

Discussion Points

DEPARTMENT OF THE TREASURY

1. The Division of Taxation addressed its succession planning in its reply to Discussion Point #8 in the FY 2013-2014 Department of the Treasury Budget Analysis. Attrition-related risk points existed at all levels of the organization from staff to middle management and senior staff. The division highlighted its Audit, Collections, and Data Systems units as the most significant risk points. Moreover, the division **anticipated that many division careers would end in June of 2014**. Presumably, the division's concerns about a spike in departures were related to the expected reduction in employees' take-home pay as a result of the implementation in July 2014 of the final stage of the phase-in of the health insurance premium sharing by State employees in accordance with P.L.2011, c.78. The law's provisions concerning health care benefit contributions will expire four years after the law's effective date.

- **Questions:** Please state whether the Department of the Treasury sees a spike in departures prior to July 2014. How many Treasury employees are anticipated to retire or otherwise leave in June 2014? How many employees left in June of 2011, 2012, and 2013? Does the June 2014 departure count meet previous department expectations? Is the department prepared for the departures? Are any divisions experiencing any serious transition challenges because of the departures? If so, please note the divisions concerned and describe the challenges. Are the departures mostly retirement or non-retirement departures?

Answer: Treasury has not experienced a spike in departures in 2014. Rather, there has been an average of 12 per month through March 31, 2014. This monthly average is consistent with the rate of departures over the last several fiscal years.

At this time, we have not been advised of any non-retirement departures scheduled for June 2014. Projecting future retirements is never a simple or accurate exercise because many employees file their retirement paperwork for a certain date and then revise it. There are now 11 employees who have filed for retirement on April 30, 2014, 15 for May 31, 2014 and 28 for June 30, 2014.

There were 49 departures in June 2011, including 38 retirements and 11 other separations. In June 2012, there were a total of 32 departures, including 22 retirements and 10 other separation. There were 23 departures in June 2013, including 11 retirements and 12 other separations.

The 28 anticipated retirement departures for June 2014 may be somewhat low at this point because employees still have ample time to file their retirement paperwork for June 2014. It would not be surprising if this number was to increase moderately.

Treasury is prepared as well as possible for these departures.

2. P.L.2007, c.200 requires the Department of the Treasury to publish an annual **Unified Economic Development Budget Report** (N.J.S.A.52:39-6). Thus far, no such report has been produced, although its first edition would have been due in 2008. According to the law, the report must include comprehensive information regarding the costs and benefits of all State

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economic development expenses, including the costs of all economic development-related tax expenditures. Tax expenditures are the amount of annual revenue foregone due to tax credits, deductions, and exemptions. In general, a unified economic development budget is intended to provide information to legislators and the public on the value and performance of a jurisdiction's economic development programs. The scale of New Jersey's economic development incentive programs adds to the significance of making the results of rigorous program analysis readily available, as evidenced by the Administration's observation on page 17 of the FY 2015 Budget Summary that "[r]edemptions of State tax credits awarded under various programs are another factor holding back Corporate Business Tax growth."

Responding to OLS Discussion Point #3 in the FY 2010-2011 Department of the Treasury Budget Analysis, the department conveyed that it intended to compile a unified economic development budget report using the annual New Jersey Tax Expenditure Report as its launching pad. A year later, the department replied to OLS Discussion Point #2 in the FY 2012-2013 Department of the Treasury Budget Analysis that it aimed at releasing an inaugural report before the end of FY 2012. The department ascribed the delay in the report's production to the difficulty of compiling and merging disparate data from multiple departments and agencies and a desire to minimize the impact on businesses. Last year, the department stated in addressing Discussion Point #2 in the FY 2013-2014 Department of the Treasury Budget Analysis that it had not completed the project because of ongoing issues regarding data sharing across agencies. Moreover, the department was working with legislators to amend unspecified provisions of P.L.2007, c.200 that stood in the way of the production of a meaningful report. Treasury stressed, however, that it had not abandoned the project.

- **Questions:** Please provide a status update on the production of a Unified Economic Development Budget Report, as required by N.J.S.A.52:39-6. Does the department anticipate publishing the report in FY 2014 or FY 2015? If not, has the department put the production of the report on hold pending changes to the enabling legislation or does work continue on a report that is responsive to the requirements of P.L.2007, c.200? Please specify any clarifications and revisions to the enabling law that would facilitate compliance with N.J.S.A.52:39-6.

Answer: Treasury is unable to produce a Unified Economic Development Budget Report as described in N.J.S.A. 52:39-6. As currently written, the law asks Treasury to provide break-out information by recipient in contravention of the Department's agreements with the Internal Revenue Service respecting the safeguarding and sharing of confidential taxpayer information. We stand ready to work with our partner agencies and colleagues in the Legislature to amend N.J.S.A. 52:39-6 to facilitate the development and issuance of an evocative and useful report.

3. Subject to certain exceptions, P.L.2001, c.404, the **Open Public Records Act (OPRA)**, makes government records accessible to the public. A governmental entity must grant or deny access to a record within seven business days unless a record is in storage or archived. Noncompliance may be penalized. A governmental entity charges for the copying cost and may levy special service charges when accommodating a request involves an extraordinary expenditure of time and effort or if copies cannot be reproduced by ordinary copying equipment in ordinary business size.

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Replying to OLS Discussion Point #3 in the FY 2013-2014 Department of the Treasury Budget Analysis, the department reported that it received 925 OPRA requests in FY 2012 and that 662 of them emanated from requestors identifying themselves as representing commercial interests, including 136 requests from the media. The Division of Taxation, the Division of Purchase and Property, and the Division of Pension and Benefits combined accounted for 473 of the department's 925 OPRA requests. The total number of record requests rose from 910 in FY 2011 to 925 in FY 2012, although FY 2012 marked the first full year in which the Treasury put employee payroll, pension, and property tax records on the **Governor's Transparency Center** website and although doing so reduced the number of requests for certain public records. Overall, the Treasury denied 29 OPRA requests in whole in FY 2012, triggering the filing of five complaints with the Government Records Council and the New Jersey Superior Court. As of the time of its response, Treasury has never been penalized for OPRA noncompliance.

The Treasury Government Records Access Unit handles Treasury OPRA requests with three full-time equivalent positions. The unit had \$214,689 in FY 2012 salary expenses, excluding fringe benefits, but the full cost of OPRA compliance is unknown, as the unit frequently calls upon the assistance of Treasury's divisions, "in but not of" agencies, the Office of Information Technology, and the Division of Law in the Department of Law and Public Safety. On the other side of the ledger, in FY 2012, the department collected \$4,240 in charges from 37 chargeable OPRA requests, mostly for the programming required for the retrieval of data in various information technology systems and databases. The amount was noticeably less than the \$14,459 charged in FY 2011, as P.L.2010, c.75 lowered the per-page printing fees and required that records submitted electronically have to be provided free-of-charge. The department did not levy permissible charges for requests that require "an extraordinary expenditure of time and effort" in FY 2012 because the Government Records Council's rules for determining such charges are so complex that an employee might need several days to perform the calculation. In response to OLS Discussion Point #3 in the FY 2011-2012 Department of the Treasury Budget Analysis, the department had previously expressed support for increasing OPRA charges so that they may cover the cost of OPRA compliance and deter broad or frivolous requests.

- **Question:** How many OPRA Requests did the department receive in FY 2013 in general and from commercial interests in particular? Was there a noteworthy change in the volume of requests received for specific types of records? How many OPRA Requests did the Treasury deny in FY 2013? How many denials, if any, have been appealed to the Government Records Council and how has the council ruled on the appeals? Was the department penalized for OPRA noncompliance in FY 2013?

Answer: The Department received 925 OPRA requests in total, of which 664 were from commercial interests. The one noteworthy change in volume relates to the increasing complexity of new OPRA requests. Many are submitted by attorneys and the scope of records responsive to a single request may reach thousands of pages, requiring intensive custodian effort and often legal review. Treasury denied 33 OPRA Requests in FY 2013. Two denials were appealed to the Government Records Council. The Council rulings on these two requests were 1) settled in mediation, redacted records released 2) dismissed complaint for unripe cause of action. GRC did not penalize Treasury for OPRA noncompliance in FY 2013.

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Question: Please indicate the department's expenditures and employee hours devoted to OPRA Requests in FY 2013. How many OPRA requests were subject to "ordinary copying charges" and "extraordinary request charges?" What were the Treasury's total FY 2013 collections from OPRA requestors?

Answer: The Treasury Government Records Access Unit administers all Treasury OPRA requests and functions with three full-time equivalent positions. The Unit had \$234,737 in FY 2013 salary expenses and roughly \$88,500 in fringe benefit costs. There are ten Treasury divisions/agencies with one or two custodians on-site who answer records inquiries, scan, redact, retrieve, store, program, perform electronic searches, transmit and research the existence of records and e-mails within their division responsive to OPRA requests. The estimated cost for the division custodians' time is over \$500,000. This does not include the time and effort of the Division of Law in the Department of Law and Public Safety, which provides legal advice to the Unit and division records custodians. In FY 2013, the Department collected \$688 in charges from 13 OPRA requests, mostly for the programming required for the retrieval of data in information technology systems. The Department did not charge for any requests that require "an extraordinary expenditure of time and effort" in FY 2013.

4. The Office of the State Auditor reported in its July 2011 audit report on the Office of Management and Budget (OMB) that the Department of the Treasury processed about 7.6 million checks and remittance advices for State payroll, pension benefit payments, tax refunds and rebates, and vendor payments every year. In calendar year 2010, the cost for printing and postage totaled about \$3.7 million. The Treasury has since been phasing out paper checks as a method of payment to State employees, retirees, and vendors. Instead, it has been processing more **State payroll, pension, and vendor payments as well as remittances advices electronically and is looking to issue debit cards for recipients without bank accounts.** Replying to OLS Discussion Point #4 in the FY 2013-2014 Department of the Treasury Budget Analysis, the department related that as a result it printed and mailed only 4.3 million checks and remittance advices in FY 2012 at a cost of \$2.9 million.

In addressing last year's Discussion Point, the department noted that the Division of Purchase and Property required vendors to receive payments electronically as part of the terms of contracts awarded in accordance with Requests for Proposal issued as of August 2, 2011. Paper checks are only continued as a payment method under prior contracts. Accordingly, the percentage of active vendors in the State's procurement system who received electronic payments rose from 37 percent in FY 2012 to 44 percent as of March 31, 2013.

Paper checks are similarly being phased out as a payment method for retirement benefits, as all State employees retiring on or after July 1, 2011 must receive their retirement benefits as an electronic direct deposit into their bank accounts. About nine percent of recent retirees, however, still received paper checks. Overall, about 13 percent of all pensioners did so. In its quest to eliminate paper checks the Division of Pensions and Benefits continued to explore debit cards as the sole payment method for unbanked pensioners. A first attempt failed when an October 2011 Request for Proposal to outsource the State's pension payroll services

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garnered no cost-effective bids. The division then considered drafting a narrower project plan in which a vendor would only be responsible for cutting checks or other forms of payment.

State employees presently elect to receive their regular biweekly pay either as a paper check or an electronic transfer to their bank accounts. But P.L.2013, c.28 imposes a direct deposit requirement as of July 1, 2014 from which the State Treasurer may grant exemptions. Accordingly, the Office of Management and Budget Circular Letter 13-19-OMB, Mandatory Direct Deposit and Online Access to Pay Stub Information, exempts the following individuals: a) seasonal employees; b) New Jersey National Guard members who are activated for State emergencies; c) former State employees with retroactive contractual payments or Back Pay Awards; d) employees with disabilities that prevent them from using a computer to access their pay stubs; and e) recipients of wage payments as a result of consent decrees. Neither the law nor the circular letter addresses unbanked State employees, though. But the OMB replied to last year's OLS Discussion Point #4 that it planned to issue pay cards to such employees. In addition, the OMB reported a reduction in the issuance of separate supplemental paper checks for overtime, as new labor contracts discontinued this previously common practice. Only four units with a total of 1,253 employees, or eight percent of the employee population with contractually stipulated supplemental overtime pay, still received separate supplemental overtime checks. The OMB noted that supplemental paper paychecks would still be necessary for non-standard overtime, salary restoration payments, retroactive pay, and payments for inactive employees.

- **Questions:** Please share the number of checks and remittance advices that Treasury processed in FY 2013 for State payroll, pension benefit, tax refunds, and rebates, and vendor payments. What was the total FY 2013 cost for printing and postage? How many regular payroll checks, one-time supplemental checks, and pay stubs were printed in FY 2013 and at what cost? What percentage of all contractual payments to vendors is now paid electronically?

Answer: The FY13 totals are: 1,120,957 paychecks and printed pay stubs (858,491 for regular payroll and 262,466 for supplemental payroll), 1,325,662 pension checks, 1,238,230 tax refund checks, 203,115 rebates, and 512,177 vendor checks. The total cost for printing and postage is not available as it varies across divisions/agencies and is not captured centrally. The percentage of all contractual payments to vendors now paid electronically is 53%.

- **Question:** What percentage of State employees who have retired after July 1, 2011 receive their pension payments through electronic funds transfer? How do unbanked State employees who have retired after July 1, 2011 receive their benefits? Has the division established a debit card alternative for unbanked State employees who have retired after July 1, 2011? If so, what are the fees associated with the debit cards and who is paying them? If the division pays the fees, what is the expected annual fee outlay? Do the fee expenditures exceed the cost savings from not issuing paper checks to all former State employees who have retired after July 1, 2011? What percentage of retirement benefits to all recipients is now paid electronically?

Answer: The Division of Pensions and Benefits' experience with requiring July 1, 2011 and after retirees to receive their pension benefits via electronic funds transfer has

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been positive. Approximately 92% of all new retirees receive direct deposit. The retirees who do not receive pension benefits through electronic funds transfer receive the funds via paper check. In total, approximately 90% of all recipients receive pension payments electronically. We are following up again with retirees who have not complied with the mandate. The Division has not yet established a debit card alternative for retirees. The Division has issued an RFP for pension disbursement services which includes this feature. The Division will consider implementing the debit card feature after contract award.

- **Question:** Please share the Office of Management and Budget's (OMB) plan for making payroll payments to unbanked State employees after July 1, 2014. Has the OMB struck an agreement with a bank to offer debit cards as the method of payment to unbanked State employees? If so, what are the fees associated with the alternative payment option and who would be paying them? If the office pays the fees, what is the expected annual fee outlay? Are the fee expenditures exceeding the cost savings from not issuing paper checks to current State employees? Please detail the progress the State has achieved in eliminating supplemental paper paychecks through labor negotiations. How many contracts remain that require supplemental paper paychecks? How many supplemental paper paychecks did the OMB print in FY 2013 and has printed to date in FY 2014?

Answer: The State has exercised its option under the contract with Bank of America for a pay card program for employees not enrolled in direct deposit. The State is working with the bank to set up the bank's CashPay prepaid debit card program for all State employees not enrolled in direct deposit by July 1, 2014.

The State will pay a \$0.01 fee for ACH funding of each card per pay period. However, for each employee that enrolls in the CashPay Card, the bank eliminates the Check Paid (Positive Pay) fee of \$0.027 per pay check, so the State saves \$0.017 per pay check transaction with Bank of America. Employees will not incur fees for withdrawing CashPay Card funds at Bank of America tellers and ATM's, credit/debit transactions at vendors, and online funds transfers from the CashPay Card to another bank account. Bank of America waives fees for the first 2 non-Bank of America ATM transactions per month, while a \$1.00 fee is charged per additional transaction. This does not include any ATM fees charged by the ATM owner. Employees may receive one free replacement card per year, with a \$5.00 fee per replacement thereafter.

The State has eliminated mandatory supplemental overtime checks in all union contracts. OMB printed 262,466 supplemental paper paychecks for FY 2013 and as of April 4th 2014 printed 179,095 for FY 2014.

5. Effective as of July 1, 2011 and in accordance with P.L.2010, c.104, the State ceased to operate **New Jersey Network Public Television and Radio (NJN)**. It divested NJN's radio assets and operating licenses for nine radio stations to two non-profit organizations. It also transferred the management of NJN's four-station television network to another non-profit organization, while holding on to its television operating licenses. Established pursuant to P.L.1968, c.405,

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the **New Jersey Public Broadcasting Authority (NJPBA)** hitherto owned and operated NJN, which broadcast New Jersey public affairs and cultural programming.

NJN's nine-station radio network was sold to WHYY and New York Public Radio for \$1.9 million in cash and \$2.4 million in non-cash compensation. In its replies to OLS Discussion Point #1 in each of the FY 2012-2013 and FY 2013-2014 Department of the Treasury Budget Analysis, the department stated that the \$1.9 million had been received and deposited in the nonlapsing "Trust Fund for the Support of Public Broadcasting," as required by P.L.2010, c.104. The fund received an additional \$158,000 from the sale of NJPBA surplus equipment in FY 2013. Moreover, the department related that the NJPBA had approved \$1.2 million for capital investments that would be charged against the fund (\$635,000 to paint and guy-wire coating at four broadcast towers; \$200,000 to construct a television studio in the Capitol Visitors Center; \$125,000 to replace the tower lighting system at the Montclair site; \$108,000 for transmitter signal switching and monitoring improvements; and \$132,000 as a contingency reserve for the projects). In April 2013, the department reported that the construction of the television studio in the Capitol Visitors Center was completed and the transmitter signal switching and monitoring project under contract and expected to be completed by June 30, 2013. The tower lighting system replacement at the Montclair site and the paint and guy-wire coating project at four broadcast towers, however, still needed to be contracted out. Furthermore, the NJPBA was considering additional capital investments to enhance media capabilities in the Capitol Building and continue the reliable and safe operation of the NJPBA's statewide broadcast transmission infrastructure.

Public Media NJ, Inc., a New Jersey not-for-profit corporation affiliated with WNET.org, runs NJN's four-station television network for five years starting on July 1, 2011. Replying to OLS Discussion Point #1 in the FY 2013-2014 Department of the Treasury Budget Analysis, the department estimated that Public Media NJ would receive a \$4.6 million State subsidy in FY 2014 (\$1.7 million in revenue from the lease of excess spectrum of the educational broadband authorizations held by the NJPBA, \$1.5 million in annual Corporation for Public Broadcasting Community Service Grant funding, \$1.0 million in revenue generated through the lease of space on the stations' broadcast towers, and \$400,000 in payments from the Food Channel for a cable waiver). In addition, the State continues to fund five management and engineering positions that allow the NJPBA to maintain, and if necessary operate, the television stations and other broadcast equipment in accordance with Federal Communications Commission licensing standards. In FY 2014, the authority received \$2.2 million in supplemental appropriations from the State for that purpose (after receiving \$2.0 million in each of FY 2012 and FY 2013). The Governor's Budget does not include an appropriation to the authority in FY 2015. However, it includes a language provision on page F-9 allowing for supplemental appropriations of unspecified amounts for the operation of the authority without additional legislative approval. The Administration invoked this language provision to authorize such supplemental appropriations in FY 2012, FY 2013, and FY 2014.

In answering OLS Discussion Point #1 in the FY 2013-2014 Department of the Treasury Budget Analysis, the department also noted that the Division of Property Management and Construction had begun a \$5 million renovation and repurposing of NJN's former headquarters in the Trenton Office Complex. The division was already undertaking limited interior renovations, such as painting and putting in new carpets. In addition, it was planning major renovations to the building's roof and mechanical equipment to be completed in 2015. State

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agency operations were to move into the building by the end of 2013 already. The department anticipated \$2 million in annual savings from a concomitant reduction in leased office space.

- Questions:** Please provide an accounting of the “Trust Fund for the Support of Public Broadcasting.” Has the fund received any revenues other than the \$2.1 million deposited through the end of FY 2013? Does the Treasury expect additional deposits into the fund in FY 2014 and FY 2015? Please delineate the amounts expended from the fund, specifying the purposes for which they were used. Please provide a status report on: a) the transmitter signal switching and monitoring project; b) the tower lighting system replacement at the Montclair site; and c) the paint and guy-wire coating project at four broadcast towers. If the projects have not been completed, by what date does the department expect their completion? How does the Treasury intend to use any remaining fund balances?

Answer: The “Trust Fund for the Support of Public Broadcasting” has no source of revenues other than the three named above. An additional \$30,000 was deposited into the Fund in FY 2014 from the proceeds of surplus equipment sales. A similar amount may yet be added to the Fund in this fiscal year or in FY 2015 depending upon the outcome of equipment sales still underway. The Fund has an uncommitted balance of approximately \$560,000 remaining at this time. It is anticipated that any remaining balance will be committed to the additional capital needs of the NJPBA.

Capital Projects Approved	Amount Committed	Current Status
Television Studio in Capital Visitors Center	\$161,346	Completed, studio in regular use
PMNJ Equipment Upgrades to enhance daily news production capabilities	\$100,000	Completed, final report in process
Transmitter Signal Switching and Monitoring	\$141,046	Completed, equipment in use
Tower lighting system replacement – Montclair site	315,000	Under contract and work is underway. Expected completion by June 30, 2014
Tower Painting Project – four sites	\$850,840	Under contract and work about to begin. Expected completion by September 2014
Total Commitments	\$1,568,232	

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Question: Broken out into its segments, what is the projected magnitude of the State subsidy to Public Media NJ in FY 2014 and FY 2015? What are the projected FY 2015 expenses of the New Jersey Public Broadcasting Authority?

Answer: There is no "State subsidy" to Public Media New Jersey *per se*. Rather, the NJPBA collects and turns over to Public Media NJ certain pre-existing and ongoing non-State appropriation revenue streams that were committed as a part of the 2011 Programming and Services Agreement. These total approximately \$4.5 million in FY 2014, and are comprised of the annual Corporation for Public Broadcasting Community Service Grant (\$1.4m), the proceeds from a frequency lease arrangement (\$1.7m), tower rents (\$1.0m), and proceeds from a cable channel contract (\$0.4m).

Financial forecasts for FY 2015 indicate these revenue lines will remain at approximately this level for the period.

The cost to the State to maintain and operate the NJPBA broadcasting infrastructure is approximately \$2.1 million per year.

- **Question:** Please provide an update on the renovation and conversion of NJN's former headquarters in the Trenton Office Complex into an office building for other State agencies. What is the status of the planned renovations to the building's roof and mechanical equipment? What State agencies have moved into the renovated facility? Are all the moves into the facility complete and is the entire office space occupied?

Answer: Over the past year, DPMC completed some interior renovations (paint, carpet, electric, telecommunications, etc.) to allow for certain agencies to move onto the fourth floor of the former NJN building as described below. DPMC also engaged an Architect/Engineer to design major renovations to the building's roof and mechanical equipment. That design work is complete. Construction of roof and mechanical equipment is scheduled to be completed in 2015.

Thus far, DPMC has relocated some staff of the Department of Health onto the fourth floor and Judiciary's warehouse operation into former studio space. Once the roof and mechanical equipment work is completed, DPMC plans to vacate a lease and relocate more Department of Health employees.

OFFICE OF MANAGEMENT AND BUDGET

6. Effective February 28, 2011, the Office of Management and Budget (OMB) and the Division of Purchase and Property changed aspects of the administration of the **moratorium on non-information technology (IT) equipment purchases of \$2,500 or more** (see Office of Management and Budget and Division of Purchase and Property Circular Letter 11-12-OMB/DPP, Moratorium on Procurement of Non-IT (Information Technology) Equipment). The moratorium was first imposed in 2008 and authorized procurements in excess of \$2,500 only with OMB pre-approval (see Office of Management and Budget and Division of Purchase and

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Property Circular Letter 08-22-OMB/DPP, Moratorium on Procurement of Non-IT (Information Technology) Equipment). Procurements in excess of \$2,500 have only been allowed if they meet one of five exceptions: a) the equipment is needed for emergency maintenance or repairs; b) the equipment replaces failing equipment so as to not adversely impact or halt mission critical business functions; c) the procurement is related to a program mandated by the federal government, state law or a court order; d) the denial of the purchase request would significantly increase future costs or e) dedicated or non-state funds provide significant funding for the initiative and there is a compelling reason for the purchase. The 2011 circular letter maintains the \$2,500 threshold for the moratorium but requires OMB pre-approval only for procurements of \$36,000 or more. If a department seeks to make a procurement valued between \$2,500 and \$36,000, it can now invoke one of the exceptions and proceed with the purchase. Any such purchase, however, will be subject to an OMB post-audit review and if the OMB determines that a purchase was made in violation of the exemption rules the offending department may once more have to receive OMB pre-approval for all non-IT procurement requests exceeding \$2,500.

Replying to OLS Discussion Point #7 in the FY 2012-2013 Department of the Treasury Budget Analysis, the OMB relayed that it processed 73 non-IT procurement requests in FY 2011, approximately 55 percent less than the 162 it had processed in FY 2010. The OMB attributed the decline in part to the March 2011 increase in the review threshold for purchase requests from \$2,500 to \$36,000. In FY 2012, the OMB received and approved 125 non-IT procurement requests, according to its response to OLS Discussion Point #5 in the FY 2013-2014 Department of the Treasury Budget Analysis. Moreover, with the conclusion of FY 2012, the first full fiscal year following the promulgation of the circular letter, the OMB would soon undertake its first post-audit of non-IT procurements valued between \$2,500 and \$36,000.

- **Questions:** For FY 2013, please indicate the number of non-information technology (IT) purchase requests the OMB reviewed and the number of non-IT purchase requests the OMB rejected. Please state the number of post-audit reviews the OMB has conducted for FY 2012 and FY 2013 non-IT procurements valued between \$2,500 and \$36,000. Are State agencies and departments complying with the requirements of OMB and Division of Purchase and Property Circular Letter 11-12-OMB/DPP? What is the number, if any, of non-IT purchases valued between \$2,500 and \$36,000, broken out by State agency and department, that the OMB deemed to be in violation of the circular letter as part of a post-audit review? Does any State agency or department once again need OMB pre-approval for all non-IT procurement requests exceeding \$2,500 because of circular letter violations? Please comment on the ways, if any, in which the circular letter has affected OMB's workload and operations now that the increase in the non-IT procurement review threshold from \$2,500 to \$36,000 and the post-audit review requirement for non-IT procurements valued between \$2,500 and \$36,000 were in effect for the second full fiscal year.

Answer: In FY 2013, OMB reviewed 135 non-information technology (IT) requests above \$36,000 and rejected one. In addition, OMB has conducted post-audit reviews of 90 FY13 non-IT procurements valued between \$2,500 and \$36,000. These audit reviews indicate that State agencies and departments are complying with the requirements of Circular Letter 11-12-OMB/DPP, as no purchases were found to be in

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violation of the circular letter. Based on these findings, no State agency or department will be subject to OMB pre-approval for non-IT procurement requests exceeding \$2,500. While OMB reviewed fewer non-IT procurement requests throughout the fiscal year as a result of the increased threshold, additional resources were required to accommodate the post-audit review process. Consequently, the threshold modification has had minimal effect on OMB's workload and operations.

NEW JERSEY LOTTERY

7. On June 20, 2013, the Division of Lottery entered into State Contract No. T-2884 for "Lottery Growth Management Services" that **outsourced the sales and marketing operations of the New Jersey State Lottery to Northstar New Jersey Lottery Group, LLC** from June 20, 2013 through June 30, 2029. The contractor took full control of the Lottery's sales and marketing operations on October 1, 2013 but will work under the supervision of the Division of Lottery. Northstar is a tripartite consortium consisting of GTECH Corp., Scientific Games International Inc., and a subsidiary of the Ontario Municipal Employees Retirement System. It was the only vendor that responded to the August 2012 Request for Proposal (RFP) 13-X-22694 for "Lottery Growth Management Services." The RFP grew out of the responses the Treasury had received to a December 2011 Request for Information that sought ideas for increasing Lottery net revenues, including the possible privatization of certain Lottery functions. GTECH Corp. and Scientific Games International Inc. were among the respondents, according to the Division of Lottery's reply to OLS Discussion Point #6. a. in the FY 2013-2014 Department of the Treasury Budget Analysis.

According to RFP 13-X-22694, the outsourcing initiative is intended to maximize Lottery proceeds for the support of State institutions and State aid for education. The compensation model reflects the pay-for-performance principle, shifts a portion of the Lottery performance risk to the vendor, and has three elements.

A) Accelerated Guarantee Payment: Northstar made a one-time \$120 million Accelerated Guarantee Payment to the State in FY 2013. The vendor may use up to \$20 million of the payment to offset any future Contribution Shortfall Payments.

B) Contribution Shortfall Payments: Northstar must make Contribution Shortfall Payments for any contract year in which it fails to meet the Lottery net income target, but not more than 2.0 percent of a contract year's Lottery net income. The payments thus represent a partial shift to the contractor of the risk of Lottery net income shortfalls. The payment equals 50 percent of the difference between the net income target and the base net income level if the actual net income falls between the two markers. If the actual net income is less than the base amount, the payment is 50 percent of the difference between the net income target and the base amount plus 100 percent of the amount by which the actual net income falls below the base amount. The contract specifies gradually increasing base amounts and net income targets.

C) Incentive Compensation: Capped at 5.0 percent of the year's lottery net income, Incentive Compensation payments by the State to Northstar occur in any year in which the Lottery net income exceeds the contractual base net income level. The base net income level in contract year 1 is \$959 million, which rises to \$1,096 million in contract year 16, implying a 0.89 percent annualized growth rate. A payment is calculated as a percentage of the year's net income in excess of the base amount with the percentage ranging from 5 percent to 30 percent depending on the size of the excess over the base, middle, and upper net income levels, as

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defined in the contract. Net income targets are immaterial to the computation. Therefore, should a year's actual net income fall between the base net income level and the net income target, Incentive Compensation payments and Contribution Shortfall Payments will both come due and will offset one another to varying degrees. The table below shows Northstar's net income targets and base net income levels for FY 2014 through FY 2018.

Fiscal Year	Base Net Income Level	Net Income Target
2014	\$959,000,000	\$1,035,000,000
2015	\$967,000,000	\$1,047,000,000
2016	\$976,000,000	\$1,060,000,000
2017	\$985,000,000	\$1,070,000,000
2018	\$994,000,000	\$1,080,000,000

The Governor's FY 2015 Budget projects net lottery sales of \$3.2 billion to be generated by 6,800 agents and 2,133 drawings. In FY 2015, the State Lottery is expected to transfer \$1.04 billion to the General Fund for the support of State institutions and State aid to education, an increase of \$44 million, or 4.4 percent, from the amount anticipated in the current fiscal year. The evaluation data in the Governor's FY 2015 Budget indicate that with Northstar the amount spent to generate one government dollar increases from 35.9 cents in FY 2013 to a revised 53.0 cents in FY 2014 and an estimated 53.4 cents in FY 2015. At the same time the ratio of government revenue over total sales falls from 34.2 percent in FY 2013 to a revised 32.8 percent in FY 2014 and an estimated 31.7 percent in FY 2015.

- Question:** Please comment on the performance of Northstar as the manager of the State Lottery's sales and marketing operations. Has the transition of the functions to Northstar been seamless? If not, what challenges needed to be resolved in executing the initiative? How does the Division of Lottery assess the performance of Northstar following its taking complete control of the sales and marketing functions on October 1, 2013? What, if anything, is Northstar doing differently in managing the State Lottery's sales and marketing operations? Are there any deficiencies that Northstar still has to address? Is Northstar operating at full capacity?

