MEMORANDUM

TO: David Samson, Chairman, Transition Executive Committee
Jeff Chiesa, Executive Director
Rich Bagger, Chief of Staff Designate
Joe Kyrillos, Executive Committee
Mark Braden, Deputy Executive Director

FROM: Mike Ferguson, Chairman, Treasury Subcommittee
Treasury Subcommittee Members and staff

DATE: January 14, 2010

RE: Treasury Subcommittee Draft Report

Please find the attached Draft Transition Report for the Department of the Treasury.

The Treasury Department is one of the most complex and far-reaching Departments within State government. With a total FY 2010 budget of $2.58 billion and 4,000 employees, the State Treasurer manages numerous grants-in-aid, state aid, capital construction, property tax relief funds, the casino control fund, debt service and direct state services. The Treasury Department is organized into eight major divisions, several specialized divisions, two semi-independent agencies and fourteen in-but-not-of agencies. The following pages outline the analysis of the eight major divisions performed by the Treasury Subcommittee, with the remaining offices reviewed by other subcommittees or deemed to not be critical to this immediate analysis.

The State Treasurer serves as the Chief Financial Officer for the state and to the Governor. In this capacity the State Treasurer and staff is the principal advisor on budget planning, budget development and budget execution. Furthermore, the State Treasurer is responsible for all other finance-related activities, including issuance of financial statements, debt management, pension administration, investments, procurement, and taxation and revenue administration. The Treasurer serves as the de facto COO of the State providing virtually all core administrative services. No other state is structured like New Jersey regarding financial administration or in defining the responsibility of the NJ State Treasurer.

In each of the Divisions reviewed, the Subcommittee observed the degree of deterioration that has occurred over the past several years. Most of the Divisions have been constrained by seemingly arbitrary hiring freezes, which have threatened the ability of the unit to perform at an acceptable level of service. The age and condition of the technology available clearly contributes to delays in producing work product or the ability of the offices to make information available to the Governor for decision-making, or to the public or other state agencies.

The major problems we found were of two types – technology and personnel management. The technology deficiencies warrant a massive, multi-year, Department-wide and centrally driven modernization effort. The management problems stem from artificial, primarily union-driven constraints which should be directly addressed and/or lifted. We believe that the management problems are perhaps an even bigger strait-jacket to optimal Treasury function than obsolete technology.

It is our opinion that an immediate focus should be to improve the availability of information so as to improve the data flow to the Governor. Similarly, we believe that the prudent use of current technology could allow human resources to be redirected to those tasks that are clearly under-staffed today. The implementation of new technology is also the ideal time to review current processes and, where appropriate, implement “best practices”. This redirection of resources must be a high priority of the new Administration as critical services are currently running well behind schedule while wasting precious fiscal and human resources.

The following report provides a brief summary of each Division with an identification of the major issues facing each unit, as well as recommendations to address current or impending challenges.

DIVISION OF INVESTMENTS

A staff of 70 is responsible for conducting investment and reinvestment of $80 billion in State funds, including the various State pension funds, the State Disability Benefits Fund, the General Investment Fund, and the Cash Management Fund, together with the control of principal proceeds and interest receipts. They also provide investment functions to other State agencies involving investment accounts. The Division is funded directly from investment funds. New Jersey's pension fund ranks 13th in size among the nation's private and public pension funds.

Current investments include domestic and international equities, various fixed income and short term cash equivalent securities and alternate investments including hedge funds, private placements, and real estate funds. The Director reports to State Investment Council and the State Treasurer and is appointed by the Treasurer from a list supplied by the Council.

Major Issues:

- The Division manages $80 billion in investments for the state with a staff of approximately 70, including only 25 (largely non-union) investment professionals. This results in approximately $3.5 to 4 billion of investments per professional, a significantly larger amount of capital per manager than most privately managed funds, and first among major actively managed US public funds. The staff is therefore tasked with a large burden and challenged by several perhaps unnecessary constraints.

- Most of the non-investment professionals perform tasks using antiquated technology and processes which ignore opportunities to reduce the labor intensity of the workflow and without regard for best practices.

