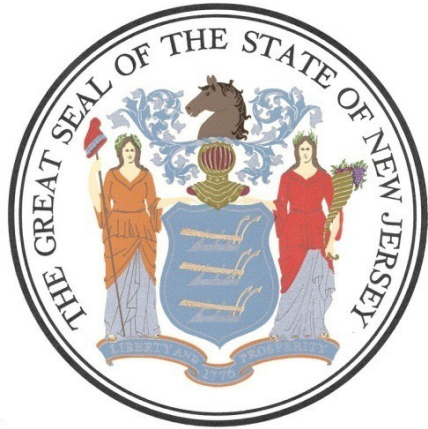


**State of New Jersey
Office of the State Comptroller**




AUDIT REPORT:
***JERSEY CITY MUNICIPAL UTILITIES
AUTHORITY***
***SELECTED FISCAL AND OPERATING
PRACTICES***

**PHILIP JAMES DEGNAN
State Comptroller**

February 21, 2018

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BACKGROUND

The City of Jersey City (City) is located in Hudson County. According to the 2010 Census, the City has a population of 247,597 and 108,720 housing units across 15-square miles of the county.

The City owns an extensive sewer and water supply system to provide services to its residents and bulk water to surrounding municipalities and other entities. The system consists of a 3,200-acre watershed, two reservoirs, a treatment facility, and a transmission and distribution system. In 1998, the City established the Jersey City Municipal Utilities Authority (JCMUA) pursuant to the Municipal and County Utilities Authorities Law (*N.J.S.A. 40:14B-1 et seq.*) to operate and maintain the City's sewer and water assets.

Almost immediately thereafter, in 1998, pursuant to the New Jersey Water Supply Public-Private Contracting Act (*N.J.S.A. 58:26-19 et seq.*), JCMUA entered into a long-term agreement (Agreement) with United Water Jersey City¹ (UW-Jersey City) delegating to it the responsibility of operating, managing, and maintaining the City's water supply system, including all treatment plants, watershed, aqueduct, and distribution system. As part of the Agreement, UW-Jersey City also provides customer service and water meter reading and billing services. The current Agreement expires in 2018. During the life of the Agreement between JCMUA and UW-Jersey City, UW-Jersey City, its parent corporation, and its affiliates have undergone various corporate ownership and organizational changes that are relevant to one or more recommendations in this report.

¹ In 1996, the City and UW-Jersey City entered into a professional services agreement for UW-Jersey City to operate the City's water system. Thereafter, in 1998, the City contractually transferred its obligation for the overall operation, maintenance, and management of the City's water services to the then newly formed JCMUA. As part of that transfer, JCMUA became the party of interest to the 1996 agreement with UW-Jersey City, in place of the City.

While JCMUA delegated to UW-Jersey City most of its responsibilities with regard to the City's water-supply system, it remained responsible for setting sewer and water user rates. Moreover, with regard to the City's sewer assets, JCMUA employees inspect, maintain, clean, and perform minor repairs to the City's 230 miles of sewers, approximately 5,000 storm drains, and 11 pumping stations.

JCMUA is governed by a Board of Commissioners (Board) consisting of five members and two alternate members, each of whom are appointed for staggered five-year terms by the Mayor of Jersey City, with the advice and consent of the City Council. As part of its governance responsibilities, the Board appoints an Executive Director who oversees the daily operations of the organization, including its 108 employees. In 2014, JCMUA's total revenue was \$120 million and its total expenses were \$107 million. JCMUA's expenses included, among other things, \$45.8 million for water operations, \$43.7 million for sewer operations, and \$6.6 million for employee salaries and other compensation.

AUDIT OBJECTIVE, SCOPE, AND METHODOLOGY

The Office of the State Comptroller (OSC) commenced this performance audit to review JCMUA's controls over selected fiscal and operating practices. The scope of the audit covers the period from January 1, 2013 to December 31, 2014. During our review, we evaluated JCMUA's:

- Water and sewer user rate setting practices;
- Water consumption, billing, and collection practices and procedures;
- Procurement and contract administration processes; and
- Employee salary and benefits programs.

To accomplish our objective, we reviewed relevant laws, regulations, and JCMUA's policies and procedures. We examined Board resolutions, financial data, contracts and related documents, records concerning water consumption and billing, and various records concerning employee expenses and benefits. We also conducted interviews with JCMUA Board members and personnel.

As part of our review, we selected a judgmental sample of contracts and modifications issued under those contracts, employee payroll and benefit payments, and selected other financial transactions concerning JCMUA's water consumption and billing practices. Our samples were designed to provide conclusions about the validity of the sampled transactions and the adequacy of internal controls and compliance with appropriate laws, regulations, policies, and procedures with regard to the same. Because we used a non-statistical sampling approach, the results of our testing cannot be extrapolated over the entire population of like transactions or contracts.

This audit was performed in accordance with the State Comptroller's authority as set forth in *N.J.S.A. 52:15C-1 et seq.* We conducted our audit in accordance with generally accepted government auditing standards. 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 objective. We believe the evidence

obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

SUMMARY OF AUDIT RESULTS

Our audit identified control weaknesses in JCMUA's practices with regard to setting water and sewer user rates, monitoring water consumption and billing, procuring goods and services and awarding contracts, and monitoring employee salary increases and other benefits. Specifically, we found that:

- The JCMUA Board authorized annual water and sewer user rate increases from 2010 to 2015 despite having an operating surplus of at least \$12 million each year and significant growth in its net position. In raising those rates, JCMUA failed to conduct the required annual evaluation of its financial status to determine whether or not rate adjustments were necessary.
- JCMUA did not adequately monitor its vendor responsible for water consumption reporting and billing or ensure the resolution of unusual water meter activity. This lack of oversight resulted in bulk-water customers not being billed for 290 million gallons of water. As a consequence, JCMUA lost revenue of approximately \$575,000.
- JCMUA failed to properly administer contracts and implement appropriate controls to ensure goods and services were procured and contracts were awarded in compliance with applicable laws and regulations.
- The removal of a provision from the former Executive Director's employment contract allowed him to authorize more than \$26,000 in salary increases and other benefits for himself without Board knowledge or approval.

OSC makes ten (10) recommendations to address the deficiencies identified in our audit.

