, or program basis rather than on a department-wide basis because of their size and complexity. We performed 19 of these audits in calendar year 2011. These audits encompassed $26.1 billion and $2.5 billion of expenditures and revenues, respectively.

Information Technology Audits

The objectives of this type of audit are to determine whether the data maintained by a particular computer system is reliable, valid, safeguarded, and recorded properly; whether agency networks are properly managed to provide for business continuity and the prevention of system abuse; and whether system development and maintenance is performed in accordance with guidelines and best practices. During calendar year 2011 we reported on the Office of Information Technology's Data Center Operations and Production Controls and performed a vulnerability assessment of Judiciary's court vicinages.

The office has begun to train all audit staff on the basics of integrated auditing, where field auditors learn how to review IT controls applicable to the scope of their audit. If the system they are reviewing has more complex controls, an IT auditor can be consulted or the system itself can be assigned to the IT unit as a separate audit. This effort will allow for review of a greater number of IT controls.

School District Audits

N.J.S.A. 18A:7F-6d authorizes the Office of the State Auditor to audit the accounts and financial transactions of any school district in which the state aid equals 80 percent or more of its net budget for the year. We audited one such school district in calendar year 2011.

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AUDIT REPORTS

Legislative Requests

From time to time the Legislative Services Commission and Legislative Leadership requests the State Auditor to conduct special projects of the fiscal practices and procedures of the major departments and agencies of the State, and to report findings to the Commission.

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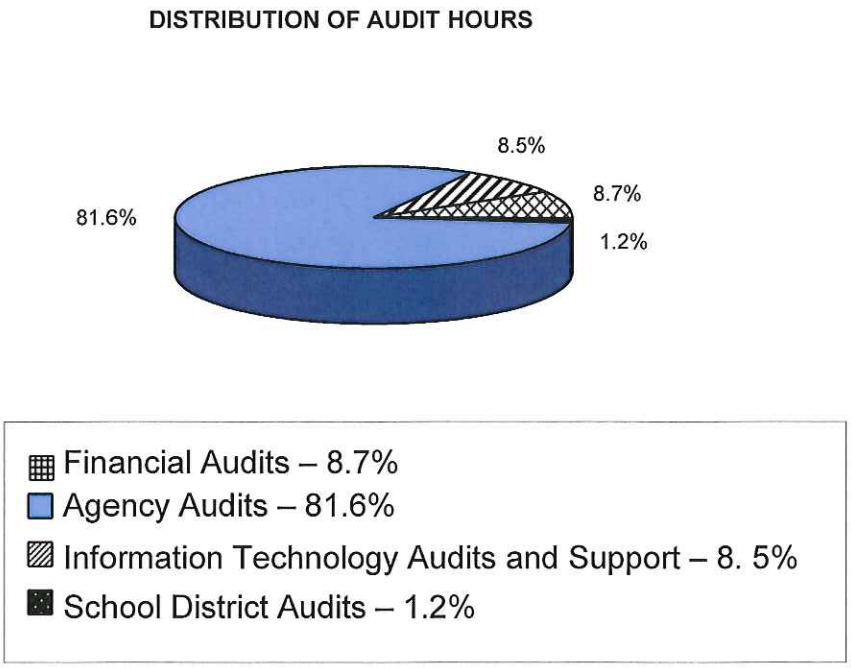
DISTRIBUTION OF AUDIT HOURS

The distribution of audit hours used in performing audits during calendar year 2011 is depicted on the following chart.



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AUDIT REPORTS

HOW AND TO WHOM AUDIT REPORTS ARE ISSUED

Findings and recommendations developed as a result of our independent audits are intended to provide accountability and improvement of government operations. All reports are discussed with agency officials prior to finalization and modifications are made where warranted. Management comments to the final report are incorporated in the document. All issued reports of the Office of the State Auditor are public documents and since 1996 are available on the Internet through the New Jersey Legislature's Home Page.