Answer: For a contract of this complexity, the transition of Sales and Marketing to Northstar has been very smooth. Although the contract took formal effect on October 1, 2013, the State Lottery began implementing Northstar's business plan on July 1, 2013. Throughout the summer months, the State Lottery worked with Northstar to transition the sales and marketing activities. In summary, the State Lottery and Northstar identified Transition Tasks, staffed Transition Teams, identified potential risks and risk mitigation steps associated with each Task, and held weekly meetings to review Transition Reports. In addition, State Lottery staff served on Integration Teams that facilitated a seamless transfer of retailer and sales data to Northstar's systems. By October 1st, all Transition Tasks were completed and the Lottery issued a Transition Certificate according to the terms of the contract.

Discussion Points (Cont'd)

As of April, sales exceed sales at the same time last year. The growth in sales, especially instant ticket sales, in spite of one of the harshest winters in memory, reflects increased marketing, increased promotions, and increased sales staff.

The State Lottery works very closely with Northstar to achieve the common goal of increasing revenue for our beneficiaries. Communication is constant, with senior staff meeting frequently to discuss ongoing initiatives. While Northstar is providing sales and marketing services under contract, and the State Lottery is the contract manager, both organizations must work together to achieve success.

Northstar has placed a fresh emphasis on addressing the needs of retailers, through the expansion of sales staff and other retail optimization measures as outlined in its business plan.

Northstar has 100 staff devoted to sales and marketing of lottery products, plus 15 staff in executive and administrative positions; all are newly created private sector jobs. This staff provides welcome added service and support to the growing network of lottery retailers throughout the State. By comparison, the State Lottery only had 64 staff devoted to sales and marketing. Looking ahead, Northstar is now recruiting multi-lingual sales staff.

As part of its retailer engagement, Northstar conducted two advisory meetings with retailers to elicit feedback on planned promotions and retailer incentive plans, player satisfaction, Point-of Sale (POS) materials, and the services they receive from their respective sales representatives.

Retailers have expressed overall satisfaction with Northstar's performance and programs, especially with the Northstar sales team's increased visits.

There are no significant deficiencies at this time.

Question: Please provide an estimate of the State Lottery's FY 2014 and FY 2015 net income. What amount is anticipated to accrue to the State Lottery as revenue and what amount is anticipated to accrue to Northstar? For FY 2014 and FY 2015, please break out Northstar's anticipated compensation by Incentive Compensation payment tier and Contribution Shortfall Payment. How is Northstar's compensation accounted for in the Governor's FY 2015 Budget? Is it included in the Division of Lottery's Services Other Than Personal account? How does Northstar's total compensation compare to the administrative costs incurred by the Lottery's Sales and Marketing Unit in FY 2012 and FY 2013? In FY 2014 and FY 2015, what is the anticipated fiscal net effect on the State Lottery of the outsourcing initiative relative to the hypothetical continuation of the in-house performance of the Lottery's sales and marketing functions?

Answer: The Fiscal 2014 net income estimate for the State Lottery is \$993,000,000; the Fiscal 2015 estimate is \$1,036,850,000.

Discussion Points (Cont'd)

In Fiscal 2014, the aforementioned \$993,000,000 is estimated to accrue to the State Lottery as revenue. It must be noted that Fiscal 2014 (the first year of the Northstar contract) is a stub year where Northstar assumed all sales and marketing function on October 1, 2013 not the July 1, 2014 fiscal year start date. Because of the contract start date, the revenue that accrues to Northstar is predicated on that portion of the aforementioned \$993,000,000 that the State Lottery accrues during the nine month period from October 1, 2013 through the end of the fiscal year. Accordingly, to reflect the revised contract start date, Northstar's Base Level Income was adjusted to \$717,279,452 and its Net Income Target was adjusted to \$760,897,061. The revenue that accrues to Northstar will be predicated on the actual accruals to the State Lottery in accordance with the contractual formula for Incentive Compensation.

Northstar's compensation is based on Lottery net income and is determined by performance with respect to two revenue amounts designated in the contract: The Net Income Target and the Base Level. If net Lottery income reaches or exceeds the Net Income Target, Northstar would receive 5% of net income. If Lottery income fails to reach the Net Income Target, compensation is effectively reduced by a "Contribution Shortfall Payment," that can be no greater than 2% of net income.

If net income for the contract year is less than the Net Income Target but greater than the Base Level Income, then Northstar will issue to the State Lottery a Contribution Shortfall Payment equal to 50% of the difference between the Net Income Target and the actual Net Income for that specific contract year. If Net Income is less than the Base Level Income, then Northstar will issue to the State Lottery a Contribution Shortfall Payment equal to the sum of 50% of the difference between the Base Level Income and the Net Income Target plus 100% of the difference between the Net Income and the Base Level Income.

Just as with all Lottery costs such as prizes and commissions, Northstar's compensation is issued directly from the State Lottery Trust fund. There is no line item for Northstar's compensation in the Fiscal 2015 Budget. The State Lottery's contribution for aid to education and State institutions (\$1,036,850,000) is net of all of the State Lottery's expenses such as the costs for prizes and commissions and Northstar's compensation. At all times, Northstar must meet the 30% minimum contribution required by law.

Northstar's compensation cannot be compared to the administrative cost incurred by the State Lottery. Northstar's compensation is predicated on the State Lottery's net income revenue. The State Lottery does reimburse Northstar for administrative costs pursuant to the contract. These administrative costs can be compared to those of the State Lottery. Northstar's administrative costs for Fiscal 2014 are anticipated to be \$50.3 million (based on 12 months.) The State Lottery's administrative costs for Fiscal 2012 and Fiscal 2013 were \$36.6 million and \$34.7 million, respectively.

The Lottery expects Northstar's FY 2015 net income to be approximately 3% higher than if marketing and sales had remained in-house.

Discussion Points (Cont'd)

Question: Please put into context the increase in the amount spent to generate one government dollar from 35.9 cents in FY 2013 to an estimated 53.4 cents in FY 2015. Is the metric an average or a marginal indicator? **Question:** Does the jump mean that the efficiency of the State Lottery's former Sales and Marketing Unit was superior to that of Northstar? Is Northstar currently maximizing the State's lottery profits? What would be the marginal return of investing an additional dollar in lottery sales and marketing?

Answer: This metric is an average indicator and, as such, may not be an appropriate measure for evaluation or provide an easy comparison to total costs under the Northstar contract. The actual cost in Fiscal 2013 to raise one government dollar (for aid to education and State Institutions) was \$0.658. Under the contract with Northstar, this figure will increase to \$0.683. This increase does not mean that the State Lottery's former Sales and Marketing unit was more efficient to that of Northstar. The State Lottery's internal unit had expanded the Lottery's branding and product line as far as possible within the restrictions inherent to State operations. The contract with Northstar will help the State Lottery go further and maximize support for State institutions and education.

8. The Governor's FY 2015 Budget states in the "Program Classifications" section on page D-385 that the State Lottery generated revenue also through a number of online games. For example, on its webpage, the State Lottery advertises the free "NJ Lottery VIP Club." Registered members get exclusive access to opt-in contests, second-chance drawings, and "some really cool online games." Moreover, the December 2013 New Jersey Lottery Commission Meeting Minutes mention under the "Online Product Activities" heading that the State Lottery had developed a December promotion in which players could enter non-winning tickets into a second-chance drawing and that it planned a January 2014 Powerball Power Play enhancement. The current scale of online lottery games appears to be small, however.

State Contract No. T-2884 for "Lottery Growth Management Services" does not require Northstar New Jersey Lottery Group, LLC to offer online lottery games. In fact, the Division of Lottery noted in its response to OLS Discussion Point #6. a. in the FY 2013-2014 Department of the Treasury Budget Analysis that the variables that determined the contractor's annual compensation did not include assumptions on any revenue from the introduction of **internet lottery ticket sales or internet-based lottery games**. The contract, however, allows for such internet-based offerings and the contractor would be ready to integrate them into its activities. Notably, Section 4.5 of the "Services Agreement" sets forth the procedure that must be followed if the Division of Lottery decided to create new online lottery game offerings during the contract period. The vendor, though, cannot make a decision to that effect. If online lottery games were to be allowed, the variables determining the contractor's annual compensation may be revised accordingly. Schedule 10.2 of the contract authorizes the Division of Lottery to recommend to Northstar upward adjustments to the variables if there was a material change in the gaming environment, such as "a change in law that would make available or expand Lottery sales channels or authorize game types or platforms currently unavailable to the Lottery." If Northstar disagreed with the recommendation, the issue would become subject to the contract's dispute resolution procedure.

Discussion Points (Cont'd)

Even so Section 21.1 of the "Services Agreement" also authorizes Northstar to recommend to the Division of Lottery downward adjustments to the variables determining its compensation in the event of an "Adverse Action," New Jersey's introduction in 2013 of **internet gambling** does not appear to be a permissible impetus. The contract defines an "Adverse Action" as any affirmative State action whose effect can reasonably be expected to have a material adverse effect on the Lottery's net income and, by extension, Northstar's compensation. However, several State actions do not qualify as an "Adverse Action," among them actions that permit internet gaming activities. P.L.2013, c.27 did just that by authorizing Atlantic City casinos to offer internet gambling to persons physically located in New Jersey for a ten-year trial period. Responding to OLS Discussion Point #6. b. in the FY 2013-2014 Department of the Treasury Budget Analysis, the Division of Lottery noted that the law's enactment had not affected contract negotiations with Northstar. Notwithstanding the contract's treatment of internet gambling, concerns over competition to the Lottery from internet gambling persist. For instance, the December 2013 New Jersey Lottery Commission Meeting Minutes mention that a commission member was apprehensive that the new internet gambling might hold down the Lottery's instant game revenues.

- **Questions:** Please list and describe the State Lottery's current online games and indicate each game's gross revenue. Are the games only available to "NJ Lottery VIP Club" members? Does the State Lottery plan to sell lottery tickets over the internet or expand its internet-based lottery game offering in the next five years? If so, what are the plans and has the State Lottery already begun discussions with Northstar regarding the implementation of the changes to the business plan and possible upward adjustments to Northstar's compensation variables? Does the State Lottery intend to desist from offering internet-based lottery games for now so that they would not compete for players' attention with online games of chance operated by Atlantic City casinos and thereby jeopardize the viability of online casino gambling? Is the nascent online casino gambling putting downward pressure on Lottery instant ticket sales? Is it the State Lottery's understanding that the contract with Northstar does not allow the contractor to request downward adjustments to its compensation variables because of the existence of internet gambling?

Answer: The State Lottery does not sell any games online. The State Lottery does not offer any games exclusively to NJ Lottery VIP Club members. The VIP Club was developed to market game promotions to frequent players who have expressed an interest in receiving promotional information about upcoming games and jackpots. Some of these promotions include 2nd chance prize opportunities on non-winning game tickets. These prize opportunities do not generate revenue since the players initially purchased the eligible tickets from retailers. These prize opportunities do, however, generate increased interest in the entire State Lottery portfolio of games. The State Lottery's continuing goal is to make the VIP Club more inclusive than exclusive.

The State Lottery is always looking for ways to maximize revenue and expand its game portfolio. It should be noted that Northstar NJ did not predicate its initial proposal on Internet sales. Net income targets are not conditioned or dependent upon Internet ticket sales or the introduction of new Internet-based lottery games.

Discussion Points (Cont'd)

The State Lottery understands that the contract with Northstar does not allow the contractor to request downward adjustments to compensation because of the existence of Internet gambling.

9. By October 1, 2013, Northstar New Jersey Lottery Group, LLC had fully taken over the sales and marketing operations of the New Jersey State Lottery in accordance with State Contract No. T-2884 for "Lottery Growth Management Services." The change effectively terminated the Lottery's Sales and Marketing Unit, which had 63 employees, according to the reply by the Division of Lottery to OLS Discussion Point #7 in the FY 2013-2014 Department of the Treasury Budget Analysis. During the Department of the Treasury's revenue and budget hearing before the Assembly Budget Committee on April 2, 2014, the State Treasurer informed the Committee that **not a single former employee of the Lottery's Sales and Marketing Unit was laid off as a result of the outsourcing.** All employees were reassigned to other positions either within the State Lottery or elsewhere within State government, retired or took positions with Northstar. The contractor had planned to create a new sales organization with 89 sales positions and 48 administrative and marketing positions, according to the Lottery's reply to last year's OLS Discussion Point #7. Former employees of the Lottery's Sales and Marketing Unit had privileged access to Northstar's new positions, as Section 6.2 of the "Services Agreement" stipulates that the contractor shall afford each existing Division of Lottery employee the opportunity to apply for a position with the contractor and interview and consider for employment any such employee who applies for a position for which the employee is qualified. The outsourcing initiative accounts for the 47-position drop in the Lottery's position count from 134 in FY 2013 to 87 in FY 2014.

- **Questions:** Please indicate the number of former employees of the Lottery's Sales and Marketing Unit who: a) took positions with Northstar, b) were reassigned to other positions either within the State Lottery or elsewhere within State government, and c) retired. Please state the number of sales and marketing positions that Northstar created and filled and the number of sales and marketing positions that it still intends to fill.

Answer: The contract impacted sixty-four (64) State Lottery employees. All were given the opportunity to apply for open positions within Lottery that were created due to the contract or to interview for Northstar positions. Selection for open Lottery positions was based on Civil Service requirements and the seniority of the applicant. Twenty-two (22) employees among those impacted were placed in these open positions. Of the remaining impacted employees, six (6) retired, and three (3) transferred to other State departments. The remaining thirty-three (33) employees transitioned to Northstar with equivalent salaries, a full benefit package, and seniority credit for Lottery years of service, etc. No employees were laid off. Those who retired did so of their own volition and choice.

Northstar has 100 staff devoted to sales and marketing of State Lottery products. This staff provides added service to the growing network of lottery retailers throughout the State. This number is expected to remain stable.

Discussion Points (Cont'd)

DIVISION OF TAXATION

10. On March 25, 2014, the Division of Taxation released a **Request for Information (RFI) for the State of New Jersey Tax Systems Modernization Project** with an April 22, 2014 submission deadline. The submissions might ultimately serve to inform the terms and conditions included in any future Request for Proposal. The RFI solicits possible solutions for the replacement of the division's current separate tax administration and collection systems with a more versatile, integrated system. The division envisions a benefit-based procurement model, whereby the vendor would get paid a percentage of the incremental savings and revenues the vendor's solution generates. The State would thus not face any significant up-front costs for the capital project and limit its financial liability in case of cost overruns and nonperformance of the vendor's solution.

The State's current tax administration systems, collectively known as TAXNET, date from the mid-1980s. They are: 1) the Taxpayer Registration System (TAXREG); 2) the Generic Tax System (GENTS), which is used for taxpayer account maintenance; 3) the Taxation Unremitted Liability Inventory Plotting System (TULIPS), which is used for collections case management; 4) the Cash Receipts Account System (CRAS); and 5) the Set-Off of Individual Liability (SOIL) system. In addition, the division would like to replace its audit case management system (ESKORT), which dates from 2005. The division hopes that a new integrated tax administration system that delivers a single view of the taxpayer and audit process will: a) improve customer service, in part through the centralized capture and tracking of all taxpayer communications; b) increase online public access and services to taxpayers; c) comply with industry security standards; d) enhance the efficiency of the division's taxpayer accounting, tax compliance, and auditing processes through the use of up-to-date database technology and big data analytics strategies; and e) augment the system's long-term viability over the current legacy systems whose maintenance depends on a shrinking number of proficient programmers.

- **Questions:** Please provide a status update on the Request for Information (RFI) for the State of New Jersey Tax Systems Modernization Project. How many submissions has the Division of Taxation received in response to the RFI? Do any of the submissions invite further pursuit? By what date does the division hope to issue a Request for Proposal to solicit bids for an integrated tax administration system?

Answer: The response period for the New Jersey Tax Systems Modernization Project RFI expired on April 21, 2014. The Division of Taxation received eight submissions in response to the RFI. After review of all the RFI responses, the Department will determine if and when it is appropriate to issue an RFP.

11. In September 2011, the Office of the State Auditor published its audit report on the Division of Taxation, Generic Tax System (GENTS). In the report the State Auditor recommended that the Divisions of Taxation and Revenue and Enterprise Services strengthen the tax administration system of internal control by routinely reconciling data in GENTS with those in the Cash Receipt Accounting System (CRAS). The Division of Taxation uses GENTS to manage individual taxpayer accounts and the Division of Revenue and Enterprise Services uses CRAS in processing cash receipts for the Division of Taxation. The data in the two systems are

Discussion Points (Cont'd)

currently not being systematically cross-checked so that no assurance is given that receipts recorded in GENTS have actually been received and deposited. Replying to OLS Discussion Point #16 in the FY 2013-2014 Department of the Treasury Budget Analysis, the Division of Taxation reiterated that although a data reconciliation process was not in place, transactional control reports between CRAS and GENTS were routinely generated. To upgrade internal control capabilities, however, the division was also working on a project in conjunction with the Division of Revenue and Enterprise Services, the Office of Information Technology, and a vendor that would permit an automatic CRAS/GENTS reconciliation but whose objective was ultimately more far-reaching. Notably, the partners were **developing a proof of concept that would allow for the tracking of payment data and associated payments as they cascade through the State's tax filing and financial recordkeeping systems.** If successful, this tool would readily identify any inconsistencies across the disparate systems. A proof of concept is usually a small-scale realization of an idea to demonstrate its feasibility and usefulness.

- **Questions:** Please provide a status update on the development of the proof of concept that would allow for the tracking of payment data and associated payments as they cascade through the State's tax filing and financial recordkeeping systems. Has the proof of concept been developed? If so, what were the determinations as to its feasibility for full implementation? Will a full-fledged tracking system be developed? If so, by what date should the system be operational and what is the project's cost estimate? If the proof of concept has not been completed, by what date does the division anticipate its completion? If there are no plans for a full-scale realization of the tracking system, please explain the reason(s) for sidelining it.

Answer: The Division of Taxation, in collaboration with the Division of Revenue & Enterprise Services (DORES) and OIT, began developing a proof of concept with the vendor. The goal is to develop a product/process that follows, and reports any failures with respect to, the path data and associated payments take through the State's systems: from their initial point of entry into the State's filing/payment stream, through the NACHA (Banking) system, and ultimately to the point of updating Treasury backend systems.

To accommodate other priorities, the Department has delayed the proof of concept until after the conclusion of tax-year 2013 processing. At that time, the proof of concept will be revisited with the vendor. As noted in the audit response, transactional control reports between CRAS and GENTS are currently in place.

12. N.J.S.A.54:53-1 et seq. authorizes the Division of Taxation to negotiate **closing agreements** with taxpayers that permanently and conclusively resolve issues related to past and future tax liabilities. The law grants broad discretion to the division as to the type of cases it may settle and the scope of any agreement. Closing agreements may cover tax liabilities for any taxable period ending prior or subsequent to the date of the agreement. The division may conclude an agreement in any case in which there appears to be an advantage in having the case permanently and conclusively closed, or if the taxpayer shows good and sufficient reasons for desiring a closing agreement and the division determines that the State will sustain no disadvantage through consummation of an agreement. The applicable regulations under N.J.A.C.18:33-1.1 et seq. do not appear to restrict the division's discretion any further.

Discussion Points (Cont'd)

Over the years, the division has routinely entered into closing agreements to settle taxpayer cases. Nevertheless, it appears that their use has intensified of late. As part of its initiative to reduce the backlog in the administrative review of taxpayer protests and appeals of division tax determination, the division has encouraged its Conference and Appeals Branch to make more frequent use of closing agreements. Accordingly, the branch concluded 82 such agreements in FY 2012 and 153 in FY 2013 through March. In addressing OLS Discussion Point #9 in the FY 2013-2014 Department of the Treasury Budget Analysis, the division explained that the settlements accelerated the collection of State revenue, added finality to the taxpayer's request for administrative review, avoided litigation, and conserved division resources for other matters. (Discussion Point #14 addresses, in part, the use of closing agreements by the Conference and Appeals Branch.) Moreover, the division's website articulates the division's willingness to negotiate taxpayer-specific closing agreements in lieu of voluntary disclosure agreements. The latter allow taxpayers who failed to file tax returns or collect sales tax to come forward and file the appropriate tax returns as well as registration materials, and pay outstanding tax obligations. (Discussion Point #13 addresses, in part, the use of closing agreements as an alternative to voluntary disclosure agreements.)

Furthermore, in reply to OLS Discussion Point #15 in the FY 2013-2014 Department of the Treasury Budget Analysis, the division related that a closing agreement represented at least part of the accord with Amazon.com that the Governor had announced on May 30, 2012. The closing agreement's confidentiality clause, however, preempts the division from disclosing any specifics other than that Amazon.com would begin to collect sales and use tax on taxable purchases by New Jersey residents starting on July 1, 2013. The Governor's May 2012 announcement had also suggested that the New Jersey Economic Development Authority would provide unspecified financial incentives to the online retailer in support of the company's construction of two warehousing and shipping facilities in New Jersey. To date it does not appear that Amazon.com has received any incentive award even though its new warehousing and shipping facility in Robbinsville is reportedly nearing completion.

In addition, it appears that the State has entered into a closing agreement with the National Football League that waived certain tax liabilities expected to be incurred by the league and its affiliates in connection with the February 2014 Super Bowl. According to news accounts, event-specific tax suspensions applied to the sale of tickets for admission and parking charges. But the National Football League's November 2009 Request for Proposal for Super Bowl XLVIII required that in return for the privilege of hosting the event the league and its affiliates would be exempt from any state, county, city or other local taxes as they relate to the holding of the game at the site and preparatory advance site visits.

- **Questions:** For each fiscal year from FY 2010 through FY 2014 to date, please indicate the number of closing agreements the division concluded and the amount of revenue collected pursuant to the agreements. Please specify the division's general policies and procedures regarding closing agreements. Beyond the broad criteria stipulated in N.J.S.A.54:53-1 et seq., what conditions must parties meet for the division to consider a closing agreement? What guidelines does the division use in determining the magnitude and terms of closing agreement payments that taxpayers must make to the State? What are the typical payment requirements?

Discussion Points (Cont'd)

Answer: The Division of Taxation executes closing agreements in three different areas: Collections, Audit, and Conferences/Appeals.

With respect to Collections, the Division evaluates cases for collectability and to determine whether or not compromising an existing deficiency is in the State's best interests.

With respect to both Audit and Conferences/Appeals cases, the Division evaluates hazards of litigation as well as the general strength of the instant facts and circumstances.

Depending on the magnitude of the settlement, several levels of approval may be required. Once approved, payment is generally expected at execution.

Audit Activity	Closing Agreements Concluded	Closing Agreement Collections
FY 2010	25	\$ 46,330,172
FY 2011	52	\$ 11,696,567
FY 2012	84	\$ 11,176,959
FY 2013	261	\$ 8,977,314
FY 2014 to Date	181	\$ 80,281,503
(As of Discussion Point Response)		

Question: Does N.J.S.A.54:53-1 et seq. prohibit the use of closing agreements as an economic development tool that conditions prospective tax exemptions on certain capital investments and the creation and retention of a certain number of jobs? If applicable, please indicate and describe every closing agreement which the division has concluded since FY 2010 that included prospective tax exemptions that were contingent upon the generation of economic activity in New Jersey. Does the closing agreement with Amazon.com include any tax exemptions for the period after July 1, 2013? Has the division concluded a closing agreement with the National Football League with regard to Super Bowl XLVIII that prospectively waived the collection of certain State taxes in connection with the event? If so, what taxes were waived and what was the rationale for concluding the closing agreement? Please provide a copy of the closing agreement concerning Super Bowl XLVIII.

Answer: N.J.S.A. 54:53-1 does not prohibit the use of closing agreements as an economic development tool that conditions prospective tax exemptions on certain capital investments and the creation and retention of a certain number of jobs. However, the Division does not use economic development and investment as a basis for entering into a closing agreement. Since FY10, there have been no closing agreements that provide prospective tax exemptions contingent upon the generation of economic activity in N.J.

Discussion Points (Cont'd)

The Closing Agreement between the Division and Amazon.com does not include any prospective tax exemptions. The Division did not enter into a closing agreement with the NFL. All financial issues relating to the Super Bowl and the NFL were detailed in the Super Bowl Agreement negotiated by the NJSEA.

13. The Division of Taxation's Audit group administers the **voluntary disclosure program**. The amnesty-like program allows taxpayers who failed to file tax returns or collect sales tax to come forward prior to being contacted by the division and file the appropriate tax returns as well as registration materials, and pay outstanding tax obligations. If approved, a voluntary disclosure agreement requires the payment of taxes owed for a look-back period equal to the current year plus the three prior years, and interest. In return, the division waives the late filing and late payment penalties for the tax years covered by the agreement. In reply to OLS Discussion Point #11 in the FY 2013-2014 Department of the Treasury Budget Analysis, the division provided the data for FY 2010 through FY 2013 as of the date of the division's discussion point reply that the table on the next page shows: the number of requests for voluntary disclosure agreements, the number of agreements concluded, and the total amount collected from the agreements. Voluntary disclosure agreements, however, are not the only option for noncompliant taxpayers to come forward. On its webpage the division notes that alternatively it may be willing to negotiate taxpayer-specific closing agreements in accordance with N.J.S.A.54:53-1 et seq. (Discussion Points #12 and #14 also address closing agreements.)

	Voluntary Disclosure Agreement Requests	Voluntary Disclosure Agreements Concluded	Voluntary Disclosure Agreement Collections
FY 2010	247	177	\$106,176,170
FY 2011	348	281	\$36,310,932
FY 2012	435	322	\$90,812,145
FY 2013 (As of Discussion Point Response)	307	132	\$56,990,776

The division is running two special voluntary disclosure program initiatives from March 15, 2014 through May 15, 2014. The Partnership Tax and Partner Fees Initiative targets partnerships and their individual partners that have New Jersey sourced income but that have not filed any of the required business registration forms or paid the required income tax amounts. The Intangible Asset Nexus Initiative, in turn, is for companies with income derived from the use of intangible assets in New Jersey that have heretofore failed to acknowledge their subjection to the State's taxing jurisdiction but that intend to henceforth comply with their corporation business tax filing requirements. Under both programs, participants must remit payment of all taxes and fees owing within 45 days of the execution of the voluntary disclosure agreement. The initiatives might be related to a "loophole-closing" proposal included in the FY 2015 Governor's Budget. Specifically, the Executive anticipates \$65 million in FY 2015 corporation business tax revenue from newly taxing certain nonresident partner gains.

- **Questions:** Please explain the factors that guide the Division of Taxation in deciding whether a taxpayer qualifies for a voluntary disclosure agreement or a closing agreement. Under what set of circumstances would the division prefer one type of agreement over the other? Which type of agreement typically results in the

Discussion Points (Cont'd)

more favorable terms to the taxpayer? For FY 2013 and FY 2014 to date, please provide summary statistics for the voluntary disclosure program: the number of taxpayers coming forward, the number of concluded voluntary disclosure agreements, and the amount of revenue collected pursuant to the agreements. Please set forth the reasons for which the division may reject voluntary disclosure agreement requests.

Answer: Voluntary Disclosure Agreements (VDA's) and Closing Agreements (CA's) are used in different circumstances. VDA's are utilized to bring non-filing taxpayers into compliance. Generally the VDA agreement requires a taxpayer to file returns subject to routine audit in exchange for the Division reducing the number of years in delinquent returns to be filed and an abatement of some or all non-amnesty penalties. CA's are used to settle ongoing cases or current issues within the statute of limitation or for future periods for known taxpayers who are already filing returns. The two types of agreements cannot be compared as to taxpayer favorability or Division preference as they are used in different circumstances. The Division would reject an offer of voluntary disclosure if the taxpayer is already known to the Division, has been contacted by the Division or its agents, is under criminal investigation or if the candidate requests a shortened look back period or different agreement provision out of the ordinary not agreed to by the Division. On a case-by-case basis, the Division will enter into an "issue only" Closing Agreement for the taxpayers that do not qualify for the VDA program.

See Attached Schedule. X-1

- **Please comment on the Partnership Tax and Partner Fees Initiative and the Intangible Asset Nexus Initiative. To date, how many taxpayers have contacted the division with a voluntary disclosure agreement request under each of the initiatives? How many voluntary disclosure agreements has the division granted to date and what cumulative dollar amount is associated with the agreements? Are the two programs related to the Administration's FY 2015 "loophole-closing" proposal regarding the taxation of certain nonresident partner gains? If so, please explain the connection.**

Answer: To date, twelve taxpayers have contacted the Division under both initiatives. However, it is the Division's experience and expectation that the bulk of taxpayers will contact the Division within two weeks of the program's expiration on May 15, 2014.

The two initiatives are not related to the "loophole closing" proposals.

See Attached Schedule. X-2

14. The Division of Taxation has been undertaking a multiyear **initiative to reduce the backlog in the administrative review of taxpayer protests and appeals of division tax determinations**. In its October 2010 audit report on the division, the Office of the State Auditor had stated that the backlog of 1,300 unassigned cases at the division's Conference and Appeals Branch meant that the average wait time for a case to be assigned to a specialist was one and a half years. This backlog left taxpayers frustrated and delayed State revenue collections. In its

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reply to OLS Discussion Point #9 in the FY 2013-2014 Department of the Treasury Budget Analysis, the division reported significant improvements. The number of unassigned taxpayer protests and appeals declined from 1,300 cited in the October 2010 audit report to 439 in March 2012 and 323 in March 2013. The average wait time between the receipt of a taxpayer protest and its resolution in the conference cycle, in turn, was cut from 21 months in calendar year 2011 to 11 months in calendar year 2012.

The Conference and Appeals Branch implemented several changes to reduce the backlog and related wait times. In response to last year's OLS Discussion Point #9, the branch stated that in FY 2013 it hired nine additional specialists who hold conferences with taxpayers at an annual cost of about \$600,000, increasing their count from 15 in FY 2012 to 24 in FY 2013. The division, however, did not plan to hire any additional conferees. The division also reorganized the manner in which the Conference and Appeals Branch processes taxpayer appeals and protests. Notably, the branch had a new Chief as of February 2011 and was reorganized into four teams specializing in a particular tax and each headed by a new supervisor, according to the division's responses to OLS Discussion Points #8 and #10 in the FY 2012-2013 Department of the Treasury Budget Analysis. Moreover, the branch allocated additional resources to its Review Group, which in FY 2013 through March resolved 24 percent of all cases without the need for an administrative conference simply by obtaining and reviewing additional documentation from taxpayers, as the division related in addressing OLS Discussion Point #9 in the FY 2013-2014 Department of the Treasury Budget Analysis. In addition, the branch enhanced its efficiency by newly grouping similar cases together and assigning them jointly to conferees, according to the division's reply to last year's Discussion Point #9. Furthermore, the branch made more frequent use of the division's authority to enter into closing agreements in accordance with N.J.S.A.54:53-1 et seq., which permanently and conclusively end taxpayer cases. It concluded 82 closing agreements in FY 2012 and 153 in FY 2013 through March. The division explained that the settlements accelerated the collection of State revenue, added finality to the taxpayer's request for administrative review, avoided litigation, and conserved division resources for other matters. (Discussion Points #12 and #13 also discuss closing agreements.)

Last year, the division also reported that in FY 2013 through the date of its response the Conference and Appeals Branch upheld division tax determinations in 56 percent of all cases, reduced the determinations in 20 percent of all cases, and vacated them in 24 percent of all cases. About 11 percent of the taxpayers who received a final determination for payment of taxes, fees, and penalties appealed to the Tax Court of New Jersey.