AUDIT FINDINGS AND RECOMMENDATIONS

Water and Sewer User Rates

JCMUA staff failed to perform the required annual financial review to justify user-rate increases.

Rate Increases

Pursuant to the Municipal and County Utilities Authorities Law (*N.J.S.A. 40:14B-1 et seq.*), JCMUA has the authority to set and revise its water and sewer rates. The law allows municipal utility authorities to establish rates to ensure that their revenues will, at all times, be adequate to cover the expenses of operating and maintaining the utility system, to pay the principal and interest on its bonds, and to maintain reserves as it deems necessary.

In 2005, JCMUA commissioned a user-rate study, which included a 10-year forecast of its financial position, to assist it in calculating new water and sewer rates. The Board accepted the conclusions of the study and authorized an increase to the water and sewer user rates, ranging from 3.5 percent to 3.9 percent annually for 10 years beginning in 2006. In 2009, JCMUA commissioned another rate study and used it to justify a nearly 45 percent increase in its sewer user rate in 2010. From 2011 to 2015, the sewer user rate increases returned to the previously authorized increases approved by the Board in 2005.

Table 1 below summarizes JCMUA's user-rate history from 2006 to 2015.

TABLE 1 - JCMUA User Rate History				
Water Rate			Sewer Rate	
Year	Rate per 100 Cubic Feet	Percentage Increase from Previous Year	Rate per 100 Cubic Feet	Percentage Increase from Previous Year
2006	\$2.98	--	\$2.91	--
2007	\$3.09	3.7%	\$3.02	3.8%
2008	\$3.21	3.9%	\$3.13	3.6%
2009	\$3.33	3.7%	\$3.25	3.8%
2010	\$3.45	3.6%	\$4.70	44.6%
2011	\$3.58	3.8%	\$4.88	3.8%
2012	\$3.71	3.6%	\$5.06	3.7%
2013	\$3.85	3.8%	\$5.25	3.8%
2014	\$3.99	3.6%	\$5.45	3.8%
2015	\$4.14	3.8%	\$5.64	3.5%

The rate studies used by the Board to justify the user-rate increases relied upon historical data and projected revenues and expenditures in forecasting future user rates. The rate studies were based upon the assumption that JCMUA’s revenue would equal its expenses each year. Total actual revenues during this period exceeded the projections in the rate studies by more than \$88 million. During our audit, we found that JCMUA accepted the projections of the rate studies without considering its “actual” financial position each year to determine the validity of the user rate increases.

Our review of JCMUA’s actual financial position during the period covered under the rate studies, as detailed in its annual audit reports, disclosed that JCMUA generated more than \$95 million of surplus. This surplus is reflected in JCMUA’s net position.

“Net position” for a given year represents the overall financial position of an organization at a given moment in time. “Cumulative net position” shows an organization’s net position over the life of its operations. Over time, increases or decreases in the net position are an indicator of whether the organization’s financial health is improving or deteriorating. The change in net position is the result of the net income (surplus) or net loss (deficit) for the year. The year-end net position for JCMUA

grew from \$10,068,262 in 2006 to \$86,397,001 in 2015, a nearly 760 percent increase. The surplus for 2010 through 2015 was more than \$90 million. In the Fiscal Year (FY) 2014 audit report, the independent auditor noted that “operating revenues increased by \$5,363,361 to \$117,959,015 in fiscal year 2014 from \$112,593,654 in fiscal year 2013. This increase is primarily due to an increase in water and sewer charges during the year.” The FY 2014 surplus of \$12.5 million includes the \$5.4 million generated from the user-rate increases.

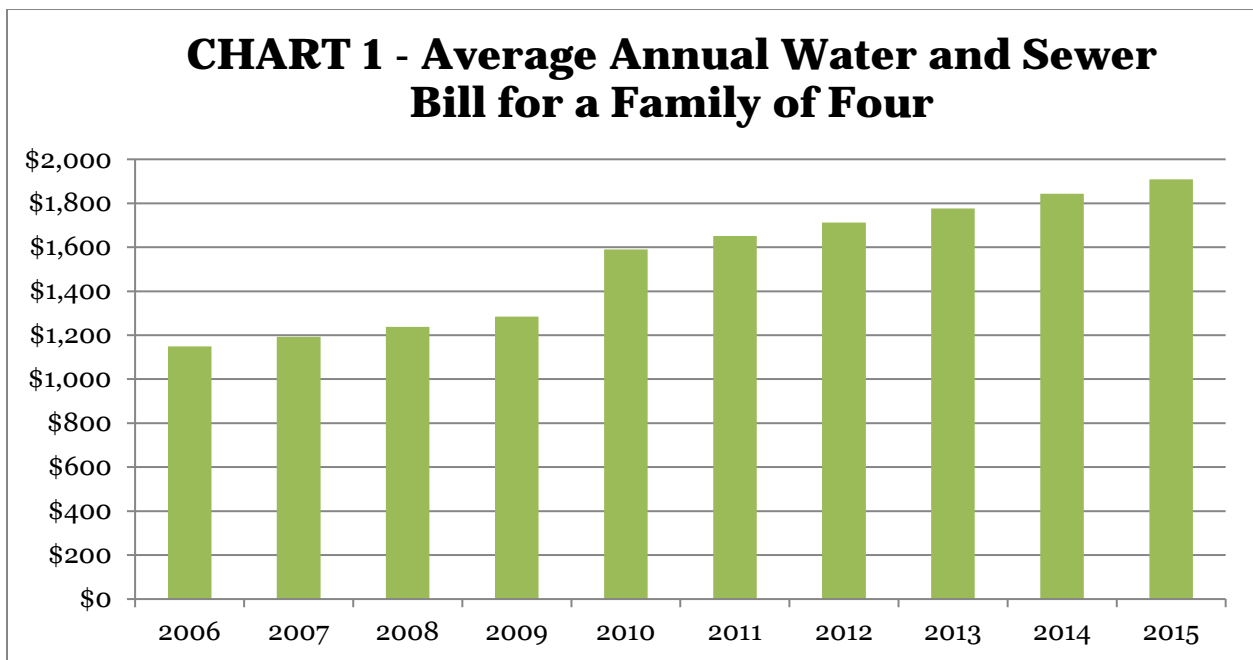
Table 2 shows JCMUA’s financial highlights and net position for 2010 through 2015 below.