- The Division, despite the challenges, continues to be among the best performing entities in the nation, and has managed to navigate the financial crisis in superior fashion when compared to its peers. However, there is tangible concern at the Division as well as among our Subcommittee that the unrealistic burden placed on the Division, combined with other factors, create significant potential risks:

    - The Division, per the settlement of a court action taken by unions, is not permitted to use external managers as true managers. Consequently, the Division must manage the entire portfolio using the in-house staff – and is the only state pension fund in the nation to do so. Given the scale of investments, the Division is having difficulty performing the appropriate level of due diligence, compliance or performance monitoring, given its fiduciary responsibility. In addition, it creates a situation where full time staff must explicitly "bless" each trade made by "external advisors" – resulting in delays in the execution of trades and/or trades not being executed in optimal market conditions. Furthermore, the quality of expertise and training of the staff is uneven, with some staff lacking the expertise necessary to perform the necessary monitoring of investments.
    - Critical procurement delays related to the acquisition of pension services are tremendously inefficient for the Division – particularly as the Procurement Division staff typically does not have the expertise to understand financial products and services. As an example, currently a critical appointment of a single global custodian service (which will

bring significant operational efficiency) is being held up by the Procurement Division for these reasons. This is an item which should be considered by the Red Tape Task Force.

- Another critical area which will need to be evaluated is the State Investment Council. Reforms are needed to institutionalize the SIC's operation. In addition, the composition of the SIC will need careful attention as:
    - Currently, 3 of the 13 members are serving without Senate confirmation, and others are in a hold-over position.
    - The Legislature has increased the mandated union representation on the SIC in recent years (without regard to qualifications), and efforts should be made to ensure that all members are appropriately skilled and understanding of their responsibilities.

Recommendations:

- Move to award a "global custodian contract" to obtain the required services.

- Retain outside advice to review technology improvements to support the Division.

- Review the statute which authorized the Division to enter into alternative investments to address the issues raised by the Appellate Court in an effort to enable the managers retained for these investment vehicles to operate in an appropriate fashion.

- Review the Alternative Investment program to ensure that appropriate procedures are utilized relating to the sourcing, due diligence and monitoring of all these investments to provide the highest level of transparency, risk aversion and control.

- Move immediately to appropriately staff the SIC.

DIVISION OF PENSIONS AND BENEFITS

This division has a staff of 307 employees and is responsible for all administrative functions of the State Pension funds, except for the functions of the investment of assets. The Divisions administers a comprehensive benefit program, the second largest public employee benefits program in the nation. The division is responsible for the State's seven major retirement systems (PERS, TPAF, DCRP, PFRS, SPRS, ABP, JRS); three closed retirement systems (CPFPF, POPF, CPF); the State's two major health benefit programs (SHBP, SEHBP) that includes nine different health plans, eleven dental plans, and a prescription drug card plan; an extensive pension loan program to its members; supplemental retirement savings programs (New Jersey State Employees Deferred Compensation Plan, Supplemental Annuity Collective Trust (SACT), an Additional Contributions Tax Sheltered Program (ACTS); and also administers the IRS Section 125 program, termed Tax$ave, for State employees.

There are 805,000 active and retired members in the pension systems and an estimated 390,000 members in the health benefit programs with covered lives of about 840,000. The Division annually handles over 940,000 phone calls (average waiting time over 30 minutes), 1.9 million internet inquiries and about 100,000 interviews and correspondence.

Major Issues:

- The Alternate Benefit Program provider (the pension system for Higher Education) contracts expire in April, and the Division has not solicited bids for a consultant to write specifications for this provider contract. This will require an extension of the current contracts and an expedited process for soliciting new proposals.

- The Actuarial report for the fiscal year ending June 2008 was not delivered until a full 10 months after the year end. A delay of this sort is unacceptable, and the situation is occurring again this year – this must be corrected.

- The IT infrastructure is 30 years old and on the verge of collapse. There is only one technician who can manage the software, as the software is written in an old code. While the Office of Information Technology (OIT) views this as a priority for upgrading, it is also viewed by them as a stable functioning system and thus has not yet dedicated resources for an upgrade.