Reports are statutorily required to be sent to the:

- Governor
- President of the Senate
- Speaker of the General Assembly
- Executive Director of the Office of Legislative Services

In addition, copies of reports are routinely sent to the:

- chairs of the pertinent Senate and the General Assembly committees,
- executive directors of partisan staff
- management of the audited entity
- State Treasurer
- State Library

Finally, reports are placed on the Internet at:

http://www.njleg.state.nj.us/legislativepub/auditreports.asp

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ORGANIZATION

HUMAN RESOURCES

The Office of the State Auditor is one of eight units within the Office of Legislative Services. The State Auditor's office is comprised of 91 professional and five support staff positions. All auditors must have a bachelor's degree in accounting or a related field and a minimum of 24 credit hours in accounting. Fifty-one staff members, 56 percent of the professional staff, possess professional certifications or advanced degrees. Working for the office qualifies for the one year intensive and diversified experience needed to become a certified public accountant in the State of New Jersey.

The office provides a minimum of 80 continuing professional education credits biennially and diversified work experience to enhance each individual's professional development. The audit staff attends professional development programs encompassing a myriad of accounting and auditing topics. In addition, staff members actively participated as officers, board members, and committee members of local, state, and national accounting and auditing organizations, including the Association of Government Accountants, Institute of Internal Auditors, National State Auditors Association, and New York/New Jersey Intergovernmental Audit Forum. The office also participates in the national peer review program under the auspices of the National State Auditors Association.

AUDIT STAFF

The audit staff is the primary operating group in the office. They plan, conduct, and control the audit engagements and prepare and edit the reports. The audit teams report the results of their work to the auditee on an ongoing basis and at the conclusion of the engagement by means of a written report. In an effort to develop expertise, field managers are assigned specific departments. This practice enhances the quality and efficiency of our audits and ensures all programs are audited within a reasonable cycle. Information technology support is also provided by the field staff.

The office maintains six active committees staffed by individuals in various titles to provide guidance in the areas of information technology, personnel, planning, policy, sampling, and training. An intranet site is also maintained that contains staff information, budget and appropriation information, and commonly used accounting and auditing research and reference internet sites that the audit staff can access through their computers.

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ORGANIZATION

QUALITY ASSURANCE

The quality assurance staff is responsible for technical compliance and quality control, oversight of staff training, and research of technical issues. Quality assurance is achieved through reviews of working papers and reports to ensure adherence to professional standards. The quality assurance staff, through its research of accounting and auditing issues, also responds to surveys, questionnaires, and exposure drafts relating to proposed accounting and auditing standards.

ADMINISTRATIVE STAFF

The administrative staff processes, files, and distributes all reports. This group is responsible for maintenance of the audit working papers and the office library, purchasing and maintaining office supplies, and other general administrative functions.

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OFFICE OF THE STATE AUDITOR
STAFF ROSTER
As of December 31, 2011

STATE AUDITOR
Stephen M. Eells, CPA
Jean Horner, Administrative Assistant

ASSISTANT STATE AUDITOR
John Termyna, CPA
Jill Bodnar, Secretary

ASSISTANT STATE AUDITOR
Thomas R. Meseroll, CPA, CGFM
Robyn Boyer, Secretary

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David J. Kaschak, CPA, CGFM
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Kenyona Booker, CGAP
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Jonathan Trauger, MBA, CPA
Shrushti Trivedi
Kurt Zadworney

ADMINISTRATIVE STAFF
Pamela J. Puca, Principal Audit Processor
Anthony Arena, Support Services Assistant

Legend:

CEH – Certified Ethical Hacker
CFE – Certified Fraud Examiner
CGAP – Certified Government Auditing Professional
CGFM – Certified Government Financial Manager
CIA – Certified Internal Auditor
CISA – Certified Information Systems Auditor
CMFO – Certified Municipal Finance Officer
CPA – Certified Public Accountant
CPT – Certified Penetration Tester
MAccy – Master of Accountancy
MBA – Master of Business Administration
PSA – Public School Accountant

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ACCOMPLISHMENTS AND RESULTS

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ACCOMPLISHMENTS AND RESULTS

SUMMARY

This section highlights five of the more significant audits issued during the past year that individually contained cost savings/revenue enhancements greater than $450,000 and collectively totaled $98.4 million. Information on these reports is presented on pages 16 through 24. The office issued seven other reports with individual cost savings totaling $1.2 million. This section also contains the significant findings from three additional audits on pages 26 through 29. In addition, our reports contain non-monetary findings addressing areas of noncompliance with laws or regulations, weaknesses in internal controls, and economies and efficiencies to improve operations.

