

A Performance Audit of Selected Fiscal and Operating Practices: Educational Services Commission of New Jersey

AUDIT DIVISION REPORT



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Audit Authority

We performed this audit pursuant to the State Comptroller's authority set forth in N.J.S.A. 52:15C-1 to -24. We conducted this audit in accordance with Generally Accepted Government Auditing Standards (GAGAS)¹ applicable to performance audits. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

The Educational Services Commission of New Jersey (ESCNJ or Commission) is located in Middlesex County. The Commission provides educational programs and services, transportation services, and cooperative purchasing to its members. The Commission offers services to over 700 school districts and government agencies. ESCNJ also operates six schools that enroll approximately 800 students with autism, multiple disabilities, and at-risk behaviors. In addition, the Commission manages a coordinated transportation service, transporting over 14,000 students on 700 different bus routes across the state. The Commission's mission is to provide statewide excellence to students in partnership with New Jersey school districts and coordinate cost-efficient purchasing opportunities for educational institutions and municipalities to limit the tax burden on New Jersey residents.

The ESCNJ Cooperative Pricing System (Co-op), established in 1977, has grown to become one of the largest cooperative pricing systems in New Jersey. The Co-op develops bid specifications and advertises bid opportunities on behalf of its members. The Co-op's website states that this service saves its members time and money by not having to conduct research or develop and advertise bid specifications for their individual needs. Another potential advantage of cooperative purchasing is that it may lower prices through the aggregation of its members' purchasing power and economies of scale.

ESCNJ is governed by a Board of Directors (Board) that consists of 31 members. The Board members include one representative from each Middlesex County school district and additional members representing boards of education outside Middlesex County. All Board members are superintendents or board of education members who are appointed by their resident school district. The ESCNJ Superintendent of Schools is a non-voting member of the Board.

Educational Service Commissions (ESCs) were initially authorized by a 1968 law that was most recently amended in 1992. N.J.S.A. 18A:6-51 to -70 (ESC Law). That law, as amended, addresses the establishment of ESCs; board membership, elections, and meetings; powers and duties; superintendent or chief school administrator requirements; naming of ESCs; annual budget preparation, adoption, and funding; approval for services provided and contracts terms; membership withdrawal; personnel employment, rights, and benefits; funds and grants contracting, receiving, and administration; bookkeeping, accounting systems, and audit

¹ UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, GOVERNMENT AUDITING STANDARDS 2018 REVISION, (Apr. 2021), ("GAGAS" or "Yellow Book"), <https://www.gao.gov/assets/gao-21-368g.pdf>.

requirements; enlargement and alteration of the purpose for which an ESC was formed; and application for admission of new members.

The chart below highlights the ESCNJ's primary sources of revenue and expenditures within the general fund for fiscal years (FYs) 2020 through 2023.

ESCNJ General Fund				
	(Figures in thousands)			
Revenues:	FY 2020	FY 2021	FY 2022	FY 2023
Tuition from Districts	\$ 37,660	\$ 35,461	\$ 46,914	\$ 50,381
Transportation Fees	34,957	23,765	41,877	54,984
Services Provided to Districts	22,531	21,562	29,569	32,667
Other	478	178	451	1,127
State Sources	5,344	6,808	8,305	8,504
Total Revenue	\$ 100,969	\$ 87,775	\$ 127,116	\$ 147,663
Expenditures:	FY 2020	FY 2021	FY 2022	FY 2023
Instruction	\$ 13,148	\$ 11,874	\$ 15,366	\$ 16,300
Other Support: Special	10,472	10,446	13,861	14,516
Student Transportation	34,813	24,272	42,224	55,525
Employee Benefits	13,550	16,878	20,018	23,061
Other Expenses	13,270	10,921	14,573	15,205
Capital Outlay	971	396	312	903
Total Expenditures	\$ 86,223	\$ 74,786	\$ 106,354	\$ 125,511
Revenues over Expenditures	14,746	12,989	20,762	22,152
Other Financing Sources (Uses)	(12,227)	(6,768)	(5,043)	(7,299)
Fund Balance, July 1	30,323	32,842	39,062	54,781
Fund Balance, June 30	32,842	39,062	54,781	69,634

Our audit found that ESCNJ has been operating at a surplus² since at least FY 2018 and that the general fund balance³ has continued to grow year over year. At the end of FY 2019, the general fund balance was approximately \$30.3 million, a growth of 11 percent from the previous year. The general fund balance continued to increase by 8 percent in FY 2020, 19 percent in FY 2021, 40 percent in FY 2022, and 27 percent in FY 2023, resulting in a general fund balance of \$69.6 million by the end of FY 2023.

² For this report, a surplus occurs when revenues exceed expenditures and other adjustments in a fiscal year.

³ Fund balance reports the accumulated annual surpluses and deficits of an organization.

Executive Summary

Our audit identified weaknesses with certain fiscal and operating practices. Specifically, our audit found that the Commission:

- Failed to properly procure health insurance coverage, health insurance brokerage services, and certain service contracts;
- Failed to comply with statutory requirements regarding notification of contracts valued in excess of \$2.5 million to the Office of the State Comptroller;
- Failed to comply with statutory requirements as a lead agency for a cooperative pricing system;
- Failed to conduct annual cost-benefit analyses for health insurance costs leading to a potential missed opportunity to save millions in healthcare costs;
- Paid \$343,000 more in medical claims than was billed in FY 2023; and
- Maintained and continues to grow an unreasonably large general fund balance.

The Commission should take appropriate action to improve its current practices, revise and develop policies and procedures, and increase management oversight in order to achieve greater operational effectiveness and to comply with applicable laws and its own internal policies and procedures.

We make 12 recommendations to improve the Commission's operations and its compliance with applicable statutes and regulations.

In addition to the weaknesses listed above, during our audit we observed areas in which ESCs lack oversight requirements. For example, ESCs are not required to conduct long range facility planning or annual budget reviews, although those activities are required for school districts by N.J.S.A. 18A:7G-4 and N.J.A.C. 6A:23A-8.1. The different treatment by law related to the oversight of ESCs increases the potential for fraud, waste, and abuse in ESCs and results in ESCs receiving less scrutiny than other school districts.

Audit Objectives

The objectives of our performance audit were to review the Commission's controls over selected fiscal and operating practices and to assess its compliance with laws and regulations.

Audit Scope

The period July 1, 2020 through June 30, 2023

Audit Methodology

To accomplish our objectives, we reviewed relevant statutes, regulations, Commission policies and procedures, collective bargaining agreements (CBAs), financial records, Board meeting

minutes, and other supporting records. We also interviewed certain personnel to understand their job responsibilities, overall operations, and ESCNJ's internal controls.