- **Questions:** Please provide an update on the initiative to reduce the backlog in the administrative review of protests and appeals that taxpayers file against Division of Taxation tax determinations. Please describe any reorganizations and changes the Conference and Appeals Branch has made in the last year in the process of handling taxpayer appeals and protests. Has the branch concluded the backlog reduction initiative?

Answer: The Branch continues to monitor and manage the inventory of protests and appeals. Approximately 23% of the protests received are resolved by the Review Group without the need for an administrative conference.

Discussion Points (Cont'd)

There have been no changes to the organizational structure of the Branch or to the process of handling taxpayer appeals and protests within the last year.

We believe that the inventory of cases has stabilized at an acceptable level. As such, the backlog reduction initiative was successful in meeting its objectives and has concluded.

- Question:** What are the current backlog of unassigned cases and related wait times? Please provide summary statistics on the disposition of taxpayer appeals in FY 2013 and FY 2014 to date, including information on the percentage of appeals that is resolved in favor of the taxpayer. What percentage of all final determinations is appealed? Please specify the number of closing agreements the Conference and Appeals Branch has concluded in FY 2013 and FY 2014 to date.

Answer: The inventory of unassigned cases as of April 15, 2014, is 370 cases, comprised of 24 sales and use tax cases, 26 cash cases, 52 corporation business tax cases, and 268 individual tax cases. The related average wait times (i.e. cycles in days for a representative group of cases) from 2013/2014 are as follows:

<u>Tax Type</u>	<u>Full Cycle</u>	<u>Review Unassigned Cycle</u>	<u>Conference Cycle</u>
Cash	368	80	107
Sales & Use Tax	360	72	100
CBT	468	95	108
Individual Tax *	163	53	36

*Includes EITC and cigarette

<u>Final Determinations</u>	<u>Upheld</u>	<u>Reduced</u>	<u>Vacated</u>	<u>Tax Court Appealed</u>
FY 2013	55%	20%	25%	13%
FY 2014 YTD	61%	16%	23%	9%

250 closing agreements were entered into for FY 2013 and 151 closing agreements for FY 2014 YTD

- Question:** Please identify any additional resources that have been committed to the Conference and Appeals Branch in FY 2014 and quantify their budgetary cost. Are the additional resources intended to be temporary or recurring? How many specialists work on administrative reviews of taxpayer protests and appeals in FY 2014? Were any new specialists hired in FY 2014 or are anticipated to be hired in the remainder of FY 2014 and in FY 2015?

Answer: No additional resources have been committed to the Conference and Appeals Branch in FY 2014. Twenty four conferees within the Branch worked on administrative reviews of taxpayer protests and appeals during FY 2014. The Division does not anticipate the hiring of any new conferees during the remainder of FY 2014 or in FY 2015.

Discussion Points (Cont'd)

15. Addressing OLS Discussion Point #8 in the FY 2012-2013 Department of the Treasury Budget Analysis, the Division of Taxation described the **reorganization of the division's Audit group**. A new Deputy Director was hired to oversee the group and auditing responsibilities were split into business and individual taxes. The Field Audit unit also created two audit groups dedicated to high-net worth taxpayers. A year later, in reply to OLS Discussion Point #10 in the FY 2013-2014 Department of the Treasury Budget Analysis, the division elaborated that the reorganization was to augment operational efficiencies and productivity through specialization. Short-term, the Audit group already observed a reduction in aged inventory and more managerial involvement in cases following the reorganization. Evaluation Data in the FY 2015 Governor's Budget, however, do not yet suggest any reorganization-related gains. As the table below illustrates, the Audit group's revised FY 2014 performance indicators fall below FY 2012 and FY 2013 levels. Nevertheless the Executive expects the performance indicators to turn the corner in FY 2015. Lastly, the division responded to last year's Discussion Point #10 that the Audit group continued to draft a comprehensive Manual of Audit Procedures, which would be published by the end of calendar year 2013.

Performance Indicator	FY 2012 Actual	FY 2013 Actual	FY 2014 Revised	FY 2015 Budget Estimate
Audits Completed	135,220	132,158	125,181	131,000
Audit Assessments	\$695,639,320	\$622,653,780	\$570,000,000	\$590,000,000
Average Number of Auditors	346	358	361	352
Average Assessments per Auditor	\$1,950,851	\$1,476,864	\$1,375,000	\$1,550,000

- Questions:** Please comment on the performance of the reorganized Audit group in the Division of Taxation. Are the expected reorganization-related efficiency and productivity gains already materializing? What factors account for the anticipated reductions in total audit assessments and audit assessments per auditor from FY 2012 through FY 2014? Please describe the reasons underlying the projected increase in total audit assessments and audit assessments per auditor from FY 2014 to FY 2015. Has the Audit group finished and published the comprehensive Manual of Audit Procedures? If not, by what date does the division expect the completion and publication thereof?

Answer: Audit Activity was reorganized into two major areas: Business Audit and Individual Audit & Technical Services. The reorganization allowed the Division to focus on the important distinctions between auditing businesses for sales tax, corporation business tax, employer taxes and the various excise taxes and auditing individuals, trusts, gross income tax and inheritance and estate tax. Following the reorganization, Audit has seen reductions in case aging, audit man-hours, no change in numbers of cases closed, and an increase in the average amount assessed. The reorganization also allowed Audit to examine its systems and technical needs and build a new business audit selection model, improve the audit workflow, enhance the Division's data warehouse, implement a new automated certified and first class mail system, and start development of a more robust and analytical approach to a GIT audit selection model.

The decline in audit assessments for FY 2012 through FY 2014 can be attributed mainly to staff turnover. Audit Activity, in particular, has had a considerable turnover in

Discussion Points (Cont'd)

experienced staff as a result of retirements and separations for other career opportunities. In most cases, it takes an auditor three years to become proficient in identifying issues and moving a case through the audit cycle in an efficient manner. The estimated increase in assessments from FY 2014 to FY 2015 reflects an expectation of increased assessments through the data warehouse and the ongoing development and training of staff.

The Manual of Audit Procedures is still in draft form.

16. In reply to OLS Discussion Point #12 in the FY 2013-2014 Department of the Treasury Budget Analysis, the Division of Taxation reported that its **Office of Criminal Investigation (OCI) had started “the largest operational expansion of its history.”** Ten additional special agents and an unspecified number of support personnel were to join the office by the end of calendar year 2013. The expansion would allow the office to widen its focus from primarily contraband-related matters to a broader spectrum of tax-related crimes. The evaluation data in the Governor’s FY 2015 Budget reflect the OCI’s hiring drive. The division anticipates the OCI to engage in 408 tax-related criminal prosecutions in FY 2014. That number marks a 171 count, or 72.2 percent, increase over the 237 actual prosecutions in FY 2013. For FY 2015, the division expects a smaller increase to 430 prosecutions. The division clarified in response to last year’s OLS Discussion Point #12 that not all OCI criminal cases represented referrals to the Office of the Attorney General in the Department of Law and Public Safety for criminal prosecution. A significant unspecified number of OCI cases were OCI direct arrests, joint investigations with other law enforcement agencies, and criminal complaints the OCI initiated directly to the courts when taxpayers fail to pay for their dishonored checks and electronic fund transfers. The division informed further that with the exception of a limited number of cases that resulted in defendant participation in a pretrial intervention program all OCI prosecutions have led to criminal convictions either in the form of a court sentencing or a plea agreement.

Contemporaneously with the expected surge in criminal prosecutions, the evaluation data in the Governor’s FY 2015 Budget show that the division projects a plunge in assessment amounts that will be generated by OCI’s tax-related criminal investigations in FY 2014. Specifically, the division anticipates \$3.7 million in assessment amounts in FY 2014. This total reflects a \$3.7 million, or 50.0 percent, decline over the \$7.3 million actually assessed in FY 2013. Assessment amounts, however, tend to fluctuate from year to year, as \$8.8 million was levied in FY 2012 and \$1.5 million in FY 2011. For FY 2015, the division estimates \$3.9 million in criminal assessments. In reply to last year’s OLS Discussion Point #12 the division ascribed the expected FY 2014 decline in part to the OCI’s plans to increase investigations which would not result in the recovery or assessment of taxes. The OCI’s Special Frauds Unit, for example, had already expanded its stolen identity refund fraud investigation activities. Given that not all prosecutions involved allegations of tax evasion, the division warned that one should not expect a direct correlation between the number of criminal OCI prosecutions and the amount of criminal assessments.

- **Questions: Please present the organizational structure of the Office of Criminal Investigation (OCI), detailing the number of subdivisions, if any, the hierarchy, and the number of employees within each job title category. Please indicate the OCI’s actual and recommended budgets for FY 2013, FY 2014, and FY 2015. Has the office**

Discussion Points (Cont'd)

hired any new staff in FY 2014 or is anticipated to hire any new staff in the remainder of FY 2014 and in FY 2015? If a reorganization accompanied the office's recent expansion, please describe the reorganization. Are the expected performance gains from expanding, and possibly reorganizing, the OCI already materializing? If so, please provide examples. Have the changes proved somewhat disruptive during the transition phase? If so, what expansion-related challenges must still be resolved?

Answer: OCI does not have a separate operating budget. However, the annual salary for OCI personnel for FY 2013, FY 2014 and the expected annual salary for FY 2015 is approximately \$3.5M. OCI does not anticipate adding additional staff for the remainder of FY 2014 or FY 2015.

Among other benefits, the addition of new Special Agents has enhanced OCI's capacity to investigate Motor Fuels tax evasion matters. Two Special Agents have been trained in motor fuels tax investigative techniques. Intelligence from other law enforcement as well as our counterparts in New York and Pennsylvania has pointed to new criminal schemes with NJ-based companies and individuals involved. OCI was also able to return a Special Agent to the Federal Stolen Identity Refund Fraud Task Force (part-time), enhancing its efforts to combat refund fraud. Further, as detailed below, OCI transferred two civil investigators from the Internal Security Unit to the Technical Enforcement Unit so as to increase recoveries and prosecutions. The Internal Security unit was realigned as a result. This has allowed OCI to manage those cases more effectively, with fewer personnel permanently assigned and resources applied from other OCI units when necessary. The changes have not been disruptive.

See Attached Table of Organization & Personnel Roster. X-3

• Question: What factors account for the anticipated decline in criminal assessment amounts from \$7.3 million in FY 2013 to \$3.7 million in FY 2014? Does the decline reflect a resource shift from certain types of investigations to others? Please breakdown the \$7.3 million in actual FY 2013 criminal assessments by tax and any other source. What components of the total are projected to fall in FY 2014?

Answer: The FY 2013 Assessment dollars were comparatively high as the result of OCI's "top debtor" program which focused on the prosecution of high-dollar amount violators. FY 2013 was the first year of this effort. As of April 1, 2014, OCI transferred two Investigators from another OCI Unit to the Technical Enforcement Unit ("TEU"), the same unit that prepares criminal cases involving taxpayers who fail to pay for their dishonored checks and electronic fund transfers. This will allow OCI to prepare additional "Top Debtor" cases as well as follow up on the larger scope of dishonored electronic fund transfers that would be subject to currently pending legislation. We believe that the assignment of additional resources, albeit from other OCI assignments, will increase overall assessments and recoveries. We expect all components to fall proportionately for FY 2014.

Discussion Points (Cont'd)**OCI-Tax Assessments by Tax - FY2013**

	Assessment Totals
Sales & Use Tax-Assessments	\$2,055,828
Corporation Business Tax-Assessments	\$6,522
Gross Income Tax - Employer-Assessments	\$176,898
TGI – Assessments	\$5,100,912
Other (TPT-MFT-CIG TAX)	\$9,496
Total Assessments- FY2013	\$7,349,656

Note: some cases will result in a court ordered filing of new or amended returns. The dollars from new filings are not reflected in these numbers.

17. The State Earned Income Tax Credit (EITC) program, which piggy-backs on the federal EITC credit program, is intended to offset the burden of Social Security payroll taxes on the working poor and provide an incentive to work. Pursuant to P.L.2000, c.80 (C.54A:4-6 et seq.), the State EITC provides a refundable credit under the State gross income tax, currently equal to 20 percent of the federal EITC benefit amount. To claim a State credit, taxpayers must first file for the federal EITC.

According to the Division of Taxation, beginning in Tax Year 2011, the division implemented an **EITC fraud screening process**. As part of the program, certain taxpayers claiming a NJ-EITC were asked to provide the division with supplemental documentation such as Social Security cards, IRS account transcripts, W-2's, 1099's, pay stubs, and birth certificates to substantiate their EITC claim.

As a result of this initiative, although 577,039 tax filers claimed EITC benefits totaling \$251.6 million for Tax Year 2011, thus far only 468,359 have received credits (totaling \$192.8 million), while 19,412 tax filers (claiming \$14.0 million) have been denied an EITC, and another 89,268 tax filers (claiming \$44.7 million) still have claims pending for Tax Year 2011 as of March 2014. According to the division, the number pending are those tax filers who were sent a notice requesting additional information but have not yet responded, or have responded and are under review; however, the division anticipates that a "very low" number of claims will convert from "pending" to paid.

Based on the data indicated, and assuming the conversion of pending claims to paid claims remains low, the number of New Jersey tax filers receiving a federal EITC who will also receive a State EITC will have decreased from 90.1 percent in Tax Year 2009 to 72.2 percent in Tax Year 2011, a level of program participation last experienced during the early years of program implementation, and a level well below the 90 percent rate anticipated nationally for a mature program, according to the Center for Budget and Policy Priorities.

However, while the drop in program participation has been steep since peaking above 90 percent in TY 2009, New Jersey is not alone in pursuing enforcement efforts within its EITC program. Research indicates that other nearby states, including Connecticut and New York,

Discussion Points (Cont'd)

implemented their own screening processes around the same period. Indeed, evidence of overpayment of EITC credits due to either error or fraud has been widely reported by the Internal Revenue Service since at least the late 1990's. And, in its most recent report, dated February 2013, the Treasury Inspector General (TIG) for Tax Administration at the United States Department of Treasury estimated an error rate in the federal EITC program of between 21 and 25 percent for the 2012 Fiscal Year, costing the federal Treasury between \$11.6 billion and \$13.6 billion.

- **Questions:** Please provide an update on the division's EITC fraud prevention efforts. Has the number of claims converting from "pending" to "paid" been in line with division expectations for TY 2011 and TY 2012? At what point are claims which are pending considered "closed" if the taxpayer does not respond to the division's request for supplemental documentation? Of the number of pending claims outstanding for TY 2011 and TY 2012, what amount, in accordance with GAAP principals, was accrued in FY 2013 to account for refund claims? When and on what basis will such accruals be reversed during FY 2014 or thereafter? Since inception of the division's enforcement efforts in TY 2011, and updated through April 2014, what number and percentage of EITC claimants, by tax year, have received letters requesting additional information? What number and percentage of claimants were able to provide the information requested by the division? Have the criteria used to determine which claimants receive letters evolved since TY 2011? Does the division anticipate that the participation rate in the State EITC program will stabilize at the current TY 2011 rate of approximately 70% or rebound closer to the 90 percent historical (and national expected) rate? Given that the federal government has also implemented a screening process for the EITC, and that New Jersey taxpayers must first qualify for a federal credit before claiming the State credit, does the division believe a 30 percent "fall off" between federal and State participation to be reasonable?

Answer: The number of claims converted from "pending" to "paid or denied" for the TY 2011 and 2012 are in line with the Division's expectations with respect to the development and execution of resolution criteria over the last year. The resolution of pending accounts has resulted in a denial of \$40.1 million in EITC claims.. As of April 2014, 28,652 tax filers (claiming \$19.4 million) still have TY2011 claims pending.

For the TY2013 the Division will evaluate all "pending" claims, beginning November 1, where more than 90 days have elapsed without sufficient response to requests for supporting documentation, and consider these claims to be "zero". Any overpayments, once validated, will be refunded. Taxpayers' claims will be reconsidered for payment upon submission of proper documentation and proofs.

As of August 8 of last year, the accrual amount was \$55.08 Million, consisting of \$52.02 Million from Tax Year 2012 and \$3.06 Million from Tax Year 2011. We have not yet established a basis upon which accruals will be reversed during FY 2014 and thereafter.

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Since the inception of these heightened enforcement efforts in TY2011 the Division has issued letters requesting additional information. An accounting of these letters sent and the number that responded, through April 2014, is listed below:

Year	Number of notices sent	Percentage of EITC Claimants sent notices	Number of responses providing sufficient information to approve or adjust the account	Percentage of claimants responding to notices
2011	145,168	25%	49,229	34%
2012	119,538	22%	25,694	21%
2013	72,661	16%	1,166	2%*

* The responses and reviews are only beginning to be generated.

The Division evaluates its criteria for issuing letters each year. Based on past experience, rules may be either relaxed or tightened-up in an effort to identify only the most probable erroneous or fraudulent claims.

The Division anticipates that the participation rate in the New Jersey EITC program will maintain its current level. A NJ EITC claimant is rarely denied because they were not paid a Federal EITC; however, the Division’s processes regularly find taxpayers who are ineligible in some way but who have nonetheless been paid by the IRS. For example, the IRS may pay two taxpayers an EITC based on the same dependent child, which is not allowed. The IRS does not appear to have systems in place that support a complete pre-processing screening and, as a result, New Jersey’s screening processes may be considered as more comprehensive. Consequently, the Division postulates that the 30% difference between the IRS and New Jersey’s participation rates will continue and is a reasonable assumption.

- **Question:** For all years since EITC program inception in Tax Year 2000, please provide the following data: number of EITC claims filed, number paid, number rejected.

Answer: The Division’s legacy system does not permit a reliable compilation of historical EITC activity prior to TY2006 and the data from 2000-2005 has been purged and is not available. However, the table below provides EITC claims data filed since TY2003, in addition to claims both paid and rejected from TY2006 forward:

	CLAIMS FILED	#PAID	#REJECTED/PENDING
2003	222,928		
2004	213,930		
2005	205,574		
2006	203,669	173,224	30,445
2007	490,164	462,271	27,893
2008	500,260	470,358	29,902
2009	543,408	508,258	35,150

Discussion Points (Cont'd)

2010	545,030	492,025	52,005
2011	578,337	469,401	108,936
2012	570,952	471,419	99,533
2013	486,221	404,326	81,895

18. Created in April 2011, the **Office of the Taxpayer Advocate (OTA)** in the Division of Taxation is to help enhance voluntary compliance with tax laws by simplifying tax regulations and assisting taxpayers. Specifically, it is intended to identify systemic tax administration problems encountered by taxpayers and recommend administrative and legislative solutions. The office is also to assist taxpayers who: a) face a threat of immediate adverse action for a disputed tax liability; b) believe that they did not receive adequate notification of the division's actions or that the division's actions are unwarranted, unfair or illegal; c) suffer or are about to suffer "undue hardship" resulting from the division's administrative actions; or d) have experienced a delay of more than 75 days in their quest to resolve a tax account problem or obtain a response to an inquiry from the division. The OTA clarifies on its website, however, that it does not handle inquiries involving the New Jersey Earned Income Tax Credit. The office is funded out of the division's operating budget and had \$312,000 in annual salary expenditures for its four employees at the time of its response to OLS Discussion Point #9 in the FY 2012-2013 Department of the Treasury Budget Analysis.

The OTA received requests for assistance from roughly 600 taxpayers in FY 2012 and FY 2013 through April, of which some 500 requests met the office's case acceptance guidelines, according to the OTA's reply to OLS Discussion Point #13 in the FY 2013-2014 Department of the Treasury Budget Analysis. At the time of the response only five of the cases remained still open and the office had closed another 20 without a resolution. In all, since July 1, 2011 through the date of the discussion point reply, about 60 percent of all cases involved the gross income tax and 15 percent the corporation business tax with all other taxes combining for the remaining 25 percent. As an outgrowth of its interactions with taxpayers the OTA identified and reviewed several systemic issues in the year prior to its discussion point answer and made recommendations regarding, among others: 1) automated Division of Taxation responses that unnecessarily requested that taxpayers provide power of attorney before the division would respond to general tax questions taxpayers had sent to the division's e-mail unit; and 2) the alleviation of taxpayer confusion on the corporate dissolution and reinstatement process and related corporate business tax filing requirements.

- **Question:** Please set forth the reason(s) for which the Office of the Taxpayer Advocate (OTA) is not helping taxpayers with inquiries regarding the New Jersey Earned Income Tax Credit. Please describe the OTA's activities in FY 2013 and FY 2014 to date. How many taxpayers have contacted the OTA in FY 2013 and FY 2014 to date? How many cases has the OTA accepted for assistance in FY 2013 and FY 2014 to date and how many cases has the office closed? What taxes have produced the most requests for OTA assistance in FY 2013 and FY 2014 to date? For the last 12 months, please indicate: a) the systemic tax administration problems encountered by taxpayers that the OTA has identified; b) the recommendations the OTA has made to rectify them; and c) the changes in tax laws, rules, and regulations that have actually been made subsequent to OTA recommendations. What are

Discussion Points (Cont'd)

the division's budget and position count for FY 2014? Are any budgetary or staffing changes anticipated in FY 2015?

Answer: During FY 2012, the Taxpayer Accounting Branch experienced a large inventory of EITC-related correspondence. The response time was averaging well beyond OTA's case acceptance guidelines. Management was concerned that, if OTA were to accept EITC inquiries, the office might not be able to assist other taxpayers. In addition, processing EITC-related documents warrants extensive review and expertise, along with direct access to the review unit that originated contact with the taxpayer. Since that group was already working a large inventory and would have been unable to assist OTA on an *ad hoc* basis, having OTA handle EITC matters would have risked adding another layer of taxpayer frustration. To mitigate that risk, management generally exempted EITC from OTA's case acceptance guidelines.

Nonetheless, OTA still receives some requests for assistance with EITC correspondence. Although many are simply forwarded to the review unit, OTA staff will intervene in cases where the Division's communication may have been questionable. Although OTA does not track EITC matters as a specific category, we estimate that approximately 10% of the Gross Income Tax inquiries received related to the EITC.

During FY 2013 and FY 2014 the OTA has continued to provide independent review of taxpayers' requests for assistance and to identify and propose solutions for systemic problems. In addition, during FY 2014, Treasury and Division management tasked OTA with reviewing the more than 300 notices the Division routinely sends to taxpayers and revising them using "plain language".

During FY 2013 and FY 2014 to date, roughly 640 taxpayers contacted OTA. All requests have been met with some manner of assistance. 92 of the 640 inquiries (14%) fell outside the case acceptance guidelines. For those cases, OTA staff identified the appropriate area within the Division to forward the request, discussed the request with appropriate personnel, and then put the taxpayer in direct contact with the appropriate Division employee. Even when the inquiry was completely outside the Division's jurisdiction (e.g. taxpayer is questioning a notice from another department within the State or from the IRS) OTA either advised the taxpayer as to where to direct their concerns or forwarded the taxpayer's correspondence to the appropriate agency. The remaining 548 cases were accepted by OTA for assistance.

As of today, seven of the 548 accepted cases remain open. Eight cases were closed without resolution either because the taxpayer failed to provide documentation or failed to take action that OTA deemed necessary. In each of those eight cases, the taxpayer was notified that their case was being closed, but could be reopened at the taxpayer's request.

Of the cases received since 7/1/2012, 61% involved Gross Income Tax, 18% involved Corporation Business Tax, and 11% involved Sales Tax. The remaining 20% involved numerous topics including property tax relief programs, inheritance tax, estate tax, bulk sales, and billings for taxes resulting from internet cigarette sales.

Discussion Points (Cont'd)

Over the past 12 months, OTA has engaged Division management with respect to three systemic tax administration problems:

Confusion regarding CBT filing requirements - OTA continues to receive numerous inquiries from taxpayers experiencing problems with the corporate dissolution process. For Federal purposes, a corporation that ceases operations must file the annual Form 1120, *U.S. Corporation Income Tax Return*, and check the box which says "final return". When filing their last CBT-100 or CBT-100S (paper filed), many NJ corporate taxpayers write "final return" across the top and believe that that is sufficient for State personnel to terminate the corporation's filing obligations. It's not until a year (or more) later that the taxpayer realizes that this is not the case when they receive a delinquency notice for unfiled CBT returns.

Penalty and interest calculations - As a result of a taxpayer inquiry, OTA staff discovered inconsistencies regarding information provided to taxpayers with respect to the calculation of penalties and interest.

Billing for old Corporate Business Tax liabilities. OTA staff discovered that, from time to time, the Division bills taxpayers for CBT liabilities that were no longer collectible. The Division is barred from collecting CBT liabilities after ten years unless the liabilities have been reduced to judgment.

The changes recommended by OTA are to processes and policies, not laws, rules, or regulations.

At its inception, the OTA was staffed with one chief and three TSR 1s. In July 2012, the chief was promoted to Assistant Director of Counsel Services. While she remains responsible for OTA, less than 20% of the AD's time is spent on OTA matters. The annual salary expenditure for FY 2014 will be approximately \$250k.

The OTA staff will be reduced to two full-time TSR 1s for FY 2015. The annual salary expenditure for FY 2015 will be \$182k.

19. The contours of the Governor's proposed FY 2015 **New Jersey Homestead Property Tax Credit program** (N.J.S.A.54:4-8.57 et seq.), renamed the **Homestead Benefit Program** by the Administration, are unchanged from FY 2014. Overall, the Executive estimates that 829,000 homeowners would collect an average \$469 benefit in FY 2015, after 843,200 homeowners collected an average \$469 rebate in FY 2014. Although the program's eligibility criteria have not changed since FY 2010, the number of claimants fell by 148,800, or 15.0 percent, from 992,000 in FY 2010 to 843,200 in FY 2014. Some 21,600 fewer seniors, or 4.2 percent, participated in the program in FY 2014 (492,400 participants) than in FY 2010 (514,000 participants). But the more significant decline transpired among non-seniors whose participation dropped by 127,200 claims, or 26.6 percent, from 478,000 claimants in FY 2010 to 350,800 in FY 2014. For all claimants combined, the Administration projects a further 1.7 percent contraction in FY 2015 to 829,000 participants. In response to OLS Discussion Point #17 in the FY 2012-2013 Department of the Treasury Budget Analysis, the Treasury conveyed

Discussion Points (Cont'd)

that its own analysis suggested that bracket creep was the primary driver of the erosion in program participation. Especially the incomes of many former non-senior participants had grown beyond the \$75,000 eligibility threshold.

Under the program's statutory structure, a homeowner's credit amount is based on the homeowner's gross income and the homeowner's property taxes paid in the last calendar year up to \$10,000. Credits equal 20 percent of allowable property taxes paid up to \$10,000 for incomes up to \$100,000, 15 percent of allowable property taxes paid up to \$10,000 for incomes over \$100,000 up to \$150,000, and 10 percent of allowable property taxes paid up to \$10,000 for incomes over \$150,000 up to \$250,000. A homeowner who is disabled, blind or 65 years of age or older receives the higher of the payment to which the homeowner is entitled under the above schedule or an amount equal to the amount by which property taxes paid in a tax year exceed five percent of the claimant's gross income subject to the following ranges: if the gross income is not over \$70,000 the claimant receives a \$1,000 to \$1,200 benefit, if the gross income over \$70,000 but not over \$125,000 the claimant receives a \$600 to \$800 benefit, and if the gross income is over \$125,000 but not over \$200,000 the claimant receives a \$500 benefit. Statutory tenant rebates in FY 2015 are \$150 for all tenants with incomes up to \$100,000, with tenants who are blind, disabled or 65 years of age or older with incomes not exceeding \$70,000 receiving up to \$850.

Relative to statutory provisions, the Governor's FY 2015 Budget proposes to: a) eliminate rebates for non-senior homeowners with incomes above \$75,000 and senior homeowners with incomes above \$150,000; b) reduce rebates from 20 percent to 10 percent of property taxes paid up to \$10,000 for senior homeowners with incomes not exceeding \$100,000 and for non-senior homeowners with incomes not exceeding \$50,000; c) reduce rebates from 20 percent to 6.67 percent of property taxes paid up to \$10,000 for non-senior homeowners with incomes between \$50,000 and \$75,000; d) reduce rebates from 15 percent to 5 percent of property taxes paid up to \$10,000 for senior homeowners with incomes between \$100,000 and \$150,000; e) eliminate the alternative benefit computation under which claimants who are disabled, blind or 65 years of age or older receive the higher of the payment to which they are entitled under the above schedule or an amount equal to the amount by which property taxes paid in a tax year exceed five percent of the claimant's gross income subject to the ranges indicated in the above paragraph; and f) maintain 2006 property taxes, as opposed to tax year 2013 property taxes, as the basis for calculating homestead benefits. The Governor also proposes continuing the elimination of the homestead property tax rebate program for tenants.

- **Questions:** Has the Division of Taxation refined its analysis of the reasons for the 15.0 percent drop in Homestead Property Tax Credit program participation from 992,000 participants in FY 2010 to 843,200 in FY 2014? If so, please set forth any available quantification of the bracket creep hypothesis and any other explanatory variable(s) that may be tied to the impact of economic and credit market conditions on the incidence of homeownership among concerned income groups.

Answer: No, the Division has not revised its participation analysis for the Homestead Property Tax Benefit.

- **Question:** For FY 2014 Homestead Property Tax Credit distributions, please provide the following data for the senior and non-senior homeowner populations: 1)

Discussion Points (Cont'd)

distribution of rebates by income brackets and 2) distribution of rebates by rebate amounts.

Answer: Attached are two tables which provide the number of Homestead Property Tax Credits and payment distributions made to seniors (attachment X-4) and non-seniors (attachment X-5) in FY 2014. While some applicants received payment by check, most rebates were applied as credits against homeowners' August 1 property tax bill. The tables provide a breakdown of the distribution of the rebates by income and amount.

20. On November 14, 2007, the United States Government Accountability Office (GAO) released a report on **tax evasion by Medicaid providers** (Medicaid: Thousands of Medicaid Providers Abuse the Federal Tax System, GAO-08-17). The GAO found that over 30,000 Medicaid providers in seven selected states (New Jersey was not included in the sample), or over five percent, had federal tax debts totaling over \$1 billion as of September 30, 2006. The unpaid taxes mostly consisted of individual income and payroll taxes. The GAO noted further that the federal government and the seven states surveyed had no process for screening health care providers for unpaid taxes and hence did not bar health care providers with tax debts from enrolling in or receiving payments from Medicaid.

In response to OLS Discussion Point #10 in the FY 2008-2009 Department of the Treasury Budget Analysis, the division related that it did not have a database of Medicaid providers. Consequently, it was unable to screen the providers for unpaid taxes. Even so, the division intended to begin discussions with the Division of Medical Assistance and Health Services in the Department of Human Services to identify and to resolve any legal issues that might impede the exchange of provider information for tax administration purposes. If successful, the Division of Taxation could then provide information to the Medicaid program on medical providers who have unpaid State taxes so that the Medicaid program may terminate such providers from the program or withhold Medicaid reimbursements until resolution of the tax matter. Replying to OLS Discussion Point #17 in the FY 2013-2014 Department of the Treasury Budget Analysis, the Division of Taxation stated that the initiative was still ongoing and that a high-level meeting between the two divisions took place on this matter on April 5, 2013. The Division of Taxation related further that it was statutorily restricted from disclosing confidential tax information to outside parties. Therefore, it would have to perform the data match of Medicaid providers against outstanding tax liabilities. To enable the data match the Division of Medical Assistance and Health Services would have to provide the Division of Taxation with a listing of Medicaid providers and relevant identifying details.