Table 2 – JCMUA Surplus Comparison						
	2010	2011	2012	2013	2014	2015
Total Revenue	\$99,130,184	\$106,412,078	\$113,254,637	\$122,763,483	\$120,476,509	\$128,183,716
Total Expenditures	(\$84,062,017)	(\$89,683,593)	(\$98,557,751)	(\$105,328,726)	(\$107,916,309)	(\$114,620,080)
Change in Net Position (Annual Operating Surplus/(Deficit))	\$15,068,167	\$16,728,485	\$14,696,886	\$17,434,757	\$12,560,200	\$13,563,636
Change In Net Position (Annual Operating Surplus/Deficit) as a Percent of Total Revenue	15.2%	15.7%	13.0%	14.2%	10.4%	10.6%
Year-end Net Position	\$26,657,882	\$43,386,367	\$58,083,253	\$74,365,284	\$88,925,484	\$86,397,001

In 2005 and again in 2009, the Board authorized rate increases and memorialized those decisions in resolutions. Those resolutions incorporated the Board’s directive that JCMUA staff review its financial status at least on a yearly basis to ensure the necessity of the rate increases. JCMUA did not provide OSC auditors any evidence suggesting that such an analysis had been performed between 2010 and 2015.

Thus, we determined that JCMUA failed to monitor its financial position on a yearly basis and, as a result, did not properly determine whether its user-rate increases were necessary or, if so, were imposed at an appropriate rate. JCMUA must have a process in place for monitoring user rates, as well as its own financial position, to ensure that any rate increases are warranted. JCMUA must consider all factors that impact estimates and projections. Without regular monitoring, JCMUA can neither evaluate the need for rate changes nor make timely changes when warranted.

Regular monitoring and appropriate rate-setting practices are critical as they have a direct impact on the water and sewer service costs passed on to the rate payers. In real dollars, the rate increases examined here, for a family of four who consume an average of 400 gallons of water per day, would have resulted in a 65 percent increase from an average of \$1,150 in 2006 to an average of \$1,900 in 2015, as illustrated in Chart 1 below.



Recommendations

1. Establish and implement policies and procedures that require the annual budget process to include detailed analysis of financial condition and user rates to determine whether the rates are appropriate and if adjustments are necessary.

2. Develop and implement procedures to ensure that all actions authorized and required by Board resolutions are implemented and reported to the Board in a timely manner to allow for appropriate oversight and transparency of JCMUA operations.

Water Consumption, Billing, and Collections

Water consumption is not adequately monitored or accurately billed, and payments were not collected in a timely manner from JCMUA's utility customers.

JCMUA and UW-Jersey City entered into a long-term Agreement pursuant to the New Jersey Water Supply Public-Private Contracting Act (*N.J.S.A. 58:26-19 et seq.*), for UW-Jersey City to operate, maintain, and manage the City's water supply system. As part of that Agreement, UW-Jersey City is responsible for providing customer service and meter reading and billing services until the expiration of the Agreement in 2018.

In conducting our audit, we examined UW-Jersey City's performance of its contractual obligations related to billing and collection of accounts receivables for water and sewer services. We also examined JCMUA's oversight of UW-Jersey City's performance under the Agreement. In doing so, we reviewed the relevant portions of the Agreement, several bulk-water agreements, water meter consumption reports, billing records, and other relevant financial data. Based upon that review, we identified certain deficiencies and the need for greater JCMUA oversight as detailed below.

Bulk-Water Agreements

"Bulk-water" is water sold to other municipalities, government agencies, regulated utilities, or other entities in large, dedicated quantities. During the period of our audit, JCMUA had four bulk-water agreements in effect. Each bulk-water agreement includes an annual minimum purchase requirement, regardless of the amount of water actually delivered during the service year. If actual purchases are less than the annual minimum purchase requirement, UW-Jersey City — on behalf of JCMUA — is contractually required to bill the bulk-water customer for the minimum purchase requirement. Under the bulk-water agreements, water consumption is measured in millions of gallons per year (MG).

JCMUA's largest bulk-water customers during the audit period were United Water New Jersey (UW-NJ) and Hoboken Water Services (HWS) both of which are related

entities of Suez Water, Inc. OSC notes that Suez Water, Inc. is also a related entity of JCMUA’s vendor, UW-Jersey City. Accordingly, in discharging its billing and collections responsibilities under the Agreement, UW-Jersey City is essentially required to bill for water consumption by and collect payments from related corporate entities.

During the audit period, two bulk-water agreements, one with UW-NJ and one with HWS, represented approximately 95 percent of JCMUA’s annual bulk-water purchase commitments. As explained more fully below, our audit found that UW-Jersey City, as JCMUA’s vendor, failed to accurately bill and collect payments from both UW-NJ and HWS in accordance with their bulk-water agreements. This resulted in approximately \$575,000 in lost revenue for JCMUA, as shown in Table 3.

TABLE 3 - Summary of Bulk-Water Consumption and Under-Billed Water in Millions of Gallons							
Bulk-Water Agreement	Service Period	Actual Water Used	Annual Minimum Water Purchase Required	Water That Should Have Been Billed	Water Billed	Under-Billed Water	Under-Billed Amount – Lost Revenue
UW-NJ	April 2011 – August 2011	1,461.35	1,071.00	1,461.35	1,208.41	252.94	\$490,361
HWS	September 2013 – August 2014	1,560.37	1,587.75	1,587.75	1,550.29	37.46	\$84,221
						290.40	\$574,582

Our review of water consumption and billing data revealed that in 2011 JCMUA and UW-Jersey City failed to bill and collect from UW-NJ \$490,361 in accordance with its bulk-water agreement. In 2011, the parties were in the final year of a 15-year bulk-water purchase agreement that required UW-NJ to purchase annually a minimum of 2,555 MG of water. Although the term of this agreement expired on March 31, 2011, the agreement provided for an automatic five-year renewal with the same terms and conditions.

