State of New Jersey

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June 15, 2011

Gary M. Lanigan, Commissioner
New Jersey Department of Corrections
P.O. Box 863
Trenton, NJ 08625

Marcus O. Hicks, Director
Office of Community Programs
New Jersey Department of Corrections
P.O. Box 863
Trenton, NJ 08625

Re: Residential Community Release Program

Dear Commissioner Lanigan and Director Hicks:

As you are aware, the Office of the State Comptroller ("OSC") recently performed an audit of the Residential Community Release Program ("RCRP"). The RCRP program is administered by the Office of Community Programs ("OCP") within the New Jersey Department of Corrections ("DOC"). Separate from those matters selected for audit purposes, in the course of our review OSC's Procurement Division identified a series of issues warranting your attention in connection with the procurement of the RCRP services. The two most recent procurements of those services took place in 2004 and 2010. We write this letter to provide guidance and to ensure that these issues are addressed going forward:

(1) OCP does not have any written, prescribed procedures to guide its procurement processes. Thus, the RCRP procurements that took place in 2004 and 2010 were

completed without the benefit of a pre-set process memorialized in agency regulations or policies. Current New Jersey law does not compel DOC to adopt such a formal procurement framework, in contrast to procurements that are handled by the state's Division of Purchase and Property. However, considering that DOC has paid private vendors more than $400 million for RCRP services during this timeframe, prescribed procurement procedures should be implemented to ensure that the public can have confidence that the vendor selection process being used is transparent, professional and efficient.

(2) The Requests for Proposals for the 2004 and 2010 procurements (the "RFPs") required vendors to submit proposed per diem rates for the services to be provided, based on the costs associated with operating the RCRP facilities. These costs included salaries and other operating costs. The RFPs state that payment of the per diem rates is "contingent upon the Contractor providing adequate documentation" to OCP. However, OCP did not corroborate the expenses listed in the per diem budgets or request any such supporting documentation. By failing to corroborate these expenses, OCP has no way of knowing whether the RCRP vendors actually incurred the expenses listed in their per diem budgets.

For example, one of the vendors, Volunteers of America-Delaware Valley ("VOA") included in its 2004 per diem budget $60,000 for "additional capital improvements to the facility." This expense was included in the calculation of VOA's per diem rate over all six years of its contract term, resulting in payments totaling $360,000. OCP's failure to corroborate this expense through appropriate documentation has led to confusion regarding the cost and scope of these capital improvements. Specifically, in response to our questions OCP informed us that these capital improvements consisted of a one-time, $60,000 expense and that in future procurements they will make it clear to prospective vendors that these costs are to be amortized over the contract term. It is OCP's understanding that the failure to corroborate these expenses resulted in a DOC overpayment of $300,000. VOA, on the other hand, informed us in writing that the cost of these capital improvements totaled $319,282. We are still awaiting documents from VOA to support that claim.

In any event, even if VOA's assertion is accurate, DOC overpaid by more than $40,000 as a result of its failure to substantiate the claimed expenses.

In addition, if DOC chooses to fund such capital improvements at private facilities, it should take steps to ensure that the state's interest in those facilities is adequately protected. Such measures might include visiting the facility to review the validity of the request and placing a lien on the facility for the cost of the improvements, as is the practice in other state contracts. Then, if the facility is sold, the vendor must pay a portion of the sales proceeds back to the state. These concerns are heightened in this instance because VOA does not own the facility in question, but rather leases it from another entity.

(3) The RFPs permitted RCRP vendors to include "administrative costs" in their per diem budgets that are paid by DOC. The RFPs defined those costs as "any regional office/home office expenses which are allocable to the RCRP." This vague definition risks vendors inflating these costs and in fact led to substantial inconsistency in the budgets submitted by vendors and approved by DOC. For example, in 2004 vendors listed administrative costs ranging from 0% to 22% of their total budgets. Similarly, in 2010, the amount of claimed administrative costs varied among vendors from $0 per inmate bed to $7,354 per inmate bed. We also note that even without this expense category DOC's per diem budget sheets seem to permit vendors to include all conceivable RCRP costs, causing us to question whether this additional category for administrative expenses is necessary.

