



**STATE OF NEW JERSEY
OFFICE OF THE STATE COMPTROLLER**


**WASHINGTON BOROUGH
(WARREN COUNTY)**

**A PERFORMANCE AUDIT OF
PROCUREMENT PRACTICES**

**A. Matthew Boxer
COMPTROLLER**

**May 6, 2009
PA-03**

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BACKGROUND



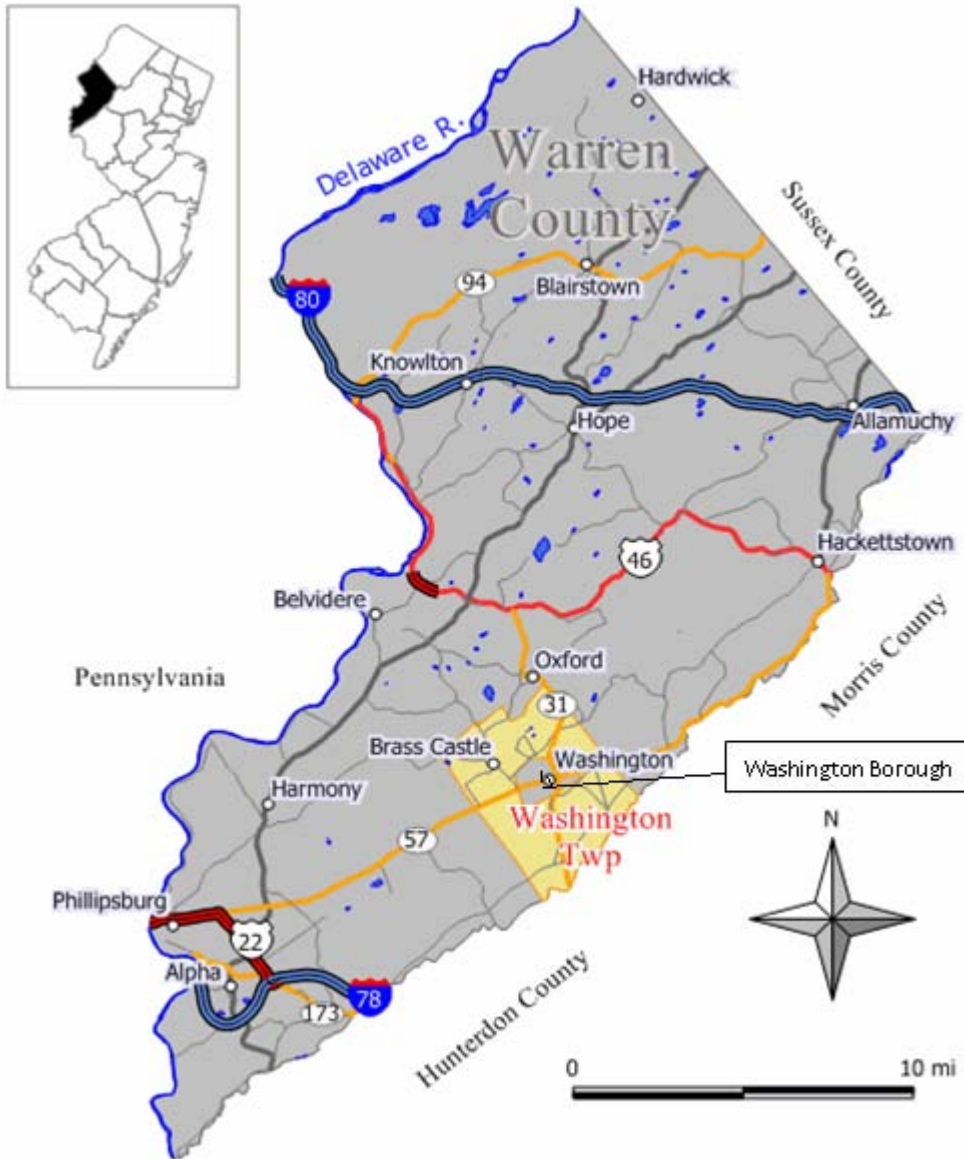
Washington Borough (Borough) was incorporated as a borough by an Act of the New Jersey Legislature on February 20, 1868. As of the 2000 census, the Borough had 6,712 residents.