- Current and long-range costs for the various pension funds and health benefits programs are on an unsustainable path, which has been exacerbated by the failure of previous administrations to budget appropriately. For example:

    - Employee benefit programs, excluding social security, are projected at $2.7 billion in FY 2010. By 2014 these costs are projected to be $8.2 billion, assuming full required pension contributions are made.

    - The aggregate unfunded accrued liability of all state pension funds as of 6/30/08 was $34.4 billion, and a recent Moody's report put the unfunded accrued liability at $51 billion as of 6/30/09.

    - Active and retired health costs are projected to be $2.3 billion in 2010 and rise to $3.7 billion in FY 2014.

- All health benefit programs are on a PAYGO basis, and as of 6/30/08 the unfunded accrued liability of health benefits for retirees is approximately $50 billion.

- Of the total employee benefit expenditures, over 50% are related to local teachers with the post retirement health benefit portion of $1.2 billion (66%) paid by the state on behalf of local teachers.

Recommendations:

- There needs to be a fresh focus on IT infrastructure, which is severely outdated, and cannot handle the frequent statutory and contractual changes. Technology changes will take time to develop and deploy and interim approaches should be considered. One option would be to standardize benefits where possible so the IT infrastructure can be more easily maintained.

- Staffing levels should be re-examined to ensure that new technology enables higher performance of personnel. Head count has decreased during the last several years, and new technology when ultimately deployed should enable the Division to function more effectively. In the interim, recent staffing reductions should be evaluated to determine interim needs or it could lead to service degradation.

- Extend the AON contract which expires on 3/31/10. AON performs actuarial consultant services for State Health Benefits program, including the dependent eligibility audit.

- Evaluate the remaining recommendations of the 2006 Bi-Partisan Legislative Committee to determine viability of the suggestions that have not been implemented.

- There are numerous Boards that have policy and operational impact on pension and health care costs. The Governor's appointees to these Boards need to be carefully reviewed and changed as appropriate.

- We have been made aware of a concept and technology developed by Lynchval Systems Worldwide that purports to provide a partial solution to the financing of the underfunded pension systems. We have not had the time or expertise to determine its viability and the feasibility of its implementation. But, given the severe unfunded liability of all of the pension systems, this tool should be evaluated as soon as possible. We have been informed that other public entities have implemented aspects of this tool.

- Increase transparency of state and local health benefits so that state government can study the drivers of cost increases.

DIVISION OF TAXATION

A staff of between 160 to 170 employees is responsible for the assessment and apportionment of taxes and the administration of all NJ tax laws. Specific functions include auditing tax returns and taxpaying entities; performing office and field audits; preparing tax refunds, certificates of tax lien search and certificates of tax lien release; holding taxpayer hearings and conferences; providing revenue analysis, research, and statistics for tax administration; services involving bankruptcies, judgments, bulk sales, liens, levies, seizures, proclamations, and reinstatements; and investigation of tax-related matters having criminal and/or civil potential. In FY 2009, revenue from enforcement actions exceeded $2 billion.

Major Issues:

- The Tax Department is understaffed and is suffering from low morale. Division senior management reported numerous human resource issues, including acting (not permanent) managers, understaffing in enforcement, only one person assigned to support technology, and cases where supervisors are paid less than those they supervise.

- The Division reported over $1 billion of tax liability; nearly $700 million of which is in conference, and nearly $400 million in Tax Court.

- The Tax Amnesty program has left the Division with only hard-core liabilities, and due to posting issues they reported that they could not validate the status of accounts making it impossible to bill for liabilities. This is particularly troubling as it brings into question the actual value of outstanding liabilities and the level of revenue that can be anticipated due to enforcement or collection efforts. The Taxation Data Warehouse will require a contract extension.

Recommendations:

- Eliminate funding for the Property Assessment Management System (PAMS) software. The State is spending $5.5 million to improve an outdated program. The Acting Director supports this recommendation. This project should be re-evaluated in conjunction with the Department of Community Affairs, at whose urging this project was initiated.