All reports issued in calendar year 2011 are identified on a schedule on pages 30 to 31 and are available for review on our internet website.

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SIGNIFICANT COST SAVINGS/REVENUE ENHANCEMENTS

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Shared Service Opportunity

Albert C. Wagner Youth Correctional Facility utilizes a correctional officer to patrol the perimeter of the correctional facility and the properties under its control. The officer must be vigilant for suspicious incidents, activities, persons, and vehicles within the security perimeter. The post is a 24 hour a day position, requiring three officers per day. Garden State Youth Correctional Facility has an identical post.

The two facilities are located adjacent to one another. There are approximately three miles of roadway that run within both facilities' perimeters. Our review of post records for the period July 1, 2010 through December 31, 2010 disclosed no major incidents occurring at either facility. By combining these two posts into one for both facilities, the state could save on salaries, fuel, maintenance, and vehicle costs. Annual salary savings alone are estimated at $340,000.

Overtime Costs Related to Sick Leave

An organization that incurs substantial overtime costs because of sick leave should have strong monitoring functions to reduce the risk of sick leave abuse. The environment within the facility tolerates a liberal use of sick time. Our analysis disclosed that of the $3.4 million in overtime costs incurred in fiscal year 2009, we estimate $2 million resulted from paid and unpaid sick call-outs.

Per the state's administrative code, an appointing authority may require proof of illness or injury when there is a reason to believe that an employee is abusing sick leave; an employee has been absent on sick leave for five or more consecutive work days; or an employee has been absent on sick leave for an aggregate of more than 15 days in a 12-month period. Even when the 15-day limit occurred, the facility did not take a strong stand on reviewing employee sick time. The Department of Correction's internal policy states that an operation unit "may" require employees to submit doctor verification after the 15-day limit. A sample test of ten employees who exceeded the 15-day limit disclosed only one had a doctor's note on file. We determined that if each custody employee reduced paid sick leave by only one day, it would save the facility $113,000 annually.

Sewage Operation Agreement

Albert C. Wagner Youth Correctional Facility (ACWYCF) maintains its own sewage treatment plant, which provides service to the facility and the adjacent Garden State Youth Correctional Facility. In 2001, ACWYCF signed a binding operations agreement with Chesterfield Township to provide sewage treatment services to the township for a 20-year period. A per gallon rate was negotiated. Chesterfield pays quarterly based on their usage. The agreement also specified that Chesterfield would be allocated a share of the repair and maintenance expenses of the plant. Management has not billed Chesterfield for its share of maintenance and repairs to the plant since the inception of the agreement.

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Repairs and maintenance are common and would include such items as sludge removal and water testing. In fiscal year 2009, we estimate that the township would have been responsible for at least $28,000 in maintenance and repair costs.

Time Reporting Inaccuracies

The Timepoint system is used to staff shifts and provide payroll information. This information is uploaded to the Time and Leave Reporting System (TALRS) on a daily basis. A Timepoint to TALRS variance report is provided by the Department of Corrections to the facility on a monthly basis to enable a review of any discrepancies between the two systems for overtime and leave time. The accuracy of the data entered into the Timepoint system and how management utilizes the system to monitor operations are important. Errors and irregularities could result in a misappropriation of funds if inaccurate data is not reviewed and adjusted.

We performed an analysis to determine if any officer was recorded as working at any two job codes at the same time. For calendar year 2009, we found 22 posts where this occurred. Nine officers received 26 hours of overtime overpayments because of these errors, totaling $1,300. Furthermore, we found 26 instances where differences between TALRS and the Timepoint variance report were not corrected by the Operations Unit and it resulted in 158 hours of sick, vacation, and administrative leave not being deducted from officers' leave balances.

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Preschool Education Aid Carryover

School districts that receive Preschool Education Aid (PEA) and have unspent aid at school year-end are instructed to budget the anticipated carryover balance to support the subsequent year's program. We found that many districts did not calculate their carryover correctly.

We recalculated the PEA carryover for 86 districts whose combined aid payments represented approximately 98 percent of total PEA payments distributed for school years 2008-2009 and 2009-2010. We used the districts' preschool budgetary expenditure schedules and the audited data received through the electronic data collection program. We found that the 86 districts had approximately $82 million in total carryover balances at school year-end 2009-2010, of which only $32 million was budgeted for school year 2010-2011. The available and unbudgeted carryover was approximately $50 million.