Washington Borough is governed under the Faulkner Act/Council-Manager form of municipal government. This form of government consists of a Mayor, a Municipal Manager, and a Council. Under this form of government, the Municipal Manager serves as the chief executive and administrative official. The Municipal Manager appoints and supervises all municipal department heads, officers, subordinates and assistants; negotiates all contracts and assures their faithful performance; recommends and executes all municipal improvements; attends all Council meetings, apprising the Council of financial and other municipal matters as necessary; and prepares the municipal budget. In addition to having the power to appoint the Municipal Manager, all matters of policy are vested in the elected Council. The Mayor's duties are confined to executing bonds, notes and contracts on the Borough's behalf, and filling certain board vacancies.

In calendar year 2006 (CY 2006), Washington Borough expended \$96,577 in New Jersey State grant funds. The Borough received additional State aid of \$242,643.

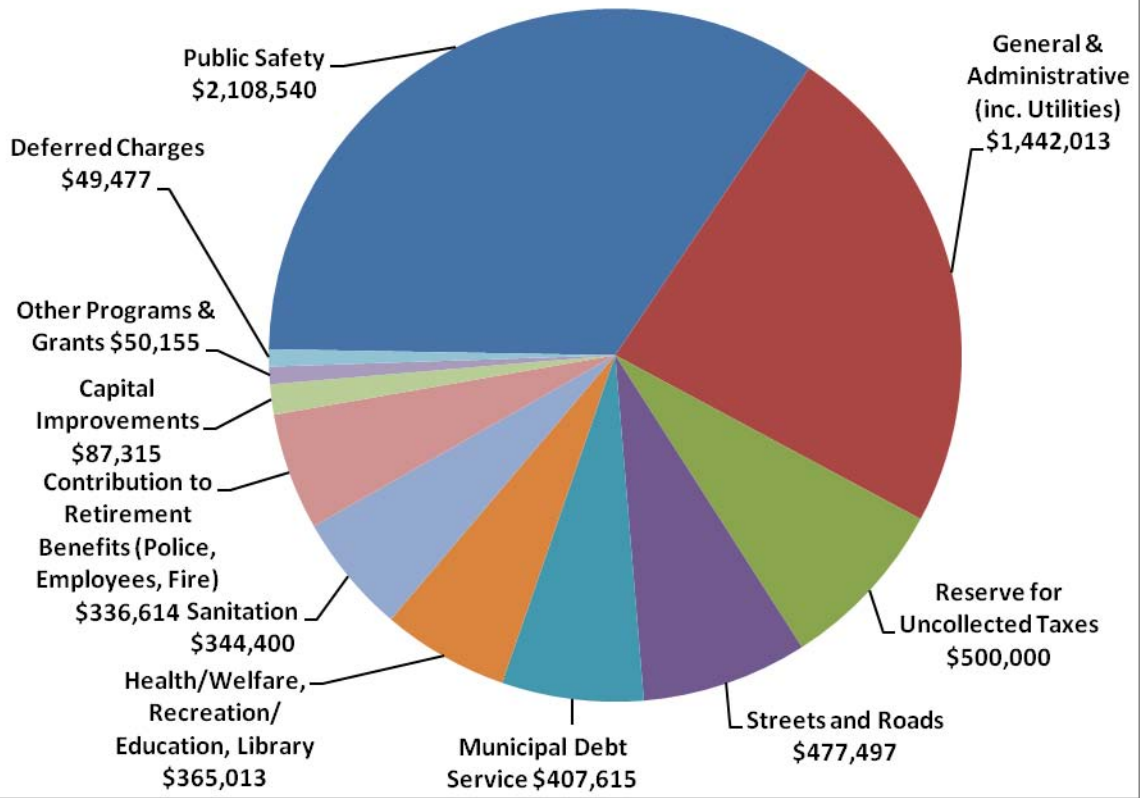
In calendar year 2007 (CY 2007), Washington Borough expended \$700 in federal grant funds and \$1,482,665 in State grant funds. The Borough received additional State aid of \$215,139.

The map on the following page shows the location of Washington Borough within Warren County. The Borough is entirely surrounded by another municipality, i.e., Washington Township.