- The state hiring freeze has had the effect of prohibiting the hiring of additional auditors. The Division management estimates that each additional auditor accounts for $1 million in additional revenues per year, so an exception should be considered to assist the state in collecting revenue properly.

- There are several court decisions that have had a negative impact on tax collections by either creating disincentives for businesses (banks and hedge funds, among others) to locate in New Jersey, or loopholes allowing unanticipated tax avoidance. These need to be reviewed for possible correction by the Legislature.

- The State should continue to participate in the Streamlined Sales Tax initiative. This requires annual legislation which should be pursued as soon as possible.

- Current policy requiring the AG's office to approve all tax court settlements has significantly contributed to the backlog and delay in resolving cases. Both the Division and practitioners believe that the existing policy is unworkable. The red tape commission should review this policy immediately with an eye toward correction.

- Use technology to improve the efficiency of the audit staff. Today, most files are maintained in paper format. Requesting the Revenue Division to digitize the files would dramatically improve the performance of this unit.

- Reconsider the implementation of the "Auditor Interns" program, which provides an entry level position for recent college graduates with an accounting background. This program would bolster the depleted ranks of the Audit Unit.

- Consider the transfer of the Revenue Forecasting Unit from within the Division of Taxation to the Office of Management and Budget to allow this unit to become a larger resource in the development and management of the annual budget. This resource should also be considered for a larger role in the economic redevelopment of the State, as they can be utilized to understand and model various economic development strategies and the economic impact of new programs or proposals being considered by various state agencies or departments. However, to achieve these goals the staffing configuration of this unit needs to be overhauled.

- A full Tax Amnesty report must be prepared outlining the source of the amnesty funds; by tax and tax year as well as an analysis of the changes in enforcement or reporting that can be undertaken to produce greater compliance in future years.

- New Jersey is one of the only States that does not permit affiliated corporations to file a combined tax return. This policy wastes Tax Division resources as the Division and taxpayers spend countless hours ensuring that transactions between related taxpayers are "arm's-length". It also encourages corporate taxpayers to use tax planning techniques to minimize NJ taxes. This policy should be changed to allow affiliated corporations to file a combined return.

DIVISION OF REVENUE

With a staff of 380 employees, the Division of Revenue's mission is to be the State's centralized service provider in the following areas: business registration and public information; tax return and payment processing; revenue recording; non-tax debt collection; and electronic imaging and storage. The Division's services have yielded the following in fiscal year 2009: an electronic filing rate of approximately 60% (2.8 million) of individual income tax returns – a 10% increase over fiscal year 2008; implementation of a 100% e-file process for all income tax withholding, wage reporting and unemployment compensation forms; and approximately $20 billion of State revenue collected through electronic systems administered by the Division.

Major Issues:

- The Division collects revenue and performs processing functions for multiple agencies, but there are several agencies that have failed to transfer operations to this central office. These agencies that should be transferring revenue collection and data processing responsibilities to this Division needs to be examined and validated, with the intent of requiring them to use the services of the Revenue Division.

Recommendations:

- Invest approximately $250,000 to purchase "Check 21" software. This software will permit the State to digitally deposit checks, thereby saving 2-3 employees and earning the State approximately $800,000 in additional interest earnings.

- Review the hiring status and use of intermittent employees. The cost of these temporary employees appears excessive as they have been afforded benefits normally considered appropriate only for full-time employees.

- Require other Departments and Divisions to use the current resources of the Revenue Division. There were repeated stories of Departments maintaining paper files--and the associated warehouse, trucking and related services or of attempting to purchase their own equipment to digitize files. Requiring digital imaging from this existing central operation could produce significant savings (the Division reported that they continue to convert electronic files to microfilm for the State Library, as an outdated law requires all files to be converted to microfilm).

DIVISION OF RISK MANAGEMENT

A staff of 45 is responsible for reducing the adverse impact of financial losses to the State through a combination of risk management and loss prevention techniques, and for administering claims against the State or on behalf of the State against others responsible for damage to State property or employees. The Division is responsible for Property and Casualty, Torts, Auto, and Workers Compensation coverage. In 2006 the Director's position was made a Gubernatorial appointment with "advice and consent" from the Legislature.