- **Questions:** Have the Division of Taxation and the Division of Medical Assistance and Health Services in the Department of Human Services concluded their discussions concerning the exchange of information on medical providers so that the Medicaid program may terminate providers with unpaid State tax liabilities from the program or withhold Medicaid reimbursements until resolution of the tax matter? If so, what has been the outcome of the deliberations? If not, what are the stumbling blocks that stand in the way of implementing the information exchange?

Answer: The status has not changed.

Discussion Points (Cont'd)

21. The Division of Taxation publishes an annual *Statistics of Income* report based on gross income tax returns filed with the division. The personal income report includes a wealth of information, such as the number of returns filed, the distribution and source of income, and the total cost to the State of assorted exemptions, tax credits and deductions. In contrast, the division does not disclose similar aggregate **Corporation Business Tax (CBT) data**. In response to OLS Discussion Point #18 in the FY 2013-2014 Department of the Treasury Budget Analysis, the division did, however, provide some summary information on tax year 2011 CBT filings, including an indication that 93.3 percent of CBT filers paid only the statutory minimum tax amounts (100,521 out of 114,742 C corporation filers, or 87.6 percent, and 100,257 out of 100,359 S corporation filers, or 99.9 percent, paid statutory minimum amounts).

- **Questions:** For tax year 2012, please indicate: a) the number of corporation business tax (CBT) return filers, segregated into at least five net income brackets; b) the total net income that taxpayers in each bracket declared; c) the total amount of tax they were charged; and d) the effective tax rate for each bracket. What was the number and percentage of CBT return filers paying the statutory minima? Please break out the number of S corporations paying the statutory minima.

Answer: The Office of Revenue and Economic Analysis recently hired a staff member who has been thoroughly reviewing data from the Corporation Business Tax. He has uncovered several data issues that we are working to resolve. Upon completion of his review, we will forward the information as requested.

DIVISION OF REVENUE AND ENTERPRISE SERVICES

22. The Office of Treasury Technology provides information technology services and support to the Department of the Treasury and agencies supported by the department. According to page D-385 in the FY 2015 Governor's Budget, the **Division of Revenue and Enterprise Services assumed jurisdictional control of the Office of Treasury Technology** from the department's Division of Administration in FY 2011. A footnote to the position data on page D-388, however, states that the Division of Revenue and Enterprise Services' FY 2014 position data newly reflect the transfer to the division of the office's functions. In addition, page C-25 in the FY 2015 Governor's Budget shows for the first time a "Treasury Technology Services" revolving fund. A revolving fund finances the operations of an intragovernmental service agency that bills client agencies for the goods and services it provides to them. For FY 2014 and FY 2015, the Treasury Technology Services revolving fund's anticipated annual revenues are \$10.3 million.

- **Questions:** Please comment on the transfer of the Office of Treasury Technology to the Division of Revenue and Enterprise Services. What was the justification for the reorganization? When did the division effectively assume control of the office? Does the fact that the office's positions are first reflected in the division's FY 2014 position count suggest a multi-year transfer of functions or complications in transfer execution? If so, please explain the timeline of any multi-year transfer or any

Discussion Points (Cont'd)

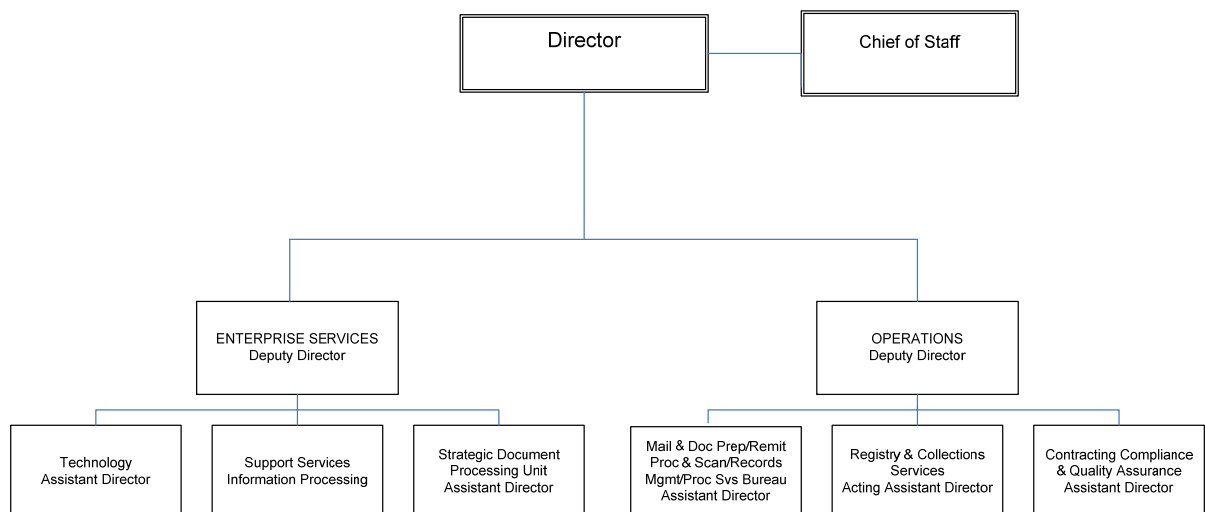
difficulties encountered. If applicable, please indicate the reorganization's actual or anticipated State cost savings.

- Answer:** The purpose/justification of the realignment was to merge the units that provide a range of technical services and support for Treasury (OTT) and for the entire State (Division of Revenue and Enterprise Services) into a single operation. This enables the Department to consolidate facilities, provide enhanced performance, and leverage staff and equipment more effectively.

The realignment became effective operationally in FY 2013. The administrative elements of the realignment, including movement of staff, became effective in FY 2014. This scheduling is not indicative of any problems.

- Question:** Please delineate all operational changes the Division of Revenue and Enterprise Services has already implemented at the Office of Treasury Technology or intends to implement in FY 2015. Has the division altered the services the office provides to client agencies? Has it restructured the office? What is the rationale for newly creating in FY 2014 the Treasury Technology Services revolving fund? Does the revolving fund finance 100 percent of the office's operations or only a portion thereof? If the revolving fund finances only a portion of the office's operations, please set forth the office's entire budget for FY 2014 and FY 2015 by funding source. Please list the client agencies that receive bills from the office. How many funded "on-budget" and "off-budget" positions does the office have in FY 2014 and is anticipated to have in FY 2015?

Answer: Please see the organization chart below.



A revolving fund was created to support the DORES role as an intra-governmental service agency that bills client agencies for services rendered. The fund finances 100 percent of the office's operations.

Discussion Points (Cont'd)

Client agencies:

Capital Post Office	Governor's Council on Alcoholism and Drug Abuse	Property Management and Construction
Central Motor Pool	Investment	Public Broadcasting Services
Central Rent	Lottery	Public Finance
Central Telephone	Management and Administration	Purchase & Property
Council on Local Mandates	Mental Health Advocacy	Revenue
Dispute Settlement	NJ Building Authority	Risk Management
Distribution Center	Office of Management and Budget	State Comptroller
Elder Advocacy	Pensions and Benefits	Taxation
Garden State Preservation Trust	Print Shop	Unclaimed Property

The Treasury Technology Services revolving fund has 96 positions in FY2014 and is anticipated to have the same amount in FY 2015. Typical of all revolving funds, these positions are categorized as non-State funded positions.

23. The Division of Revenue and Enterprise Services pays for services it receives from contracted vendors out of its **Services Other Than Personal account**. Since FY 2010, annual disbursements from the account have fluctuated significantly. For example, actual FY 2013 expenditures were \$9.8 million, some \$3.6 million, or 57.3 percent, more than the \$6.2 million expended in FY 2012. In reply to OLS Discussion Point #21 in the FY 2013-2014 Department of the Treasury Budget Analysis, the division related that an additional \$3.8 million was needed in FY 2013 to provide full-year funding for the division's mail processing and data entry vendors. The division expected the services to recur in FY 2014. The account's FY 2014 adjusted appropriation now stands at \$7.7 million, some \$2.1 million, or 21.2 percent, less than actual FY 2013 expenditures. The Administration's recommended FY 2015 appropriation is a slightly larger \$7.8 million. The following list sets forth actual account expenditures for FY 2010, FY 2011, FY 2012, and FY 2013; the FY 2014 adjusted appropriation, and the Administration's recommended FY 2015 appropriation.

FY 2010 Actual:	\$5,910,000
FY 2011 Actual:	\$3,720,000
FY 2012 Actual:	\$6,200,000
FY 2013 Actual:	\$9,753,000
FY 2014 Adjusted Appropriation:	\$7,682,000
FY 2015 Budget Recommendation:	\$7,782,000

- **Questions:** Please delineate actual FY 2013 and projected FY 2014 and FY 2015 expenditures from the Services Other Than Personal account of the Division of Revenue and Enterprise Services, indicating for each year the vendors receiving payments, the dollar amount of each vendor's payment, and the services each vendor

Discussion Points (Cont'd)

rendered in exchange for the payments. What factors account for the \$2.1 million, or 21.2 percent, drop from \$9.8 million in actual FY 2013 expenditures to the \$7.7 million FY 2014 adjusted appropriation? Have any contractor payments by the Office of Treasury Technology been moved to the new "Treasury Technology Services" revolving fund? According to current projections, will the \$7.7 million be sufficient to pay for FY 2014 contractor expenditures?

Answer: The attached spreadsheets show expenditures for Services Other Than Personal in FY 2013 and projected through FY 2014. The FY 2014 reduction reflected anticipated savings due to the implementation of the mail processing and data entry vendors. While much of this savings was realized, unexpected cost increases such as a \$500,000 increase in utilities, \$600,000 in IT costs, \$157,000 in postage costs, and \$230,000 in non-tax debt collection will bring spending in the Services Other Than Personal account to levels close to FY 2013 spending. It is expected that the \$7.7 million may not be sufficient for all contractor expenditures in FY 2014, but the Division will be able to fund any difference from other sources. The FY 2015 increase is due to anticipated growth for the cost of a Microsoft Licensing Agreement.

24. The processing of tax documents and payments is one of the core responsibilities of the Division of Revenue and Enterprise Services. In FY 2013, the processing of tax year 2012 paper gross income tax returns, refunds, and payments experienced atypical multi-month delays. FY 2013 also marked the first year in which **two private-sector contractors were fully responsible for the pre-processing of mailed paper gross income tax returns and payments as well as related data entry and verification services.** PRWT Services Inc. pre-processed the paper returns and payments and delivered them to designated State processing centers. Data Entry Company then took possession of the pre-processed returns and performed data entry and verification services. The two contractors received their first payment (\$975,000) in FY 2012. In reply to OLS Discussion Point #21 in the FY 2013-2014 Department of the Treasury Budget Analysis, the division related that it anticipated expending \$3.8 million in FY 2013 to pay the contractors for full-year mail pre-processing and data entry services.

On January 14, 2011, the Division of Purchase and Property issued Request for Proposal (RFP) 12-X-21940 for "Front End Mail Receipt & Pre-Processing Service — Division of Revenue." The contractor was expected to "expeditiously open, sort, screen and prepare mail items ... to enable subsequent, accelerated electronic document scanning, data capture and revenue deposit operations." The pre-processing encompasses all types of paper documents and payments, including those related to taxes, commercial filings, and license renewals. The RFP noted that the Division of Revenue and Enterprise Services had previously conducted the document and payment processing operations in-house with 71 full-time and 254 seasonal employees. With the award of State Contract T-2774, this function was outsourced to PRWT Services Inc. of Philadelphia, PA. The three-year contract runs from September 22, 2011 through December 31, 2014 with two optional one-year contract extensions.

On January 12, 2011, the Division of Purchase and Property issued RFP 12-X-21802 for "Data Entry/Verification Services" for paper and digitally imaged gross income tax returns on behalf of the then-Division of Division of Revenue. The RFP noted that the Division of Revenue and Enterprise Services had previously conducted data entry operations in-house with an average of

Discussion Points (Cont'd)

27 operators. The number had increased to an average of 119 operators during the height of the tax return processing season from March 1 through June 18. With the award of State Contract T-2775, this function was outsourced to Data Entry Company of Bethesda, MD. The three-year contract runs from September 22, 2011 through December 31, 2014 with two optional one-year contract extensions.

- **Questions:** Please describe the causes for the atypical multi-month delays in the processing of tax year 2012 paper gross income tax returns, refunds, and payments. What part of the process did not work as envisioned and how did the Division of Revenue and Enterprise Services address the shortcomings once they had surfaced? Did the division incur any unanticipated costs in rectifying the shortcomings?
- How does the division rate the performance of PRWT Services Inc. and Data Entry Company with regard to the tax year 2012 gross income tax return processing season? Has the division sanctioned, or does it intend to sanction, either contractor for any performance deficiencies? If not, please set forth the reasons for not doing so. What payment amounts did the contractors receive for their services in FY 2013? Were the amounts lowered as a result of the multi-month tax return processing delays? Are both vendors involved in the processing of tax year 2013 paper gross income tax returns? If so, is the division confident that the vendors have resolved any prior problems that caused last year's multi-month processing delays? What are projected FY 2014 payments to the vendors? Does the division plan on invoking the contracts' optional one-year extensions at the end of the year?
- What lessons has the division learned from the outsourcing of the pre-processing of mailed documents and payments as well as gross income tax return data entry and verification? Have the outsourcing's actual costs and benefits matched expectations? What have been the division's cost savings? Did the division incur any unanticipated costs? Does the division perceive a change in service quality relative to its previous in-house service performance? Is the division satisfied with the vendors' performance? If the division could return to the decision point for the outsourcing, would it still privatize the functions? Is the division considering returning the functions in-house?
- Has the division evaluated the role of its contract management in the multi-month delays in the processing of tax year 2012 paper gross income tax returns, refunds, and payments? How does the division rate its contract management in this case? Did the RFP clearly articulate the division's requirements and expectations vis-à-vis the contractors? By what date did the division become aware of any mail gross income tax return processing difficulties? Should the contract manager have foreseen the difficulties sooner? Does the division intend to increase the size and expertise of its contract management staff to reduce the likelihood of similar problems occurring in the future? Does the division have the capacity to effectively oversee contractors?

Answer: With regard to GIT return processing last year, DORES completed about 96% of all Tax Year 2012 returns (100% = 4.7 million) before the end of June. The year before last (Tax Year 2011 returns), DORES completed greater than 99% of all GIT return processing by the end of June. This performance variance resulted in delayed

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refunds and late posting for certain categories of GIT returns (principally 1040 hand-prints that are manually completed and extremely difficult to process, and non-resident and fiduciary returns).

The variances in 2013 stemmed from the fact that the division was in a transition year. DORES replaced an aged (16 years) tax return and payment processing platform with a new, more advanced platform. Unfortunately, not all new automated applications were available on time last year. As a result, a planned-for back-up strategy, which relied on manual data entry programs, was deployed for significant portions of returns processing. DORES also employed a planned fallback strategy for check processing that called for the selected use of legacy equipment. While these plans were effective from a functional standpoint, they were labor-intensive and time-consuming. To ensure timeliness across the board, a stable operational environment was needed.

This year, DORES is experiencing smooth GIT return and check processing operations. All automated applications for paper GIT tax forms were up and running on our new scanning system on time, and mail and data entry services (provided by the incumbent contractors) are running well. Payment processing is flowing efficiently. As a result, the Division anticipates meeting or exceeding historical performance levels this year.

We have realized a significant overall improvement in processing performance this year. As of April 15, 2014, we had seen a nearly 50% improvement in total paper GIT return processing compared to calendar year 2013. Overall check processing operations are also going very well this year: as of April 15, we had about 39,000 check items from our main tax systems in our work-in-progress inventory. At the same time last year, we had more than 146,000 items in the inventory.

The Division has also experienced considerable success with respect to contracting and, notwithstanding some challenges, believes the approach has been (and will continue to be) beneficial for processing operations.

Selective use of contracting for non-core, commodity-type services, like mail and data entry, enables DORES to lower per-item service costs, as well as to consolidate space and eliminate lease costs. The scalability afforded by contracted commodity services — the ability to expand quickly to meet evolving cross-agency processing service demands without major start-up capital or staffing initiatives/costs — also supports the DORES Enterprise service mission directly and substantially.

DORES did experience some performance challenges with the mail contractor last year. These did not have a cost impact and, therefore, there was no reason to contemplate monetary penalties (fines or lower payments). However, the Division took non-monetary corrective actions to address the performance issues and currently is experiencing smooth, responsive mail operations. As of the close of business on April 15, 2014, for example, the mail contractor had 273,000 items less in their GIT return work-in-process inventory compared with the same date in 2013.

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Our contracting arrangements did not cause unanticipated costs during the spring of 2013. DORES was able to shift portions of peak season mail preparation work to in-house staff, and thereby adjust for the ramp-up issues described previously.

The following table highlights these points and also shows payments to the contractors in FY's 2012 and 2013 with projected payments for FY's 2014-2015.

Processing Costs	FY12 Actual	FY13 Actual	Projections			
			FY14	FY15		
Contract Costs (Mail and Data Entry Contractors)	\$ 2,634,502	\$ 3,283,869	\$ 4,100,000	\$ 4,100,000		
Electronics Drive Lease and Associated Costs	\$ 346,000	\$ -	\$ -	\$ -		
Equipment Maintenance (Mail)	\$ 142,000	\$ 12,000	\$ -	\$ -		
Mill Hill Facility Operating Costs	\$ 674,000	\$ 674,000	\$ 674,000	\$ -		
Salary Costs (Processing) [†]	\$ 12,768,602	\$ 10,813,517	\$ 10,154,943	\$ 10,154,943		
Overtime	\$ 28,517	\$ 641,153	\$ 200,000	\$ 33,000		
Totals:	\$ 16,593,621	\$ 15,424,539	\$ 15,128,943	\$ 14,287,943		
Year Over Year Difference	-	\$ (1,169,082)	\$ (295,596)	\$ (841,000)		-

[†] Salary figures for FY's 13 and 14 reflect actual reductions in outlays for salaries dedicated to processing operations. The reductions are attributable to the on-going effects of contracting and general use of automation, including self-service e-file/pav applications.

It should be noted that several factors make a direct comparison of contractor performance in 2013 versus 2012 difficult. The underlying operational and technological environments in FY 2013 were highly volatile and many of the factors that impacted performance adversely were beyond the contractors' control. This said, ramp-up for mail operations fell short of our expectations. Conversely, the data entry contractor rose to the challenge of providing extraordinary levels of support for manual data entry operations. We would rate that contractor's performance highly.

Looking forward, having overcome the transient FY2013 problems, we can return to focusing on the strategic aspects of contracting, including cost/benefit considerations. As noted, selected use of contracting will enable us to save money via lower per unit costs (on average, based on current contract rates for standard work, \$36 less per batch of data-entered items and \$.42 less per processed mail item) and savings from lease consolidation. It also facilitates fiscal management and planning by transforming mail and data entry costs from semi-fixed budgetary elements (based on the need to fully staff seasonal positions) to variable elements (based on actual usage). In this connection, contractors are better able to scale staffing levels up and down during the season based on dynamic paper workloads.

With regard to contract management, DORES continues to enhance its capabilities. In FY 2014, we formed the Office of Contract Management and Quality Control (OCMQC). This Office is responsible for alerting senior management to any developing or anticipated service contract issues. It also chairs an internal steering committee on contract management to assist line managers with contractor billing, quality control, and performance monitoring operations.

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The supervisors and managers assigned to contract management responsibilities during the FY 2013 season were diligent and they reported out problems as they arose in a timely fashion. Ultimately, their efforts were successful. Still, DORES believed the development of a separate contract management function in OCMQC was indicated and that its establishment is an improvement in terms of our ability to anticipate, focus on, and respond to contractor-related issues.

We believe that existing contractual performance measures relating to mail and data entry services are adequate for the State's purposes. The RFP articulates clear performance levels. Nonetheless, DORES does anticipate honing service level provisions with the Division of Purchase and Property as the contracting model matures. In particular, in certain cases, deadline-based performance metrics may prove more meaningful and easier to track than work-day turnaround times.

Finally, DORES is now actively considering re-bid/extension options and will decide on courses of action shortly.

25. P.L.2008, c.24 statutorily centralized the **non-tax debt management** functions for State government in the Division of Revenue and Enterprise Services; Office of Management and Budget Circular Letter 13-11-OMB, Statewide Non-Tax Debt Collection and Write-Off, in turn, details the general non-tax debt management policy. Most importantly, every State agency in the Executive branch must transfer to the division every non-tax debt owed to the agency for 90 days. Most State departments and agencies comply with this mandate, according to the division's FY 2013 annual report on New Jersey's centralized non-tax debt collection program. In fact, 93.1 percent of non-tax debt subject to the transfer requirement was transferred in FY 2013. While that percentage represents a slight decline over the 94.2 percent compliance rate in FY 2012, it still is an improvement over the 82.8 percent FY 2011 and 90.3 percent FY 2010 compliance rates. The division considers a rate of at least 90 percent to equate to "substantial compliance." The table below delineates the extent to which State departments and agencies adhere to the transfer mandate.

Compliance with Non-Tax Debt Transfer Requirement in FY 2013			
Department/Agency	Debt Subject to Mandatory Transfer	Debt Transferred	Compliance Rate
Office of the Public Defender	\$80,592,014	\$80,592,014	100.0%
Human Services	\$35,111,230	\$35,111,230	100.0%
Banking and Insurance	\$19,639,312	\$19,639,312	100.0%
Lottery	\$2,344,161	\$2,344,161	100.0%
Corrections	\$458,283	\$458,283	100.0%
Parole Board	\$27,516	\$27,516	100.0%
Agriculture	\$27,265	\$27,265	100.0%
Health	\$25,503	\$25,503	100.0%
Civil Service Commission	\$5,433	\$5,433	100.0%
Treasury	\$2,942,795	\$2,942,031	100.0%
Law and Public Safety	\$29,844,197	\$29,829,902	100.0%

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Transportation	\$762,450	\$752,441	98.7%
Children and Families	\$885,436	\$830,252	93.8%
Community Affairs	\$16,608,319	\$15,350,010	92.4%
Military and Veterans Affairs	\$447,663	\$406,560	90.8%
Labor and Workforce Development	\$13,340,095	\$9,023,889	67.6%
Environmental Protection	\$30,695,505	\$20,333,956	66.2%
Motor Vehicle Commission	\$196,757	\$71,753	36.5%
Higher Education Student Assistance Authority	\$3,742	\$883	23.6%
Education	\$0	\$0	N/A
State	\$0	\$0	N/A
TOTAL	\$233,957,678	\$217,772,395	93.1%

Two departments have compliance rates below 90 percent and untransferred non-tax debts exceeding \$1 million: the Department of Environmental Protection (\$10.4 million) and the Department of Labor and Workforce Development (\$4.3 million). In response to OLS Discussion Point #22 in the FY 2013-2014 Department of the Treasury Budget Analysis, the division explained that the agencies that fell short of the 90 percent compliance threshold did so because of "staffing, budgetary and/or technological limitations." The division elaborated that in the case of the Department of Labor and Workforce Development the amount not transferred represented unemployment insurance debt and that the department claimed that the United States Department of Labor prohibited the use of amounts owed to the federal Unemployment Trust Fund for unemployment insurance debt collection operations. (After the depletion of the State's Unemployment Insurance Compensation Trust Fund account on March 5, 2009, the State commenced borrowing from the federal Unemployment Trust Fund to pay State unemployment insurance benefits.) As the division would not be reimbursed for debt collection expenses, it therefore has not taken on the administration of the unemployment insurance debt.

Non-tax debt collections were \$11.7 million in FY 2013, \$10.0 million in FY 2012, and \$11.4 million in FY 2011. The FY 2013 collection rate was 10.0 percent, an increase over the 9.7 percent rate in FY 2012 and the 9.3 percent rate in FY 2011. Overall, the division actively managed \$549.3 million of the State's outstanding non-tax debt amount at the end of FY 2013. It also wrote off as uncollectible \$57.2 million in its non-tax debt portfolio in FY 2013, marking only the third time that the division performed a write-off. Previous write-offs occurred in FY 2010 (some \$306.3 million) and FY 2011 (some \$29.3 million). Uncollectible non-tax debt typically is owed by individuals who cannot be located or are unable to pay because they have deceased, are institutionalized, unemployed or bankrupt. Importantly, write-offs do not represent a debt cancellation or forgiveness. Case files are closed but remain available for reactivation should new information surface that allows for additional collection attempts. Write-offs merely represent an accounting technique intended to paint a more realistic picture of the potentially collectible portion of the non-tax debt portfolio.

- **Questions:** Please relate whether the Division of Revenue and Enterprise Services has succeeded in having additional non-tax debt accounts transferred to its non-tax debt management program since publication of the FY 2013 annual report on the

Discussion Points (Cont'd)

centralized non-tax debt collection program. If so, please list the additional programs for which the division has assumed control of non-tax debt. Given that the Department of Environmental Protection's failure to transfer non-tax debt to the division after it has been owed for more than 90 days concerns numerous types of non-tax debt, please specify the obstacles impeding the department from achieving a 90 percent compliance rate with the debt transfer requirement of P.L.2008, c.24. Please state the amount of any write-off of non-tax debt that the division has already performed or plans to perform in FY 2014. Are the numbers presented in the FY 2013 annual report net of vendor contingency fee payments?

Answer: DORES has not added any new accounts since publication of the FY 2013 annual report.

In the past, DEP has cited several obstacles, including systems and staffing limitations and concerns about due process associated with appealed cases.

DORES anticipates some write-off in FY 2014, but no amount has been processed to date. As previously noted, uncollectible non-tax debt write-offs do not represent a debt cancellation or forgiveness. These write-offs represent an accounting technique intended to paint a more realistic picture of the potentially collectible portion of the non-tax debt portfolio. Any such write-offs are completed in accordance with Circular Letter 13-11-OMB.

The FY 2013 report lists gross collection tallies.

26. The Division of Revenue and Enterprise Services outsources the collection of non-tax debt to first and second referral non-tax debt collection contractors. Specifically, after a State agency transferred non-tax debt to the division a first referral debt collector has twelve months to collect it. Any amount still owed after the twelve-month period is transferred to a second referral non-tax debt collector. In the FY 2013 annual report on New Jersey's centralized non-tax debt collection program, the division divulged that it intended to engage a new **second referral non-tax debt collection contractor** in FY 2014. The new contract would include a revised contingency fee arrangement that would make it financially viable for third-party debt collectors. In the past at least one firm, NCO Financial Systems, Inc., had stopped working on second referral cases because it suffered financial losses in attempting to collect the debt (see the FY 2009 annual report on New Jersey's centralized non-tax debt collection program).

- **Questions:** Please indicate the amounts the Division of Revenue and Enterprise Services paid its non-tax debt collection contractors in FY 2011, FY 2012, and FY 2013. Please provide a progress update on the contract for second referral non-tax debt collection services that the division intended to award in FY 2014. Has the contract been awarded? If so, who is the contractor and what are the terms of payment to the vendor? How do the terms of payment differ from those of: a) the previous second referral non-tax debt collection contract, and b) the current first referral non-tax debt collection contract? If no contract has been awarded to date, please indicate by what date the division anticipates awarding the contract. Who is currently performing second referral non-tax debt collection services?

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Answer: Contingency fee payments in FY11, FY12 and FY13 were \$984,000, \$889,000 and \$671,000, respectively.

DORES and the Division of Purchase and Property are developing an RFP for the second referral debt collection, with a view to having a contract awarded no later than the early fall of 2014. The structure of the payment terms will not differ from the current first referral contract or previous second referral contracts. Any change in this area must be accompanied by a change in the debt collection business model.

At the present time, the incumbent vendor for the first referral contract is performing all non-tax debt collection work.

DIVISION OF INVESTMENT

27. The State Investment Council (SIC) adopts investment policies and procedures for the **various State public employee retirement funds** and functions like a board of directors in overseeing the Division of Investment. The division, in turn, implements the council’s investment policies and runs the day-to-day operations of the portfolio. For each fiscal year, the SIC adopts within a regulatory framework an **asset allocation plan** that sets targets for the percentage of the portfolio that ought to be invested in specific asset classes, such as fixed income and domestic equities. The table on the following page displays FY 2013 and FY 2014 target allocations, as well as the actual allocation on December 31, 2013, according to the New Jersey Division of Investment, December 2013 “Investment Reporting Package.” As of December 31, 2013, the State retirement funds had an aggregate value of \$76.8 billion.

The division continues to invest a gradually increasing share of the portfolio in alternative assets (hedge funds, private equity, real estate, and commodities). On December 31, 2011, some 21.0 percent of the portfolio was invested thusly; on December 31, 2012, some 24.8 percent; and on December 31, 2013, some 25.2 percent, or \$19.3 billion. The long term target is 33.2 percent, according to the division’s answer to OLS Discussion Point #23 in the FY 2013-2014 Department of the Treasury Budget Analysis. All these figures, however, fall under the 38 percent regulatory allocation ceiling for all alternative assets combined (N.J.A.C.17:16-69.9). The maximum allocation for hedge funds is 15 percent of the portfolio, for private equity firms 12 percent, for real estate nine percent, and for commodities seven percent.

<u>Asset Allocation and Targets for Pension Funds</u> <u>(December 31, 2013)</u>				
Asset Class	Target Allocation FY 2013	Target Allocation FY 2014	Actual Allocation (%)	Actual Allocation (\$ Million)
Fixed Income	24.0%	21.1%	19.0%	\$14,610.8
Alternative Assets:	29.7%	29.5%	25.2%	\$19,346.1
<i>Hedge Funds</i>	12.5%	11.0%	10.4%	\$7,955.5
<i>Private Equity</i>	7.7%	10.5%	8.1%	\$6,204.6

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<i>Real Estate</i>	5.5%	5.5%	4.3%	\$3,291.0
<i>Commodities</i>	4.0%	2.5%	2.5%	\$1,895.1
Domestic Equity	23.8%	26.5%	28.1%	\$21,581.8
International Equity	19.5%	20.7%	20.5%	\$15,723.1
Cash	1.5%	1.0%	6.1%	\$4,645.9
Police & Fire Mortgages	<u>1.5%</u>	<u>1.2%</u>	<u>1.1%</u>	<u>\$853.7</u>
TOTAL	100.0%	100.0%	100.0%	\$76,761.4

In January 2005, the SIC adopted policies and procedures establishing the **Alternative Investment Program (AIP)** under which pension funds assets may be invested in private equity, real estate, commodities, and hedge funds. Private equity groups raise capital from institutional investors and wealthy individuals to either purchase companies or to further invest in companies they already run. Hedge funds, on the other hand, are private pools of capital that are lightly regulated, often borrow to enhance returns, and pursue a myriad of investment strategies across various financial markets in the pursuit of returns that are not directly correlated with the performance of underlying financial markets. As of December 31, 2013, the division had placed \$19.3 billion in the AIP. In all, it paid \$321 million in management and performance fees and expenses for the AIP in FY 2013, \$192 million in FY 2012, \$174 million in FY 2011, and \$127 million in FY 2010. Replying to OLS Discussion Point #23, the division indicated that since inception through December 2012, the AIP's private equity program returned a positive 7.33 percent net of fees (inception in July 2005), the hedge fund program a positive 4.81 percent (inception in April 2006), and the real estate program a negative 1.31 percent (inception in December 2005). From April 2006 through December 2012, the fixed income portfolio returned a positive 9.40 percent, the domestic equity portfolio a positive 5.01 percent, and the international equity portfolio a positive 1.46 percent.

- **Questions:** Does the Division of Investment intend to revise the asset allocation plan for FY 2015? If so, please highlight any changes from the current plan and explain the rationale for the changes.