GAGAS requires auditors to plan and perform audit procedures to assess internal control when internal control is determined to be significant to the objective. The Government Accountability Office's Standards for Internal Control in the Federal Government, or "Green Book,"⁴ provides a framework for internal control systems for public entities. The Green Book establishes five components of an internal control system: control environment, risk assessment, control activities, information and communication, and monitoring. The five components include 17 principles that support the effective design, implementation, and operation of an internal control system.

GAGAS requires written communication of deficiencies in internal control that warrant the attention of those charged with governance. Deficiencies significant to our audit objectives are included in this report. We communicate internal control deficiencies that are not significant to our audit objectives through separate correspondence to those charged with governance.

As part of our review, we selected a judgmental sample of records. Our samples were designed to provide conclusions about the validity of the sampled transactions, the adequacy of internal controls, and compliance with applicable laws, regulations, policies, and procedures. Because we used a non-statistical sampling approach, the results of our testing cannot be projected over the entire population of like transactions or contracts.

Audit Findings and Recommendations

Services Contract Procurement

Objective

To determine whether the Commission properly procured and awarded contracts for professional services and extraordinary unspecifiable services (EUS) under the Public School Contracts Law (PSCL).

Findings

The Commission was unable to provide evidence that it obtained required compliance documentation from vendors awarded professional services contracts.

The Commission's procurement of health insurance coverage and health insurance brokerage services did not comply with any of the requirements for the procurement of insurance and insurance services under the PSCL.

⁴ UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, STANDARDS FOR INTERNAL CONTROL IN THE FEDERAL GOVERNMENT, (SEPT. 2014) ("Green Book"), <https://www.gao.gov/assets/gao-14-704g.pdf>.

The Commission was unable to provide a contract detailing the scope of work for its public affairs consulting firm. Invoices from the firm did not contain sufficient detail to allow for a transparent review of work performed.

Criteria

The PSCL requires public advertising for bids for the procurement of goods or services when costs exceed the bid threshold of \$44,000. Certain contracts, however, may be awarded without public advertising.⁵ For example, the PSCL provides for the award of a contract for professional services.⁶ If the services meet the definition of professional services, a contract may be awarded without public bidding by resolution that states the reasons for the governing body's action.⁷ The PSCL also provides for an exception to bidding for the procurement of insurance, including the purchase of insurance coverage and consultant services.⁸ This exception, however, must comply with the requirements for EUS. Before awarding a contract under the EUS exception, an official of the contracting unit, typically its purchasing agent, must file a certificate with the governing body describing the informal solicitation of quotes and why the contract meets the EUS exception.⁹ For both the professional services and EUS exceptions, after the contract has been awarded, the contracting unit must publish a notice of the award in its official newspaper, including details of the nature, duration, service, and amount of the contract.

By state law, vendors are required to submit the following compliance documents prior to entering into contracts with a public entity (Compliance Documents):

- Disclosure of ownership interests required by N.J.S.A. 52:25-24.2;
- Political contribution disclosure required by N.J.S.A. 19:44A-20.26;
- Certification regarding investment activities in Iran required by N.J.S.A. 52:32-55;
- Certification regarding prohibited activities in Russia or Belarus required by N.J.S.A. 52:32-60.1;
- Evidence of compliance with New Jersey's affirmative action and equal employment laws required by N.J.S.A. 10:5-31 *et seq.* and N.J.A.C. 17:27; and
- Possession of a business registration certificate required by N.J.S.A. 52:32-44.

Lobbying occurs when there is an attempt to influence legislation, regulations, or governmental processes.¹⁰ In a 2009 report¹¹ issued by our office, we shed light on the lack of transparency regarding government entities in New Jersey using public funds to hire lobbying firms to lobby other government entities within state government (e.g. Legislature, Executive Branch agency).

⁵ N.J.S.A. 18A:18A-5.

⁶ Defined at N.J.S.A. 18A:18A-2(h).

⁷ N.J.S.A. 18A:18A-5(a)(1).

⁸ N.J.S.A. 18A:18A-5(a)(10).

⁹ N.J.A.C. 5:34-2.3.

¹⁰ N.J.S.A. 52:13C-20.

¹¹ The Use of Public Funds to Lobby New Jersey State Government (March 26, 2009), available at: https://www.nj.gov/comptroller/news/docs/2009_lobbying_report.pdf.

Methodology

- Interviewed personnel responsible for procurement;
- Reviewed purchasing policies and procedures as well as Board meeting minutes for information about various service providers;
- Examined the PSCL as well as other relevant statutes and regulations;
- Requested procurement documentation for insurance and insurance services contracts;
- Requested procurement documentation for certain contracts awarded under the professional services exception; and
- Requested procurement documentation for ESCNJ's public affairs consulting firm.

Audit Results

We identified 21 vendors providing insurance, insurance services, professional services, or public affairs consulting services to ESCNJ. These vendors received compensation of approximately \$16.8 million in FY 2022. We judgmentally selected seven vendors that were paid a total of approximately \$14.6 million to determine compliance with the PSCL and other procurement requirements.

Insurance and Insurance Services

The Commission self-insures its employee medical and prescription benefits. We reviewed four vendors providing insurance or insurance services to the Commission. Our review included a vendor who processes and administers employee medical benefits, a prescription benefits provider, a dental insurance carrier, and a risk management consultant. In FY 2022, the annual value of each vendor's compensation exceeded the \$44,000 bid threshold. We requested documents for the procurement of health insurance vendors, as well as for the brokerage services and risk management services vendors. The Commission could not provide sufficient procurement documentation to demonstrate that ESCNJ followed any of the acceptable methods of procuring insurance or insurance services. The Commission violated the PSCL by failing to obtain or maintain Compliance Documents for its vendors. In addition, the Commission was not able to demonstrate that it obtained price quotes for its health insurance, health insurance brokerage services, and risk management services. This fundamental failure to obtain price quotes resulted in a lack of competition and reduced the likelihood that the Commission would obtain the best price for services.

The Commission was unable to provide resolutions awarding contracts to the broker as the health benefits agent, the health insurance carriers, or the risk management consultant. We have noted in prior reports that insurance brokers face a conflict of interest related to their own financial incentive to recommend coverage options that provide greater compensation to themselves over less expensive options that provide lesser or no compensation to the broker, as is the case for the State Health Benefits Program (SHBP) and the School Employees' Health Benefits Program (SEHBP). The Commission could mitigate the effect of these conflicts of interest by obtaining competition for insurance brokerage services and by seeking proposals for a flat fee or fixed rate contract.