Major Issues:

Total cost for Workers Compensation claims now exceed $75 million per year following a long period of steady increases in claims. Issues relating to the spike in these claims and cost avoidance opportunities need to be identified.

- The lack of investigating staff was reported as a problem and a contributing factor to the increase in claims. The average case load of a worker's compensation / adjuster is 1,100 each – the industry standard is 300. The high caseload has forced investigators to simply process claims after minimal screening.

- The States program "Sick Leave Injury" or SLI is the major cost driver and issue. This program needs to be eliminated.

- The program for evaluating coverage and ensuring the timeliness of removing property or equipment from coverage needs to be reviewed and improved.

- The total property/casualty claims and cost of insurance policies is approximately $120 million. Employee accidents paid under Workers Compensation and Sick Leave Injury (SLI) is 75% of all expenditures.

- A summarized breakdown of estimated costs for FY 2009 are as follows:

Category	**($ in millions)**
o Workers Compensation	$75.0
o SLI	15.0
o Automobile Liability	3.5
o Tort Liability	20.0
o Foster care Liability	.1
o Premiums for Property insurance	3.5
o Other Insurance (aviation, etc.)	1.4
o Operating costs of division	2.0
TOTAL	120.5

- The highest rate of accidents in departments vary by years, but in general the highest accident rates are in the departments of Human services (35%) and Corrections (25%) -- followed by the departments of Public Safety (13%), and Transportation (12%.)

Recommendations:

- The Sick Leave Injury (SLI) program should be eliminated. New Jersey is one of only 4 states that have both SLI and Workers Compensation. The SLI program is poorly designed and encourages workers to first claim a very expensive SLI injury claim before filing for Workers Compensation. This program compensates injured workers at full salary for up to one year. We should note that many local governments also have SLI programs. Reforming or eliminating SLI is a common sense solution to compensation abuses and has been proposed on many occasions but has never been approved by the Legislature.

- A viable risk control program has three critical items: (1) a visible commitment from senior management; (2) a tracking system to monitor results; (3) a system of management accountability. New Jersey has none of these items and must gain control of this issue.

- In 2005, the Public Risk Management Administration, Inc. was hired to perform a review of this program. They rendered an excellent report that contains a great deal of information, including 22 recommendations, some of which formed the basis for legislation in 2006. However, the most critical recommendations have not been implemented; this report should be reviewed for immediate implementation.

DIVISION OF PURCHASE AND PROPERTY and
DIVISION OF PROPERTY MANAGEMENT AND CONSTRUCTION

A staff of 151 is responsible for administering a centralized Statewide purchasing system, including the setting of purchasing standards and specifications; contracts for products and services to school districts, municipalities, and other political subdivisions through a cooperative purchasing program; contracts for major lease and purchase arrangements through the Master Lease Program; maintains a centralized distribution center to permit bulk purchases of all State departments; and supervises the disposition of State surplus property. The office manages over 3,100 vendors. The division works closely with the Division of Property Management and Construction in the acquisition, ongoing management and necessary construction of most leased and some state-owned real estate assets. Due to the overlap and synergies between the two divisions it is logical that they be reviewed together.

Major Issues:

- The core computer system that facilitates the state-wide procurement system was developed in the 1980's and because of old technology, and the failure to interact properly with the state-wide accounting system, it severely limits the timeliness and value of their work product.

- Operational workflow has been impacted by a 28% reduction in the workforce, leaving the Division with too few staff to perform the proper purchasing function.

- The new Director reports that cultural workforce problems, lack of understanding of the Division's mission, and the value of their work performed needs to be evaluated for immediate corrective action.

- The Division's website is clearly inadequate, resulting in a system that is not user-friendly to state departments, the public or the business community.

- The Division's strategy for using out of state purchasing contracts such as GSA and other State Association contracts needs to be evaluated for effectiveness. These contracts, entered into as a result of recent changes in procurement statutes, present an opportunity for considerable savings and efficiency, a detriment to the NJ economy, or both. Two recent procurement decisions (AutoZone and Staples) are the subject of ongoing litigation between the State and numerous vendors. The AutoZone case has been argued before the Appellate Court and the Staples case is scheduled for argument in Appellate Court on January 26th in Mercer County.