JCMUA and UW-NJ entered into a new bulk-water purchase agreement covering the time period of September 1, 2011 through August 31, 2014. The new agreement, however, did not address UW-NJ's water consumption between the end date of the previous agreement and the effective date of the new agreement, April 1, 2011 through August 31, 2011. OSC has applied the terms and conditions of the earlier agreement to the gap period. As shown in Table 3, UW-NJ received 1,461.35 MG of water during that time period, but JCMUA and UW-Jersey City only billed the entity for receiving 1,208.41 MG of water.

JCMUA failed to provide any evidence that it billed or sought to collect the payment owed or sought to amend the prior agreement or execute a new agreement to cover this period. JCMUA also failed to produce any records demonstrating that it even monitored UW-NJ's actual water consumption during this period or attempted to reconcile its actual water consumption with the minimum purchase requirement under the agreement. These collective failures resulted in \$490,361 in lost revenue.

We asked JCMUA staff about this matter and they admitted that it "should have been addressed and considered before the [new] contract was signed." Instead of doing so, however, these staff members advised OSC that in January 2016 the former Executive Director negotiated an informal agreement with UW-NJ allowing it to "take less" actual water during the agreement in effect from 2014 to 2017. Upon further examination, JCMUA staff could not provide any reasonable justification for why this informal agreement benefitted JCMUA more than billing and collecting the \$490,361 owed. Further, we found no evidence that the JCMUA Board authorized this informal agreement which may have violated *N.J.S.A. 40:14B-20*.

During our examination of these circumstances, we also found questionable practices with regard to JCMUA's oversight of its vendor, UW-Jersey City. JCMUA is ultimately responsible for ensuring its vendors fully perform their contracted-for obligations. JCMUA, however, has no processes in place or internal controls to do so. For example, JCMUA does not sample UW-Jersey City's billing or consumption reports to independently verify or confirm the information contained in them. Instead, JCMUA relies solely on the information and data provided by UW-Jersey City and was not even

aware of the unbilled bulk-water and corresponding loss of revenue until OSC auditors examined the underlying data. This is particularly troubling since all of the involved corporate entities are legally related.

JCMUA and UW-Jersey City also had failed to bill and collect \$84,221 from HWS in accordance with its bulk-water agreement. The same performance and oversight failures discussed above apply in this instance as well. After this issue was raised during the audit, JCMUA issued an invoice to HWS in June 2017 for the outstanding payment.

Zero-Consumption Meters

On a monthly basis, UW-Jersey City provides JCMUA with a report identifying water meters that did not register any consumption for the prior month. These meters are referred to as “zero-consumption meters.” Our review of the 2014 reports identified approximately 2,100 meters with no consumption for the entire year.

In many cases, the cause of a “zero-consumption meter” reading is easily explained, resulting from, for example, the identification of vacant properties, fire-line meters and emergency stand-by meters, and no-charge meters assigned to City properties. Of the 2,100 meters originally identified, OSC identified 164 meters whose zero-consumption readings could not be easily explained and, therefore, required follow-up.

UW-Jersey City provided acceptable explanations for 100 of those meters. With regard to the remaining 64 meters, UW-Jersey City advised that they were either in violation status² or being further investigated. OSC’s review of relevant records, however, showed that these meters had been continuously identified for at least one year as zero-use without any investigation by either JCMUA or UW-Jersey City. This failure to timely investigate may have resulted in lost revenue to JCMUA if a meter(s) was not properly registering water consumption.

² “Violation status” means that a UW-Jersey City employee attempted to take an actual water meter reading but was refused access to the subject property by the owner.

During the course of our audit, JCMUA updated us with regard to the status of its investigation of the 64 meters. JCMUA advised that, as of August 2017, it had resolved the readings for 54 meters but was still investigating the readings for the other 10 meters.

Meters with Consecutive Estimates

Water consumption can be billed based on either an actual reading of a customer's water meter or an estimated reading. According to the Agreement between JCMUA and UW-Jersey City, UW-Jersey City should estimate no more than one meter reading annually per account. The Agreement further states that UW-Jersey City must demonstrate that it has attempted to contact a customer with more than one estimated meter reading per year and that it has attempted to gain access to the property to obtain an actual meter reading. As required by the Agreement, UW-Jersey City provides JCMUA with a monthly consecutive-estimates report, which identifies all meters that have been billed based on estimates for consecutive billing periods.

According to UW-Jersey City, if an actual meter reading is not obtained, the field technician must leave a violation notice at the premises instructing the customer to contact UW-Jersey City. Additionally, the billing system generates automatic violation letters instructing customers to contact UW-Jersey City to schedule a meter reading.

Our review of the December 2014 consecutive-estimates report revealed more than 1,100 meters with consecutive estimates of water usage. For approximately 400 of those meters, the consecutive-estimates report indicated water usage was estimated for more than 12 months and, in some instances, estimates were recorded consecutively over 6 years. OSC selected 10 meters reported as having estimated usage for 6 years and found that UW-Jersey City failed to issue violation notices for five of them as required by the Agreement and JCMUA's rules and regulations.

Not only did UW-Jersey City fail to fully perform its contracted-for responsibilities with regard to the water-meters as described above, we also found that JCMUA failed to adequately oversee its vendor's performance by monitoring or reviewing monthly zero-consumption and consecutive-estimates reports. These collective failures may have resulted in billing errors and a loss of revenue to JCMUA.

Recommendations

3. Develop policies and procedures that limit contracting actions to responsible JCMUA officials as delegated by the Board and ensure appropriate oversight of all contract actions.
4. Establish policies and procedures that include adequate monitoring of bulk-water consumption and billings to ensure that these customers are billed in accordance with the terms of their agreements in a timely manner.
5. Develop policies and procedures to perform adequate monitoring and timely oversight of the monthly zero-consumption and consecutive estimates reports to ensure appropriate investigation and timely resolution of the issues for any meters requiring follow-up action.

Procurement and Contract Administration

JCMUA lacks adequate contract administration oversight and appropriate internal controls to ensure compliance with procurement laws and accountability for contracting activities.

In addition to its own policies and procedures, JCMUA is required to comply with Local Public Contracts Law (LPCL) (*N.J.S.A. 40A:11-1 et seq.*). Our audit scope included the review of JCMUA's contract bidding and award process, related amendments and modifications, payments issued to vendors, and an assessment of its contract administration and oversight. JCMUA provided OSC with a list of 121 contracts awarded or modified during 2013 and 2014.