Professional Services

We reviewed professional services contracts for an occupational therapy/physical therapy services vendor that received approximately \$3.6 million in FY 2022. Although the services met the definition of professional services, and the Board awarded the professional services contract by resolution, the Commission was unable to provide most of the required Compliance Documents for the vendor. In addition, the Commission failed to comply with the requirements of the PSCL because it did not publish a notice of the award including the vendor name, services to be provided, contract amount, duration, and that the resolution and contract are on file and available for public inspection in its official newspaper. This omission violated the transparency requirements of the PSCL. Because there was no competition, we were unable to determine if the Commission's contracts provided the best value.

Public Affairs Consultant

ESCNJ contracted with a vendor that provided lobbying services to which ESCNJ paid \$42,000 in FY 2022. The Commission was unable to provide a contract for our review. The absence of a contract detailing the timing and extent of services to be provided limits transparency and accountability.

Furthermore, we reviewed the lobbying firm's monthly invoices. The invoices only specified a retainer for the month invoiced and did not provide an itemized description of the actual services rendered. Unlike hourly billing, a retainer is charged regardless of whether the lobbyist has done any activity on behalf of the Commission. By requiring the vendor to document the activity/hours on the invoice, even if it is still charged as a retainer, the Commission would have data to evaluate whether the yearly retainer contract is reasonable or necessary, and to evaluate whether it should seek to convert the contract to an hourly or fixed-rate contract. The lack of specificity of the lobbying firm's invoices may be indicative of wasteful spending. Vague parameters surrounding the retention of such a firm by the Commission undermines transparency by denying the public the opportunity to see how ESCNJ spends taxpayer dollars to influence state policy.

Cause

The Commission failed to follow mandatory requirements of the PSCL in its procurement of various services, including health insurance, health insurance brokerage services, and risk management services. Furthermore, the Commission did not maintain sufficiently detailed documentation to substantiate the necessity of retaining a lobbying firm.

Effect/Potential Effect

The Commission's noncompliance with the PSCL resulted in improperly awarded contracts and a lack of transparency in spending.

Recommendations

1. Maintain all documentation from the contracting process including Request For Proposals (RFP), responses to RFPs, evaluation reports and scoring sheets, newspaper advertisements, Compliance Documents, and contracts.

2. Comply with the requirements of the PSCL for the procurement of insurance and insurance-related services.
3. In an effort to increase transparency and accountability, the services anticipated to be rendered by the lobbying firm must be incorporated into a written contract. The Commission should maintain a record of work performed under the contract.

State Comptroller Notification

Objective

To determine whether the Commission notified the Office of the State Comptroller (OSC) regarding contracts that exceeded OSC's threshold amounts of \$2.5 or \$12.5 million during the audit period.

Findings

The Commission did not notify OSC regarding contracts and cooperative purchasing procurements exceeding the \$2.5 million or \$12.5 million thresholds in accordance with N.J.S.A. 52:15C-10.

The Commission did not estimate the value of its Co-op procurements in accordance with N.J.A.C. 5:34-7.9(e) and N.J.A.C. 17:44-3.2.

Criteria

Contracting units are required to provide notice to OSC no later than 20 business days *after* the award of a contract involving consideration or an expenditure of more than \$2.5 million but less than \$12.5 million (Post-Award Notification).¹² In addition, contracting units must notify OSC as early as practicable, but no later than 30 days *before* advertisement, negotiation, or solicitation of a contract that is expected to equal or exceed \$12.5 million (Pre-Advertisement Notification). N.J.A.C. 17:44-3.2 requires contracting units to determine the estimated value of contracts if the exact value is uncertain. A lead agency of a cooperative pricing system, such as the Commission, must also comply with N.J.A.C. 5:34-7.9(e), which provides additional requirements related to estimating the value of cooperative contracts.

Methodology

- Interviewed Commission personnel responsible for procurement and purchasing Co-op operations;
- Reviewed the Commission's Board meeting minutes for awarded contracts in excess of OSC's statutory threshold;
- Reviewed FYs 2021 and 2022 vendor histories for vendors paid in excess of OSC's statutory threshold;

¹² These amounts were established in accordance with N.J.S.A. 52:15C-10(d) by notice published in the New Jersey Register. 52 N.J.R. 1443(b) (July 20, 2020).

- Reviewed FYs 2021 and 2022 purchasing Co-op vendor-reported sales reports; and
- Estimated Co-op vendor payments in excess of OSC's statutory threshold.

Audit Results

Since OSC's creation in 2008, ESCNJ has never submitted a contract to OSC pursuant to N.J.S.A. 52:15C-10. This noncompliance has persisted despite a 2017 letter from OSC's Procurement Division reminding all ESCs of their statutory responsibility for contract submission. In a separate letter to ESCNJ dated May 6, 2021, OSC requested information about contracts awarded since January 1, 2019 valued at \$500,000 or more. Based on the information provided, we notified ESCNJ on August 30, 2022 of potential violations involving noncompliance of the OSC contract notification requirements. We found that during our three-year audit period of FY 2021 to FY 2023 ESCNJ failed to notify OSC of any contracts. During FY 2021 and FY 2022, we estimate that 43 contracts should have been provided to OSC. Subsequent to the issuance of our draft report, ESCNJ began submitting contracts to OSC for review.

ESCNJ Internal Purchases

Our review of FYs 2021 and 2022 vendor expenditures, Board meeting minutes, and other contract documentation revealed three contracts exceeding \$2.5 million that were not reported to OSC as required by N.J.S.A. 52:15C-10. These included two one-year contracts for an occupational therapy/physical therapy vendor paid \$3 million in FY 2021 and \$3.6 million in FY 2022 and another contract for a construction vendor paid a combined \$5.1 million in FYs 2021 and 2022.

ESCNJ's Cooperative Pricing System

As part of the services provided to its members, ESCNJ is the lead agency for a cooperative pricing system, which is an arrangement in which a contracting unit, such as the Commission, advertises for bids and awards a master contract to a successful vendor for its own quantities and the estimated quantities of its registered members.¹³ The Co-op develops and advertises bid specifications and requests for proposals to procure goods and services for its members. The members can utilize the prices obtained by the Co-op in the master contract and avoid the costs of administering the procurement themselves. ESCNJ receives a commission from vendors for purchases made by its Co-op members, typically at two percent of each dollar spent. ESCNJ tracks revenues of all Co-op contracts through vendors' quarterly reports. We used these reports to estimate whether any contracts exceeded OSC reporting thresholds based upon the revenue ESCNJ received from its Co-op vendors.