According to its audited financial statements, Washington Borough's budgeted expenditures for CY 2006 were \$5,845,224 and actual expenditures were \$5,845,224. Budgeted expenditures for CY 2007 were \$6,168,643 and actual expenditures were \$6,168,639. In large part, these expenditures were funded through local property tax dollars. Figure 1 on the following page depicts CY 2007 actual expenditures by category.

**Figure 1: Washington Borough's Actual Expenditures CY 2007
Totaling \$6,168,639**



AUDIT OBJECTIVE, SCOPE AND METHODOLOGY



The objective of our performance audit was to evaluate Washington Borough's procurement practices for the period January 1, 2006 through December 31, 2008. Our audit included an evaluation of internal controls over procurements and purchasing as well as compliance with applicable laws and regulations. Specifically, we evaluated:

1. procurement policies and procedures;
2. the contract review process;
3. how decisions were made concerning procurements, such as responsibilities, authority and delegation; and
4. use of bond proceeds for capital projects.

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 performance audit in accordance with Generally Accepted Government Auditing Standards issued by the U.S. Government Accountability Office. 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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

To accomplish our objective, we interviewed Washington Borough management and staff, and reviewed relevant laws, policies and procedures. Using data provided by Washington Borough, we also performed a review of expenditures and tests of transactions.

SUMMARY OF AUDIT RESULTS



We conclude that Washington Borough's procurement practices are inadequate, have had negative fiscal consequences for the Borough, and need to be strengthened. For example:

- The Borough did not award professional services contracts in compliance with the State's Pay-to-Play legislation.
- Borough staff and management did not always follow the requirements set forth in the Borough's Purchasing Policy and Procedure Manual (Manual) or State law. In addition, the Manual is outdated.
- After ten years and more than \$1.9 million in costs, which is more than 280 percent over the original estimate, a prefabricated public works garage is still not completed. Engineering fees on the project, which were originally estimated to total \$33,700, stood at \$419,330 as of December 2008. Poor contract management and other Borough practices are the cause.
- The specifications for the purchase of a fire truck appeared to contain items proprietary to a specific manufacturer. This manufacturer was the only vendor to bid and was awarded the contract following a procurement process not designed to promote competitive bidding on this complex purchase.

Our evaluation of Washington Borough's procurement practices also identified several internal control weaknesses related to its fiscal operations.

We make 15 recommendations to enhance Washington Borough's procurement and fiscal operations.

AUDIT FINDINGS AND RECOMMENDATIONS

Procurement Practices

Washington Borough management did not follow appropriate procurement procedures.

Our review of Washington Borough's Purchasing Policy and Procedure Manual dated May 2005 identified the following:

- The bid threshold contained in the Manual is \$25,000. Pursuant to N.J.S.A. 40A:11-3 the current bid threshold is \$29,000 in municipalities with a "qualified" purchasing agent.¹ Washington Borough does not have a "qualified" purchasing agent and therefore should be using the lower bid threshold of \$21,000.
- The Manual does not include procedures for Borough staff to follow to comply with Pay-to-Play legislation, as set forth in N.J.S.A 19:44A-20.4 et seq.

Our review of eight purchase orders from CY 2007 found the following exceptions to Washington Borough's policies and State law:

- One purchase order (\$6,850) for repairs on a sweeper was accompanied by only one quote. According to Washington Borough's Manual, three quotes should have been obtained. Further, State law (N.J.S.A 40A:11-6.1) requires a minimum of two quotations for items estimated to cost more than 15 percent of the \$21,000 bid threshold, i.e., over \$3,150. Obtaining multiple quotations helps ensure the Borough purchases goods and services at the lowest price and guards against favoritism.

¹ Qualified purchasing agents are certified in accordance with criteria established by the New Jersey Department of Community Affairs. The criteria include actual experience as a purchasing agent and completion of certain education requirements.