Answer: The Division, in conjunction with the Investment Policy Committee of the SIC (IPC), typically develops a proposed asset allocation plan on an annual basis. The proposed asset allocation plan is presented to, and approved by, the SIC prior to the start of each fiscal year.

In February 2014, the SIC approved revised asset allocation targets for the remainder of FY 2014. These revised allocations were based on market conditions. Broadly, the revised allocation targets reduced the level of risk in the portfolio through reductions in exposure to public equities and investment grade fixed income, and increased exposure to cash and other risk reducing assets. The revised targets are shown below:

Asset Class	Target Allocation FY 2014
Fixed Income	20.2%
Alternative Assets:	27.5%
<i>Hedge Funds</i>	12.2%
<i>Private Equity</i>	8.3%
<i>Cash & Bonds</i>	2.5%

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Domestic Equity	25.9%
International Equity	19.2%
Cash	6.0%
Police & Fire Mortgages	<u>1.2%</u>
TOTAL	100.0%

The Division is currently in discussion with the IPC on the Fiscal Year 2015 asset allocation plan with the objective of presenting the Fiscal Year 2015 asset allocation plan to the SIC in May/June 2014.

Asset Allocation is the most important decision an investor makes. The Division reviews the Pension Fund's actual allocations in relation to the asset allocation plan on a daily basis. The asset allocation plan includes lower and upper limits approved by the IPC and SIC at the asset class level. The Division operates within these ranges.

Investment decisions are greatly informed by the asset allocation plan, but also by the Division's view of the current market opportunities and risks. The Division typically does not make dramatic changes to the portfolio's allocation on a short-term basis, rather short term adjustments tend to be more tactical.

- **Question: Per AIP asset class, what have been the gross returns since the AIP's inception and what have been the returns net of management and performance fees paid to alternative investment firms? How do these rates of return compare with those of the pension funds' equity and fixed income portfolios?**

Answer: Returns for Alternative Investment Program asset classes are tracked on a net of fees basis. The net of fee returns since the inception of each portfolio, as calculated by outside consultants/performance providers are:

Hedge Funds: 5.90% (Annualized rate of return from inception of April 2006 through December 2013)

Private Equity: 9.63% (Internal Rate of Return (IRR) from inception in July 2005 through December 2013)

Real Estate: 2.91% (Internal Rate of Return (IRR) from inception in December 2005 through December 2013)

The returns noted above are based on the most recent market values available for fiscal 2014, are on a lag, are unaudited and subject to change. It should be noted that Private

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Equity and Real Estate returns are reported on an IRR basis, whereas hedge fund, public equity, and fixed income returns are reported on an annualized rate of return basis. The returns for the public equity and fixed income portfolios from April 2006 through December 2013 are as follows: Domestic Equity: 8.27%, International Equity: 2.82%, Fixed Income: 7.98%.

- **Question:** Please identify all current contracts, outside vendors or entities engaged for placing investments under the AIP, including the "General Consultant." Please specify the amount paid or expected to be paid for the services of each and the terms of each contract.

Answer:

General Consultant:

ENNIS KNUPP & ASSOCIATES INC, current term 12/11/12-12/10/17, \$503,333.33 for 7/1/13-6/30/14

Hedge Fund Consultant:

Cliffwater, LLC, current term 8/11/13 – 8/10/14, \$1,300,000

Private Equity Consultant:

Strategic Investment Solutions, current term 7/1/13 – 6/30/14, \$382,500

Real Estate Consultant:

RV Kuhns, current term 12/20/13 – 12/19/2014, \$321,191.33 for 7/1/13-6/30/14

Outside Attorneys (FY14 invoices paid fiscal 2014 year-to-date through March 2014; does not include accruals for work performed but not paid):

Baker Botts	\$ 35,136.00
Day Pitney	\$ 75,356.66
Nixon Peabody	\$ 3,115.00
Gibbons	<u>\$ 28,854.40</u>
Total	\$142,192.06

28. On November 21, 2013, the State Investment Council voted to **invest \$300 million of the assets of the State public employee retirement funds in a separate account vehicle with Chatham Asset Management, LLC that will mimic the Chatham Asset High Yield Master Fund, Ltd.** Excluding fund-of-funds investments, this will mark the second largest pension fund placement in a hedge fund, according to the Division of Investment's December 2013 Investment Reporting Package. The minutes of the November 21, 2013 council meeting indicate that two council members expressed concern that investing with Chatham might result in State pension funds being placed in the troubled Revel Casino in Atlantic City, of which Chatham is the largest owner. Division of Investment staff pointed out that Chatham was expected to divest its casino holdings by the time the pension fund investment in Chatham's hedge fund would close. As a result, no State pension funds were expected to be invested in the casino.

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The Revel Casino has reportedly failed to turn a profit since opening on April 2, 2012. It continued to pile up losses even after shedding the bulk of its debt service payment obligations in a bankruptcy proceeding that ended with the United States Bankruptcy Court for the District of New Jersey approving a reorganization plan on May 12, 2013. The reorganization also turned the casino's creditors into owners. The new owners, of whom Chatham is the largest, are now reportedly considering selling the casino or initiating a second bankruptcy filing.

The State supported the casino development as part of the envisioned revitalization of Atlantic City. To that end the New Jersey Economic Development Authority approved an Economic Redevelopment and Growth Grant of up to \$261.4 million on February 1, 2011 in support of the completion of the construction of the then-unfinished casino. The State, however, does not make a one-time upfront payment of the full grant amount. Under the performance-based tax-increment financing program, the final grant amount will instead equal 75 percent of certain State tax collections the casino actually generates over 20 years. The original grant agreement also afforded the EDA a cash distribution interest of 20 percent of the management's initial 10 percent ownership. While not absorbing any of the casino's losses, the authority would share in any profits until it recoups its full investment. Moreover, the Casino Reinvestment Development Authority pledged the revenue it stands to collect under its agreements with the Revel Casino for the repayment of up to \$50 million in bank loans whose proceeds are to be used for infrastructure improvements and redevelopment projects in the Atlantic City Southwest Inlet area adjacent to the casino.

- **Questions:** Please indicate by what date the pension fund investment in the separate account vehicle with Chatham Asset Management, LLC that will mimic the Chatham Asset High Yield Master Fund, Ltd will close. Does the Division of Investment intend to delay the closing of the investment until Chatham will have divested its Revel Casino holdings? In light of Chatham's role first as a major creditor of an unprofitable casino and then as its largest owner, is the financial risk of investing with Chatham relatively elevated?

Answer: The Division is in legal negotiations with Chatham in regard to its proposed separate account vehicle; the timing of the closing of the investment has yet to be determined. Regardless of whether the investment closes before or after divestment, the Division does not intend to have any exposure to Revel Casino.

The financial risk of investing with Chatham as a previous creditor or as a current equity owner in Revel Casino is minimal. Chatham's position in Revel makes up approximately 5% of the firm's almost \$2 billion in assets under management, making it a relatively small piece of a large, diversified portfolio.

- **Question:** Is there any connection between the \$300 million pension fund investment in the Chatham hedge fund with Chatham's current or past role as the largest investor in the Revel Casino?

Answer: There is no connection. The investment with Chatham was proposed based on the strong prior performance of the fund, the attractive terms negotiated by the Division, and the investment needs of the funds.

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At the time the Division proposed an investment with Chatham, the Chatham's High Yield Master Fund had returned an annualized 8.93% since inception in September 2003 through August of 2013 (247 basis points more than the return of the HFRI Relative Value Index in the same time period on an annualized basis). Chatham has also displayed a top-quartile risk adjusted performance on a 1-year and 3-year measurement, as well as since inception. In addition, Chatham has outperformed the S&P 500, the Barclays Aggregate and the JPM High Yield index by 181, 415 and 20 basis points respectively since inception on an annualized basis. It should also be noted that Chatham's performance in 2008 was -2.57% while the HFRI Relative Value Index was -18.04% and the S&P 500 was -37%. The fees negotiated by the Division include a 0.75% management fee, compared to typical hedge fund management fees of 1.5% to 2.0%, and a preferred return of 3%, compared to 0% for most hedge funds.

29. In exercising its fiduciary duties, the division makes use of its investor right to **cast votes by proxy in corporate meetings**. Replying to OLS Discussion Point #29 in the FY 2012-2013 Department of the Treasury Budget Analysis, the division stated that it voted according to its proxy voting guidelines so as to strengthen shareholder rights and promote good corporate governance practices. Every vote, however, is cast based on a case-by-case analysis and not the dogmatic application of the guidelines. In any event, the division's shareholder activism does not encompass social issues, as section b. of N.J.S.A.52:18A-89 requires the division's director "to manage and invest the portfolio [of the pension funds] solely in the interests of the beneficiaries of the portfolio and for the exclusive purpose of providing financial benefits to the beneficiaries of the portfolio."

In addressing OLS Discussion Point #26 in the FY 2013-2014 Department of the Treasury Budget Analysis, the division furnished the "Fiscal Year 2012 Summary Proxy Voting Report" and the "State of New Jersey Division of Investment Proxy Guidelines." According to the "Fiscal Year 2012 Summary Proxy Voting Report," in FY 2012, the division voted 2,118 proxies and went against 1,261 individual proposals recommended by corporate management that were included in 794 of the 2,118 proxies. Most commonly, the division voted against management proposals concerning stock options or incentive or restricted stock plans as elements of non-salary compensation policies. Specifically, the division rejected plans diluting outstanding shares by more than 5 percent, offering stock at a discount, extending eligibility beyond employees and non-employee directors, and accelerating vesting provisions. The second most common vote against corporate management targeted proposals regarding capitalization, such as the issuance of additional shares, share buybacks, and capital increases. This ranking marks a change that is attributable to the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Until FY 2010, the second most common type of votes against corporate management was the support of shareholder proposals seeking to impose shareholder votes on the compensation of executive officers ("say on pay"). But the Dodd-Frank Act newly required shareholders to cast non-binding advisory votes on the compensation of executive officers and on whether the "say on pay" ballot should be held every one, two or three years ("say on frequency"). The novelty of "say on frequency" votes made them the second most common instance in which the division voted against management proposals in FY 2011. In FY 2012, though, division opposition to management on "say on pay" and "say on frequency" proposals became relatively rare. The division responded to OLS Discussion Point #26 that its behavior change mirrored general shareholder behavior. Prior to the Dodd-Frank

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Act's institution of the non-binding "say on pay" vote, shareholders had frequently voted in retaliation against directors who served as members of a company's compensation committee. In FY 2011 and FY 2012, however, the number of directors who failed to receive majority shareholder support plummeted. Nevertheless, the division noted that the non-binding nature of "say on pay" votes does "not necessarily empower shareholders with respect to compensation." Moreover, the division believed that the overall impact of the non-binding votes "on executive compensation has been negligible." Consequently, division opposition to management-proposed remuneration packages could regain prominence in the future.

- **Questions:** Please comment on the exercise of proxy voting rights by the Division of Investment in FY 2013. How many proxies did the division vote in FY 2013, how many management proposals did it vote against, and what areas did rejections of management proposals most commonly concern? Relative to FY 2011 and FY 2012, did the division revive in FY 2013 its proxy voting against a) corporate management on executive compensation arrangements and b) directors sitting on compensation committees? Has there been a policy change in the division's exercise of proxy voting rights since the beginning of calendar year 2013? Please indicate any changes the division has made since the beginning of calendar year 2013 to the "State of New Jersey Division of Investment Proxy Guidelines." Please submit a copy of the "Fiscal Year 2013 Summary Proxy Voting Report."

Answer: The attached Fiscal Year 2013 Summary Proxy Report provides the Proxy Voting Policy as well as an executive summary of the 2013 proxy voting season. There have been no changes to the Proxy Voting Policy.

The advent of "say on pay" predicated by the Dodd Frank Act continues to contribute to a significant decline in shareholder opposition to directors at U.S. firms. For the third consecutive year, the number of directors who failed to receive majority support declined. According to ISS data, a total of just 44 directors failed to receive majority votes in 2013, compared with 91 in 2010. We withheld votes for individual directors at 13 U.S. companies. Drivers of opposition to directors included substandard independence levels on the board or key committees, poor performance combined with problematic governance structure, and failure to respond to majority-supported shareholder proposals.

According to a report issued by ISS, the compensation plans at 52 U.S. companies failed to gain majority support from investors in fiscal 2013. The main reasons for investors voting against remuneration plans were pay for performance disconnect, poor pay practices, inappropriately high compensation and compensation committee responsiveness to investor concerns. In fiscal 2013, the Division supported management compensation at 835 companies, and voted against executive pay at 93 companies.

DIVISION OF PURCHASE AND PROPERTY

30. In their March 2014 "Overlooking Oversight" report researchers at Rutgers University found the State had "a severe lack of systematic [contractor] oversight capacity." The

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consequences of substandard contract management could be dire. It could lead to the overpayment for procurements and the delivery of goods and services that fail to meet contract specifications. Cost overruns may also result when agencies do not clearly define the scope of work to be provided by contractors. For those reasons the report identified and expressed concern about several **deficiencies in the State's management of contractors**, notably the lack of: a) routine contract costing prior to the issuance of Requests for Proposal (RFP); b) detailed specifications of contract terms in RFPs; c) adequate performance requirements, indicators, and standards, which complicates the assessment of contractor performance; d) interest in penalizing contractors for nonperformance; e) a central contractor performance database; and f) investment in contract management capacity, as attrition has depleted the ranks of contract managers who, in addition, usually do not receive proper training (The report noted that a three-hour online tutorial was the only training most contract managers received.).

Other publications had previously addressed the State's management of private-sector contractors. For example, on page 42 of the FY 2009 Budget-in-Brief, the Executive had conceded that the "State's current system for evaluating contractors [was] somewhat fragmented and the information that [was] gathered [was] not managed in a central, coordinated manner." It was hence possible that certain vendors received additional work "despite a history of poor performance." Moreover, in its November 2007 report on the Division of Purchase and Property, the Office of the State Auditor had stated that none of the contract managers in its sample had received any training. In reply to OLS Discussion Point #16 in the FY 2008-2009 Department of the Treasury Budget Analysis, the division also acknowledged that not all State contract managers at the time were "appropriately trained, skilled, or of a disposition appropriate to being a competent State Contract Manager."

The responsibility for the development of contract terms and contract management resides with contracting agencies. The Division of Purchase and Property runs only the purchasing process. Nevertheless, subsequent to the November 2007 State Auditor report that stated that none of the contract managers in its sample had received any training, the division has taken a multi-pronged approach to improving the quality of contract management in State government. The development of contract management training programs has been a hallmark of the division's initiative. In addressing OLS Discussion Point #21 in the FY 2009-2010 Department of the Treasury Budget Analysis, the division stated that all assigned contract managers were to take a newly implemented mandatory web-based State Contract Manager course and test in FY 2009, which cover State procurement law, policies, procedures, and efficient and effective procurement practices. In addition, the division continued to offer instructor-led State Contract Manager courses upon request. In reply to OLS Discussion Point #33 in the FY 2012-2013 Department of the Treasury Budget Analysis, the division noted that it had also designated a senior staff member to head the training initiative, which newly incorporated insights from protests handled by the division and final agency decisions that were appealed to the Appellate Division of the New Jersey Superior Court. Last year, in addressing OLS Discussion Point #31 in the FY 2013-2014 Department of the Treasury Budget Analysis, the division added that it had assigned two of its contract administrators to overseeing all State contract managers who handle professional services contracts worth at least \$1.0 million. While the division did not intend to change the contract management training curriculum or require continuing education, it reported that many contract managers were now proactively contacting the division with questions and suggestions.

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Questions: Please comment on the Rutgers University report's conclusion that the State has "a severe lack of systematic [contractor] oversight capacity." Does the Division of Purchase and Property agree that State agencies and departments are mostly unable to provide effective contract management due to understaffing and insufficient contract management expertise? Does the Administration intend to strengthen the State's contract management capacity? If so, please detail any plans to that effect. Does the division intend to expand its contract management training offerings? Is the division satisfied with the improvements that the training program has brought about in the quality of contract management in State government? If the quality of the State's contract management ability is questionable, should the State place a moratorium on the outsourcing of State government functions?

Answer: It is our understanding that the Rutgers University report's conclusions and recommendation were largely based on a review of third-party vendor contracts. The Division of Purchase and Property does not procure third-party contracts. Therefore, to the extent that these third-party contracts informed conclusions in the report, the DPP has no basis for comment. Further, the report did not specify a sampling size for its review of contracts procured by DPP, so it is difficult to endorse or refute conclusion with respect to systemic or agency oversight of contracts procured by DPP. DPP currently has over 2,000 contracts in place, each of which has an assigned State Contract Manager.

DPP agrees that a lack of contract management expertise in the agencies and departments can contribute to less effective contract management.

DPP regularly responds to agency requests for contract management training and provides ongoing access to its State Contract Manager (SCM) training through the web portal. The quality of contract management for contracts procured by DPP is dependent on training, the complexity of the procurement, the expertise of the assigned SCM, and the amount of time the SCM can dedicate to contract management while still fulfilling other duties required at the agency or department.

31. Standard purchasing procedures hinge on the awarding of contracts based on a formal, advertised, competitive bidding process. The **Delegated Purchasing Authority** (DPA) and **Request for Waiver of Advertising** (RWA) programs, to the contrary, exempt certain State agency purchases from the regular process. Agencies can only employ the two alternatives if they cannot procure a purchase transaction through a State contract, the State Distribution and Support Services Center, the Bureau of State Use Industries or the Central Non-profit Agency (CNA), ACCSES NJ. Of the \$1.6 billion the State spent on procurements in FY 2012, 17.4 percent, or \$274 million, was expended under the DPA and RWA programs (\$165 million, or 10.5 percent, for RWAs and \$109 million, or 6.9 percent, for DPAs).

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The DPA program covers State agency purchases valued at no more than \$36,000, which threshold the Division of Purchase and Property increased from \$29,000 effective July 1, 2010 pursuant to statutory authority (see N.J.S.A. 52:34-7 and N.J.A.C. 17:12-1A.2(b)). The table below summarizes basic DPA price solicitation requirements (see Division of Purchase and Property Circular Letter 11-10-DPP, Delegated Purchasing Authority (DPA)). To bypass the advertised competitive bidding process for a procurement whose price exceeds \$36,000 a State agency must obtain the approval for an RWA from the Division of Purchase and Property and the Department of Law and Public Safety. Existing law sanctions RWAs if an agency has contacted at least three viable firms for price quotations and if a procurement is an emergency; the services to be performed are highly complex, technical, unique or specialized; or if only a single source of supply is available. The Department of Law and Public Safety reviews all RWAs so as to ascertain that they meet legal requirements. N.J.S.A. 52:34-8 et seq., N.J.A.C. 17:12-1A.2(f), and Division of Purchase and Property Circular Letter 11-14-DPP, Requests for Waivers of Advertising, set the legal framework for RWAs. The division reported in response to OLS discussion point #32 in the FY 2013-2014 Department of the Treasury Budget Analysis that the average processing time for an RWA was approximately 41 days at the time of writing the response (it was 75 days in FY 2009). It also noted that it declined 26 RWA requests in FY 2012 and that there were seven known instances in FY 2012 in which State agencies engaged vendors prior to division approval of the RWA requests.

DPA Price Solicitation Requirements	
Purchase Value	Solicitation Requirements
Up to \$1,000	One Price Quotation
\$1,000 to \$17,500	Three Price Quotations
\$17,500 to \$36,000	Three Sealed Written Bids
Emergency	One Price Quotation

The Department of Law and Public Safety reviews all RWAs so as to ascertain that they meet legal requirements. N.J.S.A. 52:34-8 et seq., N.J.A.C. 17:12-1A.2(f), and Division of Purchase and Property Circular Letter 11-14-DPP, Requests for Waivers of Advertising, set the legal framework for RWAs. The division reported in response to OLS discussion point #32 in the FY 2013-2014 Department of the Treasury Budget Analysis that the average processing time for an RWA was approximately 41 days at the time of writing the response (it was 75 days in FY 2009). It also noted that it declined 26 RWA requests in FY 2012 and that there were seven known instances in FY 2012 in which State agencies engaged vendors prior to division approval of the RWA requests.

- Questions:** How many purchases for which total amounts were made, by State agency, under the Delegated Purchasing Authority (DPA) and the Request for Waiver of Advertising (RWA) programs in FY 2013? How do these figures compare to contracts awarded under the formal, advertised, competitive bidding process? What is currently the standard processing time for an RWA? In FY 2013 and 2014, how many RWAs did the Division of Purchase and Property decline? In how many instances did State agencies engaged vendors prior to division approval of the RWA in FY 2013?

Answer: With regard to the procurements made in FY2013:

Delegated Purchasing Authority (DPA)	84,039 purchases valued at \$108M
Waiver of Advertising (RWA)	2,174 purchases valued at \$276M
Competitive Bids	76,610 contract orders valued at \$1.4B

- The current processing time for an RWA is approximately 46 days.
- In FY 2013, the number of declined waiver requests was 15; and thus far in FY 2014, the number declined is 20.
- The Division's records indicate 11 instances in which State agencies engaged vendors prior to Treasury approval in FY 2013.

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32. Between July 1, 1998 and June 30, 2001, the State received \$101.1 million in federal Medicaid funds for school-based health services claimed by school health providers under the **Special Education Medicaid Initiative (SEMI)**. In its May 18, 2006 audit of these claims, the Office of Inspector General in the United States Department of Health and Human Services recommended that New Jersey refund \$51.3 million to the federal government after finding that 109 of 150 audited school-based claims had violated federal and State program guidelines. The State contested the findings. In its reply to OLS discussion point #32 in the FY 2012-2013 Department of the Treasury Budget Analysis, the Department of the Treasury conveyed that through the appeal process the United States Department of Human Services reduced its final reimbursement claim to \$44.5 million. The State paid the amount in January 2012.

SEMI is a school-based federal Medicaid Title XIX reimbursement program that allows participating school districts to recover a portion of the costs for certain Medicaid-covered services provided to Medicaid-eligible pupils. The Department of the Treasury shares the administrative responsibility for operating SEMI with the Departments of Children and Families, Education, and Human Services. Specifically, Treasury serves as the contract manager for the billing agent whose responsibilities, in turn, include receiving and processing billing agreements and pupil registration information from school health providers; conducting Medicaid eligibility verification for registered pupils; and monitoring program compliance.

Maximus, Inc., served as the State's billing agent during the period covered by the federal \$44.5 million refund claim. In response to the initial notification of disallowance, the Treasury did not release the \$440,000 performance bond posted by Maximus and opined that it should seek to recover the contingency fees paid to the vendor on the final disallowed claim amounts, and, if possible, an additional amount for damages (department response to OLS Discussion point #4 e. in the FY 2007-2008 Department of the Treasury Budget Analysis). In addressing OLS Discussion Point #33 in the FY 2013-2014 Department of the Treasury Budget Analysis, the Treasury related that the Office of The Attorney General was considering bringing legal action against the vendor. It stated further that, at the time of the response, Maximus no longer served as the State's SEMI billing agent but still had three contracts with the State for other services, including website services, arbitration and mediation services, and support and quality assurance services. Moreover, the Treasury noted that while N.J.A.C.17:12-6.3 (10) allowed for the debarment of a contractor for unsatisfactory performance, it could not debar Maximus for two reasons. First, the unsatisfactory performance had to have occurred within a reasonable time preceding the determination to debar. The unsatisfactory performance in this case, though, dates to 1998 to 2001. Second, the unsatisfactory performance had to have been caused by acts within the control of the debarred contractor. However, in this case Maximus was not solely responsible for the rejection of claims by the United States Department of Health and Human Services because some school districts had failed to properly document services eligible for reimbursement and because some services had been performed by providers who had been qualified under New Jersey Department of Education requirements, but not under federal Medicaid requirements.

- **Questions:** What legal recourse, if any, is the State considering, or has initiated, against the vendor, Maximus, Inc., to recoup the \$44.5 million the State had to reimburse the federal government for having filed claims in violation of federal and State Special Education Medicaid Initiative (SEMI) program guidelines? As the State's billing agent was Maximus responsible for program compliance monitoring and

Discussion Points (Cont'd)

ensuring that the documentation submitted to the United States Department of Health and Human Services met program guidelines? If not, who performed, or was supposed to perform, that control function? Please detail the contracts under which Maximus is currently performing services for the State.

Answer: The State has a claim against Maximus for reimbursement of the 3.5% commission that Maximus was paid on the disallowed amount. That claim, and any related claims, has been referred to the Attorney General's Office. The State is no longer engaged in any SEMI claiming contracts with Maximus. Maximus presently holds two State contracts for other services, including arbitration and mediation services and quality assurance services (in connection with the DHS CASS contract).

33. On July 7, 2010, the Office of the State Comptroller released its audit report on Billing and Contracting for Telecommunications Services. In the report, the State Comptroller concluded that the Division of Purchase and Property and the Office of Information Technology (OIT) had inappropriately turned several **State telecommunications contracts** into no-bid contracts. One way of circumventing the competitive bidding process was to extend contracts beyond the terms authorized by original contract awards. Specifically, each of the four contracts reviewed by the State Comptroller was first competitively awarded to the current vendors 10 to 15 years ago, had an initial term ranging from one to three years, and authorized a single one- or two-year extension. The division and the OIT, however, extended the contracts between seven and 22 times after exercising the contracts' extension options. A second approach the division and the OIT reportedly used to award no-bid telecommunications contracts involved the approval of Waivers of Advertisement on the basis that only one vendor existed for these services or that the State or federal governments regulated the vendors. In its audit response, the OIT reported that significant discounts accompanied the extensions and that only one vendor was suitable for some of its telecommunications contracts given that the State's outdated internal telephone system precluded competitors from providing telecommunication services. Nonetheless, the State Comptroller recommended that the division and the OIT no longer extend telecommunications contracts beyond their original terms, issue Requests for Proposals to procure telecommunications services and supplies through competitive processes, and review all Waivers of Advertisement for telecommunications services to ensure the proper use of statutorily permissible exceptions to competitive procurement processes.

Responding to OLS discussion point #34 in the FY 2011-2012 Department of the Treasury Budget Analysis, the division stated that it and the OIT were heeding the recommendations and that contracts would be extended only when necessary to allow time for the completion of the competitive bidding process. Accordingly, the division listed six telecommunications contracts that were in the rebid process. Over the next two years, in its replies to OLS discussion point #34 in the FY 2012-2013 Department of the Treasury Budget Analysis and OLS discussion point #34 in the FY 2013-2014 Department of the Treasury Budget Analysis, the division reported that new vendors had been selected for the following four contracts: 1) Video Teleconferencing, 2) Telecommunications Equipment and Services, 3) Wireless Devices and Services, and 4) Radio Communications Equipment and Accessories. The division noted further that the terms and conditions of the new contracts were more favorable to the State than those of the previous contracts with greater discounts and better options and solutions. The procurement process, however, was still ongoing for the remaining two telecommunications

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contracts: 1) Telecommunications and Data Services, and 2) Toll and 800 Services. In response to OLS discussion point #34 in the FY 2013-2014 Department of the Treasury Budget Analysis, the division stated that the estimated value of the new contract for telecommunications data services was \$120 million over five years and that of the new contract for toll and 800 services \$75 million over five years.

Questions: Please provide an update on the status of the rebidding process for each of the following two telecommunications contracts: 1) Telecommunications and Data Services, and 2) Toll and 800 Services. For each contract, please indicate how many vendors submitted bids; which vendor was selected; the start date of the contract; the term of the contract, including that of any optional extension; and which vendor held the previous contract. Are the terms and conditions of the new contracts more or less favorable to the State than those of the previous contracts? What is the updated estimated value of the new contracts over five years?

Answer: The Telecommunications Data Services contracts were previously held by AT&T Inc. and Verizon Communications. They have been rebid and new contracts were awarded effective 2/10/2014. Eight (8) proposals were received and contracts were awarded to four (4) vendors: AT&T; Carousel Industries of N.A.; Lightower Networks; and Verizon. The terms of the contracts are for five (5) years with the option for two (2) one year extensions. The new contract terms are considered more favorable than those of the previous contract and the estimated value of the new contract over five (5) years is \$108 million.

The Toll and 800 Services contracts were previously held by AT&T. The contracts were consolidated, along with the Centrex Waiver and rebid as RFP 13-X-22465, T1297 Voice Communications Network Services. Seven (7) proposals were received and contracts were awarded effective 10/01/2013 to two (2) vendors, Broadview Networks, Inc. and AT&T, Inc. There were no responsive proposals for the Centrex piece. The contracts are for a term of five (5) years with options for two (2) one year extensions. The new contract terms are considered more favorable than those of the previous contract and the estimated value of the new contract over five years is \$68 million. Due to the State not receiving any responsive proposals for the Centrex services, the Division of Purchase and Property, the Division of Law and the Office of the State Comptroller revisited the OSC audit provision indicating that the Centrex services should be procured via an advertised procurement. It was determined that the services could not be competed and should be obtained through the waiver process. The Centrex services are gradually being replaced by voice over internet protocol (VOIP).

DIVISION OF PROPERTY MANAGEMENT AND CONSTRUCTION

34. The Division of Property Management and Construction manages the real estate needs of State government. Its responsibilities include the **awarding of contracts for architectural, engineering, design, and construction services** for State facilities and the management of the projects. It also provides State agencies with technical assistance in planning their real estate projects.

Discussion Points (Cont'd)

Cost overruns are a common occurrence in construction and infrastructure projects worldwide. Published research suggests that deliberate “strategic misrepresentation” runs rampant in vendor *ex ante* bids and that the vast majority of large projects finish with cost overruns, suggesting that errors were not random and the estimates biased. In addressing OLS Discussion Point #28 in the FY 2013-2014 Department of the Treasury Budget Analysis, the division explained that it priced envisioned construction projects before issuing construction bid solicitations. Notably, it first uses a competitive bidding process to hire independent design consultants and professional estimating firms to prepare project designs, specifications, and cost estimates. Upon advertising the completed project plans and specifications, the division awards the actual construction contracts to the “lowest responsible” bidders. The division does not maintain historic data comparing design consultant estimates to actual bid prices and final project costs.

Questions: Please comment on the experiences of the Division of Property Management and Construction with the accuracy of vendor bids for construction-related services for State facilities. What are the average error rates and error variances when *ex ante* vendor bids are compared to actual *ex post* costs? Are the errors biased in one direction? Do the error rates differ according to project size and type? In the last five years, what project produced the largest discrepancy between a winning vendor bid and actual cost?

Answer: Over the past several years, construction bids have come in lower than estimated. The Division does not track error rates in vendor bids to actual costs because contractors are bound to complete the contract within the contract bid amount/sum. The sum is only altered on a project by approved change orders for unknown field conditions, scope changes and/or design errors/omissions that may expand or decrease the work.

Question: Please describe the safeguards the division employs to protect the State against implausibly low vendor bids for construction-related services for State facilities. What techniques does the division use to determine the accuracy of vendor bids? Does the division accord preferential treatment to vendors in the contractor selection process whose bids have proven reliable over time? In setting a project budget, does the division include a cushion of a certain percentage to accommodate unforeseen cost overruns? If so, how does the division determine the percentage? What sanctions could the State bring to bear on contractors whose bid prices turn out to have been unrealistic? Has the division ever brought a lawsuit or contemplated bringing one against a vendor it suspected of having provided a negligent or fraudulent bid? Does the division have the legal authority to bring such a lawsuit?