We calculated vendor sales for a two-year period by combining FY 2021 and FY 2022 vendor-reported sales for active Co-op contracts. We estimated that 43 contracts with a combined value of more than \$900 million might have required notification to OSC. Because of ESCNJ's failure to properly estimate quantities of goods or services desired from its registered members before issuing a solicitation as required by N.J.A.C. 5:34-7.9(e), we cannot know with certainty the number of contracts that exceeded OSC's review thresholds. However, when reviewing the sales volume associated with these contracts, we found that of the 43 contracts:

¹³ N.J.A.C. 5:34-7.2.

- Sales made under 24 contracts were worth between \$2.5 million and \$12.5 million. These contracts likely should have been the subject of a notice within 20 business days after the contract award.
- Sales made under 19 contracts were worth more than \$12.5 million. These contracts likely should have been the subject of a notice to OSC, as early as practicable, but no later than 30 days before advertisement, negotiation, or solicitation of a contract.

In addition, we reviewed a Co-op request for a bid ESCNJ issued in FY 2022 with an estimated value of \$11.7 million. ESCNJ was required by N.J.S.A. 52:15C-10(a) to provide a Post-Award notice, but failed to do so. Our review identified deficiencies including:

- The request for bid contained an estimated contract value of \$11.7 million based on previous sales. However, this “estimated value” is not compliant with N.J.A.C. 5:34-7.9(e), which provides that:

[t]he lead agency of a cooperative pricing system shall include in the specifications lead agency requirements, stated in definite quantities; and registered member requirements, stated as individual estimated needs.

1. The specification shall list the registered members who have submitted estimates, their delivery address, their estimated maximum quantities and other relevant information to permit the bidder to understand what is potentially involved.

None of this required information was present in the bid specifications.

- The request for bid stated that “[a]ll cooperative pricing awards are open to current and future ESCNJ Members to utilize as they deem appropriate.” This is inconsistent with N.J.A.C. 5:34-7.12, which states that “[a] registered member of a cooperative pricing system which has not submitted estimates to the lead agency before the advertisement for bids may participate in the resulting contract for that particular item only with the prior written approval of the lead agency and the contractor.” This also applies to members that join the Co-op after the contract is awarded.
- Various sections of the request for bid refer to awarding a contract per ESCNJ’s “best interest,” which is an incorrect award standard. Both the PSCL¹⁴ and cooperative purchasing rules¹⁵ require a contract to be awarded to the lowest responsible bidder.

Cause

The Commission failed to comply with notices from OSC’s Procurement Division and lacked policies and procedures to facilitate compliance with OSC’s notice requirements for contracts valued at \$2.5 million or more and pre-advertisement review requirements for contracts valued at \$12.5 million or more. The Commission also failed to estimate the value of the contract before bidding as required by N.J.A.C. 5:34-7.9(e) and N.J.A.C. 17:44-3.2.

¹⁴ N.J.S.A. 18A:18A-4.

¹⁵ N.J.A.C. 5:34-7.10.

Effect/Potential Effect

In addition to circumventing OSC's role in auditing and monitoring the process of soliciting proposals and awarding contracts under N.J.S.A. 52:15C-10(a), the Commission and taxpayers are not obtaining the benefit of OSC's review and guidance to ensure compliance with applicable procurement laws and regulations. Also, ESCNJ's failure to properly estimate usage of the goods or services by itself and its members may result in the Co-op not obtaining the best pricing.

Other Relevant Information

One way for government units to document cost savings is to compare the State's current contract pricing with the prices available through master contracts awarded by the Co-op. To determine the lowest cost available to a Co-op member, we performed an analysis to ascertain if the Commission's contract pricing was comparable to the State's. Our analysis compared individual items from a major office supply vendor's contract with the Commission to items from that vendor's contract with the State.

Although many of the items were not an exact match, we were able to identify 19 of 100 items on the Co-op's contract that were also included in the State contract. All 19 items identified were found to be priced lower on the State contract, with an average savings of approximately 53 percent. In this example, Co-op members will miss out on saving taxpayer dollars if they purchase through ESCNJ.

Additionally, the State's Department of Community Affairs issued cooperative purchasing guidance¹⁶ which notes that items purchased through a cooperative pricing system are not always the lowest cost option available to its members. Further, no member of a cooperative pricing system should make a purchase for a price exceeding any other price available to it from any other system in which it is authorized to participate. Moving forward, ESCNJ should consider comparing cooperative bid results to pricing for equivalent goods and services available from State or national cooperative pricing systems to ensure that its members receive the best price available.

Recommendations

4. Update policies and procedures to include the OSC contract award notification requirements of N.J.S.A. 52:15C-10(a) and (b).
5. Develop a methodology to estimate the value of both internal and cooperative contracts for notification to OSC based upon requirements in N.J.A.C. 17:44-3.2 and N.J.A.C. 5:34-7.9(e) and memorialize the methodology through written policy or procedure.
6. Notify OSC of any internal and cooperative contracts estimated to exceed \$2.5 million, but less than \$12.5 million, to OSC in accordance with N.J.S.A. 52:15C-10 for post-award review.

¹⁶ https://www.nj.gov/dca/divisions/dlgs/programs/lpcl_docs/copurguide.doc.

7. Submit internal and cooperative contracts with an estimated value of \$12.5 million or more to OSC for pre-advertisement review and approval.

Health Benefits

Objective

To conduct a cost-benefit analysis to determine whether the self-insurance fund is cost effective.

Finding

The Commission's failure to conduct a cost-benefit analysis could result in a missed opportunity for savings in health benefit costs.

Criteria

The Commission switched to a self-insurance benefits program in September 2016 as a cost savings measure. Medical, prescription, and dental benefits are included as part of the self-insurance program. Despite ESCNJ's use of a self-insured program, the Commission has reserved the right to select alternative carriers providing comparable coverage according to its CBA. Management should obtain and analyze all relevant information needed to achieve the entity's objectives of providing medical coverage to its employees in a cost-efficient manner. The information it uses should be appropriate, current, complete, accurate, accessible, and provided on a timely basis.