- The Division of Property Management and Construction, which was reviewed in concert with the Division of Purchase and Property, is responsible for negotiation and management of all leases, but is not able to maintain a current inventory or the related management of these properties. Many leases continue beyond their term, on month-to-month extensions, until retroactive negotiations and revised terms can be developed.

Recommendations:

- Improve the Division's website and web based resources to make their work product transparent to the public and to the Agencies and Departments of the State.

- Review S-2316 (Bateman) and A-1054 (Bramnick) as tools to resolve the issues inherent in the application of the statute that allows the use of out-of-state procurement systems as raised in the AutoZone and Staples contracts. Immediate attention should be paid to the State's position and argument now scheduled for January 26, 2010 before Judge Skillman in Mercer County as this case will impact purchasing decisions and budgets of municipalities and school districts as well as the state.

- With respect to the Division of Property Management and Construction, undertake an immediate and comprehensive inventory of all leases for space utilized by the State or its Agencies to allow for the development of a Master Plan for space use. Freeze all pending or proposed real estate transactions during the 90 days needed for the master plan to be developed.

- An extensive report on the operations of the Procurement Division was performed September, 2006 by the National Academy of Public Administration and contained numerous recommendations. This report needs to be reviewed for current relevance.

OFFICE OF MANAGEMENT AND BUDGET

A staff of 148 is responsible for providing strategic direction and financing alternatives within the policy framework set by the Governor, and implementing the results of those decisions. The Director is appointed by the Governor and supervises two distinct units: Budget, Management and Planning; and Financial Management. OMB functions include coordinating the annual agency-based planning process; evaluating budget requests from State departments and formulating the annual budget; providing for the receipt, processing, recording and reporting of all financial data of the State's various funds; and assuring that State employees and vendors are paid accurately and on a timely basis.

The Director's title previously included that of the Comptroller of the State. With the establishment of the new State Comptroller's office, that title was removed from the OMB Director -- however almost all of the functions remained with the OMB Director, including; operation of the accounting functions, cash management, payroll, and preparation of the Annual Financial Statements. It appears that some of the duties were transferred to the separate Office of the Comptroller -- or, are now performed by both. This issue and related oversight mandates should be re-evaluated.

Major Issues:

- The Division operates with 50 fewer staff than 7 years ago. Many of the functions that the OMB used to perform are no longer performed due to staff reduction or reassignment to the Comptroller's Office. Further reductions in this office could have negative state-wide implications.

- OMB systems are outdated. The OMB operates and maintains three key state-wide systems – the core accounting system, the budget planning, development and monitoring system, and the payroll system. All systems are outdated and lack desirable connectivity among them. By far the oldest system is the payroll system which is over 40 years old.

- The ability of the Division to produce timely and accurate financial reports appears to have been diminished. It is critical to understand the issues that are driving the production schedules and steps that could be taken to improve the performance of this critical task.

- Like other parts of state government, the Division cannot terminate non-performing personnel, nor can they reward outstanding personnel. It routinely loses its best people to higher-paying, less stressful jobs at other Divisions and Departments because of OMB's personnel policy limitations. This is perhaps an even bigger problem than outdated technology.

- OMB is a vitally important resource for the Governor and Treasurer and must have the support and recognition that is necessary to ensure budget discipline across the State.

Recommendations:

- OMB must take the lead in making the budget and financial reports of the state transparent to the public and state agencies and Departments.

- OMB analysts assigned to individual state Departments and agencies should be utilized to provide private and detailed briefings to newly appointed cabinet officers, offering their unique perspective on the operations and issues of each Department.

- The Revenue and Economic Forecasting Unit currently housed within the Division of Taxation should be reconstituted within the OMB to be led by an economist. This Office should be charged with providing ongoing analysis and support of the OMB management function as well as analysis and guidance on the impact of proposed economic development strategies, proposed legislation and related economic development initiatives of State Agencies and Departments.