We judgmentally selected 20 contracts for review. These 20 contracts related to different types of services and resulted from a variety of procurement methods authorized by LPCL. As detailed below, our review found deficiencies with 6 of the 20, or 30 percent, of the contracts reviewed.

Inadequate Contract Management and Administration System

OSC found that JCMUA did not have adequate procurement and contract administration controls to ensure compliance with appropriate laws and regulations, contract terms and conditions, or even its own policies and procedures. JCMUA's weak contract oversight and lack of a management tracking system to monitor all contract actions, including awards, authorizations, changes, amendments, and payments, contributed to the findings detailed in this report.

Specifically, this deficiency resulted in overpayments, improperly managed contract change orders and amendments, and a lack of compliance with the LPCL and applicable purchasing regulations and internal policies and procedures. As evidence of JCMUA's lack of internal controls, while reconciling the list of contracts provided to us from JCMUA with the details of the Board resolutions for contracts and amendments executed

in 2013 and 2014, we found an additional 33 contracts that JCMUA failed to identify or include in the contract list it provided to OSC.

Contract Overpayments

Our audit found that JCMUA issued payments on three contracts in excess of the maximum contract amount authorized by the Board. For one contract included in our sample, the total authorized contract amount was approximately \$400,000. However, we found payments issued under that contract totaled approximately \$442,000. This \$42,000 overpayment was not supported with an authorized contract change order and Board resolution.

To determine if other overpayments occurred, we reviewed all JCMUA contracts awarded or modified during 2013 and 2014 and compared the maximum authorized contract award with payment history data. As a result, we identified two other contracts with a combined value of \$168,718 in which vendors were paid approximately \$52,000 more than the total authorized contract ceilings.

Improperly Managed Change Orders

JCMUA adopted a new Purchasing Policies and Procedures Manual (Manual) in 2014. This Manual establishes guidelines and standards for the management of change orders with particular focus on capital construction projects. In addition to compliance with LPCL and *N.J.A.C. 5:30-11.1 et seq.*, the Manual requires change orders to be categorized into one of four categories, a construction manager or consulting engineer to produce a cost estimate for use in evaluating and negotiating change orders, and for negotiated amounts to be within 25 percent of the estimate. The Manual also requires change orders to be tracked and measured by JCMUA's change order performance metric.

For two contracts, subject to the provisions of the Manual, OSC found two change orders that neither included cost estimates nor were properly classified for the purposes of being tracked and reviewed against the Manual's performance metric. JCMUA's lack of oversight over contract awards and change orders and its failure to adhere to the Manual potentially contributed to significant unplanned contract cost increases.

Failure to Adhere to LPCL

OSC's review revealed that three contracts in our sample did not comply in all respects with LPCL. Specifically, OSC found:

- JCMUA did not adequately justify the award of a contract for extraordinary unspecifiable services (EUS) pursuant to *N.J.A.C. 5:34-2.1 - 2.3*. LPCL regulations require that these services must be of such a qualitative nature that they cannot be reasonably described by written specifications. Contrary to this requirement, the EUS contract included a specific scope of work consisting of detailed tasks for community relations, program innovations, and grant consulting services. In addition, an authorized JCMUA official failed to provide a certification describing the nature of the work to be done, stating that it is not reasonably possible to draft specifications, describing the informal solicitation of quotations, and indicating why the contract met the EUS statutory provisions as required by *N.J.A.C. 5:34-2.3(b)*.
- For one of the amended contracts, work was performed and billed in excess of the contracted-for amount before the Board had approved the amendment in violation of *N.J.A.C. 5:30-11.5*, and JCMUA policies.
- One contract incurred a modification exceeding 20 percent of the contract award but did not include a contractor's certification justifying the additional scope of work, as required by *N.J.A.C. 5:30-11.9*.

Recommendations

6. Establish and implement policies and procedures that provide appropriate management oversight of the procurement, bidding, evaluation, and contract award process. This process should also include specific measures to ensure compliance with the appropriate laws and regulations, including Local Public Contracts Law, pertaining to the award and modification of contracts.

7. Develop a contract tracking system or process and actively monitor all contract actions to ensure timely amendments, renewals, invoice reviews and approvals, and payment processing in accordance with appropriate laws and regulations, internal policies, and contract terms.
8. Document all contract overpayments noted in this report with change orders authorized by the Board, as appropriate, and in compliance with the guidelines and standards of the Manual.

Employee Salary and Benefits

Employee salary increases and other benefit payments are not adequately monitored and approved by the Board.

During the period of our audit, JCMUA employed 108 individuals. Approximately 90 employees were in operational positions and were covered under the Collective Bargaining Agreement (CBA) between JCMUA and the International Union of Operating Engineers. The remaining employees were non-union or administrative employees and were covered by JCMUA's Personnel Policies and Procedures Manual.

Executive Director's Compensation

N.J.S.A. 40:14B-18 provides that every municipal authority may appoint and employ an executive director and shall determine his or her compensation. In November 2005, the Board approved an employment contract for an Executive Director. Under the terms of that contract, the Executive Director was responsible "for all JCMUA personnel matters, including but not limited to, all decisions involving the employment hiring/engagement matters, employment firing/termination matters, employee suspensions, employee promotions, employee transfers and employee pay increases/raises . . . but shall exercise authority over Employment Matters after reporting proposed action in advance to the Board of Commissioners." Contract extensions executed with the now former Executive Director in 2009 and 2011 removed the requirement that he notify the Board before exercising authority over employment matters.

During our review of payroll expenditures for 2013 and 2014, OSC found that the former Executive Director authorized and approved more than \$26,000 in salary increases and other benefits for himself without Board knowledge or approval. In 2013 and 2014, the former Executive Director granted administrative employees, including himself, a yearly cost-of-living adjustment that increased his annual salary by \$7,625. He also authorized JCMUA's vacation and sick leave buy back policy for administrative

employees, including himself. The former Executive Director was reimbursed more than \$18,000 as a result of this policy.

The contract language that empowered the Executive Director to affect his own compensation amounts to an improper delegation of authority by the Board in violation of *N.J.S.A. 40:14B-18*.