Methodology

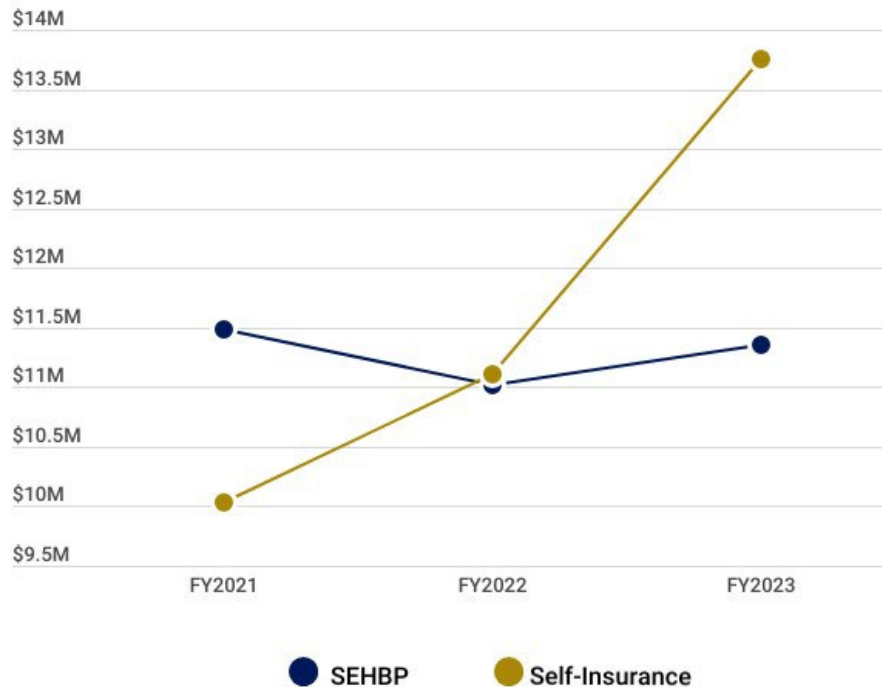
- Interviewed Commission personnel responsible for health benefits and the Commission's insurance broker;
- Reviewed the Commission's CBA;
- Reviewed health benefit participant reports and payment summaries for FYs 2021 through 2023;
- Reviewed SEHBP costs for FYs 2021 through 2023; and
- Completed a cost-benefit analysis of the SEHBP and self-insured plans for FYs 2021 through 2023.

Audit Results

We completed a cost-benefit analysis for FYs 2021 through 2023 to determine which benefits plan was most cost-effective. We utilized the Commission's internal health benefits payment summary and summarized the employer portion of health benefit costs. We projected the estimated employer portion of health benefit costs under the SEHBP based on the average number of participants participating in the Commission's current benefits program.

We compared the Commission's health benefits costs to the estimated SEHBP costs for each fiscal year. The results of the comparison are displayed in the exhibit below.

HEALTH INSURANCE COSTS -- EMPLOYER PORTION



FY 2021: The estimated costs for the self-insured plan were approximately \$10 million compared to our estimate of approximately \$11.5 million for the SEHBP. For FY 2021, it was more beneficial for the Commission to be self-insured with a savings of approximately \$1.5 million.

FY 2022: The estimated costs for the self-insured plan were approximately \$11.1 million compared to our estimate of approximately \$11 million for the SEHBP. For FY 2022, it was more beneficial for the Commission to participate in the SEHBP with savings of approximately \$88,000.

FY 2023: The estimated costs for the self-insured plan were approximately \$13.7 million compared to our estimate of approximately \$11.3 million for the SEHBP. For FY 2023, it was more beneficial for the Commission to participate in the SEHBP with savings of approximately \$2.4 million.

The Commission could have saved up to approximately \$1 million over the three-year period by participating in the SEHBP.

Cause

The Commission last performed a cost-benefit analysis in FY 2020. Comparing the costs of its self-insurance health benefits plan to the costs of different health benefits plans, including the SEHBP, would enable the Commission to choose the most cost-effective benefits for its employees. The analysis should include both cost and other factors, including but not limited to,

administrative costs to transfer to a new provider, CBA language, costs to employees, and types of coverage.

Effect/Potential Effect

Without conducting an annual analysis of health insurance costs, the Commission may miss an opportunity to save money in future years.

Recommendation

8. Conduct an annual cost-benefit analysis of the self-insurance health plan costs and evaluate the costs of participating in the SEHBP and/or other options to determine which plan will provide cost savings.

Objective

To determine whether the Commission is overpaying on health insurance claims.

Finding

The Commission paid \$343,000 more in health insurance claims than it was billed in FY 2023.

Criteria

The State of New Jersey operates a self-insurance fund similar to the one operated by the Commission. Because the contract terms between the State and the insurance administrator included agreed-upon amounts that were higher than the costs actually billed by providers, the State, by paying the agreed-upon amount, paid more than what was billed by the provider. In the most recent SHBP and SEHBP Plans contract, the State added an additional clause to address this issue. Section 4.1.6.J of the State contract requires “that the Member and the Plan, as appropriate, will be charged the lower of the Provider’s billed charges and the Contractor’s discounted or negotiated rate with a Provider or rate agreed to by the State and the Provider.” The Commission’s contract with its claims administrator does not include a similar type of clause.

Methodology

- Reviewed FY 2023 claims reports and weekly claims bills;
- Reviewed the SHBP and SEHBP Plans Bid Solicitation; and
- Reviewed the Commission’s contract with its medical claims administrator.

Audit Results

We reviewed claims paid by the Commission to determine if it made overpayments. We reviewed a list of all FY 2023 claims over \$75,000 provided by the insurance vendor. We identified seven instances in which the Commission paid more than the billed amount charged by the provider. In total, the Commission paid approximately \$343,000 in payments to its claims administrator above what was billed. Because the Commission is self-insured, this cost is ultimately paid by the Commission and its members.

Cause

The Commission does not have a clause in the contract with its claim administrator to avoid making overpayments.

Effect/Potential Effect

The Commission paid approximately \$343,000 over the billed amount for medical claims. The Commission can potentially lower costs by changing the terms of future claims administrator contracts.

Recommendation

9. Analyze the effect of adding a contract clause to limit payments for health benefit claims to the lower of the billed amount or contracted rate. If such a clause would be feasible and lower the overall expenses of health insurance costs to the Commission, include the clause in future claim administrator contracts.

General Fund Balance

Objective

To determine whether the fees charged by ESCNJ are appropriate and necessary for business operations and to provide services to its members at the lowest possible price.

Finding

The Commission's administrative fees and Co-op revenue exceeded costs related to providing services to its members.

The Commission has been operating with a significant general fund balance in recent years and lacks a formal process to return excess funds to its members.

Criteria

As noted previously, the ESC Law provides the legal framework for creating and administering an ESC in New Jersey under the oversight of the State Board of Education.¹⁷ The ESC Law covers the establishment of a commission, board membership, appointment of a board secretary and superintendent, and financial reporting requirements. N.J.S.A. 18A:6-62 requires that an ESC adopt a budget annually providing an estimate for the cost of providing each service or program. An ESC pays its expenses with accumulated prior year fund balances, revenues generated for programs or services, payments from member districts, and other revenues it expects to receive during the year. Payments from its members allow an ESC to continue programs and services when expenditures exceed expected revenues. The ESC Law does not include a requirement to return member funds when revenue and accumulated prior year balances exceed budgetary

¹⁷ In re Middlesex Regional Educational Commission Name Change Request, 453 N.J.Super.243 (App. Div. 2018).

expenditures. During our audit, we found that ESCNJ had accumulated a substantial general fund balance from prior years and was not required to return the balance to its members through direct payment or reduced fees.

