

State of New Jersey
Office of the Inspector General

Mary Jane Cooper, Inspector General



**New Jersey Schools
Construction Corporation**

Update Report

January 12, 2006



State of New Jersey
OFFICE OF THE INSPECTOR GENERAL
PO Box 208
TRENTON NJ 08625-0208

RICHARD J. CODEY
Acting Governor

MARY JANE COOPER
Inspector General

January 12, 2006

The Honorable Richard J. Codey
Governor, State of New Jersey
P.O. Box 001
Trenton, New Jersey 08625

Dear Governor Codey,

On February 14, 2005, you requested that the Office of Inspector General (OIG) conduct a review of the New Jersey Schools Construction Corporation (SCC). Because during the initial stages of our review, we saw indications of inefficiency and waste that could impact future spending of SCC funds, on March 10, 2005, OIG requested that SCC be directed to refrain from committing its funds for future projects until further notice. Our purpose was to further review the problematic areas and recommend changes that, when implemented, would enable school construction to move forward more effectively using SCC funds.

On April 21, 2005, OIG issued an Initial Report of Findings and made recommendations for SCC's future operations. In Executive Order # 32, you directed that SCC implement OIG's recommendations.

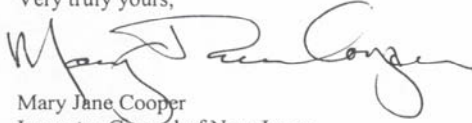
SCC has made a great deal of progress toward accomplishing its goal to efficiently build schools in New Jersey's Abbott districts. New SCC leadership committed to and substantially implemented OIG's recommendations and implemented other changes intended to improve SCC's operations. Most importantly, an experienced Chief Financial Officer was appointed and an internal controls system is in place, two changes that should go a long way toward safeguarding State funds.

Attached is an updated report of OIG's work at SCC since April 21, 2005 monitoring and assisting new SCC leadership in the implementation of the recommendations; and conducting investigations. The update report also makes additional recommendations to further bolster the safeguards in place. These recommendations have been discussed with and are supported by SCC management.

Because of the significant improvements at SCC, OIG respectfully recommends that the hold on SCC spending for future projects be lifted.

I will be happy to discuss this initial report with you at any time.

Very truly yours,

A handwritten signature in black ink, appearing to read "Mary Jane Cooper", written over a horizontal line.

Mary Jane Cooper
Inspector General of New Jersey

c: Honorable Joseph J. Roberts, Speaker of the Assembly
Peter Maricondo, Acting Chief Executive Officer, SCC



Office of the Inspector General New Jersey Schools Construction Corporation Update Report

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NEW JERSEY SCHOOLS CONSTRUCTION CORPORATION UPDATE

On February 14, 2005, at the request of Governor Richard J. Codey, the Office of the Inspector General (OIG) began a review of the New Jersey Schools Construction Corporation (SCC) to determine whether there was evidence to support the numerous allegations that the entity had wasted and mismanaged funds while building schools in Abbott Districts throughout the State of New Jersey. Within several weeks, it became evident to OIG that there were weaknesses in the SCC internal control systems that could have resulted in financial mismanagement, waste, or loss of State funds. As a result, on March 10, 2005, OIG requested that Governor Codey halt SCC's spending on future projects until OIG could conduct a more thorough review of SCC's internal controls and recommend changes as necessary.

On April 21, 2005, OIG issued a report describing several SCC internal control deficiencies that made the agency vulnerable to waste, mismanagement, fraud and abuse of taxpayer dollars. OIG recommended that SCC not resume spending on future projects until several specific steps were taken to rectify the internal control deficiencies. Governor Codey issued Executive Order #32 directing that SCC implement all of the recommendations contained in OIG's report.

Since OIG's Initial Report of Findings was issued, there have been many changes at SCC. New SCC leadership committed to implementing OIG's recommendations and made other structural and procedural changes intended to improve SCC's operations in accomplishing its mission to efficiently build schools in Abbott districts. The purpose of this update report is threefold: (1) to describe SCC's implementation of OIG's recommendations; (2) to review OIG's work with SCC since April 2005; and (3) to provide recommendations for consideration as SCC moves forward.