Leave Time Payouts

The CBA between JCMUA and the International Union of Operating Engineers allows JCMUA to buy back the full amount of vacation and sick time earned but not used in the prior year. The buy-back reimbursement is based on the rate of pay when the time was earned. In November 2012, the former Executive Director extended this benefit to administrative personnel.

During our review of 2013 and 2014 payroll expenditures, we tested the rate of pay used by JCMUA to calculate the vacation and sick time reimbursed to employees. OSC found that JCMUA incorrectly used the current rate of pay rather than the rate of pay when the leave was earned.

Recommendations

9. Develop a policy and procedure to ensure salary adjustments and other employee benefits for the Executive Director are approved by the Board.
10. Establish and implement a process that ensures payments to employees for the reimbursement of leave buy-back are paid at the correct rate of pay.

REPORTING REQUIREMENTS

OSC provided a draft copy of this report to JCMUA officials for their review and comment. Their comments were considered in preparing our final report and are attached as Appendix A. We address selected points in their response in Notes set forth in Appendix B. We acknowledge that JCMUA indicated in its response that some of our recommendations have already been implemented and they will ensure that appropriate steps are taken to address each item detailed in our report.

OSC is required by statute to monitor the implementation of our recommendations. In accordance with *N.J.A.C. 17:44-2.8(a)*, JCMUA shall report to OSC within 90 days following the distribution of the final audit report, what corrective action has been taken or is underway to implement the recommendations contained in this report. If JCMUA does not implement any of the recommendations, it must provide a written explanation for each such refusal. On behalf of OSC, we thank JCMUA's management and staff for the courtesies and cooperation extended to our auditors during this engagement.



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January 12, 2018

Via Electronic Mail and First Class Mail

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Re: Audit of The Jersey City Municipal Utilities Authority, Selected Financial and Operating Practices

Dear Director Tierney:

On behalf of the Jersey City Municipal Utilities Authority (the "Authority" or "JCMUA"), we are in receipt of and have reviewed the draft preliminary results of the performance audit (the "Draft Audit") conducted by the Office of the State Comptroller ("OSC") for the period from January 1, 2013 to December 31, 2014. We offer the following responses and comments to the matters addressed in the Draft Audit.

Water and Sewer User Rates

OSC notes that the Authority commissioned a user-rate study in 2005 that included a 10-year forecast of the JCMUA's financial position. The Authority then utilized the conclusions and recommendations in that study to structure a series of rate increases over a 10-year period which would permit the Authority to adequately fund its water and sewer operations. The Draft Audit concludes that the actual revenues during that period exceeded projections by more than \$88 million, resulting in a significant increase to the Authority's "net" financial position. Based on this analysis, the Draft Audit concludes that the Authority should (i) establish and implement policies and procedures requiring an annual budget process to include detailed analysis of

financial condition and user rates to determine whether the rates are appropriate and if adjustments are necessary, and (ii) develop and implement procedures to ensure that all actions authorized and required by Board resolutions are implemented and reported to the Board in a timely manner to allow for appropriate oversight and transparency of JCMUA operations.

The Authority is committed to ensuring that its budgeting and rate setting processes are undertaken in a fair and transparent manner with the goals of minimizing rate increases to its customers while simultaneously allowing the Authority to remain on solid financial footing and effectively carry out the numerous water and sewer related projects that are required. As such, the Authority will take appropriate steps to implement the OSC recommendations concerning rate setting processes.

However, it should be noted that what is not reflected in the Draft Audit is the Authority's "net unrestricted" financial position, which accounts for such things as escrow accounts for bonded indebtedness, operational reserves and net investment in capital assets. When those items are accounted for, the Authority's "net unrestricted" position at the end of 2015 is approximately \$31.6 million, not the \$88 million set forth in the Draft Audit. Additionally, it is important to note that the Authority's net unrestricted position in 2010 was \$10 million. It was therefore important, and in the JCMUA's best financial interests, to increase that number in the years subsequent to 2010.

Comptroller Note 1

Water Consumption, Billing, and Collections

Bulk Water Agreements

The Authority is now in the process of entering into, and seeking approval from the New Jersey Department of Environmental Protection for new Bulk Water Contracts with United Water New Jersey and Hoboken Water Services (now known as Suez Water Environmental Services) . These new contracts will have an effective date of January 1, 2018 so that, in future contracts there will not be any gap periods between new and expiring contracts and it will be easier for the JCMUA to track payments due under such contracts. With respect to any gap period of time between the new Bulk Water Contracts and the current contracts, the Authority is assessing and collecting the correct amounts owed in accordance with the terms and conditions of the current contracts.

Zero Consumption Meters

The Authority's water treatment and supply system is operated by Suez Water Environmental Services, Inc. ("Suez"), pursuant to an operator's agreement, dated April 1, 2008,

(the "Contract"). Pursuant to the Contract, the JCMUA is authorized to offer Suez an extension of the Contract term upon its expiration at the end of March, 2018. The Authority has recently completed negotiations of an Amendment and Extension Agreement with Suez. The JCMUA has notified the Comptroller, the Board of Public Utilities, the Department of Community Affairs Division of Local Government Services and the New Jersey Department of Environmental Protect, as required pursuant to N.J.S.A. 58:26-19.1 et seq., of its intent to (1) hold a public hearing concerning the Amendment and Extension Agreement, and (2) submit a formal application to the agencies for their review of the Amendment and Extension Agreement following the completion of the public hearing process.

The Amendment and Extension Agreement establishes a procedure for zero consumption meters. The procedure requires that the Suez (1) provide monthly reports of all zero consumption meters and (2) visit at least once annually all zero consumption meters that have at least two (2) consecutive zero consumption readings.

In addition the Amendment and Extension Agreement expands Suez's scope of work to include the acquisition and installation of Advanced Metering Infrastructure ("AMI") which will result in the changing out of all of the Authority's customer meters to smart meter technology. Once installed the smart meters will ensure that a reliable source of data is communicated instantaneously to Suez and the Authority. The anticipated level of data will allow the JCMUA to more easily identify and rectify most meter and account related problems.