- One purchase order (\$5,000) for the purchase of a lawn mower was accompanied by a form containing three quotations on different models of lawn mowers, all from one vendor. Instead, a minimum of two quotations from two different vendors for the same purchased model should have been obtained as per N.J.S.A 40A:1-6.1A.
- One purchase order (\$1,350) for repairs on a loader was not accompanied by quotes. Washington Borough's standard procedures require a minimum of three written price quotations for items estimated to cost over \$1,000.
- Two purchases exceeded the original quoted price without justification (or approval by Washington Borough's Borough Manager²). One purchase had an original quote of \$6,850 and a final cost of \$8,543, an increase of \$1,693 (25 percent). The second purchase had an original quote of \$6,300 and a final cost of \$11,085, an increase of \$4,785 (76 percent). The lack of a justification for the increased costs circumvents budgetary and approval controls.
- Purchasing activities were not reviewed and monitored by the Borough Manager, as required by the Borough Code, to ensure legitimacy and accuracy. During the period of our audit, the CFO/Treasurer was allowed to complete purchasing activities with minimal oversight. Six purchase orders were not approved by the Borough Manager.

Non-Compliance with the Pay-to-Play Law

Washington Borough did not adhere to contracting procedures required by the State's Pay-to-Play legislation and related State-issued guidelines. In general, Pay-to-Play legislation requires that in awarding Professional Service contracts otherwise exempted from formal bid procedures, an entity must select either a "fair-and-open" process (one that bases selection of prospective professionals on award criteria publicly established by the entity in advance of the award) or a

² Washington Borough uses the term Borough Manager to refer to its Municipal Manager.

“non-fair-and-open” process (one that does not require public notice and application of award criteria in advance of the award but instead requires a certification by the professional that reportable contributions have not been made to certain political organizations and individuals in the previous year).

We reviewed four professional service contracts awarded between January 1, 2006 and December 31, 2008. We found the following:

- The Council resolutions did not indicate whether the contracts were awarded pursuant to a “fair-and-open” or “non-fair-and-open” process for any of the four contracts tested.
- There were no public notices of solicitation pursuant to a “fair and open” process along with pre-award publication of award criteria for any of the four contracts tested. These would have been found had the Council intended the process to comply with the “fair-and-open” process.
- In the absence of evidence supporting a “fair and open” process, the vendor did not supply the requisite vendor certification of Pay-to-Play contribution compliance for a “non-fair-and-open” process for any of the four contracts tested. (However, we are not aware of any disqualifying contributions having actually been made).
- All contracts should include language demonstrating compliance with the reporting requirements of N.J.S.A. 19:44A-1 et seq. relating to political contributions. Three of the four contracts did not include such language. The contract that did comply was prepared by the Borough Attorney.

When asked, Borough management acknowledged that they had not implemented the Pay-to-Play legislation.

Contract Language does not Protect the Borough’s Interests

Borough contracts for professional services lacked certain enforcement provisions that are necessary to protect the Borough’s interests. First, Council resolutions awarding these contracts were required by N.J.S.A 40A:11-4.

Second, N.J.A.C. 5:30-5.4 further requires a governing body to provide a certification of availability of funds indicating the exact line-item appropriation of the local budget to which the contract will be charged. That regulation also requires that the certifying document itself be attached to the resolution. To carry out the intent of the certification requirement, when the value of the contract is not known, the entity should include a “not-to-exceed” amount in the resolution and contract. Two of the four contracts reviewed were not awarded pursuant to any resolution and therefore did not have a corresponding certification of funds. Without Council action in the form of a resolution, the Council and local taxpayers did not have an opportunity to review the merits of these contracts.

Prior to 2008, professional engineering services performed for Borough projects were not governed by contracts covering a specific project. Instead, engineering services were performed at rates established in a general contract. Since this general contract did not make reference to a specific project, the progress of services provided under the contract could not be monitored with respect to any specific project. Further, in the absence of a defined scope of services and not-to-exceed cost language, the engineer could continue to submit bills under the contract without limitation. As discussed later in this report, these deficiencies in the contracts resulted in Washington Borough paying excessive engineering fees for a capital project we reviewed.

Recommendations

1. Update the Purchasing Policy and Procedure Manual to conform with the Borough Code and State law including Pay-to-Play legislation.
2. Familiarize employees with the newly updated Manual and monitor compliance.
3. Approve all purchase orders in accordance with the Borough Code.
4. Justify purchases that exceed the original estimate. The purchase, along with the justification, should be approved by the Borough Manager.