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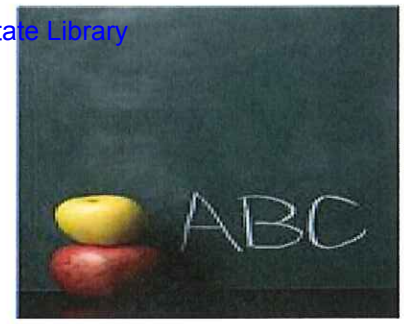

Preschool Education Aid to SDA Districts

In accordance with the School Funding Reform Act of 2008 (SFRA), preschool education aid is provided to school districts that received early childhood program aid, early launch to learning initiative aid, or preschool expansion aid in fiscal year 2008. A total of $596 million was appropriated for preschool education aid in fiscal year 2010, of which $550 million was distributed to the 31 SDA school districts, formerly known as Abbott school districts.

Annually, SDA districts project their preschool enrollment and receive a fixed amount of aid per pupil based on placements. The per pupil aid amounts for fiscal year 2010 were $11,890 for pupils enrolled in an in-district program, $13,366 for pupils enrolled in a licensed child care provider program, and $7,385 for pupils enrolled in a Head Start program.

Our review noted that 25 SDA districts overestimated their preschool enrollment in fiscal year 2010. Collectively, the projected preschool program enrollment for the 31 SDA districts was 1,480 pupils greater than the actual enrollment, which is a four percent error rate. The largest disparity, 765 pupils, was with the provider program where 51 percent of the pupils were placed. SDA district enrollments for in-district and Head Start preschool programs were also overestimated by 331 and 384 pupils, respectively. One district overestimated their preschool enrollment by 358 pupils resulting in an additional $4.7 million in aid. Our review also noted that five districts underestimated their preschool enrollment by a total of 147 pupils.

If payments for preschool education aid were adjusted based on actual enrollments, the Department of Education could have saved $18.4 million in fiscal year 2010.

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Provider Enrollment

Controls over the enrollment of prosthetic and orthotic providers should be improved.

Overall the Division of Medical Assistance and Health Services (division) has adequate controls in place for enrolling providers. However, we identified a weakness relating to the enrollment of prosthetic and orthotic (P&O) providers. P&O providers supply custom fabricated orthotic and/or prosthetic devices to enable recipients to function better and increase their mobility. Regulations require that to be an approved P&O provider, applicants must submit a copy of their facility and personnel certifications by the American Board for Certification in Orthotics and Prosthetics.

We tested 15 of the 93 P&O providers eligible as of March 2011 and found that seven had not submitted documentation of their facility and/or personnel certification with their application. Further review disclosed that none of the seven had the proper facility and personnel certifications to be enrolled as a P&O provider. During the period from July 1, 2008 to March 25, 2011, these seven providers had claims totaling $839,000.

The moratorium on durable medical equipment providers is being circumvented.

A moratorium on durable medical equipment (DME) providers has been in effect since July 2006 to ensure that only DME providers whose services are deemed necessary to meet special needs by the division become providers. Providers have circumvented the moratorium by enrolling as a P&O provider and then operating as a DME provider. We tested five P&O providers enrolled after the moratorium and found that four were operating as DME providers. Since their enrollment, the four providers billed $1.2 million in DME claims, but only $645 in P&O claims. Because P&O providers can sometimes have legitimate DME claims, the Medicaid system is set to allow P&O providers to submit DME claims when necessary. However, these four providers were clearly operating as a DME provider and should be examined further by the division.

Hearing Aid Services

The New Jersey Medicaid program provides hearing aids and related services to eligible recipients. Related services include dispensing fees, batteries, and repairs. Regulations require that recipients must first be medically cleared and referred by a physician prior to the prescribing of a hearing aid. For the period July 1, 2008 through June 27, 2011, claims for hearing aids and related services totaled $19.1 million for 12,300 recipients. Hearing aid and related services claims have increased from $3.6 million for 6,000 recipients in fiscal year 2007 to $7.1 million for 7,000 recipients in fiscal year 2010.

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Monitoring of hearing aid service claims should be improved.

