

APPENDIX I

Accountability Recommendations Regarding the Application of Sarbanes-Oxley And Other Requirements on Recipients of State Aid

DCA is a large, complex organization. It has significant fiduciary responsibilities that bring with them a commensurate level of fiduciary obligations. It is also subject to a wide array of statutes, regulations and codes of conduct on both the State and Federal levels. Significant improvement is required in DCA's auditing, compliance, and enforcement control systems.

For DCA, like other institutions, a vigorous system of auditing, compliance and enforcement controls is required to provide reasonable assurance that operations will proceed effectively and efficiently, that financial reports are reliable and that processes and procedures comply with applicable laws, regulations and policies. Other important potential benefits include the ability to:

- Demonstrate to New Jersey taxpayers DCA's commitment to fiscal responsibility;
- Identify and prevent criminal and unethical conduct;
- Improve sources of information on what expenditures do or do not work in a cost-effective manner in the public interest;
- Encourage people both inside and outside DCA to report potential problems;
- Improve procedures that allow the prompt, thorough investigation of alleged misuse of taxpayers' funds--whether through negligence or intentional misconduct; and
- Ensure immediate and effective corrective action where misuse has occurred.

There are significant opportunities for improvement throughout DCA's grant-in-aid process in the areas of control systems and performance measures to ensure that funds are properly used, that they achieve their intended results and that non-compliant organizations are censured.

Over the course of a number of years, a series of budget cuts at DCA have been applied in a manner that has compromised severely its ability to administer the necessary level of controls. In fact, the Internal Auditing Department staff has been allowed to decrease to a level (two auditors) where its effectiveness can be substantially questioned. Even in extreme budgetary circumstances, administrative

units that provide checks and balances to ensure accountability (such as internal auditors, financial and legal support, etc.) are central to the long-term health and appropriate functioning of a strong institution.

Ensuring that DCA's Auditing Department is not only adequately staffed to meet the growing demands of the DCA but that its personnel also have the requisite skills is a critical first step for DCA. Although ensuring an effective auditing program will require a commitment of financial resources, the necessary expenditures are relatively insignificant in comparison to the problems of waste and misuse inherent in expending taxpayers' funds without a vigorous auditing and compliance program.

Furthermore, strong consideration should be given to the development and incorporation of SOX-like corporate responsibility best practices at the recipient level. As a first step, a certification of fiscal controls should be required from the Mayor, Business Administrator, Chief Financial Officer (or equivalent), the governing body and their nonprofit counterparts. In the private sector, SOX requires that both Chief Executive Officers (CEOs) and Chief Financial Officers (CFOs) review and sign quarterly and annual reports certifying that the reports do not misstate or fail to state material facts, and based on their knowledge, "fairly present in all material respects the financial condition and results of operations of the [company] as of, and for, the periods presented in the report." The same certification requirements can and should be applied to those officials of organizations receiving taxpayer funds through DCA.

Certification requirements should include those policies and procedures that:

- (a) pertain to the maintenance of records that in reasonable detail accurately;
- (b) fairly reflect the transactions and dispositions of the assets of the local government or nonprofit entity;
- (c) provide reasonable assurance that expenditures are being made only in accordance with the authorizations of the elected officials or nonprofit executives entrusted by the taxpayers with such responsibility (in the case of a municipality, the mayor and governing body); and
- (d) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements submitted to DCA.

While there are critical fiscal accountability weaknesses inside DCA, they are compounded by the lack of necessary skills at the grantee level (municipalities and nonprofits). Consequently, where it is the

case that DCA exercises suboptimal oversight and sporadic enforcement, the recipients themselves are occasionally incapable and/or unwilling to exercise fiduciary controls of their own.

Grantees need sufficient training so that they can understand the legal and fiduciary requirements governing grant funds. It is common sense that if grantees do not understand the various laws, policies and procedures governing grant funds, those laws, policies, and procedures will not be followed. To that end, a required formal education process stressing fundamental fiscal accountability should be developed for those who have responsibility for administering federal and state funds.

Once grants are awarded, it is vital that DCA properly manage the grants. DCA needs to ensure that grant funds are used for intended purposes in accordance with state and federal law, and will lead to planned results. Effective grant management increases the likelihood that grants will contribute to DCA's goals. When managing grants, DCA should address:

- **Better monitoring the financial status of grants;**
- **Ensuring results through performance monitoring;**
- **Using audits to provide valuable information about grantees; and**
- **Monitoring sub recipients as a critical element of grant success.**

Finally, serious consideration should be given to the centralization of compliance and fiscal enforcement in the Treasurer's Office where presumably there will be a higher level of fiduciary skills; the ability to share best practices on a broader (inter-departmental) level; and, importantly, the authority to administer penalties if necessary. To be successful, this centralization decision requires an initial and continuing investment of professional resources at Treasury or there is the risk of surrendering local control without improving the system.