I. IMPLEMENTATION OF RECOMMENDED CORRECTIVE ACTIONS

1. *SCC Internal Management and Financial Controls*

A. Recommendations:

Because of the absence of a key financial officer to oversee SCC's financial operations, OIG recommended that SCC create a high level management position – either a Chief Financial Officer (CFO) or a Controller – with a direct reporting relationship to the SCC Board and having responsibility for implementing appropriate internal financial controls. OIG also recommended that SCC hire a qualified person from outside SCC for that position.

SCC Actions Taken:

SCC created the position of CFO to report to the SCC Chief Executive Officer (CEO) and the SCC Board's Audit Committee and hired an experienced financial manager for the position. The CFO was assigned responsibility for implementing appropriate internal controls and as described below, he has overseen the installation of staff and processes that have strengthened and centralized SCC's accounting and internal control processes. At the time of this report, the CFO was also serving as Acting CEO.¹

B. Recommendations:

Prior to OIG's Initial Report of Findings, there was a single accountant at SCC who was responsible for reviewing all SCC operating expenses except for payroll and booking entries on the corporation's ledgers; and there was no segregation of duties. There was inadequate SCC financial oversight for managing the billions of dollars dispensed on school construction projects. The small internal audit staff in place at SCC could not provide assurance that SCC funds were being properly managed.

OIG recommended that SCC create an accounting department separate from the finance department; that these departments and the internal audit department report to the new top financial officer; that the accounting, finance, and audit functions be sufficiently staffed; and that the internal auditor report to and regularly meet privately with the SCC Board's Audit Committee.

SCC Actions Taken:

As part of an overall effort to implement stronger internal controls, the SCC CFO created the position of Controller, who is responsible for the propriety of SCC's financial books and records. The accounting department is in the Controller's Office. A Controller was

¹ The former CEO issued his letter of resignation on August 17, 2005, effective September 7, 2005, and the CFO was subsequently appointed as Acting CEO.

hired, and ten SCC staff with accounting or business experience were assigned to his department. The Finance Director, with a staff of 22 SCC employees, also reports to the CFO and is primarily responsible for cash management.

SCC projects were never managed with a budget. Instead, the projects each started with a construction cost estimate that was readily open to increase. The Office of CFO has created a budget for each project scheduled for construction with currently available funds and monitors the expenditure of funds to assure strict adherence to budgets.

Because of the size of the SCC internal audit function, SCC management, with Board approval, made the decision to outsource the function. A contract to perform this work was awarded after a Request for Proposal was issued to outside companies. The internal audit function will report directly to the SCC Board's Audit Committee and meet regularly with that Committee. The internal audit function will also meet regularly with SCC's CFO to assess areas of risk and develop an effective audit program.

C. Recommendations:

OIG recommended that when establishing the accounting and auditing departments, SCC implement internal financial controls that comply with Sarbanes-Oxley provisions to the extent feasible for government entities.

SCC Actions Taken:

SCC has implemented stringent accounting procedures for overseeing expenditure of State funds entrusted to it and to the extent feasible, is in the process of following guidelines recommended by Sarbanes-Oxley legislation compatible with government entities.²

D. Other SCC Actions Taken:

SCC has created the position of Senior Director of Legal Services and has appointed an attorney to fill the position who has experience in corporate legal offices. In addition, SCC has created the position of Compliance Officer in the Legal Services unit and hired a person with financial, accounting, and compliance experience to fill the position. The Compliance Officer serves as the SCC ethics officer and will work with the new internal audit function to assure that appropriate controls are in place in areas of material risk.

SCC's Accounts Payable unit was responsible for processing payment of invoices and had the opportunity to raise objections to payments. New SCC management found that in the past, objections raised by this group were often inappropriately dismissed as unnecessary impediments. To strengthen the function, it is now in the Office of the Controller.