Our review found that the division has inadequate controls in place to monitor hearing aid claims. Hearing aid providers submit claims along with supporting documentation to the state's fiscal agent. These manual claims and their support are not critically reviewed for accuracy and controls are not adequate to detect or prevent provider billing errors or abuses.

The administrative code states that reimbursements for hearing aids will be at wholesale cost, which historically has been the provider's actual or net cost of obtaining the hearing aid from the manufacturer. However, the department issued a newsletter in 1992 that modified these regulations. The newsletter eliminated both prior authorization and the requirement that providers submit manufacturer invoices as proof of cost. Instead, the newsletter provided the option to use manufacturer price lists, thus changing the reimbursement criteria from cost to single-unit pricing. The single-unit price is the price a provider would pay for a single hearing aid, which is much higher than the provider's net cost since providers often receive significant discounts from hearing aid manufacturers.

Our initial review of 70 claims for hearing aids from 26 providers indicated only four claims showed a discount. We contacted a hearing aid manufacturer to obtain copies of four invoices we suspected had been altered. We found that the providers received substantial discounts from the manufacturer. These discounts did not appear on the invoices that were submitted to Medicaid for reimbursement. For example, one provider billed Medicaid $2,295 while the manufacturer's invoice, including the discount, showed a cost of $1,056. Another claim had a cost of $2,900, while the actual invoice was for $915. We conservatively estimated the average discount to be 50 percent. There is the strong likelihood of significant cost savings if the division were to reimburse providers at their net cost as required by the administrative code.

Our review indicated the program is in need of additional oversight. Twenty-six of 29 files reviewed did not contain a signed beneficiary agreement or confirmation from the recipient that the hearing aid was received. We also noted two providers had expired licenses. There were four claims that did not have the required medical clearance and eight claims for which the provider could not verify the make, model, and serial number of the hearing aid dispensed.

Other notable exceptions included one provider who admitted submitting 25 duplicate and 4 unsupported hearing aid claims of the 85 we tested, resulting in overpayments of $53,000.The provider's files were so poorly kept we could not confirm the validity of their other 56 claims reviewed totaling another $82,000. Another provider created invoices in an attempt to make them appear to be originals from the manufacturer. A third provider had a relative act as an intermediary company and submitted inflated invoices from that company rather than the actual invoice cost from the manufacturer. A fourth provider overcharged Medicaid on 37 of 40 transactions resulting in an overpayment of at least $31,000. Although we did not test all transactions for this provider, we noted 421 similarly priced transactions representing a potential of $270,000 in overpayments. All four providers were referred to the Division of Criminal Justice for further review. Our review also resulted

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in the identification of several thousand dollars in additional overpayments and provider errors that we reported to the division.

The division overpaid for hearing aid batteries.

A system edit within the Medicaid Management Information System allows certain procedure codes to automatically process the claim if the value of the item is below a pre-defined limit. In the case of batteries, the limit was set in 2003 at $2 per battery and all claims below that amount were not reviewed. Our analysis of battery claims between July 1, 2008 and February 10, 2011 indicated a total of 943,000 batteries were reimbursed at a cost of $1.7 million for an average cost of $1.80 per battery. Research indicates the retail cost of these batteries to be approximately 50 cents.

By not monitoring and adjusting the allowable price for batteries, the division overpaid approximately $962,000 during the period analyzed. The division agreed with our conclusions and adjusted the price ceiling for batteries from $2 to 80 cents effective February 12, 2011. By changing the allowable price for batteries, we estimate the division will realize an annual cost savings of $367,000.

Drug Screenings

The New Jersey Medicaid program pays for drug screenings for recipients in treatment for substance abuse. Drug screening claims are billed based on a service unit that represents a specific drug class. The division has established a reimbursement rate of $5.20 per drug class and allows providers to test for up to ten drug classes per recipient per day. For the period July 1, 2008 through March 6, 2011, drug screening claims totaled $20.3 million for 70,000 recipients. The majority of screenings were performed by a laboratory at the request of a treatment facility ($13.6 million) or in-house by the facility providing treatment ($5.4 million). Drug screening claims have increased from $1.5 million for 13,500 recipients in fiscal year 2003 to $8.4 million for 27,000 recipients in fiscal year 2011.