DIVISION OF PUBLIC FINANCE

This Division, staffed with six professionals and one support employee, is responsible for the issuance of bonds and other instruments of indebtedness that are secured by payments from the State of New Jersey in a manner that achieves the lowest cost of capital. The Office must monitor and report upon the obligations in a timely and accurate manner. In addition, the office monitors and participates in the issuance of bonds not secured by payments from the State of New Jersey, such as those of the Turnpike Authority, South Jersey Transportation Authority, the South Jersey Port Corporation, the Tobacco Settlement Financing Corporations, and similar entities.

With regard to the debt of the State, as of November 30, 2009:

- The total outstanding debt of the state, including general obligation, appropriation debt, and moral debt is $33.8 billion.
- Of the total outstanding debt, 50 % relates to the Transportation Trust Fund ($10.2 billion,) and school construction ($7.1 billion.) No other single item exceeds $2.6 billion.
- Authorized but unissued debt amounts to another $10 billion – again the largest being for transportation and school financing – 87% of the total.
- The total amount of debt service in the FY 2009 budget is $2.9 billion – or 10% of the budget.

Major Issues:

- The Transportation Trust Fund is a major looming issue. Current information suggests that the TTFA has nearly reached the end of its ability to finance transportation projects under present revenue streams.

- The options available to the State to address the $500 million interest rate SWAP agreements must be addressed before May 1, 2010. Factors to be considered include timing issues relating to disclosure and the state budget calendar.

- The status of professional service contracts necessary to the continued operation of this Division needs to be reviewed. These contracts could include the SWAP advisory/monitor contract and the Bank Letter of Credit service both of which may need to be addressed in January.

- The entire debt and financing calendar and all the component requirements for 2010 must be evaluated and identified in order to avoid any problems with the orderly issuance of debt by the new administration.

- Various debt service initiatives, principally refinancing actions, have been accomplished during the first six months of this fiscal year to achieve most of the debt service savings that were assumed in the budget. Several smaller refinancing opportunities are available aggregating to approximately $15 million and should be accomplished in the second half of the fiscal year, and opportunities for further savings in fiscal year 2011 should be explored.

- Management of the State's $4 billion of derivatives (28 swaps outstanding) remains a challenge and should be monitored closely. The Office noted that the aggregated estimated termination value of all School Development Authority swaps is about $545 million.

- While the Office successfully guided the State out of the auction rate securities market (there had been $3.6 billion outstanding), some Authorities still have this debt outstanding.

- There are several areas related to the $12.5 billion school construction program that need attention by the new State Treasurer during the first six months of calendar 2010. The issues are related to (1) credit security, (2) interest rate swaps involving Merrill Lynch, and (3) the possible use of Build American Bonds and Qualified School Construction Bonds.

- The legislation governing state-supported county college bonds has a provision that limits debt not to exceed $ 265 million. The legislation also allows the amount of retired debt to be “re-issued”, as the Chapter 29 Statute creates this as a revolving fund for the Community College sector. Currently $ 30 million is available.

- Currently, the state has a contract agreement with the NJ Health Care Financing Authority paying $26.7 million in annual debt service -- (total debt issued is $450m) for what is known as the ‘Hospital Asset Transformation program.’ This program has allowed the state, through the Authority, to help financially stressed hospitals by essentially loaning money to one hospital to acquire another hospital. Hospitals that have helped include: St. Mary’s buying Beth Israel; Solaris–JFK/Muhlenberg; and Catholic hospitals. The Office of Public finance advises that the St. Mary project needs re-structuring at additional cost to the state and that the Solaris deal may also need restructuring.

Recommendations:

- Options for the continuation of the Transportation Trust Fund need to be developed immediately.

- The Office has developed a policies and procedures manual which is near final form as well as a comprehensive bond database which is essential so that the State does not miss important deadlines that could result in fines and penalties. These important documents should be completed as soon as possible.

- The state has LOC's expiring in the first quarter and these LOC's must be renewed. The cost of LOC's has risen dramatically from 15 basis points before the financial/bank crisis last year to from 140 to 200 basis points today. The renewal of the Letter of Credits must be a high priority and accomplished early in 2010.