² SCC had undertaken this effort as part of its response to OIG recommendations and has taken part in the training required by Governor Codey in Executive Order #41.

2. Contract Approval Procedures

A. Recommendations:

Under prior SCC procedures, the CEO was authorized to singularly approve contracts for up to \$20,000,000, and the Chief Operating Officer and other managers were singularly able to approve contracts for up to \$10,000,000. Senior managers, using a procedure for “contingencies” could authorize expenditures of up to 20 % over the contract amount approved by the SCC Board. OIG recommended that single-signature authorization cease and that management’s ability to authorize payments over the amount previously approved by the Board be sharply curtailed to only emergent circumstances and then only with subsequent Board notice.

SCC Actions Taken:

Single-signature authority has ceased at all levels. Contingencies for spending beyond SCC Board approved amounts have been severely restricted to emergent circumstances and require subsequent Board notification.

B. Other SCC Actions Taken:

New SCC management has made the Operating Authority more restrictive by requiring the CFO’s review and approval of expenditures.

3. Employee Bonuses

Recommendations:

SCC was routinely awarding bonuses to some staff members in the amount of several thousands of dollars. This is a highly unusual and arbitrary practice for government entities. OIG recommended that the practice be terminated.

SCC Actions Taken:

The practice of awarding bonuses to SCC employees has ceased. The last bonus payments were awarded in the first quarter of 2004 for SCC fiscal year 2003. Bonuses were scheduled for payment in first quarter of 2005 for fiscal year 2004, but were not paid. There is currently no bonus program in place at SCC.

4. SCC Regional Offices

Recommendations:

SCC has been leasing space for its four Regional Offices, primarily for members of SCC's Design and Construction Division (D&C). Three of the Regional Offices are responsible for school construction projects in the northern part of the State. Each has its own leased office space, but the offices are in close proximity in northern New Jersey urban areas. The fourth Regional Office, responsible for all school construction projects in the central and southern areas of the State, is located at SCC headquarters in Trenton. OIG recommended that SCC management review this situation to determine whether it was cost effective to maintain three leased regional offices in close proximity in the northern part of the State and whether the office in Trenton was properly located to best serve the areas for which it is responsible.

SCC Actions Taken:

Shortly after OIG's Initial Report of Findings was issued, while prior SCC management was still in place, SCC performed an analysis and concluded that it is more cost effective to continue the leasing arrangements for the three offices in the northern part of the State which were due to expire in the next few years rather than to attempt to terminate the leases early. The analysis determined that location of all regional offices was appropriate in view of the projects that SCC was overseeing and their staffing needs.

As SCC moves forward, SCC's current management has committed to review the regional office concept in its entirety in conjunction with its analysis of the appropriate structure of D&C and in view of the projects underway to assure that the concept contributes to the efficient construction of schools throughout the State.

5. Outside Employment Contracts

Recommendations:

SCC was utilizing an employment contract for up to \$25,000,000 for temporary professional staff. OIG recommended that SCC evaluate terminating the contract. OIG further recommended that SCC enter into future outsourcing contracts only under extraordinary circumstances and with full review and approval of the SCC Board.

SCC Actions Taken:

SCC has terminated the staffing contract.

As discussed earlier, the SCC Board has approved outsourcing SCC's internal audit function because of the difficulty of establishing within a short time an appropriately staffed audit department to perform this function.

6. SCC Board of Directors

Recommendations:

OIG found that the SCC Board of Directors had not been provided with timely and sufficient information. OIG recommended that the independence of the SCC Board be strengthened with the addition of two new Board positions to be occupied by public members with financial management backgrounds and with no personal or professional interests in either the educational community or the construction industry. OIG also recommended that procedures and practices be adopted to provide the Board with timely, cogent, and comprehensive information.

SCC Actions Taken:

Two new SCC Board positions were created, and the then-Chairman of the Board stepped down from the Chair position. Governor Codey appointed a new Chairman of the Board and two individuals to fill the new Board seats. They all have significant experience in business and financial management but have no significant business interests in the educational community or the construction industry.³

Procedures have been adopted requiring that the Board be provided with information one week before Board meetings. In addition, the Board has refused to take action on matters about which it feels inadequately informed.