Please be advised that the Authority's priority, second only to providing clean high quality drinking water, is to ensure that all accounts are correctly identified and, where applicable, all fees assessed to such accounts are collected. While the Authority does have the ability, in some instances, to terminate water service to customers that do not pay for water service on a timely basis; it is the Authority's preference to maintain services and work out a reasonable payment plan for such customers. Further, OSC should be aware that in some instances it is not possible for the JCMUA to terminate water service to non-paying customers. For instance, the Authority cannot terminate water service to a non-paying customer when the domestic water and fire service lines are interconnected. To do so would render the dwelling defenseless against a potential fire. There are many examples of interconnected services throughout Jersey City. Moreover, the JCMUA can only disconnect water if a curb box exists between the main and the lateral to the dwelling or business. If there is no curb box then there is no physical way to disconnect the customer without exposing the main and manually removing the lateral connection.

Lastly, it should be noted that although OSC identified 164 zero consumption meters, only 10 of these meters remain under review by the Authority. To be clear these 10 meters represent approximately 0.0294% of the JCMUA's entire meter fleet. Nonetheless, the

Authority will continue to pursue the identity and location of these meters/accounts to ensure that they are in fact appropriately zero consumption meters.

Meters with Consecutive Estimates

As noted above, the Authority and Suez are on the verge of entering into an Amendment and Extension Agreement. The Amendment and Extension Agreement also addresses consecutive estimates. Specifically, the Amendment and Extension Agreement requires:

- Suez to generate monthly consecutive estimate reports for the Authority;
- Letters will be generated from the Customer Information System to all customers (except those with fire lines connected to domestic supplies) following two (2) consecutive estimates;
- Customers with three (3) consecutive estimates shall be assessed a fine;
- All accounts with four (4) consecutive estimates shall be issued a disconnection letter issued from the Customer Information System.

The issuance of the warning, fee and disconnection letters from the Customer Information System will be automatic and will eliminate the potential for any delay in the issuance of such communications to the customers. However, for the reasons noted above, the JCMUA cannot, in every instance, disconnect a customer from the system.

The AMI technology, once installed, is designed to minimize consecutive estimates because the advanced meters will communicate directly with the Authority and provide real-time data concerning water consumption by account. It should be noted that even after AMI is installed it will still not be possible, in every instance, to disconnect a customer from the system for the reasons noted above.

Procurement and Contract Administration

Inadequate Contract Management and Administration System

As part of the scope of its Draft Audit of JCMUA's fiscal and operating practices, OSC examined contracts awarded or modified during 2013 and 2014. It is important to bear in mind that the Authority formally approved on May 22, 2014 a Purchasing Policies and Procedures Manual, pursuant to duly adopted Resolution 5/14/9, in the interest of applying standardized purchasing procedures and complying with all applicable laws, rules and regulations concerning public procurement and purchasing. The Authority also approved on October 30, 2014, pursuant to Resolution 10/14/18, revisions to the section of the Purchasing Policies and Procedures Manual pertaining to change orders to ensure that capital construction projects are completed on

time and within budget. Prior to May 2014, the Authority did not have formal procedures in place governing the procurement of goods and services and management of contracts. The implementation of the Purchasing Policies and Procedures Manual formalizes procurement and contract administration practices and should avoid the repetition of the deficiencies cited in the Draft Audit.

1. Contract Overpayments

As part of its ongoing effort to improve the management of contracts, JCMUA put into place in the second half of 2016 an open purchase order system that tracks the amount of a contract award, the remaining balance on the contract, and any change orders that have been issued upon Board approval. In conjunction with the adoption of the Purchasing Policies and Procedures Manual, JCMUA is confident that the inadvertent errors that led to the over-payment on the contract with Adjusters International will be eliminated.

The Draft Audit references contract overpayments of approximately \$56,000 on two contracts that were awarded or modified during 2013 and 2014. The first contract was let in early-2013 for the emergency and non-emergency rental, delivery, setup and return of various size trailer-mounted, self-priming discharge pumps, trailer-mounted diesel generators, submersible pumps, and associated equipment. The overpayment occurred as a result of the Authority having to publicly bid three times in order to be in a position to award a new contract. During the time the Authority was engaged in the bidding process, orders for pumps and related equipment were placed to maintain the temporary pump stations and prevent flooding. The Authority does not disagree that better contract administration practices should have been implemented to authorize change orders. However, services and payments under this contract took place prior to the adoption of the Purchasing Policies and Procedures Manual, and the open purchase order system, making it highly unlikely this situation will reoccur.

The second contract was not required to be publicly bid as the value of the contract was well below the bid threshold of \$40,000. The contract award in the amount of \$17,917 did necessitate certain procedures be met as it exceeded the threshold under the New Jersey Local Unit Pay-to-Play Law. These procedures were followed when the contract was awarded in April 2013 for fuel management services for Authority vehicles. During the term of the contract through the remainder of 2013, the Authority required additional services in the amount of approximately \$8,600, which were informally authorized without the knowledge of the Authority's Purchasing Agent. The Authority acknowledges that approval for the issuance of a change order should have been obtained, and this requirement has been formally effectuated through the subsequent adoption of the Purchasing Policies and Procedures Manual.

The purchases made in 2014 in the amount of approximately \$4,300 were pursuant to a separate, non-bid contract. This amount should not be considered to be an overpayment on the

contract awarded in 2013 as it constituted a separate contract award altogether from the non-bid contract in 2013 that could be awarded by the Purchasing Agent without the need for Board approval due to the amount of the contract being less than 15% of the bid threshold consistent with N.J.S.A. 40A:11-6.1 and resolutions of the Authority appointing and re-affirming the Purchasing Agent.

2. Improperly Managed Change Orders

The contract cited in the Draft Audit was awarded in August 2013 for the provision of emergency and non-emergency plumbing repair services. It is critical to understand that the amount of the contract award of roughly \$1.3 million was based upon an estimate of the number of hours and equipment necessary to provide the services that were utilized to compare bids in order to determine the lowest, responsible and complying bidder. It is essentially an open-ended service contract that establishes costs for equipment and hourly rates for services, and the amount paid under the contract in any given year ultimately depends on circumstances beyond JCMUA's control and the number of emergencies that determine the need for the services.