Answer: To protect against implausibly low bids, DPMC conducts a detailed post bid review and interview with the design consultant and the winning bidder. That post bid review, analysis and discussion with the design consultant, comparison to pre-bid estimates and comparison to other bids are all used to determine the accuracy of vendor bids. No preferential treatment is given to contractors who have submitted reliable bids over time. The applicable laws require award to the lowest responsible bidder whose bid is responsive.

Discussion Points (Cont'd)

There is a contingency used in all project budgets. Ordinarily DPMC sets a contingency of 5% of the construction cost and 10% of the design cost.

Sanctions for contractors who bid an unrealistic price would start by compelling the contractor to perform the work. If the contractor refuses, DPMC can seek relief under the bid bond based on the difference between the low bidder and second lowest bid. DPMC may also bypass the bidder and award to the next bidder (pursuant to applicable case law) in the event of a bid mistake or if it is determined that the bid is too low and not in the State's best interest.

The Division has not brought a lawsuit based on a negligent or fraudulent bid.

35. In its December 2013 audit of the Division of Property Management and Construction, the Office of the State Auditor stated that the division's contractor prequalification and classification process, bid evaluation and contract award process, and contract management were adequate. Nevertheless, the State Auditor pointed to one **shortcoming pertaining to the prequalification and classification of firms seeking to perform construction services for the State, and another concerning consultant selection evaluations.**

First, firms must prequalify before they can bid on a State construction project. In order to receive a prequalification that is valid for 24 months a firm must submit comprehensive, multi-faceted information on its operations, including financial statements prepared by independent accountants. Since firms may submit the financial statements directly, however, they could alter or forge their accountants' documents. Indeed, among 35 sampled vendors the State Auditor found one whose independent financial statement appeared to have been altered. Wary of the submission of falsified financial documents the State Auditor thus recommended that the division require firms to have the preparers of their financial documents transmit them directly to the division. Apprehensive that this change would prolong the prequalification process, the division dismissed the idea in its audit reply. Instead, it intended to post a statement on its website that all information submitted by firms would be subject to verification and that any falsehoods would expose a firm to possible civil and criminal proceedings and disbarment from future work. In addition, the division intended to sample applicant materials to ascertain their accuracy. If the sampling revealed instances of strategic misrepresentation, the division would consider a verification process in the future.

Second, the State Auditor found that the division did not have any policies or procedures in place that guide evaluators of consultant services bids on the completion of bid evaluation forms. As a result, the State Auditor counted four among the 15 projects it sampled that had at least one of the evaluators give a numeric score without any written justification. The lack of information, however, impedes unsuccessful bidders in the identification of their bids' relative weaknesses. Consequently, the State Auditor recommended that the division implement policies and procedures requiring evaluators to provide detailed comments supporting their numeric grades on each evaluation. In its audit response, the division announced the recommendation's future implementation.

Discussion Points (Cont'd)

Question: Please indicate whether the Division of Property Management and Construction has already posted a statement on its website that information submitted by firms would be subject to verification and that false claims could lead to civil and criminal action and disbarment from future work. Has the division already begun to sample and verify the accuracy of documents submitted by firms seeking to prequalify for State construction contracts? If so, what are the types and prevalence of any inaccuracies? Has the division initiated any debarment from future State work, or any criminal or civil proceedings, for false claims in a firm's prequalification materials? If the division has not yet started the sampling of applicant documentation, by what date does it intend doing so? Will this additional duty divert division resources from other priorities or require the hiring of any additional staff?

Answer: Yes, the Division posted this statement regarding false claims and debarment on its website and in several locations on the prequalification application including the cover page, instructions, and certification pages. The Division has not yet performed sampling of prequalification documents, but plans to do so by the end of the Fiscal Year. DPMC has not initiated any type of debarments or legal proceedings for false claims in prequalification materials, but this may be considered after July 1, 2014 when the sampling of applicant documentation begins. This additional duty may require some shift in priorities and the reevaluation of staffing needs.

Question: Please report whether the division has already adopted policies and procedures on the written justification evaluators must provide in support of their numeric grades on their bid evaluation sheets. If so, please summarize the policies and procedures. If they have not been established yet, by what date does the division anticipate their implementation? If the division has abandoned the crafting of the policies and procedures, please explain the rationale for the abandonment.

Answer: Yes. DPMC adopted a policy prior to the initiation of the audit that evaluations would not be accepted unless detailed comments are provided by the evaluator supporting their numeric score on each evaluation.

36. On October 29, 2012, **Superstorm Sandy** made landfall in New Jersey. The severe weather event inflicted \$935,260 worth of **damage on State-owned facilities and properties**, according to the reply by the Division of Property Management and Construction to OLS Discussion Point #27 in the FY 2013-2014 Department of the Treasury Budget Analysis. The table below itemizes the facilities damaged, each facility's recovery cost, and the status of each facility's recovery.

Facility	Storm Recovery Costs	Recovery Status
James J. Howard Marine Lab (Sandy Hook)	\$445,973	Completed
Distribution and Support Services Facility (West Trenton)	\$229,556	Partially Completed
Department of Health's Health and Agriculture Lab (Ewing Township)	\$188,825	Partially Completed
William Ashby Building (Trenton)	\$24,692	Completed
Miscellaneous (Various Locations)	\$19,500	Completed

Discussion Points (Cont'd)

Capital Post Office (Ewing Township)	\$18,752	Completed
Department of Environmental Protection Facility (Trenton)	<u>\$7,962</u>	Completed
TOTAL	\$935,260	

As of the date of the division’s discussion point response, all recovery projects had been completed but for the acquisition of a replacement generator at the Distribution and Support Services facility in West Trenton (\$160,000) and several projects at the Department of Health’s Health and Agriculture Lab in Ewing Township: the repair and replacement of solar panels (\$95,000), the repair of skylights (\$74,160), building façade repairs (\$5,000), lighting protection (\$4,205), and the purchase of 300 gallons of diesel fuel for the backup generator (\$1,008). The division also noted that the Department of the Treasury was seeking reimbursement from the Federal Emergency Management Agency (FEMA) for all eligible recovery costs at a 75 percent reimbursement rate. But the Departments of Health and Environmental Protection had to apply for FEMA reimbursements on their own for the recovery costs they incurred at their respective facilities.

Question: Please indicate whether the replacement generator for the Distribution and Support Services facility in West Trenton has been acquired.

Have the recovery projects at the Department of Health’s Health and Agriculture Lab been completed? If applicable, please update the \$935,260 cost total of Superstorm Sandy-related recovery projects at State-owned facilities and properties. Please report on the status of the State’s efforts to secure reimbursements from the Federal Emergency Management Agency (FEMA) for all eligible recovery costs at a 75 percent reimbursement rate. Has the State received the requested payments? If so, what is the aggregate dollar amount received? Has FEMA denied any reimbursement requests? If so, for what reason(s)? What reimbursement requests are still pending?

Answer: The replacement generator has been acquired. Recovery projects at the Health and Agriculture Lab are completed. The \$935,260 costs remain the working number, but there may be an additional \$60,000 required at the Department of Health’s Health and Agriculture Lab.

The effort to secure FEMA reimbursement is ongoing. On the positive side, much of the reimbursement will be at a 90% rate, not the 75% rate. Treasury has received some reimbursement on this claim, with a total of \$244,000 paid to date. No reimbursement requests have been denied. The pending amount for reimbursement is approximately \$600,000.

37. As the manager of State government’s real estate needs, the Division of Property Management and Construction is also responsible for the leasing of office and warehouse space. In carrying out this function, section (c) of N.J.A.C.17:11-2.2 mandates that the division conduct periodic **site visits of leased properties**. In its November 2012 audit report on the division and the building leases program, the Office of the State Auditor noted the long frequency between site visits. As of June 14, 2012, some 30 of 248 leased offices had not been inspected in 12 to 23 months. The office expressed concern that if the division did not visit

Discussion Points (Cont'd)

leased properties at least annually, safety and security issues might develop. In addressing OLS Discussion Point #29 in the FY 2013-2014 Department of the Treasury Budget Analysis, the division reported that its Lease Compliance Unit had five filled positions and that it was hoping to refill two of the unit's previously vacated positions in FY 2014. The division remarked further that other priority needs and limited existing staffing made it impractical to reassign staff to the unit from elsewhere within the division.

- **Question:** Please indicate the number of the State's leased offices that the Lease Compliance Unit in the Division of Property Management and Construction has not inspected within the last 12 months. What is the time that has elapsed since the last inspection of the leased office that has gone the longest without an inspection?

Answer: There is only one office that DPMC has not inspected in the last 12 months. The elapsed time for the office that has gone the longest without inspection is 22 Months.

- **Question:** Does the Lease Compliance Unit still operate with five filled positions? Has the division succeeded in bolstering in FY 2014, or does it intend to bolster in the remainder of FY 2014 or FY 2015, the unit's staffing level so as to up the frequency of site visits of leased properties? If so, how many filled positions have been or will be added to the Lease Compliance Unit? Have all of these positions been filled or will they be filled by new hires? How many vacant positions does the unit currently have?

Answer: The Lease Compliance Unit is no longer operating with just five filled positions. The Compliance Unit has drawn from the Lease Development Units to provide resources to accomplish the goal of annual site visits. Also, some Compliance Unit staff responsibilities have been changed to help meet this goal.

38. On March 9, 2011, the Office of the State Comptroller released its audit report on the "Disposition of Excess and Surplus Computer Equipment." In reaction to the report, the Division of Purchase and Property and the Office of Information Technology (OIT) **have revised the policies governing the disposition of surplus computer equipment and the protection of data stored thereon.**

Previous Policy: Division of Purchase and Property Circular Letter 00-17-DPP, Disposition of Excess and Surplus Computer Equipment, required that all excess computers be sent to the Surplus Property Unit within the Division of Purchase and Property for centralized redistribution, donation, sale or disposal. In actuality, the Bureau of Special Services warehouse within the Division of Property Management and Construction exercised this function. Once the warehouse received the equipment it was to notify State agencies of its availability, according to N.J.A.C.17:12-9.4. If no State agency claimed the equipment within 30 days, it was disposed of through either sale at public auction or donation to local governments and non-profit organizations. The circular letter also directed State agencies to remove all data from a computer's hard drive and data storage media before sending the computer to the warehouse.

Discussion Points (Cont'd)

Audit Report: In its March 2011 audit report, the Office of the State Comptroller exposed substantial deviations from regulatory policies and procedures. For example, the State Comptroller found data on 46 of 58 hard drives slated for redistribution in the Bureau of Special Services warehouse and business-related data on 37 of those hard drives, of which 13 were already packaged for public auction at the time of review. The State Comptroller pointed out that granting third parties access to confidential and sensitive information presented a security risk and violated several federal and State data protection and privacy laws. The State Comptroller also found irregularities in the central redistribution of excess computer equipment that reaches the Bureau of Special Services warehouse. For example, the bureau did not announce the availability of excess computer equipment to all State agencies, but frequently contacted certain State agency staff directly to grant them first access to the equipment. In addition, the State Comptroller gained the impression that certain State agency staff received preferential treatment in part in return for office supplies and equipment.

Policy Revisions: In reaction to the report, the Division of Purchase and Property and the OIT have issued revised policies governing the disposition of surplus computer equipment and the protection of data stored thereon (State of New Jersey IT Circular 152-00-01 — Information Disposal and Media Sanitization Procedure, No. 09-10-P1-NJOIT; and Division of Purchase and Property Circular Letter 13-18-DPP, Disposition of Excess and Surplus Computer Equipment). The circular letters discontinue the central redistribution of surplus computers within State government. Nowadays hardware may only be reassigned within the using agency or it has to be sold to the general public at auctions conducted by either a contract vendor or the Surplus Property Unit in the Division of Purchase and Property. The Surplus Property Unit may conduct auctions at the Bureau of Special Services warehouse in the Division of Property Management and Construction or in-house at the sending agency. Furthermore, the circular letters newly require that agencies remove or destroy media capable of storing data (such as hard drives and removable storage devices) before auction. Previously, the data had to be purged, but data storage devices could be part of the excess computer equipment to be redistributed or auctioned. For auctions that will be conducted at the Bureau of Special Services warehouse, warehouse staff will ascertain that all data storage ability has been removed by verifying that the physical equipment count sent to the warehouse by agencies matches the count in the documentation and confirming that agencies properly filled out and signed Form PB180, "Declaration of Removal of all Hard Drives and Other Data Storage Devices on Surplus Computer and other Electronic Devices," according to the Division of Property Management and Construction's response to OLS Discussion Point #30 in the FY 2012-2013 Department of the Treasury Budget Analysis. But warehouse staff only sample, instead of systematically inspect, the equipment to confirm that hard drives and data storage devices are actually removed. If a using agency does not call on the services of the Bureau of Special Services warehouse it must still fill out Form PB180 before any auction and the hardware may at any time be inspected or audited to confirm compliance with the circular letters. Division of Purchase and Property Circular Letter 13-18-DPP, however, does not clearly state whether Bureau of Special Services warehouse staff or Surplus Property Unit staff exercise the control function when auctions are held either by contractors or in-house at using agencies.

According to the Division of Property Management and Construction's response to OLS Discussion Point #30 in the FY 2013-2014 Department of the Treasury Budget Analysis, in sampling incoming shipments Bureau of Special Services warehouse staff had not yet

Discussion Points (Cont'd)

discovered any non-compliance with the circular letters' removal of hard drives and other data storage devices requirement. There were, however, five instances of discrepancies between the actual count of computer equipment and the declaration forms. Lastly, the division indicated that the State earned \$470,000 from the sale of surplus computers and other equipment in FY 2012 and \$187,000 in FY 2013 through February 28, 2013.

- Questions:** Please describe the current division of labor in the excess computer equipment disposition process between the Bureau of Special Services warehouse in the Division of Property Management and Construction and the Surplus Property Unit in the Division of Purchase and Property. Is the perception correct that Division of Purchase and Property Circular Letter 13-18-DPP reduced the responsibilities of the Bureau of Special Services warehouse? Does the warehouse play any role in auctions conducted by contractors or run in-house at using agencies? Please provide aggregate statistics on the prices and quantities of excess computer equipment sales in FY 2013 and 2014, and break out the total by auction type: Bureau of Special Services warehouse auctions, in-house auctions by using agency, and contractor auctions.

Answer: DPMC's Bureau of Special Services (BOSS) Unit schedules incoming shipments of surplus data processing and communications equipment delivered to the BOSS warehouse, inspects incoming product and accompanying Data Storage Device Removal Declaration Forms, receives, stores and readies the equipment for online auction. When the volume of such equipment is sufficient for an auction, BOSS notifies the DPP Surplus Unit of the equipment to be auctioned. The Surplus Unit conducts the online auction, collects funds from the winning bidder, issues a sales receipt and notifies BOSS to release the equipment to the winning bidder. If there are any issues with the winning bidder or with the physical pick-up of the equipment, BOSS personnel notify the Surplus Unit for assistance and resolution.

BOSS continues to play the same role that it has in the past, collecting and staging equipment for auction, while the Surplus Property Unit continues to manage the auction process. The BOSS warehouse plays no role in the auction of assets held at using Agency or contractor sites. These auctions are run by DPP's Surplus Property Unit, not by the agency or contractor.

Auction Statistics for FY 2013 and FY 2014 YTD March	FY2013	FY2014
Total Number of Computer/Related Auctions:	60	42
Total Pallets:	798	564
Total CPU's:	13,470	9,912
Total Value	\$296,000	\$199,000
Auctions from BOSS:	57	38
Auctions from 3 rd Party Contractor	3	3
Auctions from Agencies	0	1

Discussion Points (Cont'd)

- **Question:** Is it the view of the Division of Property Management and Construction that agencies are complying with New Jersey IT Circular 152-00-01 and Division of Purchase and Property Circular Letter 13-18-DPP in removing or destroying media capable of storing data before requesting the auctioning off of excess computer equipment? How many auction requests were at first denied in FY 2013 and FY 2014 because of a lack of proper certification that all hard drives and other data storage devices were removed or because hard drives and other data storage devices were actually found not to have been removed? Do Bureau of Special Services warehouse staff conduct the off-site inspections of excess computer equipment that is to be auctioned in-house at the using agencies or by third party contractors? If not, who performs the inspections?

Answer: The Division believes that agencies are complying with the new requirements.

Three shipments have been rejected for missing or incorrect declaration forms during FY 2013 and FY2014.

Any inspection of equipment held by agencies or third-party contractors is conducted by the Surplus Property Unit, not the BOSS warehouse staff.

OFFICE OF PUBLIC FINANCE

39. On March 7, 2014, the Tobacco Settlement Financing Corporation entered into a **pledge agreement concerning two classes of refunding bonds it had issued in 2007 as part of the \$3.62 billion Tobacco Settlement Asset-Backed Bonds (Series 2007-1)**. The bond issuance is backed by a portion of the payments the State receives from leading United States tobacco product manufacturers in accordance with the November 23, 1998 multi-state Tobacco Master Settlement Agreement (MSA). The MSA settled New Jersey's claims for relief with respect to the costs it had incurred from residents' cigarette smoking in the year of payment and earlier years. As announced in the MSA, New Jersey was expected to receive approximately \$7.6 billion in payments through 2025 with unquantified payments continuing in perpetuity thereafter. In accordance with P.L.2002, c.32, the State sold its future MSA payment stream to the newly-established single purpose corporation. Serving as a conduit, the corporation then sold the payment stream to bondholders. Under the terms of the Tobacco Settlement Asset-Backed Bonds (Series 2007-1) the corporation subsequently refunded the outstanding bonds in such a manner that it pledged 76.26 percent of the State's future MSA payment stream to bondholders. The corporation transfers the residual, unsecuritized MSA payments, an anticipated \$56.0 million in FY 2015, to the State for general State purposes.

The two bond classes subject to the pledge agreement are capital appreciation (or zero-coupon) bonds, meaning that the corporation will not make any interest payment on them. Instead, it issued the bonds at steep discounts relative to their face value and will pay bondholders the face value at maturity. The two bond classes, Series 2007-1B and 2007-1C, have a \$1.28 billion maturity value and a June 1, 2041 maturity date. Presumably, bondholders sought the pledge agreement in reaction to projections that the collateral amount pledged to the bond repayment in 2041 would be insufficient to cover required debt service payments. Instead, according to the "Bond Enhancement Memorandum," dated March 6, 2014, the corporation

Discussion Points (Cont'd)

will now pay the bonds off early in return for a bond enhancement premium. Specifically, the corporation pledged the unsecuritized 23.74 percent of its MSA payment stream starting in FY 2017 to the repayment of the two bond classes until they are fully paid off. This is expected to occur in FY 2023 after \$406.7 million in payments to bondholders. During this period these funds will not be available to the State General Fund. Afterwards, the 23.74 percent of the MSA payments will become available again for general State purposes. In return for the payment acceleration the corporation received a \$91.6 million bond enhancement premium in FY 2014, net of transaction costs, that it transferred to the State for general State use. Based on the interaction between MSA payments to the States and the terms of the bond issuance, the Executive also projects that the corporation will retain \$1.63 billion in bond payments from FY 2042 through FY 2049 that the Executive believes the corporation would otherwise have to make to bondholders. The pledge agreement is reportedly estimated to generate \$136.7 million in net present value savings to New Jersey.

- **Question:** Please describe the elements of and assumptions behind the projected \$136.7 million net present value savings of the March 2014 pledge agreement concerning two classes of bonds that the Tobacco Settlement Financing Corporation issued as part of the Tobacco Settlement Asset-Backed Bonds (Series 2007-1). What is the calculation's discount rate? Please explain the \$1.63 billion in bond payments that the corporation is estimated not to have to make from FY 2042 through FY 2049 because of the pledge agreement. What is the total dollar value, in nominal terms, that holders of the two concerned bond classes will receive through maturity?

Answer: The net present value (NPV) analysis discounted the expected incremental cash flows, consisting of \$91.6 million inflow in FY2014 (the net credit enhancement fee), an aggregate \$406.7 million outflow in fiscal years 2017 through 2023 (the incremental pledge of MSA receipts to redeem the Series 2007-1B and Series 2007-1C prior to their stated maturity of FY 2041), and an aggregate \$1.633 billion inflow in fiscal years 2041 thru 2049 (the expected amount of the pledged revenues needed to redeem the Series 2007-1B and 2007-1C that would then be in default). The sum of that cash flow is a net inflow of \$1.318 billion, which when discounted equates to \$136.7 million NPV.

The discount rate is 5.00%.

At the time of the 2007 bond issue, pledged tobacco settlement receipts (TSR), which are based on tobacco consumption, were expected to be sufficient to pay off the Series 2007-1B and Series 2007-1C on or prior to their June 1, 2041 maturity date. Thus the pledge of 76.26% of the TSR would expire and the State would be entitled to receive 100% of the TSR thereafter. Due to the decline in tobacco consumption (at a greater rate than was expected at the time of the bond issue in 2007), the State presently expects that: a) the pledged TSR will be insufficient to redeem the bonds at their 2041 maturity, thereby triggering a default, and b) the pledge of 76.26% of TSR will continue to be used to retire the bonds through 2049. The State will lose that expected revenue in years 2041-2049.

Discussion Points (Cont'd)

The total dollar value, in nominal terms, that holders of the two concerned bond classes will receive through maturity is \$406.7 million.

- **Question:** In addition to the net present value calculation, did the Office of Public Finance perform a risk-return analysis? If so, what were the conclusions? Given that significant uncertainty surrounds the scale of United States cigarette sales of manufacturers participating in the Tobacco Master Settlement Agreement (MSA), and hence the size of MSA payments to New Jersey, from FY 2042 to FY 2049, is it accurate to state that the pledge agreement shifted the risk tied to the uncertainty from FY 2042 to FY 2049 from bondholders to the corporation and thus to the State? If so, what risk premium did the Office of Public Finance exact from the bondholders subject to the pledge agreement?

Answer: The Office of Public Finance engaged the services of a financial advisor (The Acacia Financial Group). The financial advisor's function was to provide a Certificate of Financial Advisor which opined upon certain aspects of the transaction.

The Certificate of Financial Advisor provided a description of the transaction and certified the following: i) The financial advisor's analysis was mathematically consistent with those prepared by the Enhancement Agent (Barclay's Capital), ii) That the value of the Bond Enhancement Premiums, as a percentage of the estimated change in the value of the 2007-1B CABs and the 2007-1C CABs by virtue of the execution of the Pledge Agreements, represented a reasonable extraction of value by the Tobacco Settlement Financing Corporation and the State; and iii) That the execution of the Pledge Agreements in exchange for the Bond Enhancement Premiums, in consideration of the increase in the projected gross and present value of the net TSRs anticipated to be received by the Corporation (which will then be paid to the State as the registered owner of the Second Amended and Restated Residual Certificate), is a reasonable transaction for the Corporation to execute.

Regarding shifting of risk, it is not accurate to say that the agreement shifted risk from bondholders to the State. After several IHS Global Insight projections, there is a very clear trend that tobacco use is continuing to decline. If declines are greater than projections, MSA payments in FY 2050 and beyond would be needed to satisfy bondholder demands. Clearly, all of the risk was held by the State. It is not a question of "if" but a question of "when" the bondholders would be repaid.

40. The Office of Public Finance (OPF) issues and manages all State-backed bonded debt. In its September 2013 audit report on the OPF, the Office of the State Auditor found that the OPF had adequate procedures in place to manage the issuance of State-backed debt in accordance with applicable regulations. Nevertheless, the State Auditor brought attention to one shortcoming, namely the inadequate **monitoring of cost of issuance accounts that the OPF had set up with trustee banks to pay for bond issuance expenses**. The State Auditor based this determination, in part, on having located unexpended balances in inactive cost of issuance

Discussion Points (Cont'd)

accounts. As a remedy, the State Auditor recommended that the OPF routinely monitor cost of issuance accounts and develop monitoring procedures that also provide for the proper use of unspent account balances. In its audit response, the Department of the Treasury concurred and outlined its rectification strategy. It reported that the office was already canvassing trustee banks to inventory all cost of issuance accounts and compile the data into a master spreadsheet or database. Furthermore, the office would establish procedures for the periodic review of cost of issuance accounts, the closure of obsolete accounts, and the use of unexpended balances in obsolete accounts.

Bond issuance expenses; such as accounting, legal, advertising, and bond rating fees; are typically paid out of bond proceeds by way of trustee bank accounts. The amounts deposited in the accounts for vendor payment reflect initial cost projections. If unexpended balances remain in the accounts after compensating all vendors for their services, the State is to close the accounts and use the remaining sums either to make debt service payments or to support the bond sale's intended purposes.

- **Questions:** Please indicate whether the Office of Public Finance (OPF) has completed its inventory of cost of issuance accounts that the office had set up with trustee banks to pay for bond issuance expenses. If so, how many cost of issuance accounts are currently active and what total amount of unexpended balances do they hold? How many inactive cost of issuance accounts has the office closed as a result of the inventory and what total amount of unexpended balances has been returned to the State? How has the State used the unexpended balances?

Answer: OPF estimates that the inventory process is 90% completed and has identified eleven active accounts holding approximately \$704,000. OPF has initiated the closure of three inactive accounts with an aggregate balance of approximately \$478,000. The accounts closed are in connection with several series of motor vehicle surcharge revenue bonds issued by the NJEDA. In accordance with the governing bond documents, the NJEDA directed the trustee to transfer remaining balances into the Revenue Fund and from there to be applied to required amounts for the debt service and other funds. Any excess amounts will fall to the Surplus Fund to be returned to the State at the close of the fiscal year.

Question: Please report whether the OPF has established procedures for monitoring and managing cost of issuance accounts. If so, please summarize the procedures and indicate the periodicity of account reviews. If the procedures have not been established yet, please indicate by what date the office anticipates their implementation. If the office has abandoned the development of monitoring procedures, please explain the rationale for the abandonment.

Answer: OPF staff will maintain the account inventory upon completion. As new bond issues occur, they will be added to the inventory. At least semi-annually, OPF staff will review the inventory to identify accounts no longer required and take appropriate steps to close such accounts in accordance with the governing bond documents.

Discussion Points (Cont'd)

CAPITAL CITY REDEVELOPMENT CORPORATION

41. Established pursuant to P.L.1987, c.58 (N.J.S.A.52:9Q-9 et seq.) and allocated “in but not of” the Department of the Treasury, the **Capital City Redevelopment Corporation (CCRC)** finances community and economic development projects in Trenton’s Capital City District in accordance with the Capital City Renaissance Plan. The Capital City Redevelopment Loan and Grant Fund, a nonlapsing revolving fund, finances corporation activities out of moneys received from prior State appropriations and loan repayments. P.L.2009, c.252 changed the corporation’s organizational structure and powers so as to transform it from a financing and regulatory agency to a municipal redevelopment agency. The corporation, now constituted as an independent, self-supporting authority, is newly able to add to its financial wherewithal through the sale of bonds, notes, and other obligations paid for from non-State sources.

Nevertheless, the corporation experiences a state of financial penury that has impinged on its effectiveness. According to its reply to OLS Discussion Point #38 in the FY 2013-2014 Department of the Treasury Budget Analysis, the Capital City Redevelopment Loan and Grant Fund was in need of recapitalization. At the same time the CCRC had not yet used its new power to issue debt instruments. As a result of the financial deficiency, the CCRC was unable to advance some of its FY 2013 objectives, as the table below indicates in listing: a) several priorities and programming recommendations for FY 2013 that the CCRC had planned to present to the City of Trenton, Mercer County, and the Governor’s Authorities Unit, according to its response to OLS Discussion Point #35 in the FY 2012-2013 Department of the Treasury Budget Analysis; and b) the project updates the CCRC provided in answering OLS Discussion Point #38 in the FY 2013-2014 Department of the Treasury Budget Analysis.

Initiative (April 2012)	Update (April 2013)
Craft economic development strategy inclusive of Downtown Master Plan	Ongoing.
Locate funding to provide capital to small and emerging businesses in the Capital District	Unable to secure funding
Develop façade improvement programs for S. Broad Street, N. Broad Street, and State Street	On hold due to lack of funding
Devise a comprehensive redevelopment plan for the former Glen Cairn Arms apartment building on West State Street	The building is demolished and the property will serve as Thomas Edison State College’s new nursing education center. The CCRC is involved in planning the development of adjacent properties.
Assist in carrying out first phase of lighting and streetscape improvement plan for the Capital District	Ongoing

In response to OLS Discussion Point #38 in the FY 2013-2014 Department of the Treasury Budget Analysis, the corporation listed its FY 2014 objectives: a) obtaining redevelopment authority designation for the Capital District from the City of Trenton; b) identifying opportunities to issue debt instruments with the assistance of the New Jersey Economic

Discussion Points (Cont'd)

Development Authority; c) identifying funding alternatives to recapitalize the Capital City Redevelopment Loan and Grant Fund; d) assisting the City of Trenton in completing the Capital District lighting improvement plan; e) assisting Mercer County Community College with the expansion of its Capital Campus; f) collaborating with its Capital District partners to develop a business attraction, retention, and expansion strategy; and g) developing the Capital State Park. Moreover, on its website, the CCRC states that it was developing a set of economic benchmark indicators for the City of Trenton that would be used to track the City's economic progress.

- **Questions:** Please provide an accounting of the Capital City Redevelopment Loan and Grant Fund for FY 2012, FY 2013, FY 2014, and FY 2015, showing each year's actual or anticipated opening balance, expenditures, revenues, and closing balance. Has the Capital City Redevelopment Corporation (CCRC) been able in FY 2014 to recapitalize the fund? What is the dollar amount of the fund's total outstanding loan portfolio? Which portion thereof is non-performing? Has the corporation ever written off any non-performing loans? Has the CCRC issued any bonds, notes or other debt instruments? Does the CCRC have any financial resources other than those accounted for in the Capital City Redevelopment Loan and Grant Fund?

Answer: Please see attached audited financial statements for FY2012. The FY 2013 audit is just now getting underway.

CCRC has not yet been able to recapitalize the fund. There are no outstanding loans. The corporation has written off one non-performing loan. The corporation has not issued any bonds, notes or other debt instruments and it has no other financial resources than those in the Fund.

- **Question:** Please provide an update on the corporation's activities in FY 2014 and comment on the state of the revitalization of Trenton's Capital City District. Has the City of Trenton designated the corporation as the redevelopment authority for the Capital District? Has the CCRC co-developed an economic development strategy inclusive of the Downtown Master Plan? If so, please detail the elements of the strategy. Has the corporation co-developed and implemented the envisioned façade improvement programs for S. Broad Street, N. Broad Street, and State Street? Has the CCRC co-developed a redevelopment plan for the properties adjacent to Thomas Edison State College's future Nursing Educational Facility on West State Street? If so, please detail the elements of the redevelopment plan. Has the corporation co-administered and completed the first phase of the lighting and streetscape improvement plan for the Capital District? Has the CCRC provided capital for small and emerging businesses in the Capital District? Has the corporation developed a business attraction, retention, and expansion strategy for the Capital District? Has the corporation assisted Mercer County Community College with the expansion of its Capital Campus? Has the CCRC advanced the development of the Capital State Park? Has the CCRC developed the economic benchmark indicators for Trenton that would be used to track the city's economic performance?

Answer: The CCRC currently has no Executive Director and no full-time staff. As such, progress on the projects and initiatives listed above has been limited.

Discussion Points (Cont'd)

- **Question:** What objectives does the corporation intend to pursue in FY 2015? Does it intend to issue any bonds, notes or other obligations in FY 2015? How many filled full-time positions is the CCRC projected to have in FY 2015?