The drug screening reimbursement rate should be reevaluated.

In comparison to neighboring states, the division's reimbursement rate appears to be generous. New York has established a maximum rate of $1.25 per unit. Pennsylvania's maximum allowable price per drug class screened is $3 per unit compared to $5.20 in New Jersey.

According to the New Jersey Department of Health and Senior Services' Clinical Laboratory Improvement Service (CLIS), reimbursing $5.20 for each and every drug class tested is excessive as the incremental cost of additional drug classes screened is minimal. CLIS suggested a more reasonable payment rate would be to pay $5.20 for the first drug class tested and a lesser amount for each additional drug class. We estimate that drug screening costs during fiscal year 2010 would have been reduced by $4.9 million had the division reimbursed $5.20 for the first drug class tested and $3 for each additional drug class.

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One laboratory appears to be questionably billing additional drug screening procedures.

The division paid for various additional drug screening procedures including the confirmation of a positive screening, the interpretation of screening results by a medical review officer, and tests to ensure sample validity. Analysis disclosed that a single laboratory accounted for $1 million of the $1.2 million paid for these additional procedures from July 1, 2008 through March 6, 2011. Although not all of the $1 million was billed inappropriately, the laboratory appears to be billing some of these additional procedures unnecessarily or excessively.

- The laboratory billed $397,000 for the confirmation of positive screenings using a procedure code that is reimbursed at $21.50 per unit when the procedure code used by all other laboratories for confirmations is reimbursed at only $15 per unit. The laboratory's use of the more expensive procedure code did not appear to be appropriate and resulted in $120,000 in additional costs.

- The laboratory also accounts for $355,000 of the $360,000 in claims for the interpretation of screening results by a medical review officer. According to the Clinical Laboratory Improvement Service, the medical review of these Medicaid drug screenings is not necessary. The laboratory billed for a medical review of nearly every drug screening it performed whether the screening was positive or negative.

- Finally, the laboratory appears to be excessively performing validity testing. The laboratory accounted for $316,000 of the $452,000 in claims for two validity testing procedures. Although validity testing is appropriate on a limited basis, constantly testing samples for validity should be questioned by the division.

Medicaid Provider Debt

Active providers in the Medicaid program were found to have debts recorded in the State's Set-off of Individual Liability (SOIL) program. The Department of the Treasury, Division of Taxation administers several set-off programs. The purpose of these programs is to prevent an individual or business from receiving a payment from the government while owing money to the government. Per statute, child support and Division of Taxation debt has precedence over all other debt types when payments are received.

A match of eligible providers with the SOIL database disclosed 479 providers with federal and state debts totaling $20.2 million, including $3.9 million owed to New Jersey as of February 2011. Analysis revealed 155 of the 479 had claims totaling $29.5 million since their debt was recorded by the SOIL program. The 155 providers accounted for $7.4 million of the $20.2 million, including $1.5 million owed to New Jersey.

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Opportunity for Cost Savings

The Department of the Treasury annually processes 7.6 million checks and remittance advices for state payroll, tax refunds and rebates, and vendor payments. A significant number of non-payroll payments in our analysis were for monthly pension benefits. The total cost of printing and postage for all payments during calendar year 2010 was approximately $3.7 million. The following facts were identified.

- The Office of Management and Budget (OMB) processes the regular payroll for 80,000 employees on a biweekly basis. Employees have the option of receiving a check or having their pay electronically transferred to their bank accounts (direct deposit). Those who receive direct deposit may also elect to receive their pay stub information through the internet ("pay stub on the web"). Approximately 31 percent of state employees receiving direct deposit participate in this program.

- A supplemental payroll is processed on the alternate week for such pay types as overtime, retroactive adjustments, bonuses, retirement payments for unused sick and vacation time, and any other one-time payments. Direct deposit is not available for supplemental payroll, therefore between 10,000 and 30,000 checks are printed biweekly. The quantity of these checks could be significantly reduced if all overtime payments were included with the regular pay. Many employees already receive their overtime pay in their regular pay.

- During calendar year 2010, 1.8 million regular payroll checks and stubs, and supplemental overtime checks were printed at a cost of $474,000. This amount does not consider the additional cost of sorting, mailing, and physical distribution by agencies.