The Government Finance Officers Association recommends that governments establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund for Generally Accepted Accounting Principles and budgetary purposes. Such a guideline should be set by the appropriate policy body and articulate a framework and process for how the government would increase or decrease the level of unrestricted fund balance over a specific time period.

Methodology

- Reviewed ESC Law;
- Interviewed Commission personnel responsible for operations and finances;
- Reviewed the Commission's financial documents;
- Reviewed FYs 2018 through 2023 Annual Comprehensive Financial Reports (ACFRs) of ESCNJ and seven other ESCs;
- Reviewed the Commission's Co-op commissions; and
- Reviewed the Commission's grant administration fees.

Audit Results

Our review of ESCNJ financial data identified two areas that generated revenues exceeding related expenditures: Co-op commissions and grant administration fees.

Co-op Commissions

The Co-op's stated goal is to save taxpayers money by identifying the lowest prices on a range of equipment and services for ESCNJ's over 1,475 members. The Commission typically receives a two-percent commission from Co-op vendors on any sales derived through the contracts with its members. ESCNJ received vendor commissions totaling approximately \$9.5 million in FY 2021 and \$10.8 million in FY 2022. ESCNJ stated in its FY 2021 and 2022 financial statements that the general fund balance increase was "mainly due to the increases in the Co-op purchasing and pricing programs."

ESCNJ accounts for the salaries of the chief business official, business office staff, and Co-op office staff, as well as all general fund business office-related expenditures, under "central services." ESCNJ expended approximately \$2.75 million in FY 2021 and \$3 million in FY 2022 for central services. The Co-op revenue exceeds general fund central services costs to such a degree that the Co-op revenue can cover all general fund central services costs and still provide over 70 cents of every dollar received directly to ESCNJ's general fund balance.

Grant Administration Fees

Our review found that part of the Commission's grant arrangement during FYs 2021 and 2022 added to the fund balance maintained by ESCNJ. As part of its establishment, ESCNJ provides services or assistance to various nonpublic schools throughout New Jersey. In FY 2022, the

Commission participated in 19 state and federal grant programs. The Commission received fees for the administration of several of these programs. In some cases, ESCNJ charged fees as high as six percent of the aid received. This represents the maximum allowable administrative fee for auxiliary services and nursing grants the state provides for nonpublic schools. In FY 2021, the Commission contracted with DOE to administer a portion of the Emergency Assistance to Nonpublic Schools (EANS) grant as part of the federal Coronavirus Response and Relief Supplemental Appropriations Act (CRRSAA or Act). As part of the Act, New Jersey received approximately \$68.8 million, of which the Commission was contracted to administer approximately \$29 million.

During our review, we found the Commission received six percent of EANS grant expenditures as an administrative fee. As of June 2023, the Commission had processed 858 EANS grant purchase orders and had received approximately \$1.16 million in administrative fees. This amounts to over \$1,350 in fees per purchase order. The administrative fee structure substantially exceeded the actual costs associated with the delivery of the program. Although permissible under the grant, this excess revenue added to the general fund balance and reduced the funds available to provide goods and services to nonpublic school students.

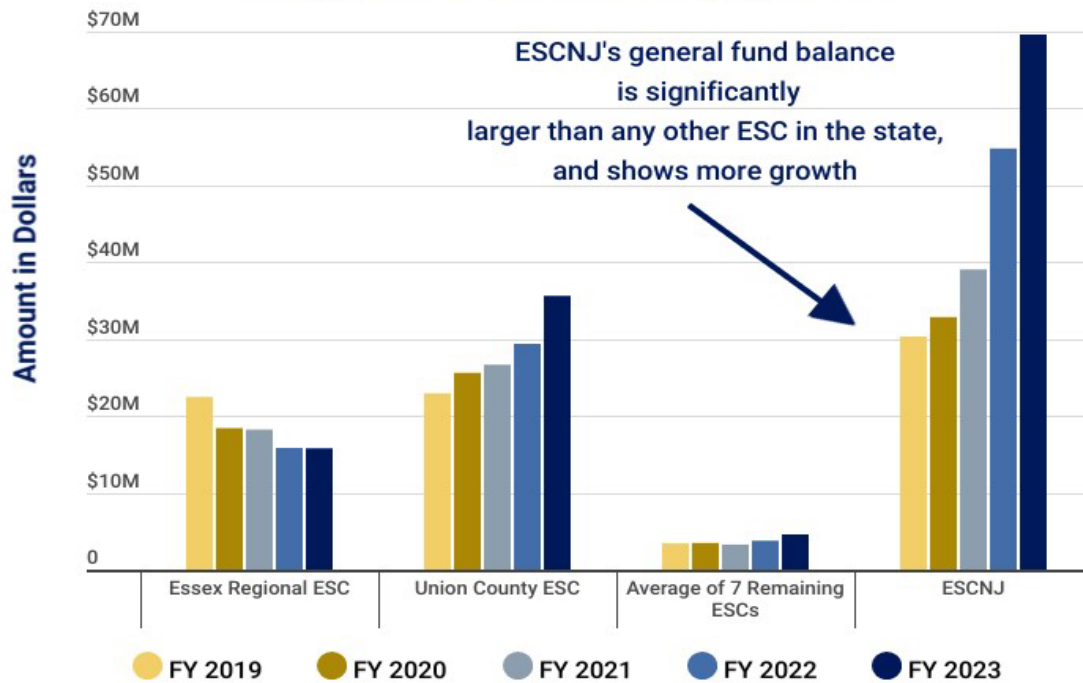
We also found that ESCNJ directed EANS purchases to its Co-op vendors. Even though this reduced the actual work required to deliver the program, ESCNJ did not reduce the fees charged for program administration. In fact, as mentioned above, the Commission received approximately a two-percent commission from Co-op purchases in addition to the six percent allowed under the EANS grant leading to additional revenue caused by the stacked administration fees. For example, ESCNJ's most utilized EANS vendor was paid approximately \$13.4 million, resulting in ESCNJ receiving approximately \$805,000 in administrative fees. Based on the typical two-percent commission rate received by ESCNJ on sales derived through its Co-op contracts, we estimated that ESCNJ received an additional \$268,000 in revenue by utilizing this one Co-op vendor.