5. Consider requiring the Borough Attorney to review contracts prior to their execution.
6. Write contracts that include enforcement provisions to protect the Borough's interests. Ensure all contracts include scope of services provisions detailing vendor obligations under the contract. In cases in which the contract amount is unknown, use "not-to-exceed" language.
7. Attach a certification of funds to resolutions awarding contracts and recite in both the certification and the resolution the line-item appropriation to which the contract will be charged.

Construction of Public Works Garage

Ten years, \$2.7 million, garage still not completed.

In December 1998, at the request of the Washington Borough Council, the former Borough engineering firm investigated the feasibility of and costs associated with the construction of a garage for the Borough's Department of Public Works (DPW). The total cost estimated at that time was \$569,311 (including engineering fees of \$33,700). It was not until August 2008, nearly 10 years later, that the Borough broke ground for the garage. As of December 17, 2008, we found that despite borrowing nearly \$3 million and thus far expending over \$1.9 million to construct the garage, it is still not completed (See Figure 2). The anticipated completion date (according to Washington Borough staff) is now July 2009. The projected final cost is currently \$2.7 million, which is more than four times the original cost estimate.

Figure 2: Progress on garage being erected using prefabricated steel.



November 20, 2008.

We identified a series of factors that contributed to the excessive costs and extended timeline of this project, including:

- no project budget,
- no cap on engineering fees,
- no project-specific engineering contract, and
- an overall lack of project management.

To give an accurate accounting of what took place regarding this project, we reviewed ledgers beginning in CY 2000, at which time the DPW garage account had \$36,709. We were unable to identify the source of the beginning balance of \$36,709 because the general ledger for the period prior to 2000 was not available. Since there was no complete accounting of the project at the Borough, we prepared the following Table:

Table 1: Accounting of DPW Garage Financing

| Bond Issuance | Capital Bond Proceeds | Money Transferred In | Money Transferred Out | Money Spent on DPW Garage | Encumbered for Construction | Account Balance (unallocated) |
|-------------------|-----------------------|----------------------|----------------------------|---------------------------|-----------------------------|-------------------------------|
| Beginning Balance | | \$36,709 | | (\$36,709) | | -0- |
| 15-2000 | \$600,000 | \$97,196 | (\$245,180)* | (\$452,016) | -0- | -0- |
| 8-2005 | \$700,000 | \$2,932 | (\$24,481)** (\$8,414)* | (\$610,421) | -0- | \$59,616 |
| 7-2007 | \$1,670,000 | -0- | -0- | (\$826,982) | (\$817,175) | \$25,843 |
| Total | \$2,970,000 | \$136,837 | (\$278,075) | (\$1,926,128) | (\$817,175) | \$85,459 |

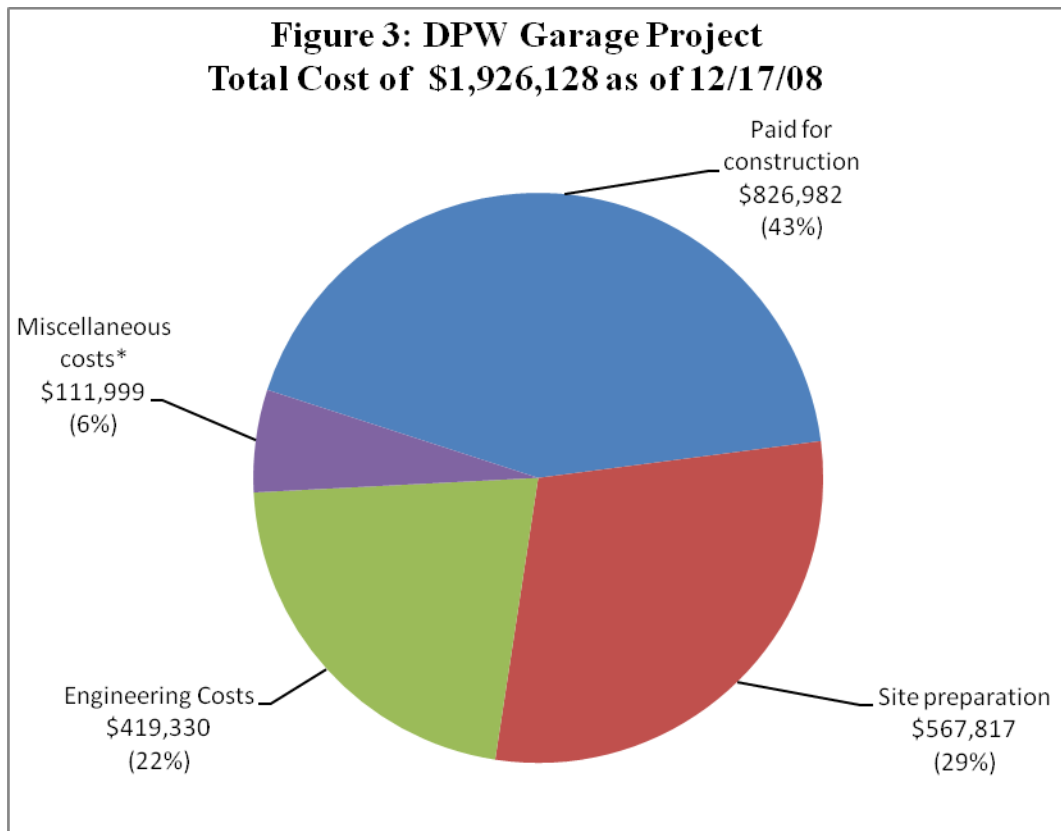
* Violation of Local Bond Law, N.J.S.A. 40A:2-39 [(245,180) + (8,414) = (\$253,594)]