7. Change Orders

A. Recommendations:

OIG's review found that SCC has processed nearly \$586,000,000 in change orders. SCC procedures did not always require Board approval for change orders representing large increases in contract amounts. Even when existing procedures required Board approval of the expenditures, the work for which the change orders were issued often had been

³ As of this report the Chairman and one of the new Board members have submitted their resignations.

completed before the Board was given an opportunity to consider the matter. As of October 2005, SCC designated approximately \$30,000,000 worth of change orders as design errors and omissions, and approximately \$450,000,000 in change orders as “other” or “not assigned”.⁴

OIG recommended that under the direction of the new financial officer, SCC revamp its policies and procedures governing the review and approval of all change orders. These included attempting to recoup funds from third parties who were inappropriately awarded payments for change orders that resulted from their own conduct.

SCC Actions Taken:

In accord with OIG’s recommendations, SCC:

- created a Change Order Review Unit (CORU) and assigned staff to review previously approved change orders for appropriateness and to determine whether SCC could recoup funds disbursed as a result of improperly approved change orders;
- referred several previously-approved and paid change orders to the Attorney General’s Office for legal review to determine whether SCC funds can be recovered;
- implemented procedures requiring that:
 - CORU approve all change orders greater than or equal to \$100,000; and CORU is now expected to review change orders representing nearly 80 % of the dollar value of all processed change orders, and audit the balance of change orders;
 - the CFO approve all future change orders in accord with the revised operating authority;
 - all future change orders valued in the aggregate at more than 5% of the original contract amount be approved by the SCC Board; and
 - only in emergent circumstances will change orders be submitted to the Board for work already completed; and in those cases, the Board must be presented information justifying the emergency circumstances as well as the need for work requiring additional payments.

B. Other SCC Actions Taken:

SCC has hired a Senior Director of Construction and a Managing Director of CORU with relevant experience. SCC leadership is committed to hiring additional CORU staff with appropriate expertise.

SCC management realized that in the past, many change orders were necessitated when the Department of Education (DOE) approved district-originated design changes after construction on a project had begun. To remedy this, SCC management has entered into

⁴ The amounts listed in this paragraph are larger than the amounts listed in OIG’s Initial Report of Findings because they include additional change orders processed by SCC since April 2005.

discussions with DOE to limit changes to an early stage of the project design. Those discussions have resulted in a potential agreement currently in the DOE approval process.

SCC management also realized that many change orders were necessitated by its failure to obtain necessary permits before proceeding with construction. SCC has implemented a process whereby final and complete drawings will be submitted to the Department of Community Affairs for approvals before construction projects are put out to bid.

8. Architectural Designs

A. Recommendations:

During OIG's review, SCC revealed that its contracts with architectural firms did not enable SCC to use designs on more than one project. Projects required expenditures of funds and time for design, permits, and components that did not take advantage of savings emanating from duplication or standardization. OIG recommended that SCC evaluate its contracts and implement other processes enabling it to use designs on more than one project and to evaluate standardization of designs and components.

SCC Actions Taken:

SCC adopted a policy allowing designs to be re-used. The policy is currently being reviewed by the Attorney General's Office. Also under consideration for future projects is the use of standardized component materials and designs.

B. Other SCC Actions Taken:

SCC has approximately 100 design contracts in process for projects in addition to those projects which SCC has scheduled for construction within the currently available funding. SCC has suspended future design contracts for projects for which there is currently no funding. SCC has estimated that this aspect of its orderly plan for construction projects will make approximately \$100,000,000 available for current projects and will help bring the current projects to completion within the existing budget.