ESCNJ's Co-op and grant administration program provides revenues that exceed its costs. This has contributed to higher fund balances in the last few years.

ESC Comparison

We reviewed the ACFRs of ESCNJ and nine other ESCs in the state. We compared the fund balances for FYs 2019 through 2023. The chart below compares ESCNJ's general fund balance to the general fund balance of two other ESCs with the greatest fund balances and the average of the remaining seven.

ESCNJ Maintains a Much Higher Balance Compared To Other ESCs in the State



ESCNJ has a significantly larger general fund balance than any other ESC. We also noted a majority of the ESCs maintained a consistent level of general fund balance each year while the ESCNJ general fund balance has grown much larger over the same period.

Legislative Limits on General Fund Balances

The Legislature has implemented limitations on the amount of general fund balance school districts, vocational schools, and county special services school districts may maintain from one year to the next. The table below describes the limitations.

Type of Entity	Statute	Unassigned General Fund Balance limited to the greater of \$250,000 or
Local School District*	N.J.S.A. 18A:7F-7	Two percent of adjusted audit year general fund expenditures
Vocational School District	N.J.S.A. 18A:7F-7	Six percent of the first \$100 million of adjusted audit year expenditures plus three percent of adjusted audit year expenditures in excess of \$100 million
County Special Services School District	N.J.S.A. 18A:46-31	Ten percent of general fund budget exclusive of prior year tuition adjustments
Charter Schools or Renaissance School Projects	Not Applicable	Not subject to excess surplus limitations

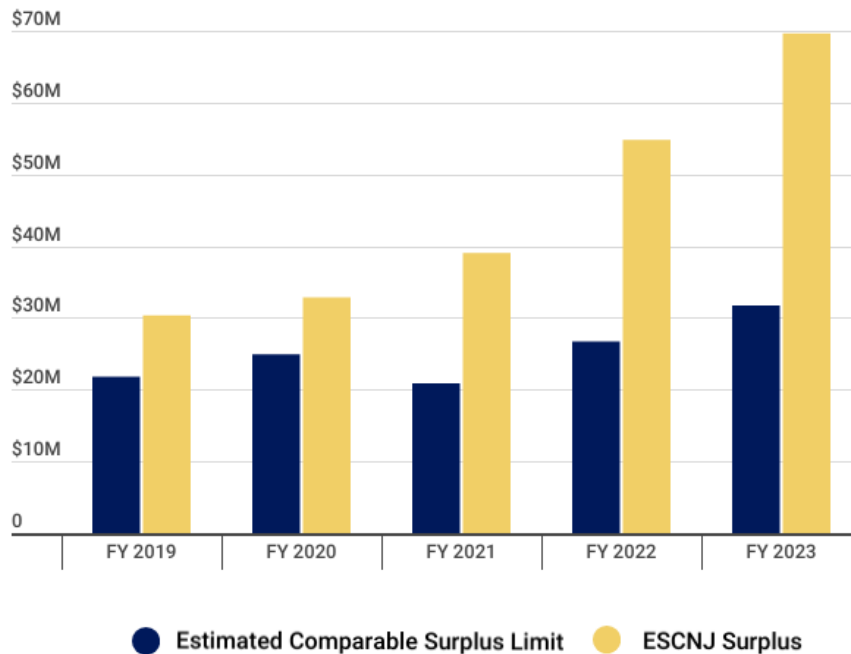
* Pursuant to P.L. 2021, c35, a school district, other than a county vocational school district, may maintain an undesignated general fund balance of four percent of the budgeted general fund for the pre-budget year for FYs 2021 and 2022.

For local school districts and county vocational school districts, N.J.S.A. 18A:7F-7 requires that the school district must use funds in excess of the limitations to decrease taxation in future budgets. The excess general fund balance for county special services school districts will be used to lower the special education program tuition rate. However, these requirements do not apply to ESCs.

Despite the inapplicability of the law to ESCNJ, we viewed the concept as a relevant analog in the absence of any other standard established by law and performed an analysis to estimate the excess general fund balance that existed at ESCNJ between FYs 2019 and 2023. Our estimate applied a more generous ten-percent limit to the Commission's general fund balance and adjusted for commonly excluded reserves. We utilized the ten-percent limit so that our estimate was conservative but remained consistent with statutory limitations. The purpose of this analysis was to identify excess funding available to provide additional benefits to taxpayers or other stakeholders.

As viewed in the chart below, the Commission's FY 2019 general fund balance exceeded the calculated general fund balance limit and continued to grow year after year through FY 2023. The FY 2023 general fund balance exceeded the calculated general fund balance limit by approximately \$37.9 million.

COMPARABLE SURPLUS LIMIT VS. ESCNJ'S SURPLUS



Although it does not levy taxes, the Commission could utilize the excess funds available to lower fees charged or return funds to member school districts directly. The members can use these lower costs or returned funds to decrease their reliance on taxes to fund their operations. This would be consistent with ESCNJ's stated goal of saving taxpayers money.

ESCNJ General Fund Balance Usage

Our discussions with ESCNJ revealed that the increase in general fund balances over recent years was intentional. ESCNJ indicated that in prior years insufficient fund balances led to a lack of working capital, which made it difficult to fund its operations. ESCNJ relies on payments from member agencies to cover the cost of its operations. ESCNJ must often pay employees and contractors before receiving payment from its members. This timing difference can lead to inadequate cash resources if not properly managed. In FYs 2022 and 2023, ESCNJ had fund balances in the general fund of \$54.8 million and \$69.6 million. The balances included amounts receivable from vendors of \$23.6 million and \$26.6 million.

The Commission stated that part of the reason for its large general fund balance is to pay for various facility projects. ESCNJ provided a list of potential facility projects, totaling approximately \$29 million, including mechanical, electrical, plumbing, and other types of work. However, this is not an officially approved plan, but rather a list of all possible projects to be completed at some point in the future. As of June 30, 2023, ESCNJ has reserved \$10.5 million of general fund balance for future capital projects and maintenance. Without an official plan or notification, the Commission is not being fully transparent with its members or the public regarding the use of public funds.

Cause

ESCNJ has demonstrated that there is an appropriate level of general fund balance necessary to maintain its operations. However, ESCNJ did not have a process or policy through which ESCNJ identified the level of general fund balance necessary to maintain operations and take action by raising fees or returning funds to its members when the actual amount of general fund balance differs from the amount needed.

Effect/Potential Effect

The Commission has accumulated a substantial general fund balance from prior years, but has not returned the balance to its members through direct payment or reduced fees. This leads to higher costs to local governments and ultimately, the taxpayers.