** Of the \$97,196 that was transferred in, \$24,481 came from Bond Issuance 8-2005 and the remaining \$72,715 came from other sources.

As shown in the above table, the Borough raised nearly \$3 million in financing for the garage through 3 separate bond issuances. Of that \$3 million, \$1.9 million was spent on the garage project (see Figure 3 for details) with an additional \$817,175 set aside for continued construction.

Of the \$278,075 that was transferred out of the bond proceeds, \$253,594 was transferred to other accounts (for example, park drainage and current fund unrelated to the DPW garage) prior to the start of the garage construction. N.J.S.A. 40A:2-39 prohibits the transfer of borrowed monies from one project to another prior to the completion of the initial project unless the funds are no longer needed for the original bonding purposes and the governing body authorizes the transfer of such funds by resolution. In this instance, the funds were transferred out despite the fact that the money was still needed for the project and that no resolution was passed authorizing the use of DPW garage bond funds for other purposes.

The results of our review of spending on this project are shown in Figure 3 below:



*Miscellaneous costs include: publishing fees, bond issuance costs, interest, attorney fees and accountant fees.

Our audit further revealed the following:

- There was no overall capital budget for the garage project which would have allowed Washington Borough management and the Council to monitor the project's cost and progress.
- As of December 17, 2008, engineering fees were 22 percent of the total project cost, a significant increase from the 6 percent for engineering fees in the original project estimate.
- Included in the \$419,330 in engineering fees is \$115,000 paid to the current Borough engineering firm appointed in 2008 and \$304,330 paid to the former Borough engineering firm for the following:
 - \$130,223 for feasibility studies (55 billings from May 2000 through December 2005),
 - \$115,012 for garage design fees (46 billings from February 2004 through February 2008),
 - \$50,335 for site inspection (22 billings from March 2005 through November 2007), and
 - \$8,760 for services that were undeterminable due to insufficient documentation.

As previously referred to, the applicable contracts did not set forth the scope of engineering services to be provided and did not include not-to-exceed cost language.

- In January 2008, a new engineering firm was awarded the contract to oversee the construction of the DPW garage. In a letter to Washington Borough, the new engineering firm indicated that segments of the garage design were not in compliance with the most recent Building Code. As a result, Washington Borough obligated another \$75,000 in 2008 for design services.

- The site preparation costs of \$567,817 were separate from the engineering costs and included: \$149,707 for equipment rental (including the cost of excavator rental for 244 days, bulldozer rental for 192 days and compactor rental for 100 days), \$184,921 for materials and \$233,189 for trucking services. The labor for the site preparation phase was performed by DPW staff. We were unable to determine the costs associated with this labor as DPW did not track such costs on a project by project basis. Therefore they are not included in the cost of the garage.
- In November 2007, the construction contract was awarded in the amount of \$1,513,000. This was a 282 percent increase from the 1998 estimate of construction expenses.