- The Department of the Treasury processed 5.5 million non-payroll checks during calendar year 2010. Included in this amount were 555,000 payments to vendors and 531,000 payments to pensioners at a cost of $330,000 and $316,000, respectively. The costs to process pension checks are paid by the Division of Pensions and Benefits and are reimbursed by the pension funds.

According to a national survey, other states have mandated electronic payment of payroll, and at least one state has required web-based notification for all employees. These states have experienced a nearly 100 percent participation rate in their programs. Similarly, the Social Security Administration has mandated electronic payment for new applicants for retirement benefits as of May 1, 2011 and will require all benefit payments to be electronic by March 1, 2013.

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OTHER REPORTS OF INTEREST

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Cost per Pupil

The Department of Education, using information supplied by the school districts, issues an annual Comparative Spending Guide (CSG), which allows officials and the public the opportunity to review and compare various components of a school district's annual expenditure and appropriation data to other similar districts in the state. The CSG excludes certain costs to provide an unbiased comparison among districts. Examples of these costs include tuition paid to providers for preschool, expenditures funded by restricted grants, and tuition payments to other districts and private schools. The CSG is divided into groups based on operating type and projected enrollment. Asbury Park School District was included in the comparison of SDA districts, formerly known as Abbott districts. We reviewed the March 2010 CSG, which provides three years of comparative data and includes actual expenditure amounts for 2007-2008 and 2008-2009 school years and budgeted amounts for the 2009-2010 school year. The district had the highest cost per pupil in each of the last three school years. The district's 2009-2010 budgeted cost per pupil totaled $24,306 and was $7,800 greater than the state average for SDA districts. We also obtained the district's 2010-2011 school year budget dated April 12, 2010 and noted that the cost per pupil for 2009-2010 was revised and increased $2,476 to $26,782. The 2010-2011 estimated cost per pupil is $4,692 less than the 2009-2010 revised amount. The district reduced staff by 64 employees at the end of the 2009-2010 school year that contributed to the reduction in the 2010-2011 estimated cost per pupil. Although the 2010-2011 estimated cost per pupil is less than the prior year, it is approximately $5,600 higher than the 2009-2010 average for SDA districts. As part of our audit, we identified contributing factors for the high cost per pupil at the district. While not the only factors, we believe the following issues play a part in the high cost per pupil for the district.

We performed an analysis of Department of Education data and found that teacher and administrator staffing levels have declined 13.0 percent and 10.0 percent, respectively, over the past 12 years. Student enrollments declined 38.8 percent over the same period.

We noted the following based on our review of the March 2010 CSG.

- Asbury Park's student-to-teacher ratio was 8.7 (students) to 1 (teacher). The district had the second lowest ratio, ranking 30th out of 31 schools in the operating category of SDA districts. The average ratio for this operating category was 12 to 1, and the state's average ratio for K-12 districts was 12.4 to 1.

- Asbury Park's student-to-administrator ratio was 78.3 (students) to 1 (administrator). The district had the second lowest ratio, again ranking 30th out of 31 schools in the operating category of SDA districts. The average ratio for this operating category was 141.5 to 1, and the state's average ratio for K-12 districts was 164.3 to 1.

- Asbury Park's legal cost per pupil was $174. The district had the highest legal cost per pupil ranking 31st out of 31 schools in the operating category of SDA districts. The average cost for this operating category was $37, and the state's average ratio for K-12 districts was $33. In accordance with N.J.A.C. 6A:23A-5.2, districts with legal costs that exceed 130 percent of the statewide average per pupil cost ($46) are required to implement procedures to reduce these costs. According to management, these procedures have been implemented near the end of calendar year 2010. Annual legal payments made during fiscal years 2008 to 2010 averaged $390,000.

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The district should make a determination on the efficient use of its school buildings because of declining enrollment and excess capacity. The district operated three elementary schools except during the 2007-2008 school year. When one (Barack Obama) was closed for remediation. According to the district's long-range facilities plan, total capacity of the three elementary schools is 1,788 students. However, enrollment as of September 2010 for these schools was only 1,208 students. Two of these schools have a combined capacity of 1,364 students. The possibility of consolidating schools to operate more efficiently was recommended and implemented in school year 2010-2011.