Answer: Objectives for FY 2015 include:

- Identify opportunities to use the Corporation's bonding authority and successfully issue bonds with the assistance of the NJEDA
- Obtain Redevelop Authority designation for the Capital District from the City of Trenton
- Identify funding alternatives to recapitalize the Capital District loan and grant fund and secure investment
- Assist the City with the completion of the Capital District lighting improvement
- Assist Mercer County Community College with the expansion of the Capital Campus
- Collaborate with Capital District partners to develop a business attraction, retention and expansion strategy
- Development of the Capital State Park

The corporation does intend to use its authority regarding bonds, notes and other non-State obligations at some point, but has no immediate plans at this time. The CCRC has the ability to fill one full-time position in FY 2015.

PRINT SHOP

42. The State Police and the Departments of Corrections, Health, Labor and Workforce Development, and Treasury each operate print and copy shops. The Treasury Print Shop handles printing and photocopying services for the remaining State government agencies. Operating as a revolving fund, the self-supporting entity bills client agencies for the expenses it incurs in printing and photocopying documents on their behalf. According to the Governor's FY 2015 Budget (page G-6), the Treasury Print Shop is expected to have 24 employees in FY 2015, the same number as in FY 2014 but four fewer than in FY 2013. Overall, the Governor recommends a \$2.0 million FY 2015 appropriation to the Treasury Print Shop, the same as its revised FY 2014 appropriation, and \$320,000 less than actual FY 2013 expenditures.

In reply to OLS Discussion Point #37 in the FY 2012-2013 Department of the Treasury Budget Analysis, the Department of the Treasury noted that it would conduct a comprehensive review to determine **the most cost-effective method of printing documents for State government**. The review would not just look at the optimal allocation of print assignments between the several in-house print shops and outside contractors but would also consider the structure of printing contracts, the reduction of in-house printing costs, and the modification of print jobs and specifications. A year later, in addressing OLS Discussion Point #39 in the FY 2014-2015 Department of the Treasury Budget Analysis, the Treasury informed that the review was almost finished. The bulk of the analysis had been completed and the department anticipated implementing the review's recommendations in FY 2014. Notably, the department expected placing a greater emphasis on a central review of all print assignments so as to allocate them in the most cost-effective manner between in-house print shops and outside contractors. State

Discussion Points (Cont'd)

print shops would continue to handle the processes for which they had existing production capacity, while outside vendors would do specialty work. But the department could not yet determine whether any task realignment would alter the balance between in-house and outside printing and photocopying. In FY 2012, the State paid private vendors about \$14.4 million for printing services (including paper), and roughly \$12 million in FY 2011. The department hoped, however, that more favorable terms for the procurement of paper would generate significant future cost savings. In addition, the department related that the comprehensive review had already led to the Treasury Print Shop initiating a move from off-set printing to digital imaging. Doing so would be more cost-effective, given the improvements in digital technology and the advanced age of the Treasury Print Shop's off-set printing equipment.

- **Questions: Please indicate total FY 2013 State printing and photocopying expenditures and their anticipated FY 2014 and FY 2015 levels. What dollar amount did the State expend on third party printing services (including paper) in FY 2013? By what date does the Department of the Treasury expect savings to begin materializing from more favorable terms for paper purchases?**
- **Please provide a status report on the comprehensive review the Treasury has conducted on the State's printing operations. Has the department concluded the review? If not, please indicate by what date the department expects its completion. If the review has already been concluded, what were its findings and what are the projected annual cost savings from implementing its recommendations? Which of the recommendations does the Treasury intend to implement? If there are any recommendations that the Treasury does not intend to implement, please list them and provide the rationale for not heeding them.**
- **Has the Treasury Print Shop completed the transition from off-set printing to digital imaging? Has the central review process for print job allocations between in-house print shops and third-party contractors been strengthened? If so, who conducts the central review, are the review's determinations binding, and does the review also encompass non-Treasury print shops? Have the changes spurred by the comprehensive review of State printing operations shifted the balance of print job assignments between in-house print shops and contractors to date?**

Answer: Treasury was unable to complete the analysis and review of all printing operations. The arrangement with the vendor doing the review required no up-front State expenditure; the vendor would be compensated only from realized savings. The agreement was based on use of another State's contract through a Participating Addendum. Because the base contract expired in October, 2012, Treasury had to work on a new Participating Addendum for the extended base contract. While doing so, the review work was put on hold.

A contractual issue arose that prevented us from creating a new Participating Addendum and continuing the engagement. The project was terminated in July, 2013. We do not have the data on total expenditures on printing across State agencies.

Although the comprehensive review and central review of jobs for in-house vs. third-party contractor was not able to be completed and implemented, the Treasury Print

Discussion Points (Cont'd)

Shop continues to work on a model to move toward greater use of digital production and away from off-set printing. Similarly, Treasury Print Shop continues to use private vendors where that option is most effective (for example when we do not have the specific equipment or if the cost would be cheaper than in-house rates).

STATE CENTRAL MOTOR POOL

43. The Bureau of Transportation Services in the Division of Administration runs the **State Central Motor Pool (CMP)**. Operating as a revolving fund, the self-supporting CMP bills client agencies for the expenses it incurs in managing the State's motor vehicle fleet. Its responsibilities include vehicle purchasing, assignment, maintenance, repair, and fuelling. According to the Governor's FY 2015 Budget (page G-5), the State's estimated FY 2015 vehicle count is 14,700, some 43 vehicles more than in FY 2014. This total includes 8,100 vehicles on agency assignment whose maintenance expenses are accounted for separately in agencies' budgets. The CMP expects to oversee the remaining 6,600 vehicles at an estimated FY 2015 cost of \$29.5 million, the same as the adjusted FY 2014 appropriation, but \$4.3 million less than the \$33.8 million actually expended in FY 2013. The FY 2014 decline is primarily attributable to a reduction in the Additions, Improvements and Equipment account from \$5.3 million in FY 2013 to \$185,000 in FY 2014. Replying to OLS Discussion Point #37 in the FY 2013-2014 Department of the Treasury Budget Analysis, the Division of Administration noted that the CMP had procured 798 new vehicles in FY 2013 at a cost of \$28.4 million. In FY 2012, it had purchased 1,008 new vehicles for \$25.0 million.

The Department of the Treasury has experienced mixed fortunes in its recent attempts to generate cost savings in the management of the State passenger vehicle fleet through outsourcing initiatives. First, according to the FY 2012 Budget Summary, the State was expected to realize \$4.0 million in savings in FY 2012 by privatizing the ownership and maintenance of all or a portion of the State passenger vehicle fleet. The initiative was abandoned in November 2011 after all five bid submissions to a May 2011 Request for Proposal (RFP) failed to fully meet the specifications of the bid solicitation, as the department indicated in response to OLS Discussion Point #36 in the FY 2012-2013 Department of the Treasury Budget Analysis. Similarly, the department reported a year later, in reply to OLS Discussion Point #37 in the FY 2013-2014 Department of the Treasury Budget Analysis, that it had closed another competitive bidding process without a contract award on April 8, 2013. The RFP had sought bids for scheduled and unscheduled maintenance for the CMP fleet. The bids, however, failed to provide any significant cost savings. Nevertheless, the department would continue to explore other options for potential cost savings.

In contrast to the aforementioned outsourcing efforts, the Treasury implemented a new short-term passenger vehicle rental program by joining a multi-state contract with Enterprise, Hertz, and National through the Western States Contracting Alliance. Since May 2012 State agencies and departments can newly avail themselves of the companies' services at discounted rates. Previously, employee travel on State business could only be effectuated in a State vehicle or the employee's own personal vehicle with the State reimbursing the employee for mileage driven. In addressing OLS Discussion Point #37 in the FY 2013-2014 Department of the Treasury Budget Analysis, the department disclosed that, through March 2013, State agencies had used 2,773 vehicle-days for FY 2013 at a cost of \$97,800, thereby allowing the CMP to reduce the

Discussion Points (Cont'd)

size of its "rental" fleet by 80 vehicles. This resulted in the sale of 80 additional vehicles at auction, which netted \$95,700. The department did not anticipate that the new short-term passenger vehicle rental program would lead to any workforce reductions at the CMP.

- **Questions:** Please provide explanatory details on the anticipated decline in spending from the State Central Motor Pool's (CMP) Additions, Improvements and Equipment account from \$5.3 million in actual FY 2013 expenditures to the adjusted FY 2014 appropriation of \$185,000. Please delineate actual and anticipated FY 2013 and FY 2014 expenditures from the account, listing for each year the goods and services purchased and the dollar amount associated with each purchase. Will the discontinued FY 2013 purchases reoccur periodically? If so, what is their expected periodicity?

Answer: A new fueling system was installed in FY2013, and that accounted for the bulk of the \$5.3 million reduction. This was a one-time expenditure.

- **Question:** Please comment on the use by State agencies and departments of the multi-state contract through the Western States Contracting Alliance

that allows for short-term passenger vehicle rentals. How many vehicle-days have been rented in each of FY 2013 and FY 2014, at what cost, and what are the associated cost savings? What is the CMP's projection for contract usage in FY 2015? Does the FY 2015 Governor's Budget include any cost savings related to the contract? Beyond the 80 vehicles auctioned off in FY 2013, does the CMP anticipate any additional reductions in its vehicle count because of short-term passenger vehicle rentals? Please describe any other initiative(s) the CMP may have undertaken in FY 2014, or may plan to undertake in FY 2015, to further lower the State's cost of employees traveling on State business.

Answer: Based on statistics from the Division of Purchase and Property, it appears that in FY 2013 there were 4,289 vehicle days of rentals at a cost of \$174,454 from Hertz, and in FY 2014 to date there have been 6,057 vehicle days of rentals at a cost of \$235,418 from Hertz. In FY 2014 Enterprise began participating in the contract, adding another 1,022 rental days at a cost of \$40,310. That puts total rentals for FY 2014 through March at 7,079 days at a cost of \$275,728. Beyond the 80 vehicles already auctioned, there have not been any specific reductions in passenger vehicles attributed to the availability of short-term rentals. Any cost savings are not found in Central Motor Pool; the agencies that rent vehicles incur the expense and thus realize any savings.

- **Question:** For FY 2014, please provide the number of vehicles retired and purchased, indicating how many of the vehicles purchased directly replaced a retired vehicle. What sum does the CMP expect to spend on new vehicle purchases in FY 2014 and 2015?

Answer: To date in FY 2014, the State has purchased 494 cars and trucks. Of that number, one vehicle represents an increase to the fleet while the other 493 were one-

Discussion Points (Cont'd)

for-one rotations for retired vehicles. These 494 vehicles cost \$12.9 million in FY 2014. We anticipate a similar expenditure in FY 2015.

- Question:** For the most recent month for which the data are available, please indicate the total number of State vehicles listed by State department and agency. In the list, please differentiate between passenger vehicles and all other vehicles, and the number of vehicles on individual assignment and pool assignment.

Answer: The chart that follows shows the current status of the State fleet as of the beginning of April, 2014.

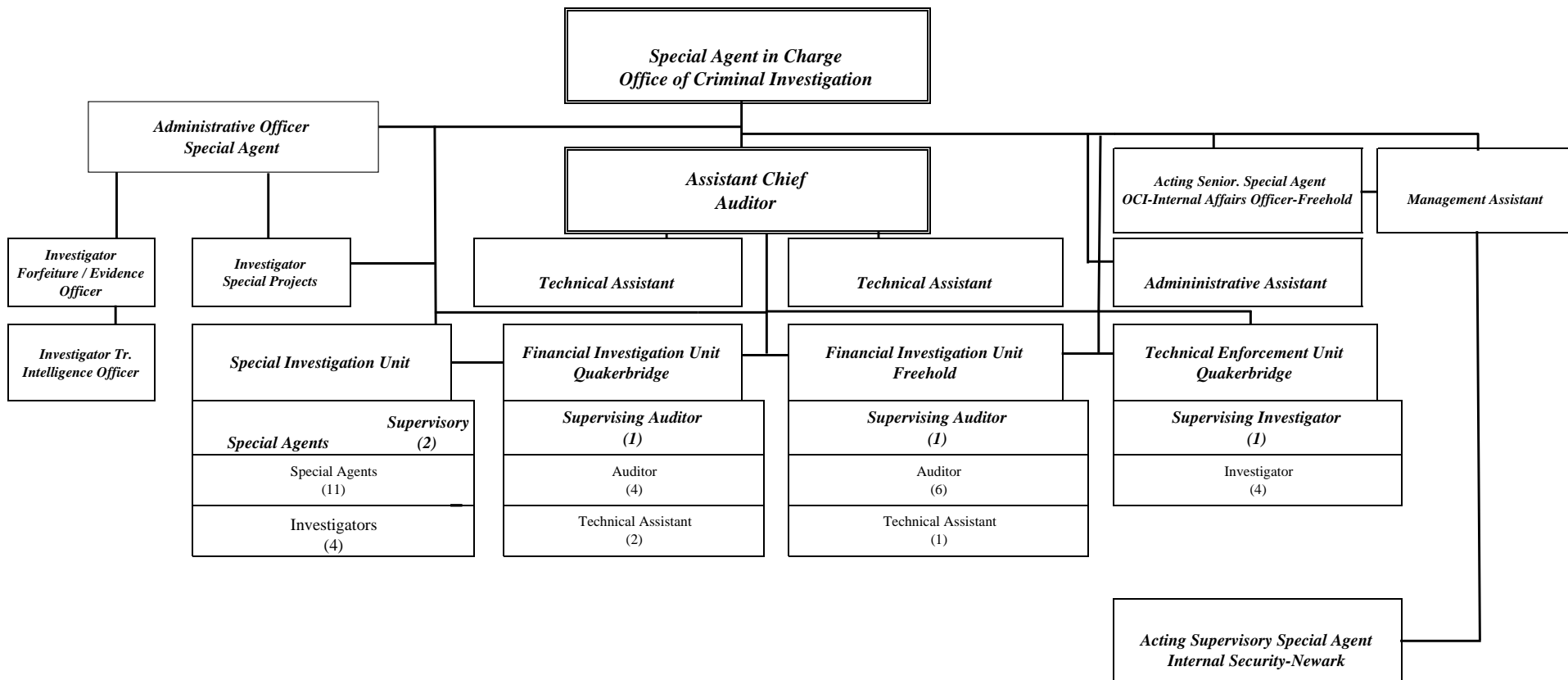
TOTAL VEHICLE ASSIGNMENTS BY DEPARTMENT AND ASSIGNMENT TYPE

DEPARTMENT/AGENCY	TOTAL VEHICLES	PASSENGER VEHICLES	OTHER VEHICLES	INDIVIDUAL ASSIGNMENTS	POOL ASSIGNMENTS
AGRICULTURE	71	48	23	43	28
BANKING and INSURANCE	100	100	0	1	99
CENTRAL MOTOR POOL	36	8	28	0	36
CHILDREN AND FAMILIES	2,359	2,197	162	1	2,358
COMMUNITY AFFAIRS	191	186	5	172	19
CORRECTIONS	1,161	725	436	30	1,131
EDUCATION	39	27	12	1	38
ENVIRONMENTAL PROTECTION	1,340	565	775	556	784
GOVERNOR'S OFFICE	9	9	0	0	9
HEALTH	159	139	20	9	150
HUMAN SERVICES	989	558	431	63	926
LABOR and WORKFORCE DEVELOPMENT	89	82	7	60	29
LAW & PUBLIC SAFETY (Excluding State Police)	854	755	99	31	823
MILITARY & VETERANS AFFAIRS	109	31	78	8	101
MOTOR VEHICLE COMMISSION	259	198	61	146	113
STATE	13	12	1	5	8
STATE POLICE	2,610	2,286	324	0	2,610
TRANSPORTATION	3,899	485	3,414	435	3,464
TREASURY	439	358	81	116	323
GRAND TOTAL	14,726	8,769	5,957	1,677	13,049

X-1							
Business Audit	Voluntary Disclosure Agreement Requests	Voluntary Disclosure Agreements Concluded	Voluntary Disclosure Agreement Collections	Individual Tax Audit	Voluntary Disclosure Agreement Requests	Voluntary Disclosure Agreements Concluded	Voluntary Disclosure Agreement Collections
FY 2010	247	177	\$106,176,170	FY 2010	26	26	\$693,818
FY 2011	348	281	\$36,310,932	FY 2011	9	5	\$192,831
FY 2012	435	322	\$90,812,145	FY 2012	19	17	\$365,149
FY 2013	307	132	\$56,990,776	FY 2013	14	12	\$779,681
FY 2014 (As of Discussion Point Response)	245	135	\$57,990,776	FY 2014 (As of Discussion Point Response)	35	4	\$255,031
X-2							
Business Audit	Intangible Asset Nexus Initiative-Requests	Intangible Asset Nexus Initiative-Concluded	Intangible Asset Nexus Initiative-Agreement Collections	Individual Tax Audit	Partnership Tax & Fees Initiative-Requests	Partnership Tax & Fees Initiative-Concluded	Partnership Tax & Fees Initiative-Agreement Collections
FY 2014 (As of Discussion Point Response)	10 Stats are thru March 31, 2014. The IHC Initiative runs until May 15, 2014 and the Dollars will come in 30 - 45 days later.	0	\$0	FY 2014 (As of Discussion Point Response)	2 Stats are thru March 31, 2014. The Partnership Initiative runs until May 15, 2014 and the Dollars will come in 30 - 45 days later.	0	\$1,984

**Office of Criminal Investigations
April 2014**

X-3



Special Agent title series	17
Investigator (civil) title series	12
Auditor title series	13
Technical Assistant title series	5
Management Assistant	1
Administrative Assistant	1
TOTAL OCI Personnel	49

2011 Homestead Homeowner Rebates by Income (Seniors) as of 4/16/14

REBATE AMOUNT	0.01-200.00	200.01-400.00	400.01-600.00	600.01-800.00	800.01-1000.00	1000.01-1049.99	1050.00	***TOTALS**
								# REBATES & AMTS BY INCOME LEVEL
GROSS INCOME	14,856	68,934	80,903	44,523	16,553	1,410	4,251	231,430
0.00 - 10,000	2,249,920.02	21,393,243.15	40,072,602.03	30,519,601.18	14,729,964.12	1,443,418.34	4,463,550.00	114,872,298.84
10,000.01 - 20,000	2,894	9,679	10,020	4,981	2,450	3	17	30,044
	407,104.63	2,972,408.34	4,935,313.10	3,411,132.07	2,249,674.30	3,076.64	17,850.00	13,996,559.08
20,000.01 - 30,000	2,560	12,664	17,395	10,991	6,540	0	3	50,153
	372,524.68	3,963,811.71	8,637,333.48	7,552,239.28	6,040,691.10	0.00	3,150.00	26,569,750.25
30,000.01 - 40,000	1,617	9,036	13,693	9,317	6,137	0	6	39,806
	239,905.82	2,853,201.49	6,825,668.95	6,421,215.75	5,682,011.57	0.00	6,300.00	22,028,303.58
40,000.01 - 50,000	953	6,530	10,785	8,067	5,740	0	1	32,076
	143,020.58	2,078,137.61	5,396,621.24	5,555,200.46	5,328,072.74	0.00	1,050.00	18,502,102.63
50,000.01 - 55,000	337	2,583	4,509	3,613	2,754	0	0	13,796
	50,822.71	825,158.35	2,262,311.55	2,494,385.91	2,559,505.63	0.00	0.00	8,192,184.15
55,000.01 - 60,000	263	2,248	4,230	3,303	2,647	0	1	12,692
	38,859.53	720,620.07	2,125,983.49	2,290,843.83	2,461,846.25	0.00	1,050.00	7,639,203.17
60,000.01 - 75,000	529	4,723	9,084	7,989	6,923	0	4	29,252
	80,060.93	1,516,099.40	4,575,631.30	5,527,408.37	6,454,470.00	0.00	4,200.00	18,157,870.00
75,000.01 - 100,000	274	2,956	5,658	5,053	4,257	0	1	18,199
	42,129.18	955,611.73	2,841,678.79	3,497,100.70	3,976,305.48	0.00	1,050.00	11,313,875.88
100,000.01 - 125,000	2,279	12,265	7,739	18	20	0	1	22,322
	355,386.44	3,739,197.50	3,634,616.89	12,514.60	18,936.61	0.00	1,050.00	7,761,702.04
125,000.01 - 150,000	907	6,405	5,201	3	3	0	1	12,520
	143,160.48	1,983,107.75	2,453,701.93	2,251.28	3,000.00	0.00	1,050.00	4,586,271.44
TOTAL NUMBER	27,469	138,023	169,217	97,858	54,024	1,413	4,286	492,290
TOTAL AMOUNT (All Incomes)	4,122,895.00	43,000,597.10	83,761,462.75	67,283,893.43	49,504,477.80	1,446,494.98	4,500,300.00	253,620,121.06

ACCOUNT AND DESCRIPTION	FY13 ACTUAL EXPEND & OBLIG as of 3/31/14
30-Travel	
3010-Tolls	61.55
3015-EZ-Pass	68.00
3030-Mileage Reimbursement	1,068.88
30 - SUBTOTAL	1,198.43
31-Telephone	
3110-Central Telephone Charges	487,000.00
31 - SUBTOTAL	487,000.00
32-Postage	
3210-Central Postage Charges	1,404,626.07
32 - SUBTOTAL	1,404,626.07
34-Information Processing External	
3410-NORTHROP DPS System Maint	1,322,100.00
3430-Salesforce License	74,275.72
3430-Misc Software Purchases	230,980.00
3450-AXWAY software maint (Tumbleweed)	11,301.39
3450-OTT Seat Charges	714,158.00
3450-CISCO Routers Maintenance	28,833.89
3450-Filenet/IBM Rev/OTT & C.R. Maintenance	666,074.35
3450-IBM/Filenet Services	113,000.00
3450-STG computer maintenance	20,000.00
3450-STG discount (1)	(42.81)
3450-Avaya Maintenance	1,789.32
3450-Oracle Maint - Business Services	73,329.70
3450-OPEX Maintenance (included in ERC)	189.04
3450-DCR License renewal	34,980.90
3450-NORTHROP SW Maint	185,303.00
3450-DP500 Software Maint SHI	142,862.72
3450-Misc Software Maintenance	139.43
3450-Maximus-MaxCars Software	1,700.00
3450-ERC Hardware maintenance	452,901.09
3450-IBM-Server Maintenance	93,918.98
3450-ARTEMIS SW maint Paris funds to reimburse	93,900.00
3499-Reimbursement from DOS	(93,900.00)
3499-Reimbursement from APU 015	(1,358,000.00)
3499-Homestead Rebate Reimb	(56,304.71)
34 - SUBTOTAL	2,753,490.01
35-Household and Security	
3520-Guard Services (MH Procg Cntr & Base 10)	240,756.82
35 - SUBTOTAL	240,756.82
36-Professional Services	
3620-2nd Ref Debt Collect-Tax	21,600.00
3620-Non-Tax Collections	708,000.00

3620-Discount for Penn Credit	(8,393.77)
3620 - Financial Asset Mgmt	430,000.00
3620 - Discount for FAMS	(5,899.71)
3620-PRWT Services Inc.	2,500,000.00
3620-TDEC	1,100,000.00
36 - SUBTOTAL	4,745,306.52
38-Other Services	
3810-Training	5,245.00
3820-Subscriptions	4,169.60
3830-Memberships (FTA-UA) (DISA-UA)	300.00
3856-Prompt Payment Interest	6.64
3859-Procurement Efficiency Assessment	1,221.77
3890-EAS Contract	5,000.00
3890-State Police Investigations	288.00
3890-DARM Record Storage	22,920.35
3890-Docusafe Record Storage	4,756.34
3890-Media storage-Recall	2,000.00
3890-IDENTRUST	119.00
38 - SUBTOTAL	46,026.70
39-Information Processing Internal	
3910-Information Processing Internal - OIT SAVI	68,644.87
39 - SUBTOTAL	68,644.87
APU 004	9,747,049.42

ACCOUNT AND DESCRIPTION	FY-14 ADJUSTED SPENDING PLAN
30-Travel	
3010-Tolls	50.00
3015-EZ-Pass	100.00
3030-Mileage Reimbursement	1,000.00
30 - SUBTOTAL	1,150.00
31-Telephone	
3110-Central Telephone Charges	470,000.00
31 - SUBTOTAL	470,000.00
32-Postage	
3210-Central Postage Charges	1,562,000.00
32 - SUBTOTAL	1,562,000.00
34-Information Processing External	
3410-NORTHROP DPS System Maint	879,000.00
3410-AXWAY	74,205.16
3410-avaya	1,221.00
3430-AVAYA	11,126.64
3430-Salesforce License	78,449.95
3430-Misc Software Purchases	15,000.00
3450-AXWAY software maint (Tumbleweed)	444,677.95
3450-AXWAY accelerators	46,901.66
3450-OTT Seat Charges	908,940.00
3450-CISCO Routers Maintenance	11,165.02
3450-Filenet/IBM Rev/OTT & C.R. Maintenance	514,574.92
3450-IBM/Filenet Services	115,448.45
3450-STG computer maintenance	5,000.00
3450-STG discount (1)	(3.08)
3450-Avaya Maintenance	1,631.63
3450-Oracle Maint - Business Services	82,748.08
3450-OPEX Maintenance	12,140.00
3450-NORTHROP SW Maint	93,719.00
3450-DP500 Software Maint SHI	149,970.15
3450-Misc Software Maintenance	5,000.00
3450-Maximus-MaxCars Software	1,700.00
3450-ERC Hardware maintenance	417,540.69
3450-Misc. Comp Maint & Repair	14,000.00
3450-ARTEMIS SW maint Paris funds to reimburse	94,109.40
3450-GARTNER SERVICES	39,000.00
3450-Fairfax IBML maintenance	101,661.99
3499-Reimbursement Oracle (discount)	(1,031.77)
3499-Reimbursement - cisco	(11,165.02)
34 - SUBTOTAL	4,106,731.82
35-Household and Security	
3520-Guard Services (MH Procg Cntr & Base 10)	278,000.00
3599-Reimb for Lib for Blind portion of guard bill paid in error	(3,744.08)
35 - SUBTOTAL	274,255.92

36-Professional Services	
3620 - Financial Asset Mgmt	660,000.00
3620 - Discount for FAMS	(3,655.20)
3620-PRWT Services Inc.	2,500,000.00
3620-TDEC	1,600,000.00
3620-TDEC	998.93
36 - SUBTOTAL	4,757,343.73
38-Other Services	
3810-Training	15,000.00
3820-Subscriptions	5,000.00
3830-Memberships (FTA-UA) (DISA-UA)	5,000.00
3856-Prompt Payment Interest	12.17
3859-Procurement Efficiency Assessment	8,000.00
3890-EAS Contract	5,000.00
3890-State Police Investigations	1,000.00
3890-DARM Record Storage	28,000.00
3890-Docusafe Record Storage	4,756.34
3890-Media storage-Recall	2,000.00
3890-Relocate MH Server rm to 50 W State	75,000.00
3890-IDENTRUST	714.00
3890-Allstate interiors teardown/reinstall furn at woolverton	7,200.00
3890-Misc Other Services rmc booth rental	2,000.00
38 - SUBTOTAL	158,682.51
39-Information Processing Internal	
3910-Information Processing Internal - OIT SAVI	70,000.00
39 - SUBTOTAL	70,000.00
APU 004	11,400,163.98



State of New Jersey

CHRIS CHRISTIE
Governor

DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
P.O. BOX 290
TRENTON, NJ 08625-0290

ANDREW P. SIDAMON-ERISTOFF
State Treasurer

KIM GUADAGNO
Lt. Governor

November 21, 2013

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough, Acting Director

SUBJECT: **Fiscal Year 2013 Summary Proxy Voting Report**

I. DOMESTIC PROXY VOTING SUMMARY

In fiscal year 2013, the Division of Investment (“Division”) voted 1,096 proxies of U.S. companies, compared with 1,105 proxies in fiscal year 2012 and 1,190 proxies in fiscal year 2011.

With 569 proxies, we did not oppose management on any issues. On the remaining 527 company proxies, we voted against management on 777 individual proposals. Exhibit II contains a categorized summary of the Division’s proxy votes where we voted against the recommendation of management.

Exhibit I outlines the Division's current guidelines for addressing key proxy issues. As previously discussed with the State Investment Council (the “Council”), the Division does not interpret these guidelines as rules that must be followed in every instance. We attempt to review each noteworthy and/or contentious proxy item individually and apply our business judgment to determine the position that is most advantageous to the funds as shareholder.

Shareholders continue to seek greater board accountability in the U.S. Issues which were at the forefront this proxy season included shareholder proposals regarding a retention period for stock awards, the right of shareholders to act by written consent, proration of accelerated vesting of equity awards, independent Chairman of the Board, and the annual election of Directors (all of which we support). Also in the forefront this proxy season was the ratification of executive compensation by advisory vote as required by the Dodd-Frank Act.

Retention Period for Stock Awards

As was the case last year, proposals that encourage stock retention by senior executives accounted for the majority of compensation-related proposals voted. Typically, these proposals call for companies to require executives to retain a specified amount (often 75%) of shares acquired through compensation plans for a specific period, generally extending past retirement. Despite the growing number of proposals, none that came to a vote during the 2013 proxy season garnered a majority of shareholder support, as was the case last year.

We supported all 39 domestic shareholder proposals in support of a retention period for stock awards. The proposals that we supported this fiscal year averaged 24% support, and drew more than 30% support at four firms (Actavis, McDonald's, Allstate, and Ventas).

Right of Shareholders to Act by Written Consent

The Division supports proposals calling for the right of shareholders to act by written consent. Although the total number of shareholder proposals for written consent rose to 25 in 2013 from 20 in 2012, support for these proposals has steadily declined (48% in 2011, 45% in 2012 and 40% in 2013). Institutional Shareholder Services ("ISS") states that the low average support for the written consent proposals may be partly explained by the fact that most of the companies targeted with written consent proposals already permitted shareholders to call special meetings.

We supported all 25 domestic shareholder proposals in support of shareholder action by written consent. The proposals that we supported this fiscal year averaged 40% support, and drew more than majority support at Duke Energy (67%) and Occidental Petroleum (53%).

Pro-rata Vesting of Equity Awards

The Division supports shareholder proposals for pro-rata vesting of equity awards. These proposals request that the company adopt a policy that in the event of a change in control, there will be no acceleration of vesting of any equity award granted to any senior executive. A change-in-control event should not provide an immediate automatic economic windfall, especially one that could incentivize executives to pursue transactions that are not in the best long-term interest of shareholders.

Combined, proposals for pro-rata vesting and retention of stock awards accounted for 73% of all compensation-related shareholder proposals voted this year.

We supported all 25 domestic shareholder proposals in support of pro-rata vesting of equity awards. The proposals that we supported this fiscal year averaged 34% support with strong support at Gannett (45%), Honeywell (44%), Quest Diagnostics (45%), and Raytheon (43%).

Independent Chairman/Separation of Chairman & CEO

The Division supports proposals calling for an independent Chairman or separation of the Chairman and CEO positions absent a compelling corporate case (such as a strong lead Director). The SEC and the Dodd-Frank Act now require public companies to disclose in the annual proxy the reasons why it has chosen the same person to serve as Chairman of the Board and CEO or why it has chosen different individuals to serve in those roles.

For the second consecutive proxy season, calls for independent Board leadership outpaced all other governance-related shareholder proposals, although average support for these proposals has retreated slightly to 31% in 2013 from 36% in 2012. In 2013, 44% of the S&P 500 companies have appointed a separate Board Chairman to serve alongside the CEO on the Board, as compared to 27% in 2004.