Washington Borough is expected to spend \$2.7 million (not including the unknown site preparation costs associated with the work of DPW staff) and at least 10 years on the DPW garage project. Taxpayers have borne the burden of the bonded debt and still do not have the benefit of a useable DPW garage.

Based on the overall results of this audit, and in particular the contract deficiencies and lack of project budgetary oversight, we conclude that had the Borough exercised appropriate oversight from the project's inception, it would have been completed in significantly less time and at a lower cost to taxpayers, particularly in light of the fact that the garage used a prefabricated design.

Recommendation

8. Contract for services in accordance with the recommendations in the previous section of this report. Then, exercise adequate contract management to control spending and monitor the progress of projects. One way of accomplishing this goal would be to develop line-item capital project budgets and monitor actual costs against budgeted line-items.

Purchase of Fire Truck

Borough fire truck specifications favored a specific manufacturer.

In October of 2008, Washington Borough approved the purchase of a new 95-foot Arial Fire Fighting Apparatus (fire truck). Only one company (Pierce Manufacturing) responded to the Borough's request for proposals (RFP). A second company requested a copy of the specifications for the fire truck, but did not submit a proposal because it could not produce one within the time allowed. The contract was awarded to Pierce Manufacturing for \$891,177³ on December 31, 2008.

We examined the 2008 fire truck procurement process and concluded the following:

- Several items in the specifications appear to be proprietary (those requiring a specific manufacturer or vendor) to a specific manufacturer. Among these items were two items (a “hands-free auto clamp style bracket for SCBA type seats” and a “luminescent rung cover”) that are exclusive to or patented by Pierce Manufacturing. Other examples of anti-competitive specifications in this RFP included a requirement that the cabin chassis be manufactured by a single source manufacturer and specifications governing the size of the compartments (within a tenth of an inch) and type of side-view mirrors. Such specifications make it nearly impossible for other bidders to meet the specifications without exceptions.⁴

³ Washington Borough received a \$375,000 grant from the Federal Emergency Management Administration for the purchase of the fire truck, issued bonds to raise \$500,000 and funded the remainder from general operating funds.

⁴ In September 2008, the State Commission of Investigation issued a report entitled *Alarming Contracts* that looked at the purchase of fire trucks in New Jersey. The investigation examined dozens of fire truck procurements in localities across the State. (Washington Borough was not among the localities included in the report). Among the report's conclusions was: “The dysfunctional hallmark of this system is heavy reliance by local public officials on proprietary specifications written by fire truck manufacturers and passed along by their dealers' sales personnel.”

- The bid was open for only 12 days (9 business days). This did not allow enough time for at least one interested bidder to properly prepare a bid proposal. Although the time frame was legally compliant, this bid window was not in the best interests of the taxpayers and not designed to promote competitive bidding on this complex purchase.

By using specifications that call for items that are exclusive to or patented by a particular manufacturer, the population of bidders is effectively narrowed or limited to the one vendor who can meet the RFP with no material exceptions. This is a violation of N.J.S.A. 40A:11-13 which requires that specifications be drafted “in a manner to encourage free, open and competitive bidding.” The use of proprietary specifications is only permitted if first approved by resolution of the governing body and only when functionally necessary to carry out the contract.

Recommendations

9. Extend the bid times for complex purchases.
10. Describe items in RFP specifications in generic component terms to avoid proprietary specifications and benefit from open competition.

Internal Controls

Washington Borough's management has not established an effective system of internal control.

Internal controls are the methods and measures adopted within an entity to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies. Additionally, such controls should be in place to ensure compliance with applicable laws and regulations. Management is responsible for evaluating its operational and fiscal environment and establishing an effective system of internal control.

Our evaluation of Washington Borough's procurement practices revealed weaknesses in internal controls as follows:

- The organizational structure lacked segregation of duties in critical areas that would help ensure the safeguarding of Borough assets. For example, the same individual receives and records revenues, and prepares the deposit slips and makes the actual deposits.
- We identified 115 general ledger adjustments totaling \$395,497 in 2006 and 61 adjustments totaling \$97,572 in 2007. The Borough could not provide supporting documentation for these adjustments, nor were they approved by management.
- The Borough has 32 separate bank accounts. The majority of the accounts have minimal activity consisting of occasional deposits and monthly interest.
- Monthly bank statements are not reconciled to the check registers and book balance.