(4) In the 2004 procurement, DOC did not use submitted per diem rates as a factor in its vendor-selection process. While it is understandable in a procurement such as this one that cost would not be the only selection factor, to exclude cost entirely as an award criterion appears to be inconsistent with the interests of taxpayers. In 2010, OCP addressed this deficiency by considering proposed per diem rates in its vendor selection process. OCP informed us, however, that it did not attempt to negotiate any of the per diem rates submitted to it, as it believed it would be inappropriate to do so because of language in the RFP requiring that the per diem

rates submitted by vendors constitute their "best and final offer." OCP is not otherwise bound by any procurement policies that prohibit negotiations, and we recommend that future RFPs for these services do not preclude negotiation of cost since such negotiation would provide an opportunity to reduce agency expenditures. We note in this regard that agencies in New York and Pennsylvania reported to us that their negotiations of rates with vendors for similar RCRP services have led to cost savings.

(5) The RFPs required interested vendors to set forth the number of inmate beds that each RCRP facility would be capable of providing. DOC then awarded a set number of beds to each vendor based on DOC's institutional needs. Following the 2004 RFP, DOC awarded one vendor, named Education and Health Centers of America, Inc. ("EHCA"), 282 beds for one of its facilities. Due to the subsequent closing of two other RCRP facilities, EHCA's contract was amended twice to add a total of 34 additional beds. In December 2009, EHCA's contract was amended again, adding an additional 400 beds, bringing the total to 716 beds at the facility. The 2009 contract amendment did not include any explanation for the 400-bed increase and according to OCP's Director, OCP had not identified at the time any institutional need for the 400 additional beds. DOC and EHCA provided us with differing justifications for the increase. From a procurement perspective, the awarding of the additional beds was inconsistent with DOC's initial competitive selection process as well as notions of transparency in government contracting.

(6) As you know, pursuant to N.J.S.A. 30:4-91.12 RCRP vendors are required to establish community relations advisory boards ("Advisory Boards"), which are required to, among other duties, "monitor the operation of" the RCRP facilities. Under this statute, the Advisory Boards may include public officials, including a representative of DOC. However, pursuant to the New Jersey Uniform Ethics Code, "No state officer or employee . . . should have any interest, financial or otherwise, direct or indirect, or engage in any business or transaction or professional activity, which is in substantial conflict with the proper discharge of his/her duties in the public interest."

Our review found that one of the RCRP vendors, specifically VOA, listed OCP's Director and the supervisor of OCP's Contract Administration Unit as members of its Advisory Board in its 2010 RCRP proposal. Both of these OCP employees advised us that they were invited to be members of VOA's Advisory Board, but declined because they felt that such participation could be perceived as a conflict of interest in violation of the Ethics Code. The listing of two OCP employees as members of VOA's Advisory Board in the 2010 proposal, while apparently a mistake, could have influenced the members of the evaluation committee. We suggest that you have VOA clarify its records to correct this discrepancy. In addition, we suggest that for future procurements the evaluation committee should not be permitted to see the names of Advisory Board members, in order to ensure that the evaluation process is not swayed by the presence of senior government officials on these boards. Also, although N.J.S.A. 30:4-91.12 permits RCRP vendors to include DOC representatives on the Advisory Boards, we suggest that OCP adopt a policy excluding OCP staff specifically from these boards given OCP's role in the contract award process, its oversight of RCRP vendors and the requirements of the Uniform Ethics Code.

(7) EHCA's subcontracting arrangement with a for-profit company raises questions as to its eligibility to provide RCRP services for DOC. Prior to 1976, DOC was not authorized by state law to confine inmates in privately operated facilities. That changed in 1976, when the statutory definition of "facility" was expanded to include "private nonprofit community-based residential treatment centers which provide for the care, custody, subsistence, education, training and welfare of inmates." N.J.S.A. 30:4-91.2 (emphasis added). Attorney General Opinion 86-0155, issued on March 12, 1987, interpreted N.J.S.A. 30:4-91.2 and concluded that it was "clear that the Legislature contemplated and authorized a delegation of correctional responsibilities and authority to a private entity only in the context of a non-profit 'facility.'"

Thus, DOC does not have legal authority to enter into a contract for RCRP services with a for-profit entity. *See generally* Topics in Community Corrections, Annual

Issue 1998: Privatizing Community Supervision, at 4-5 ("As the private profit-making sector has become more involved in the provision of correctional services, concern has grown about the potential tension between the need to maximize profit and the need to provide the best possible correctional services."). Accordingly, the RFPs for RCRP services state that "[t]he facility must have a governing authority to assume legal responsibility for the management, operation, and financial viability of the facility. Pursuant to N.J.S.A. 30:4-91.2, the governing authority must be a non-profit corporation or association."