We supported 13 of the 49 proposals presented for an independent chairman. We supported management at the remaining 36 companies where they had established an independent lead director with clearly delineated and comprehensive duties, elected by and from among the independent board members. The 49 proposals that we voted this fiscal year received an average of 30% support, with the highest support at Vornado with 56%.

Election of Directors

The advent of “say on pay” continues to contribute to a significant decline in shareholder opposition to directors at U.S. firms. For the third consecutive year, the number of directors who failed to receive majority support continued to decline. According to ISS data, a total of just 44 directors failed to receive majority votes in 2013, compared with 91 in 2010.

We withheld votes for individual directors at 13 companies (American Axle, Cablevision Systems, FirstEnergy, Hewlett-Packard, iRobot, JPMorgan, Nabors Industries, Penn National, Safeway, Strategic Hotels, United States Steel, Vornado Realty and W.R. Berkley). Subsequent to these shareholder meetings where directors received a low level of shareholder support, certain directors resigned from the boards of Hewlett-Packard and J.P. Morgan. For the third consecutive year, nominees at Vornado received significant shareholder opposition for failure to act on shareholder-approved proposals from prior meetings, yet the Board members chose to remain on the Board.

Drivers of opposition to directors included substandard independence levels on the board or key committees, poor performance combined with problematic governance structure, and failure to respond to majority-supported shareholder proposals.

We supported the opposition slate of Directors at Hess and International Gaming Technology because at each company, the dissidents provided a compelling case for change, and we believed that the nominated candidates were more likely to effect that change than the current board. On

the eve of the shareholder meeting, Elliott Associates settled for three of the five seats it sought from Hess. Ader Investment Management won one of the three contested seats at International Gaming Technology.

Stock Options

We voted against 357 management proposals involving stock options, incentive or restricted stock plans. We continue to withhold support for the majority of option plans based on our policy guidelines which include voting against plans with greater than 5% dilution of outstanding shares, plans offering stock at a discount, plans that extend eligibility beyond employees and non-employee directors, and plans with accelerated vesting provisions. We do vote in favor of a portion of such plans that we believe are consistent with shareholder interest.

Advisory Vote on Executive Compensation and Vote Frequency

The Dodd Frank Act imposed a requirement for public companies to provide a non-binding shareholder advisory vote on executive compensation. Shareholder meetings on or after January 21, 2011 were required to hold votes on the compensation of executive officers (“say on pay”) and whether the “say on pay” vote should be held every one, two or three years (“say on frequency”). We only support proposals for an annual shareholder advisory vote on compensation.

According to ISS, the 2013 proxy season saw a 16% increase in the number of firms presenting shareholders with advisory votes on executive compensation. The increase was largely attributable to first-time votes for smaller companies (with a public float of less than \$75 million dollars), which had previously been granted a temporary exemption from such votes.

According to a report issued by ISS, the compensation plans at 52 companies failed to gain majority support from investors in fiscal 2013. The main reasons for investors voting against remuneration plans were pay for performance disconnect, poor pay practices, inappropriately high compensation and compensation committee responsiveness to investor concerns.

In fiscal 2013, we supported management compensation at 835 companies, and voted against executive pay at 93 companies.

II. INTERNATIONAL PROXY VOTING SUMMARY

In fiscal year 2013, the Division received proxies for 934 international meetings, the types of which include, but are not limited to, annual/ordinary meetings, extraordinary/special meetings and consent (to board action) meetings. The Division received 1,013 proxies in fiscal year 2012 and 913 proxies in fiscal 2011. The combination of multiple meeting types and the multiple

funds in the international portfolio resulted in the voting of multiple proxy ballots for some companies.

On occasion, the ballot is received the morning of or after the cutoff date for the vote. In addition, the level of securities regulation and disclosure requirements regarding voting items varies among countries. In some countries, items on the agenda are only disclosed at the meeting itself. Although we utilize ISS proxy research for clarification of issues, information for some of the international meetings or proposals is sometimes limited or unavailable. In certain share-blocking markets, we elected to abstain from voting.

Our strategy in voting international proxies is to attempt to apply the Division's voting policies on a global basis. With 561 proxies, we did not oppose management on any issues. On the remaining 373 company proxies, we voted against management on 749 individual proposals. Exhibit III contains a categorized summary of the Division's proxy votes where we voted against the recommendation of management.

Non-Salary Compensation

We voted against management on 276 proposals on non-salary compensation. Most of those involved stock option and/or restricted stock plans. It is our policy to vote against plans with a high dilution and immediate (or excessively short) vesting periods or those that can be accelerated in an anti-takeover situation. Other proposals related to severance payments, compensation ceilings, and bonuses.

Capitalization

We voted against 261 management proposals regarding capitalization which includes issuance of shares, cancellation of shares, stock splits, share buybacks, capital increases, bonds, warrants, and spin-offs. Our policy is to vote against pre-emptive rights issues (unless the issue states "with or without pre-emptive rights" and does not give the option to vote for "without pre-emptive rights"), issuance of excessive shares, and plans which give directors complete control of unissued shares.

Routine Business

The Division voted against the recommendation of management regarding the routine business on 105 proposals. Most of these votes were against amendments of Articles, Bylaws, Charter, etc. Other categories included voting against auditors for non-independence or high non-audit fees, or the election of committee members that are not majority independent.

III. PROXY VOTING PROCEDURES

Using ISS ProxyExchange, we receive and vote all proxies electronically. Our position on proxy proposals reflects the Council's longstanding policy that the Division examines each proxy issue on its own merits and votes consistent with the best financial interests of the fund's beneficiaries. While we utilize a set of proxy voting guidelines (Exhibit I), high profile issues are reviewed with the Director. The Director may contact the Chairman of the Council and/or individual Council Members for their views and guidance.

The Division does not retain the legal right to vote the proxies of shares on loan under our securities lending program. When we are aware of significant issues (e.g. pending mergers, etc.), we evaluate the cost/benefit of having the shares out on loan, and in some cases, restrict the shares from being loaned or seek to recall shares that were previously put out on loan.

The following pages include:

EXHIBIT I Division of Investment Guidelines on Key Proxy Issues

EXHIBIT II Domestic Proxy Voting Record -- Fiscal Year 2013

EXHIBIT III International Proxy Voting Record -- Fiscal Year 2013

EXHIBIT I

STATE OF NEW JERSEY
DIVISION OF INVESTMENT PROXY GUIDELINES

Board of Director Issues

ELECTION OF DIRECTORS - INDEPENDENCE

We favor diversity of experience on the Board and believe that corporate management should not dominate the Board. Votes should be cast in favor of shareholder proposals asking that boards be comprised of a majority of independent directors.

Votes should be cast in favor of shareholder proposals asking that board audit, compensation and nominating committees be comprised exclusively of independent directors.

In assessing whether a proposed outside director may be viewed as independent, with respect to building long-term shareholder value, the Division employs, as a guideline, extracts from the Council of Institutional Investors' "Definition of Independent Director".

Council of Institutional Investors—Guideline Extracts from Definition of Independent Director:

An independent director is someone whose only nontrivial connection to the corporation is that person's directorship.

A director will not generally be considered independent if he or she:

- a) has been employed by the corporation or an affiliate in an executive capacity;
- b) is an employee or owner of a firm that is one of the corporation's or its affiliate's paid advisors or consultants;
- c) is employed by a significant customer or supplier;
- d) has a personal services contract with the corporation or one of its affiliates;

- e) is employed by a foundation or university that receives significant grants or endowments from the corporation or one of its affiliates;
- f) is a relative of an executive of the corporation or one of its affiliates;
- g) is part of an interlocking directorate in which the CEO or other executive officer of the corporation serves on the board of another corporation that employs the director.

ELECTION OF DIRECTORS IN A PROXY CONTEST

In instances where two slates of directors are proposed, one by the corporation and the second by an independent group, we evaluate the competing groups and make a decision that best suits the financial interests of fund beneficiaries, as is required by State prudence law. Competing groups have equal access to the Division, including, where appropriate, a meeting between the top management of each group and the staff of the Division. In his discretion, the Director may consult with the Chair of the Council, who in turn may poll the other Council members.

ANNUAL DIRECTOR ELECTION/CLASSIFIED BOARDS

We vote in favor of the annual election of directors and support shareholder proposals to eliminate a classified (staggered) board.

MAJORITY VOTE TO ELECT DIRECTORS

We vote in favor of shareholder proposals requiring a majority affirmative vote for the election of directors. We favor the amendment of a company's governance documents (certificate of incorporation or bylaws) to provide that director nominees shall be elected by the affirmative vote of the majority of votes cast at an annual meeting of shareholders.

INDEPENDENT CHAIRMAN/SEPARATE CHAIRMAN/CEO

We support shareholder proposals calling for an independent chairman or separation of the chairman and CEO positions absent a compelling corporate case, such as a strong lead director, elected by and from the independent board members, with clearly delineated and comprehensive duties.

CUMULATIVE VOTING

Cumulative voting gives shareholders the option to cast all of their votes for a single board nominee or to apportion those votes among a selection of nominees in any combination desired, thereby maximizing the shareholders' voting power. Historically, the Division has not supported

proposals to create cumulative voting in the election of corporate directors on the theory that such voting would enable dissident directors to be more easily elected to corporate boards.

CONSTITUENCY REPRESENTATION ON BOARD

We oppose shareholder proposals requesting an employee or union representative on the Board.

DIRECTORS' LIABILITY AND INDEMNITY

The Division supports management proposals to limit director liability and provide indemnification in the event of successful lawsuits, except for fraud on the part of a director, to help ensure the availability of a pool of able directors.

STOCK OWNERSHIP REQUIREMENTS

The Division votes against shareholder proposals for stock ownership requirements for directors.

STOCK RETENTION

We support shareholder proposals requiring that executive officers retain a certain level of shares acquired through compensation plans for a specified period of time after leaving the company.

DIRECTOR TERM LIMITS

The Division routinely votes against shareholder proposals to limit directors' term of office.

Corporate Governance Issues

SELECTION OF AUDITORS

In considering the selection of auditors, the Division staff reviews the experience of the auditors, the possibility of conflict with the company and whether the auditors are subject to periodic rotation to insure independence.

NO CONSULTING BY AUDITORS

The Division supports shareholder proposals requesting that boards adopt policy that independent auditors provide only audit services to a company and not provide any other services.

REINCORPORATION OUTSIDE THE U.S.

The Division rejects company proposals for reincorporating in Bermuda, Switzerland and Ireland and supports proposals recommending reincorporating back to the United States.

ANTI-TAKEOVER MEASURES

The Division reviews these proposals on a case-by-case basis. Historically, we have measured the proposals against four main principles. First, that all shares should have equal voting rights, namely, one vote per share; second, all shareholders should be treated equally, which would prohibit "greenmail" and exclusionary tender offers; third, shareholders should be able to vote on issues which would have a material financial effect upon a corporation; and, fourth, executive compensation and the choice of outside auditors should be the responsibility of independent directors on the company's board.

Historically, we have generally supported the elimination of staggered boards of directors, a rescission of "poison pills," and the elimination of super majority voting requirements. We also support shareholder proposals intended to reverse shark repellents where consistent with the positions discussed herein.

SHAREHOLDERS' RIGHT TO CALL SPECIAL MEETING

We support a shareholder's right to call a special meeting.

SHAREHOLDER ACTION BY WRITTEN CONSENT

We support shareholder action by written consent.

ADJOURN MEETING TO SOLICIT VOTES

We vote against management proposals to adjourn meetings to solicit additional votes.

SHAREHOLDER RIGHTS PLAN

We support shareholder proposals to submit Shareholder Rights Plans to shareholders for a vote.

CONFIDENTIAL PROXY VOTING/INDEPENDENT VOTE TABULATION

We support shareholder proposals for the confidential voting and independent tabulation of proxies.

Capital Structure

INCREASE IN SHARES OUTSTANDING

We generally support increases in authorized shares of common stock by corporations, unless the number appears to be unduly excessive or the increased shares would further acquisitions or a financial recapitalization that we would prefer be referred to shareholders. We generally oppose the authorization of shares of preferred stock whose terms can be set at the discretion of the company's board of directors or management. This preferred stock is sometimes referred to as "blank check" preferred stock, and can be used as a shark repellent or to create special voting rights for favored shareholder groups.

PREEMPTIVE RIGHTS

From time to time shareholders propose that a corporation adopt the principle of preemptive rights, which requires that a company offer its existing shareholders new shares of publicly-offered stock so they may maintain their pro rata ownership in the company. This is a costly procedure that we generally oppose if there is a liquid market through which we may maintain our proportional position in most company stocks. On occasion, we may support preemptive rights proposals in the case of companies whose shares are very lightly traded and cannot be readily acquired in the marketplace.

MERGER/ACQUISITION

We review all proposed mergers/acquisitions on a case-by-case basis.

Executive Compensation

STOCK OPTION AND RESTRICTED STOCK PLANS

Stock option and restricted stock plans are reviewed on a case-by-case basis, applying general guidelines concerning acceptable terms and conditions of the plans.

Expensing

Options: We support the expensing of all equity based grants.

Price: One hundred percent of fair market value on date of grant.

Dilution: Generally, five percent dilution of outstanding shares will be acceptable for most companies. Higher thresholds will be considered for less mature companies where stock ownership may constitute the major attraction to the recruitment of capable managers.

Eligibility: Employees and non-employee Directors

Vesting: Preferable over a minimum of five years. We do not vote against plans with a shorter vesting period, except in the case of immediate vesting. We vote against plans that would accelerate vesting in a take-over situation.

Option Repricing (Underwater

Options): As a rule, plans that permit a reduction in the exercise price of existing options or the replacement of those options with new options or other equity awards, should be opposed, in the absence of unique circumstances.

Discretion: Plans that are not specific in their terms should be generally opposed.

We generally favor restricted stock programs over stock option incentive plans. We review the proposals on a case-by-case basis and if the plan does not result in excessive compensation and has a reasonable vesting period, we support the proposal.

PAY FOR PERFORMANCE

We review these proposals on a case-by-case basis to evaluate the selected financial performance criteria, prescribed benchmarks and minimum bonus payment criteria.

EMPLOYEE STOCK PURCHASE PLANS

We generally support plans with 15% discount open to all employees.

FREQUENCY OF SAY-ON-PAY VOTES

We support proposals for annual shareholder advisory votes on executive compensation.

ADVISORY VOTE ON EXECUTIVE COMPENSATION

We review management proposals to ratify executive compensation on a case-by-case basis evaluating whether the company has clear, comprehensive compensation disclosures; maintains an independent and effective compensation committee; avoids arrangements that risk “pay for failure”; and maintains appropriate pay-for-performance alignment, with emphasis on long-term shareholder value. The portfolio analyst and Director review instances where we intend to vote against management.

GOLDEN PARACHUTES

"Golden Parachutes" (severance packages usually triggered by a change in control of the company) are normally not subject to shareholder approval, but must be disclosed in the proxy material, and often become the subject of shareholder proposals calling for their rescission.

These are reviewed on a case-by-case basis, and where viewed as excessive, rescission is supported. In general, we would view anything more than three years' compensation as being excessive.

GOLDEN COFFINS

We generally support shareholder proposals prohibiting “Golden Coffins” (compensation to executives' beneficiaries based upon salary and bonuses that have not been earned prior to death, accelerating the vesting on equity grants, and egregious life insurance policies).

Other**MISCELLANEOUS SOCIAL ISSUES**

On proposals related to various social issues, which can only be loosely connected with corporate governance and which normally bear little relation to the companies' long-term economic

viability, we believe that, under present fiduciary law, our primary responsibility should be to vote solely in the financial interest of the beneficiaries of the pension funds. The establishment of standards for social behavior is appropriately the province of the law and is not the province of the staff of the Division. The Division tends to support management's position when it is consistent with existing law, including rulings of the U.S. Supreme Court. However, the Division has recognized that social issues may have significant financial impact, and, in the past, has supported certain proxy issues on the grounds that these issues could have material financial effects on the company and on shareholders.

ENVIRONMENTAL CONCERNS

Generally, we favor the spirit of environmental concern and support corporate practices that reflect sensitivity to furthering an ecologically sound environment. Environmental issues can impact a corporation's long-term financial performance and its image as a responsible corporate citizen. In this connection, the Division's selection of investment opportunities reflects the Council's stated policy..."the Council believes that good corporate citizenship enhances the value of a company, and, conversely, that poor corporate citizenship detracts from a company's value."

Environmental policies are well established by law and regulation at the Federal, State, and local levels, and each corporation must comply with these strictures or face the appropriate penalties. We believe that the law is the proper determinant of corporate responsibility, and that pledges which mandate that corporations go beyond the requirement of the law should be avoided. We do not support measures such as the establishment of specific target goals or the compilation of detailed scientific reports which can impose additional expenses and duplicate existing regulations.

CORPORATE ACTIVITY IN NORTHERN IRELAND

P.L. 1987, c. 177, requires the Director of the Division of Investment to initiate and support shareholder petitions or initiatives requiring adherence by corporations to standards set forth in the Act (i.e., the MacBride Principles), where appropriate, and consistent with prudent standards for fiduciary practice.

CORPORATE ACTIVITY IN SUDAN

P.L. 2005, c.162 requires the Director of the Division of Investment to divest of any foreign company that has an "equity tie" (as defined by the law) to the country of Sudan. We support shareholder proposals requiring a company to cease operations in Sudan or disclose any activities related to Sudan. We also support proposals requesting a human rights committee of the board when Sudan-related.

SMOKING-RELATED PROPOSALS

Generally, we do not support using the proxy voting process to proscribe the business of any corporation, if that business is permitted under existing law, given our fiduciary obligation to vote solely in the financial interests of the pension fund beneficiaries.

With respect to the smoking-related concerns, we believe the appropriate venues to assess and remedy these concerns exist with the State and Federal legislative bodies, the designated regulatory agencies, and judicial forums.

We normally support shareholder proposals barring advertising to youth.

REPORT ON CONTRIBUTIONS TO POLITICAL ACTION COMMITTEES

Generally, we vote against such proposals, as the information is a matter of public record. Existing law requires that PACs, political parties and candidates file reports with the FEC.

EXHIBIT II**DOMESTIC PROXY VOTING RECORD**

Of the 1,096 proxies voted in fiscal year 2013, the Division voted against the recommendation of management on 777 proposals at 527 company meetings. These 777 votes are summarized below.

1) **DIVISION VOTED “FOR” SHAREHOLDER PROPOSALS INVOLVING:**

39	Retention period for stock awards
25	Right of shareholders to act by written consent
25	Pro-rata vesting of equity awards
21	Annual election of directors
13	Independent Chairman
13	Majority voting in election of Directors
13	End supermajority voting
8	Shareholder right to call a meeting
7	Excessive severance pay agreements/death benefits
6	Anti-takeover measures (voting rights, rights plan, etc.)
4	Adopt proxy access
3	Routine environmental report
2	Performance-based awards
1	Adopt policy on succession planning
1	Confidential voting
<u>1</u>	Prohibit sales to Sudanese government
<u>182</u>	

2) **DIVISION VOTED “AGAINST” MANAGEMENT PROPOSALS INVOLVING :**

357	Stock option, incentive or restricted plans for Directors
93	Ratification of executive compensation by advisory vote
53	Directors (withheld or voted opposition slates)
39	Adjourn meeting to solicit votes
12	Transact other business at meeting
11	Anti-takeover measures (supermajority vote, rights plan, etc.)
11	Advisory vote on severance plans (golden parachutes)
10	Executive compensation advisory vote frequency

6	Stock Issuance
2	Merger
<u>1</u>	Repricing of options
<u>595</u>	

International Proxy Voting Record

Of the 934 proxies voted in fiscal year 2013, the Division voted against the recommendation of management on 749 proposals at 373 company meetings. These 749 votes are summarized below.

276	Non-salary compensation
261	Capitalization
105	Routine business
53	Director-related
25	Mergers/Reorganizations
22	Anti-takeover
<u>7</u>	Compensation
<u>749</u>	Total



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MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Capital City Redevelopment Corporation (the "CCRC") annual financial report represents our discussion of the CCRC's financial performance and an overview of the activity for the year ended June 30, 2012. This discussion and analysis designed to assist the reader in focusing on the significant financial issues and activities and to identify any significant changes in financial position. Please read it in conjunction with the CCRC's financial statements.

Overview of the Financial Statements

The annual report consists of two parts – management's discussion and analysis (this section) and the basic financial statements. The basic financial statements include the statement of net assets, statement of revenues, expenditures and changes in net assets, statement of cash flows and notes to the financial statements.

Basic Financial Statements

The basic financial statements are designed to provide readers with a broad overview of the CCRC's finances. The statement of net assets presents information of all of the CCRC's assets and liabilities, with the difference between the two reported as net assets. Net assets increase when revenues exceed expenditures.

The statement of revenues, expenditures and changes in net assets presents information showing how the CCRC's net assets changed during the fiscal year. All changes in net assets are reported as the underlying events occur, regardless of the timing of the related cash flows. Therefore, revenues and expenditures are reported in this statement for some items, such as loan interest receivable, that will result in cash flows in future years.

The statement of cash flows shows how cash was provided and used during the year and the net change in cash flow during the year.

The notes provide additional information that is essential to a full understanding of the data provided in the basic regulatory financial statements.



MANAGEMENT’S DISCUSSION AND ANALYSIS

Net Assets

	<u>June 30, 2012</u>
Current Assets	\$360,655
Total Assets	<u>\$ 360,655</u>
Current Liabilities	
Net assets – restricted	<u>360,655</u>
Total Liabilities and net assets	<u><u>\$ 360,655</u></u>



STATEMENT OF REVENUES EXPENDITURE AND CHANGES IN RESTRICTED NET ASSETS
Year Ended June 30th, 2012

Revenues

Interest Income (loans)	\$ 443
Interest Income (money market)	<u>260</u>

Total Revenues 753

Operating Expenditures

Salaries and fringe benefits	90,925
TDA-administrative support	5,500
Professional services	6,700
Telephone	4,033
OTT	5,534
Printing and office supplies	1,863
Maintenance Building and Grounds	801
Postage	1,800
Encumbrance Cancelled	(4,166)
Employee Advisory Service	0
Travel	0
Insurance	<u>2,904</u>

Total operating expenditures 115,894

Decrease in restricted net assets (115,141)

Net assets restricted, beginning of year 475,796

Net assets restricted, end of year 360,655



STATEMENT OF CASH FLOWS

Year Ended June 30th, 2012

Cash Flows from Operating Activities

Cash received from loan repayments	\$ 8,824
Interest on Investments	260
Cash payments for operating expenses	<u>(297,100)</u>
Net cash used in operating activities and net decrease in cash	(288,016)
Cash and equivalents, beginning of year	<u>452,441</u>
Cash and equivalents, end of year	\$ 164,425
Cash Flows from operating Activities	
Change in restricted net assets	\$ (115,141)
Changes in operating assets and liabilities	
Loans receivable	8,331
Adjustments Carry Forward	(181,206)
Accounts payable	<u> </u>
Net cash used in operating activities	<u>\$ (288,016)</u>



CONTACTING THE CCRC'S FINANCIAL MANAGEMENT

This financial report is designed to provide New Jersey citizens, investors, and creditors with a general overview of the CCRC's finances. If you have questions about this report or need additional information, you can contact the Capital City Redevelopment Corporation office at 135 West Hanover Street, 2nd Floor, P. O. Box 203, Trenton, New Jersey 08625.



INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Capital City Redevelopment Corporation
Trenton, New Jersey

We have audited the accompanying statement of net assets of the Capital City Redevelopment Corporation (the "CCRC") as of June 30, 2012, and the related statements of revenues, expenditures and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the CCRC's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the regulatory basis financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the CCRC's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Capital City Redevelopment Corporation as of June 30, 2012, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.



In accordance with *Government Auditing Standards*, we have also issued our report dated June 30, 2013 on our consideration of the Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance.

That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis on pages 2 and 3 is not a required part of the basic combined financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However; we did not audit the information and express no opinion on it

Yusufali & Associates, LLC

September 30th, 2012
Short Hills, New Jersey

FINANCIAL STATEMENTS

STATEMENT OF NET ASSETS

Year Ended June 30th, 2012

ASSETS

Current Assets

Cash \$ 360,655

Total Current Assets 360,655

Total Assets \$ 360,655

LIABILITIES AND NET ASSETS

Current Liabilities

Net assets - restricted \$360,655

Total Liabilities and Net Assets \$360,655

The Notes to Financial Statements are an integral part of this statement

Yusufali & Associates, LLC

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55 Addison Drive Short Hills NJ 07078



STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN
NET ASSETS

For the Year Ending June 30, 2012

Operating Revenues

Interest income – loans	\$ 493
Interest income – money market	260

Total operating revenues	753
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Operating Expenditures

Salaries and fringe benefits	90,925
TDA-administrative support	5,500
Professional services	6,700
Telephone	4,033
OTT	5,534
Printing and office supplies	1,863
Maintenance Building and Grounds	801
Postage	1,800
Encumbrance Cancelled	(4,166)
Employee Advisory Service	0
Travel	0
Insurance	2,904

Total operating expenditures	115,894
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Decrease in restricted net assets	(115,141)
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Net assets restricted, beginning of year	475,796
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Net assets restricted, end of year	360,655
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STATEMENT OF CASH FLOWS

Year Ended June 30th, 2012

Cash Flows from Operating Activities

Cash received from loan repayments	\$ 8,824
Interest on Investments	260
Cash payments for operating expenses	<u>(297,100)</u>
Net cash used in operating activities and net decrease in cash	(288,016)
Cash and equivalents, beginning of year	<u>452,441</u>
Cash and equivalents, end of year	\$ 164,425
Cash Flows from operating Activities	
Change in restricted net assets	\$ (115,141)
Changes in operating assets and liabilities	
Loans receivable	8,331
Adjustments Carry Forward	(181,206)
Accounts payable	<u> </u>
Net cash used in operating activities	<u>\$ (288,016)</u>



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NOTES TO FINANCIAL STATEMENTS

1. Organization

The Capital City Redevelopment Corporation (the "CCRC") was created by the New Jersey State Legislature in 1987 to promote the revitalization of the Capital City District through the initiation of projects, encouragement of private development, restoration and improvement of historic areas, sites and structures, and formulation and implementations of programs and strategies which will enhance the vitality of the district as a place to live, visit, work and conduct business and thereby help restore the prominence and prestige of the capital area. At its inception, the CCRC received State appropriations of \$500,000 for its General Administrative Fund and \$4,500,000 for its Loan and Grant Fund.

2. Summary of Significant Accounting Policies

Basis of Accounting

The financial statements of the CCRC have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America applicable to governmental proprietary-type funds. Revenues are recognized when earned and expenses are recognized when incurred.

The Governmental Accounting Standards Board ("GASB") is responsible for establishing generally accepted accounting principles for state and local governments. The Corporation elected alternative No. 2 of GASB No. 20, as amended by GASB No. 34, which states that governmental entities using proprietary type accounting must follow all GASB pronouncement and all Financial Accounting Standard Board Statements and Interpretations and APB Opinions, no matter when issued, except those that conflict with GASB pronouncements.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Cash



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Cash consist of deposits held in the State of New Jersey Cash Management Fund and operating account balances.

Loans Receivable and Allowance for Uncollectible Loan

Loans are reported at principal amounts outstanding, less unearned income, including net deferred fees, and the reserve for loan losses. Interest is calculated at 8%, compounded annually.

An allowance for uncollectible accounts is provided based on management's evaluation of potentially uncollectible loans and loan interest receivable.

Concentration of Risk

The CCRC maintains cash balances with financial institutions which, at times, exceed amounts insured by the Federal Deposit insurance Corporation. Management monitors the soundness of these institutions and considers the CCRC's risk negligible. Cash balances are insured by the Federal Deposit insurance Corporation up to \$250,000 (through December 31, 2013) for each account.

Income Taxes

As a public body, the CCRC is exempt from both federal and state taxes under existing statutes.

Deficiencies, Liquidity and Management's Plan

At June 30, 2012, the CCRC had a deficiency of revenues over expenses of approximately \$115,141. The CCRC has limited sources of revenue and future operating deficits are likely to continue into future periods, based on current trends. The CCRC is not expecting any funding to come through at this time to be distributed for loans and grants. The CCRC continues to reach out to the Governor's office for funding to recapitalize the organization. Additionally members of the board are also in negotiation with the City and County regarding funding for proposed projects that would be funded in part by CCRC.

The CCRC is considering options that would allow the organization to function more effectively as an economic development entity, such as the ability to issue bonds, to procure services and to collect fees and consequently, allow the organization to function as other state economic development and redevelopment entities do. This would potentially generate positive cash flow



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from operations and expanding various project opportunities enable the CCRC to further its mission.

The CCRC is also considering a number of financing mechanisms to recapitalize the organization including, but not limited to, primary developer and co-developer opportunities that have the potential to generate developer's fees; fee for service for the issuance bonds; use the value of the state conveyed properties or leasehold interest as collateral for a financing mechanism similar to that of bond; State appropriation requests; and interest on loans.

3. Cash and Cash Equivalents

New Jersey state statutes permit the deposit of public funds into the State of New Jersey Cash Management Fund or into institutions located in New Jersey that are insured by the Federal Deposit Insurance Corporation (the "FDIC") or by any other agencies of the United States that insure deposits. New Jersey statutes require public depositories to maintain collateral for deposits of public funds that exceed insurance limits as follows:

- a. The market value of the collateral must equal 5% of the average daily balance of public funds; or
- b. If the public funds deposited exceed 75% of the capital funds of the depository, the depository must provide collateral having a market value equal to 100% of the amount exceeding 75%.

All collateral must be deposited with the Federal Reserve Bank, the Federal Home Loan Bank Board, or a banking institution that is a member of the Federal Reserve System and has capital funds of not less than \$25,000,000.

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government may not be able to recover deposits that are in the possession of an outside party

The New Jersey Cash Management Fund is a pooled investment fund and is guaranteed by the State of New Jersey. As such, deposits in the New Jersey Cash Management Fund are not subject to credit risk or custodial credit risk

Cash balances at June 30, 2012 was: \$360,655

4. Loans Receivable



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There was no loans receivable as of June 30th, 2012.

5. Subsequent Events

The CCRC has evaluated subsequent events occurring after the balance sheet date through the date of November 30th, 2012, which is the date the financial statements were available to be issued. Based on this evaluation, the CCRC has determined that no subsequent events have occurred which require disclosure in the Financial Statements.



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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

To the Board of Directors
Capital City Redevelopment Corporation
Trenton, New Jersey

We have audited the financial statements of the Capital City Redevelopment Corporation (the "CCRC") as of June 30, 2012 and have issued our report thereon dated September 30th, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States, and audit requirements prescribed by the State of New Jersey, Department of the Treasury.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the CCRC's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the regulatory basis financial statements, but not for the purpose of expressing an opinion on the effectiveness of the CCRC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the CCRC's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, which that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be significant deficiencies or material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the CCRC's financial statements are free of material misstatement we performed tests of its compliance with certain provisions of



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laws regulations and contracts, noncompliance with which could have a direct and material effect on the determination of financial statements amounts. However providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards. This report is intended solely for the information and use of the audit committee, board of directors, management, others within the CCRC and the State of New Jersey and is not intended to be and should not be used by anyone other than these specified parties

Yusufali & Associates, LLC

September 30th, 2013
Short Hills, New Jersey