- Any remaining Auction Rate Securities still held by Authorities or Units of the State should be immediately evaluated to see if a replacement strategy can or should be implemented.

- The Office of Public Finance must be give clear authority to be involved in any decision by any Agency or Unit of the State to issue debt.

- The American Recovery and Reinvestment Act (ARRA) and companion enabling NJ legislation enable the Governor to re-allocate certain bonding allocations to final users. The legislation requires an Executive Order by the Governor to permit the State Treasurer to receive and re-allocate this bonding authority. This Executive Order should be considered immediately.

- Tobacco Settlement Financing Corporation. The industry is currently holding $2 billion from the states because of a dispute in language in the agreement. The states are hiring lawyers to represent them. New Jersey is part of this group and should agree to participate in the case recognizing that our share of the cost is $1 to $2 million.

OFFICE OF INFORMATION TECHNOLOGY

Organized "in-but-not-of" the Department of Treasury, the Office of Information Technology (OIT) provides information technology services to state agencies. OIT oversees the mainframes, servers, networks, and databases that compose the State's technical infrastructure; operates the Garden State Network, a statewide integrated communications network; and operates the State's major data centers, including the Office of Information Technology Availability and Recovery Site (OARS). In addition, OIT manages the State's internet environment and offers application development and maintenance, geographical information systems, and data management services and telephony services for all state offices.

In 2005, OIT operated with a staff of 962; it now has 810. OIT receives its funding from line-item charges contained within the budgets of each department of State Government.

While other states have centralized their information technology systems, New Jersey continues to operate a bifurcated system with responsibilities split between the OIT and the individual state agencies. The State's efforts to centrally manage its technology over the past twenty years have never been fully supported by any administration.

Major Issues:

- The state has failed in all attempts to create a central agency that is charged with setting standards or controlling statewide projects. Departments have developed their own technology systems that are currently supported by an estimated 2,000 employees statewide. These employees frequently do not have technology job titles making their identification more difficult.

- The struggle for control of technology systems will continue between the departments and OIT without strong intervention. Executive Orders issued by the Corzine Administration concerning centralization appear to have been ignored by the departments.

- The Chief Technology Officer (CTO) has the authority to approve any department driven technology projects. The rate of rejection is reported to be 50% of all projects. This high rate of rejection is indicative of the continued desire of the operating agencies to develop redundant and unnecessary independent systems and the number of independent systems operating across the state.

- The use of outsourced technology has remained a critical issue as agencies continue to demand custom solutions to every application. Control over the development of the systems and control of the systems remains a significant obstacle. The failure of the Division of Taxation and Department of Community Affairs to manage the replacement of the Property Tax management system is an example of a flawed outsourced project.

- Transparency of state business remains a significant issue. Issues arising from the age of the technology used to develop and retain much of the State's information as well as an extreme concern over the release of information has resulted in very poor access to public information.

- The State's Data Centers are seriously challenged and potentially approaching their maximum capacity.

Recommendations:

- The consolidation of IT centers and all technology into one central agency responsible for all equipment and software should be pursued. The current model does not work as there is no single office with a state wide perspective that can draw on and focus the appropriate resources on the highest priority technology issues.

- The Office of Information Technology should be made a clear and direct report to a single Cabinet officer, perhaps the State Treasurer or as a separate department, as it is in many states. The authority intended to be conveyed by the semi-independence provided by in-but-not-of status has failed and the Office of the Governor cannot be expected to provide the focus or attention to detail necessary for OIT to succeed.

- A professional Chief Information Officer or Chief Technology Officer with clear authority and responsibility for the performance of the state's systems is critical to the success of the State in moving more rapidly into the vanguard of the State's using technology to improve transparency and efficiency. This individual should have both an understanding of the business needs of the State as well as the opportunities offered by the appropriate application of technology.

- A clear message conveying the Administration's commitment to transparency and the use of technology to provide immediate access to the public's business needs to be made with a concurrent charge to OIT to deliver on that commitment.

- A detailed review of the OIT was completed in September, 2006 by the National Academy of Public Administration and addresses in great detail many of these issues alluded to above. This report should be reviewed by the new State Treasurer.