Recommendations

11. Evaluate the operational and fiscal environment of the Borough. Establish a formal system of internal control that mitigates risk and vulnerabilities. Train staff in the application of controls and monitor adherence thereto.
12. Review the organizational structure to ensure segregation of duties.
13. Provide detailed explanations to support general ledger account adjustments.
14. Review the number of bank accounts and reduce them in order to increase control over cash management.
15. Perform proper monthly bank reconciliations on a timely basis.

REPORTING REQUIREMENTS



We provided a discussion copy of this report to Washington Borough officials for their review and comments. Their comments were considered in preparing our final report and are attached as Appendix A. The Borough's response indicated that our report will assist them in moving in the correct direction in the future. The response indicated several actions, both pending and implemented, to address some of the issues and recommendations contained in our report. At a future date, the Borough will provide a corrective action plan addressing all of the report's recommendations.

The Office of the State Comptroller is required by statute to monitor the implementation of our recommendations. To meet this requirement, Washington Borough shall report periodically to this Office advising what steps have been taken to implement the recommendations contained herein, and if not implemented, the reason therefore.



BOROUGH OF WASHINGTON

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BOROUGH CLERK EXT. 113
CODE ENFORCEMENT EXT. 139
EMERGENCY MANAGEMENT EXT. 131
FINANCE EXT. 117
FIRE PREVENTION EXT. 142

A Council Manager Community

MANAGER EXT. 119
SEWER EXT. 116
TAX ASSESSOR EXT. 129
TAX COLLECTOR EXT. 117
ZONING EXT. 139

April 20, 2009

Mr. William P. Challice
Audit Director
Office of the State Comptroller
P.O. 024
Trenton, NJ 08625-0024

Dear Mr. Challice:

I am in response of your "discussion copy" of the Performance Audit of Procurement Practices within the Borough of Washington dated April 2009. Since its receipt, I have reviewed the report in great detail, as well as met with your staff do discuss the findings and recommendations outlined. As such, I would like to take the opportunity to identify the corrective action(s) that the Borough will be moving forward with as a result of your report, which are as follows:

Pending Actions

- Our purchasing manual is being updated to properly reflect the various thresholds reflected in the Local Public Contracts Law, as well as ensuring staff is properly trained in public purchasing procedures.
- Revamping the structure of the Finance department to ensure proper oversight, as well as segregation of duties where possible.

Implemented Actions

- Purchase requisition approval has been modified to ensure all funds have been properly certified prior to generating a purchase order. Additionally, no purchases will be approved unless the user department has the actual purchase order in-hand, which reflects the total encumbrance of funds. (This is for both bid and non-bid items)

- Any changes in the dollar amount of purchase must properly be justified prior to approval.
- All of the appropriate Pay-2-Play language and documentation (Chapters 19 & 271) will be received for all professional service (IE: Fair-and-Open or Non-Fair-and-Open) contracts over \$17,500, as well as any vendor whom we receive any goods/services from whose aggregate costs exceed this threshold.
- When awarding contracts for professional services (as indicated above), not-to-exceed amounts for each contract will specifically be outlined in the awarding resolution, as well as individual certification of funds.
- Working closer with staff and professionals to ensure more accountability and oversight as it relates to contract management. This includes, but is not limited to proper bid specification development and enforcement of the Local Public Contracts Law.

With the above in mind, I would like to take the opportunity to thank you and your staff for the hard work that was put into compiling the information addressed in your report. It was very informative, and will assist me greatly in pointing the Borough in the correct direction in the future. That being said, I can not attest to how or why things were done prior to my employment with the Borough, but as a Registered Public Purchasing Official (RPPO) and Qualified Purchasing Agent (QPA), my education and training has provided me with the skills needed to ensure that the errors noted will not happen again in the future.

I thank you and your staff for your time, and offer of assistance should we request it in the future. Hopefully, should our paths cross again; it will be under better circumstances.

Sincerely,

A handwritten signature in cursive script that reads "Richard D. Phelan". The signature is written in dark ink and is positioned above the printed name.

Richard D. Phelan
Borough Manager