Change orders to the contract were authorized by the Board through duly adopted resolution in May and September 2014. The change orders complied with the Local Public Contracts Law and the implementing regulations of the Department of Community Affairs. The change order authorized in September 2014 preceded the amendment to the section of the Purchasing Policies and Procedures Manual in October 2014 that supplemented the provisions pertaining to change orders. As a result of this amendment, request for a change order to any contract, except for professional services and extraordinary unspecifiable services, must comply with the requirements of N.J.A.C. 5:30-11.1 to 11.20, and contains sample change order forms and instructions for preparing a request for a change order were incorporated in the Purchasing Policies and Procedures Manual. The modification of the change order requirements should prevent this situation from reoccurring in the future.

3. Failure to Adhere to LPCL

The Draft Audit made reference to three contracts where the Authority did not "comply in all respects with the [Local Public Contracts Law]." In the first instance, the Authority did not fully justify the award of a contract for the provision of grant consulting and community relations services. The authority concedes that a certification as required by N.J.A.C. 5:34-2.3(b) was inadvertently omitted from the contract award resolution. Mechanisms have been put into place to avoid this type of omission from happening in the future.

However, the Draft Audit maintains that the contract for the services contained a list of detailed tasks that would lead one to conclude written specifications could have been prepared and a contract awarded after public bidding. There is no dispute that the language of N.J.A.C.

5:34-2.1 through 2.3 states that extraordinary unspecifiable services must be qualitative in nature such that written specifications could not reasonably be prepared and the services publicly bid. However guidance from the Division of Local Government Services in the Department of Community Affairs specifically provides in Local Finance Notice 2002-2 that public relations consulting services satisfy the criteria for an extraordinary unspecifiable service and, therefore, constitute an exception to public bidding.

For a second contract, the Draft Audit cites the fact that work was performed and billed in excess of the contract award amount before the amendment was approved in violation of N.J.A.C. 5:30-11.5. The third contract involved a change order in excess of 20% that failed to include a certification from the contractor as required by N.J.A.C. 5:30-11.9. As stated at various earlier points in this response to the Draft Audit, procedures have been formalized and put into place through the adoption of the Purchasing Policies and Procedures Manual that should prevent a repeat of the circumstances that led to the failure to comply with the requirements of both of these regulations.

Employee Salary and Benefits

Executive Director's Compensation

OSC noted that the former Executive Director authorized and approved salary increases and other benefits for himself without Board knowledge or approval and that there was a provision in his employment contract that gave him responsibility for all personnel matters that amounted to an improper delegation of authority by the Board, in violation of N.J.S.A. 40:14B-18.

Please note that the Authority's current By-Laws, which were amended in April, 2014, directly address this issue by providing as follows:

"the Commissioners shall have the following responsibilities, among others, which are designed to ensure that the Authority operates in an efficient, transparent and ethical manner:

- 1. Exercise direct oversight over the Executive Director; ... [and]*
- 5. Establish policies concerning personnel matters, such as job qualifications, hiring practices, and compensation, including the adoption, upon the recommendation of the Executive Director, of a personnel manual;*

Additionally, the current Executive Director's employment contract expressly provides that:

“The Employee shall perform all of his duties as Executive Director in accordance with all applicable laws, and in accordance with the JCMUA By-Laws, the JCMUA Personnel Policies & Procedures, and all other applicable policies and procedures that are currently in effect, or that may hereinafter be put into effect by the JCMUA during the term of this Agreement”

and, further that

“It is understood and agreed that the Employee reports directly to the JCMUA Board of Commissioners. The Commissioners of the JCMUA may, from time to time and in the Commissioners’ sole discretion, establish performance metrics for the Employee and evaluate Employee’s job performance based on those metrics.”

As such, it is the Authority’s position that whatever delegation of authority may have existed in the previous Executive Director’s employment contract, no longer exists under the current Executive Director’s employment contract.

Leave Time Payouts

OSC also noted that certain buybacks of vacation and sick time were made at current rates, not the rate of pay when the time was earned. The Authority will take steps to ensure that all vacation and sick time buybacks are implemented in accordance with applicable law and at the correct rate of pay.

In conclusion, the Authority will ensure that appropriate steps are taken to address each of the items identified in the Draft Audit. If you have any questions or concerns, please do not hesitate to contact me.

Very truly yours,



John D. Folk
Director of Finance

Cc: (all via electronic mail)

George Derbaly, Office of the State Comptroller
Hon. Maureen Hulings, Chair, JCMUA
Hon. Board Members, JCMUA
Francis J. Borin, Esq., General Counsel

APPENDIX B
COMPTROLLER NOTES ON AUDITEE RESPONSES

The following notes correspond to JCMUA's response as indicated in the margins of Attachment A.

1. In its response to the draft audit report, JCMUA draws a distinction between its "net unrestricted" financial position, which JCMUA calculates at \$31.6 million, and its total net position, including funds classified as restricted and unrestricted, which OSC identifies as \$86 million. In an effort to justify the rate increases during that time, JCMUA states that it was in the "best financial interests" of the authority to "increase that number in the years subsequent to 2010."

Importantly, JCMUA does not dispute OSC's ultimate finding that JCMUA did not conduct the required yearly financial analysis to ensure the necessity and reasonableness of the rate increases. Indeed, JCMUA has simply stated that the rate increases were necessary to ensure that the authority could meet its future operating costs, not to improve its net financial position.

In reality, however, without an appropriate level of analysis contemporaneous to the rate increases such assurances are not compelling. Regardless of the classification of net position as restricted or unrestricted, the user-rate increases between 2010 and 2015 did, in fact, result in an increase in JCMUA's net position. There may, or may not, be appropriate justification for that, but because JCMUA did not comply with the required process, that justification cannot be analyzed and considered in the audit process. As a result, OSC's findings remain unchanged.

2. JCMUA concedes that it did not execute the certification required by *N.J.A.C. 5:34-2.3(b)* to support its use of the extraordinary and unspecifiable services (EUS) exception for its public relations consulting services contract. It is also worth noting that contrary to JCMUA's assertion, Local Finance Notice 2002-2 simply provides that public relations consulting services "might" satisfy the criteria for utilizing the EUS exception. JCMUA should seek the advice of legal counsel to ensure any future use of

the EUS exception is appropriate especially where the authority has detailed a vendor's tasks in a scope of work.