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National School Lunch Program

The Division of Food and Nutrition within the Department of Agriculture oversees the administration of the National School Lunch Program. State and federal reimbursements are paid to school districts for the cost of free or reduced school lunches provided to eligible students. As of May 2010, there were 428,000 students participating in the program.

We performed independent tests of approved applications by randomly sampling students from ten school districts. We compared information self-reported by the program's applicants with information we were able to obtain through resources of the Department of Human Services, the Department of the Treasury, and the Department of Labor and Workforce Development. Our tests disclosed potential status changes for at least 172 of 746 (23%) applications sampled, 134 (18%) of which would be ineligible. The questions surrounding these applications focused on the total amount of income claimed by the applicants, as well as proper reporting of all members of the household. We also found 24 percent of the applicants did not provide a social security number, inhibiting our matching process, which may have reduced our overall error rate. If this ineligibility error rate is indicative of the entire population of approved applications, 58,000 students would be ineligible.

Statistics relating to the school lunch program are used for other state funding and policy decisions. For example, the Department of Education's state formula aid per the School Funding Reform Act of 2008 is increased to a school district by between $4,700 and $5,700 for each student eligible for the school lunch program. Furthermore, a conflict exists in that school districts perform the review and approval process while also receiving additional funding for each student they enroll in the program.

While the error rate would have an effect on the school aid calculation, provisions in the act require fiscal year 2009 funding levels be maintained which would significantly reduce the current impact of the errors.

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Improper Payments

The New Jersey State Council on the Arts (council) entered into three memorandums of agreements with a vendor for payments totaling $300,000. The vendor had a working relationship with the council in prior years as an intern. Two of the agreements were approved by an employee of the council who does not have the authority to execute such agreements. The agreements allowed for payment to be received by the vendor in advance of services being rendered. In one instance, the advance was made prior to the execution of the memorandum of agreement. In all three instances, the Department of State (department) and the council have not received any documentation or substantiation of the deliverables being provided by the vendor and there was no monitoring of the projects to ensure deliverables were received. Projects approved by the council are processed by the department, which has a fiduciary responsibility to ensure their propriety. Furthermore, this matter has been referred to the Department of Law and Public Safety, Division of Criminal Justice for further investigation.

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OFFICE OF LEGISLATIVE SERVICES
OFFICE OF THE STATE AUDITOR
SCHEDULE OF REPORTS ISSUED DURING CALENDAR YEAR 2011

	TYPES OF FINDINGS			
REPORT	**COMPLIANCE**	**CONTROLS**	**ECONOMY/ EFFICIENCY**	**NONE**
Asbury Park School District	X	X	X	
Casino Control Fund		Opinion Report		X
Department of Agriculture		X		
Department of Community Affairs				
American Recovery and Reinvestment Act				
Weatherization Assistance Program				
Grant to New Jersey Community Action Association	X	X		
Department of Corrections				
Albert C. Wagner Youth Correctional Facility	X	X	X	
South Woods State Prison		X		
Southern State Correctional Facility	X	X	X	
Department of Education				
Division of Early Childhood Education				
Preschool Education Aid	X	X	X	
State Aid			X	
Department of Environmental Protection				
Water Funds	X			
Department of Human Services				
Division of Developmental Disabilities				
Hunterdon Developmental Center	X	X	X	
North Jersey Developmental Center			X	
Division of Medical Assistance and Health Services				
Medicaid Provider Enrollment, Hearing Aid Services, and Drug Screenings	X	X	X	
Department of State	X	X	X	
Department of Transportation				
Bridge Maintenance Contract Expenditures		X		
Department of the Treasury				
Division of Pensions and Benefits				
College, University, Authority, and Commission Participation in the State Health Benefits Program			X	
Division of Taxation				
Generic Tax System		X		
Office of Management and Budget Selected Programs			X	

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	TYPES OF FINDINGS			
REPORT	**COMPLIANCE**	**CONTROLS**	**ECONOMY/ EFFICIENCY**	**NONE**
Judiciary				
Administrative Office of the Courts				
Probation Services Division		X	X	
Vulnerability Assessment-Court Vicinages		X		
New Jersey Schools Development Authority				X
Office of Information Technology				
Data Center Operations and Production Controls		X		
Pinelands Commission		X	Opinion Report Single Audit Report	
State of New Jersey				
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards		X		