EHCA is a non-profit corporation founded in 1978. In each year since FY 1998, DOC has paid EHCA for RCRP services approximately half of OCP's total RCRP budget.

In 1996, EHCA's President/CEO formed a private, for-profit corporation named Community Corrections Corporation for the purpose of providing support services to EHCA. Following a name change, that for-profit company became known as Community Education Centers, Inc. ("CEC"). Under the terms of an agreement (the "Agreement") between CEC and EHCA, CEC provides "all the services" under EHCA's public contracts, including the "operation, support services management and maintenance of [the RCRP] facilit[ies]." Currently, EHCA pays to CEC the entire contracted per diem rates (ranging from $62 to $75), less the sum of $2. Thus, records reveal that out of $400,255,168 that DOC has paid to EHCA for RCRP services since FY 1997, EHCA has paid CEC approximately $390,000,000.

The same individual who serves as EHCA's President/CEO (the "CEO") also serves as the President/CEO of CEC. Similarly, there are several other people serving in executive management positions with both entities. According to EHCA's 2010 proposal for RCRP services, CEC "maintains a staff of approximately 800 in New Jersey specifically to service EHCA contracts," while EHCA has a staff of ten employees, five of whom are also employed by CEC. OCP's Assistant Superintendent informed us that OCP views these two entities as "the same company."

It appears that at this point a primary business purpose of EHCA is to receive public contracts on behalf of CEC. In an interview with OSC, the CEO explained that in its role as EHCA's support services provider, CEC "owns, operates and manages the facilities" and obtained all of the financing necessary to operate the facilities. The CEO described EHCA as "an independent holding company" that "wouldn't exist without CEC." He also has estimated that the state would save approximately $1 million annually in reduced per diem rates if CEC was not required to use the non-profit intermediary of EHCA.

EHCA's legal counsel subsequently asserted to us that EHCA and CEC are separate entities because each entity has separate boards of directors (with no overlapping membership), legal counsel, offices and auditors. EHCA similarly stated in its 2010 RCRP proposal that "the two organizations are not related parties." Furthermore, although the RFPs required all vendors to submit audited financial statements with their proposals, EHCA did not submit to DOC any of CEC's financial statements. Thus, DOC has no direct knowledge of CEC's financial condition. This is a cause for concern because if CEC were to become insolvent, EHCA itself would be incapable of performing the RCRP services for which the state has contracted.

The CEO stated to us that around the time of CEC's formation, he worked with the New Jersey Attorney General's Office (the "AG's Office") to structure the Agreement between CEC and EHCA in a manner that would be compliant with New Jersey law. He further presented us with two letters from the AG's Office to his attorney, dated October 7, 1994 and August 2, 1996. The first of these two short letters states, in relevant part: "We have reviewed this proposed subcontract and have discussed it with the Department of Corrections. We believe it is acceptable and therefore approve its execution." The second provides in relevant part, "On behalf of the Department of Corrections, and in conformance with our discussions, please be advised that the Department approves the revised Support Services Provider Agreement between [EHCA] and Community Corrections Corporation." Neither of the letters explains specifically how the contractual arrangement between

EHCA and CEC complies with the requirements of N.J.S.A. 30:4-91.2 and the 1987 Attorney General Opinion.

We recommend that OCP seek formal and updated legal guidance from the AG's Office on this issue. We note in this regard that the scope of EHCA's RCRP services has changed substantially since the time of the 1994 and 1996 correspondence referenced above. For example, in FY 1996, EHCA contracted with DOC for 152 beds at one facility and was paid a total of $2,998,469.22. In FY 2011, EHCA is under contract for 1,390 beds at multiple facilities for a total of $34,808,590, out of which $33,793,890 will be paid to CEC. In the event that the AG's Office finds that subcontracting arrangements between non-profit entities and for-profit entities for all RCRP services are permitted under N.J.S.A. 30:4-91.2, we recommend that this be made clear in RFPs issued in connection with future RCRP procurements so that other potential vendors are aware that such arrangements are permissible.

Please inform us of the steps you plan to take to address the issues set forth in this letter. If you have any questions, please call me at (609) 984-2888. Thank you for your attention to these matters.

Very truly yours,

Dorothy Donnelly

Dorothy Donnelly
Director, Procurement Division

c: Robert M. Hanna, Esq., Director, Division of Law, Department of Law and Public Safety