9. Project Management Firms

Recommendations:

OIG learned that SCC's use of project management firms (PMFs) to manage school construction projects was problematic in several ways. The firms simultaneously managed multiple projects in an area; had responsibility for the projects from design through completion; were paid on average 10 % of the estimated costs of projects they

managed; and operated with minimal SCC oversight. OIG's review revealed an inherent conflict since a PMF in one area could serve as a prime contractor or a sub-contractor in an area where another firm was designated PMF. This created the possibility that firms serving as PMFs would be supervising each other on collateral projects and might find it difficult to appropriately manage and evaluate each other.

OIG recommended that firms serving as PMFs not be permitted to serve as prime contractors or sub-contractors on any SCC work. In addition, OIG recommended that SCC: (1) take steps to scale back PMF responsibilities with the goal of eliminating reliance on PMFs; (2) replace PMFs with qualified construction managers with less responsibilities than currently assigned PMFs and with adequate levels of SCC oversight; and (3) attempt to hire qualified SCC staff to manage projects.

SCC Actions Taken:

Going forward, SCC has barred PMFs from working on other SCC-managed projects as prime contractors or subcontractors. SCC has undertaken a review of D&C, the division responsible for oversight of the PMFs. Part of this review is intended to determine the appropriate responsibilities of D&C, including the use of PMFs to manage projects, and their oversight of vendors and contractors. SCC has also limited PMF responsibilities before the actual construction phase of a project, and is attempting to hire competent and adequate staff to function as project managers.

At the request of the SCC Board and new management, OIG undertook an operations review of D&C. OIG provided the results of that review to SCC management and issued a report of the findings to Governor Codey in December 2005.

10. Land Acquisition

A. Recommendations:

Prior to OIG's review, SCC had spent \$328,800,000 for acquisition of land intended for school sites and associated relocation, demolition, and other associated costs. These expenditures were the source of several OIG concerns. There were insufficient guidelines for determining appropriate sites, and many project sites were environmentally contaminated land. Numerous sites were purchased for multiple projects in a scatter-gun approach although it might be years before construction on some of the sites would begin. SCC purchased property from other government entities, including the municipalities for which schools were planned. OIG found instances in which SCC purchased district-identified properties for school construction without concern for the cost of the property or the associated costs of environmental remediation, relocation for existing uses, or other extraordinary construction problems.

OIG recommended that SCC implement procedures for the appropriate expenditure of funds for land acquisition including the right to reject district-selected sites that required expensive environmental remediation or relocation.

SCC Actions Taken:

SCC adopted procedures for land acquisition. Among the procedures is a requirement that, when feasible, municipalities and other governmental agencies donate land identified for school construction. New SCC policies allow the SCC to reject district-identified sites because of environmental contamination and unreasonable expenses associated with construction on the site. These procedures mandate that districts select more than one site and allow SCC to reject sites and choose the most appropriate.

Since OIG's April 21, 2005 report, SCC has taken several steps for the orderly construction of schools including creating a list of schools already in some phase of development which SCC has determined can be built with existing SCC funds. As a result, SCC has scaled back its land acquisition activities to land required for those ongoing projects as well as land which SCC determined it was otherwise obligated to purchase. This has resulted in a decision to refrain from purchasing over 700 sites previously identified as school sites by districts.

B. Other SCC Actions Taken:

SCC is attempting to recover funds that were expended to clean up environmentally contaminated sites. It is working with the Attorney General's Office to identify possible remediation costs that may be recoverable from prior owners.

II. OIG'S CONTINUING WORK WITH SCC

In addition to monitoring and assisting SCC's implementation of OIG's recommended corrective actions⁵, OIG has continued to work at SCC to complete investigations that were underway at the time the Initial Report of Findings was issued; to conduct an operations review requested by the SCC Board of Directors and new SCC senior management; and to conduct, at the request of the SCC Board's Audit Committee and senior management, an investigation of an allegation of circumvention of the SCC Board's authority.

1. Operations Review

At the request of the newly assembled SCC Board and the new Acting CEO, OIG conducted an operations review of D&C, the SCC division responsible for the actual construction of schools. The review included interviews of 42 D&C non-clerical staff and a review of relevant SCC documents. The results of that review were reported to SCC management and to Governor Codey in a report issued in December 2005.