Recommendations

10. Conduct analyses on all lines of business to determine the fiscal performance of each and identify where revenue exceeds the cost of operations. Determine if the Commission could provide its members with a reduction of fees or rates. Substantiate any analysis performed or accounting policy updates with written documentation.
11. Conduct an analysis of the Commission's existing general fund balance to substantiate the necessary amount of working capital needed on-hand for business continuity. Substantiate any analysis performed and document necessary working capital for accounts receivable and capital improvements in a written and transparent document.
12. Develop a policy to dictate the required level of general fund balance needed for business continuity in future years. The policy should also include both a minimum and maximum fund balance level at which the Board will act to increase rates or the level at which the board should return fund balance in excess of its policy goals back to its members.

Reporting Requirements

We provided a draft copy of this report to ESCNJ officials for their review and comment. The Commission generally agreed with our audit findings and conclusions, and its response indicated that it will implement corrective actions to address our recommendations. In its response, ESCNJ disagreed with differences OSC identified between health benefit charges and payments made by its claims administrator. The figure presented in our report agrees with the supporting documentation provided by ESCNJ during our audit. Nevertheless, ESCNJ agrees with our recommendation to review its claims administrator contract to determine if limiting payments for health benefit claims to the lower of the billed charges or contracted rate would be feasible and lower the overall expenses of the Commission. The Commission's comments were considered in preparing our final report and are attached as Appendix A.

We are required by statute to monitor the implementation of our recommendations. In accordance with N.J.A.C. 17:44-2.8(a), within 90 days following the distribution of the final audit report, the Commission is required to provide a plan detailing the corrective action taken or

underway to implement the recommendations contained in the report and, if not implemented, the reason therefore. We will review the corrective action plan to evaluate whether the steps taken by the Commission effectively implement our recommendations and upon approval anticipate sharing the plan on OSC's website.

We thank the management and staff of ESCNJ for the courtesies and cooperation extended to our auditors during this engagement.



DOUGLAS M. SILVESTRO
SENIOR PARTNER
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July 12, 2024

VIA EMAIL TO [REDACTED]

Daniel Rosenberg
Auditor-in-Charge, Audit Division
State of New Jersey
Office of the State Comptroller
PO Box 024
Trenton, NJ 08625

RE: Educational Services Commission of New Jersey – Draft Audit Report

Dear Mr. Rosenberg:

This firm represents the Educational Services Commission of New Jersey (“ESCNJ”). The ESCNJ is in receipt of the Office of the State Comptroller (“OSC”) Draft Performance Audit of Selected Fiscal and Operating Practices Report, last edited July 10, 2024 (“Report”). Please accept this letter as the ESCNJ’s position with respect to the Report’s findings and recommendations pursuant to N.J.A.C. 17:44-2.7.

1. **Services Contract Procurement.**

The ESCNJ appreciates the OSC’s guidance and recommendations regarding the use of Requests for Proposals and additional scope-of-work clarity needed for professional services and extraordinary unspecifiable services agreements. The ESCNJ has started implementing internal procedures to address these issues going forward. An RFP for insurance brokerage services is already being generated and RFPs for other relevant services will be utilized as existing agreements expire.

The ESCNJ also agrees that it should receive more detailed billing regarding professional services dedicated to addressing legislative and related issues. These services have generally not been utilized for the purpose of “lobbying” as that term is defined by statute, but have instead largely focused on collaborating and fostering discussions with non-legislative groups such as trade unions regarding issues that might otherwise negatively impact the ESCNJ’s services and operations. However, the ESCNJ agrees with the OSC’s recommendations and will ensure that the attorney providing these services submit detailed bills outlining the work performed.

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2. State Comptroller Notification

The ESCNJ acknowledges that OSC notification procedures were not consistently implemented when cooperative pricing system or direct contracts were anticipated to or did exceed the requisite reporting thresholds. The ESCNJ has already addressed this issue internally and has begun filing the required reports to the OSC retroactively for contracts dating back to March 2024. Proper procedures are also now in place to ensure OSC is notified on all relevant future contracts.

The ESCNJ is also contracting with James Shoop of Shoop SBA, LLC to provide a 12-hour course on Public School Purchasing and Public School Bidding to six (6) ESCNJ staff who have responsibilities for procurement procedures for the Commission. The ESCNJ also intends to utilize Mr. Shoop's services in August 2024 to provide additional professional development regarding procurement to all administrators and support staff.

3. Health Benefits

The ESCNJ's insurance brokers have advised the Commission that the Report's finding that there was an "overpayment" of health insurance claims in the amount of \$343,000 is inaccurate. As noted in the Report, the ESCNJ's health benefits administrator, Horizon Blue Cross, utilizes both diagnostic-related group (DRG) and Case Rate pricing methodologies, which processes utilize a combination of fixed pricing and history evaluative procedures to determine costs beyond just individual invoices. The brokers also identified at least one claim flagged by the OSC as incorrectly listed in the Report. Specifically, the Report includes within the alleged overpayments a claim said to have been invoiced at \$0.08 but the brokers state that was actually invoiced at \$12,833.44 and paid at \$7,501.11 (i.e., less than was invoiced). However, the ESCNJ agrees with the OSC's recommendation to explore changes to the health benefits administrator's agreement to determine if additional cost savings can be realized.

With respect to making comparisons between the ESCNJ's self-insurance plan and the State Health Benefits Plan(s), the ESCNJ is required by its respective collective bargaining agreements to offer certain benefits that make direct comparisons of plans difficult. If the ESCNJ were to enroll in the SEHBP/SHBP, the ESCNJ would have to negotiate the impact of this change with the local unions and may not be able to realize any savings identified in the Report. However, the ESCNJ will attempt to address these issues in future collective bargaining sessions.

The ESCNJ agrees with the recommendation that it engage in a regular cost analysis regarding the viability of remaining self-insured – ESCNJ administration does already meet regularly with the broker regarding renewal rates as well as the success and issues with the plan.

Our File No.
Page 3

To date, it has been more beneficial to remain self-insured, but the ESCNJ acknowledges that this could change in the future.

4. General Fund Balance

The ESCNJ agrees that it needs an internal policy that sets clear goals and guidance regarding the general fund balance needed for business continuity in future years. The ESCNJ is in the process of developing this policy.

The ESCNJ thanks the OSC for its collaboration and guidance throughout this process and looks forward to continuing our goal of providing excellent services and cost savings to its members while remaining in compliance with all applicable rules and regulations.

Sincerely,

THE BUSCH LAW GROUP LLC

Douglas M. Silvestro

Douglas M. Silvestro
Partner

cc: Nadia Romano, Superintendent (via email)
Steve Robinson, Interim Business Administrator/Board Secretary (via email)