The review revealed significant weaknesses in the structure of D&C and the need to have competent personnel in place whose job descriptions make clear their responsibility for overseeing PMFs. New SCC senior management was provided with the results of OIG's review and is in the process of considering appropriate changes, including re-organization of D&C, to rectify those weaknesses.

2. Allegation of Circumvention of Board Authority

During the summer of 2005, the newly constituted SCC Board's Audit Committee learned that significant terms of a Board-approved contract were changed by members of D&C without Board approval. The Audit Committee asked OIG to investigate how this occurred.

The investigation revealed that D&C employees increased the maximum Board-approved fee payable to one PMF. Although SCC procedures dictated that Board approval was required, the employees took steps to increase the approved fees without presenting the change in contract terms to the SCC Board. These steps included creating misleading documents indicating that Board approval was not required. Their actions could result in additional payments to the vendor of as much as \$3,400,000 in excess of the fee approved by the Board.

The employees then expedited a payment to the vendor of almost \$1,600,000 of its total fee by allowing the vendor to submit four separate invoices for a single billing period

⁵ NJSA 52:15B-15 provides that OIG monitor implementation of its recommendations for corrective or remedial actions made in its reports of findings.

instead of the usual one invoice per billing period. Each of the four invoices was for an amount of just under \$400,000 – 25 % of the total billed for the period. This conduct avoided signature approvals required by SCC procedures for the payment of amounts over \$1,000,000.

The amount the vendor invoiced per billing period before and after that one-time anomaly was between \$200,000 and \$300,000. To date, the D&C employees have not provided documentation to demonstrate that the vendor was entitled to the payment of \$1,600,000 for work completed during the billing period, indicating that the payment may be an advance or “frontloading”.

During our investigation, SCC employees involved in this conduct were not forthcoming and attempted to mislead the investigation.

The weight of the evidence uncovered during OIG’s investigation substantiates the allegation of circumvention of SCC Board authority. The evidence also substantiates a finding of expedited payments to the PMF. OIG’s findings were reported to SCC Board’s Audit Committee and new senior management. OIG’s review of collateral matters is ongoing.

3. SCC Ethics Procedures

OIG’s review revealed past practices by some SCC managers that are not in accord with standards promulgated by the Executive Commission for Ethical Standards. For instance, some SCC managers often scheduled restaurant meetings with individuals whose firms did business with SCC. Some of the SCC employees’ expenses from these meals were passed on to SCC. One former manager excused his inability to demonstrate that he paid his share of meals with interested third parties by calling the contacts “personal”. SCC records also revealed instances where SCC managers obtained reimbursement for expenses for their meals with their subordinates.

Another area of potential abuse was the practice of SCC employees assigned State-owned vehicles to use for SCC purposes. These employees are required to obtain gas for these vehicles from State-operated pumps, and only in emergency situations, should the employee purchase gas at a non-state run facility and submit for reimbursement. However, OIG’s review revealed regular non-emergency use of the reimbursement process causing the State to pay market price for gas rather than the State negotiated price. Moreover, since the purchased-gas receipt does not identify the vehicle for which gasoline was purchased, this practice can lead the SCC to pay for gasoline for a personal vehicle.

Recommendations:

Because of the nature of SCC’s business and the constant interaction between some SCC employees and outside vendors, OIG recommends that SCC implement a stringent ethics

policy requiring all meetings with interested third parties take place during normal business hours and at appropriate office locations. They should rarely occur in a setting requiring expenditures for meals and related expense – only when circumstances require it. These occasions should be documented, and even then, SCC should not pay for employees' expenses.

If an SCC employee has or develops a personal relationship with a member of a company that does business with SCC, the employee should disclose that relationship to an appropriate level of management, and management should reassign the employee to avoid all further activities with that third party. Nonetheless, because the employee may still have the apparent opportunity to influence SCC business with the individual, the employee should submit, and SCC should maintain, documents describing payments of all expenses incurred because of contacts with the third party.

At the end of every fiscal year, employees should sign a sworn document affirming the absence of any benefits received from interested third parties, including meals, beverages, gifts, and attendance at events or in the alternative, listing benefits obtained from interested third parties and the reason the employee believes that it was appropriate to accept them.

It is recommended that SCC conduct a review of reimbursement forms to identify employees who use the reimbursement process to obtain payment for personally purchased gasoline and take steps to curtail the practice.

The SCC Compliance Officer should maintain and review the data collected as a result of the new ethics procedure.

SCC Actions Taken:

New SCC management is in the process of implementing a new ethics policy at SCC. In addition, SCC managers have attended a training session with the Executive Commission on Ethical Standards.⁶

4. Temporary Classroom Units

SCC has spent more than \$34,000,000 to purchase and install temporary classroom units (TCUs), each comprised of two trailers, in Abbott districts. Most of the TCUs were purchased four years ago to create legally-required early childhood education centers. Some other purchased TCUs were used as “swing space”, temporary classrooms for students displaced during school construction. Still other TCUs, with DOE approval, have been purchased for school administration use, freeing up space in existing school buildings for classrooms. Districts lease the TCUs from SCC for \$1 per year and are responsible for their maintenance, including paying insurance and utility costs. Although

⁶ These training sessions were provided to other State agencies as well as directed by Governor Codey's Executive Order # 41.

TCUs were purchased through SCC's Purchasing Division, D&C controlled TCU orders, installation, and use.

After a constituent raised concerns of waste and inefficiency associated with SCC-owned TCUs, OIG reviewed SCC's use and control of TCUs. The review revealed that SCC had no procedures to prevent misuse or waste of the TCUs. For instance, SCC did not maintain an accurate inventory of the TCUs, and when the SCC Board and OIG asked for an exact count of SCC-owned TCUs, each was provided with a different "total" number.

In addition, SCC did not maintain an accurate record of the location and actual use of TCUs or when they would become available for relocation to another site. Thus, after a district's need for TCUs was eliminated by completion of a construction project, TCUs sometimes remained in the district unused or used for non-classroom purposes. Either SCC was unaware that the need for swing space had expired or knew but did not take steps to relocate the unit.

The lack of adequate controls resulted in unnecessary expenditures for new TCUs. In spring 2005, SCC purchased eight TCUs (16 trailers) at a cost of just under \$700,000 for use as swing space in a district where new school construction was scheduled to begin in September, but OIG later found that there were SCC-owned TCUs available for timely relocation from nearby districts.

Flawed records may have contributed to further waste of SCC funds. SCC records erroneously indicated that four TCUs had been installed at another district's elementary school for about a year. A change order for their installation had been approved at that time. The D&C Project Officer explained that the change order was used because circumstances required a quick installation and the bid process would have taken too long.

In fact, the TCUs were actually parked unused and uninstalled in a field for the year. The TCUs have sustained damage from sitting unsecured and exposed to the elements for that year, and district representatives are now questioning whether they can be used at all. Ironically, the D&C Project Officer explained that this delay resulted from his efforts to negotiate downward the high cost of installation (and OIG has since learned that another district had installed its TCUs using the bidding process and had paid about half the cost of the SCC change order amount).

Recommendations:

OIG reported its findings to new SCC management recommending that SCC create and maintain an accurate inventory of the number, location, and use of its TCUs and tracking the dates on which TCUs are expected to become available for relocation. OIG recommended that this list be reviewed before the purchase of any new TCUs.

SCC Actions Taken:

SCC sent staff to physically inspect and mark with an identifier each TCU it owns. The effort produced a count that was consistent with project purchase documents indicating that the physical count was accurate. SCC also made a record of the location of TCUs, their current use, and the anticipated date on which TCUs would be available for relocation.

New SCC management also designated staff responsible for maintaining a TCU database with a requirement that there be an annual physical inventory and the database be updated after the on-site inspections in the spring. SCC is developing new policies to regulate the use and purchase of TCUs that include a review of the availability of TCU inventory before any new purchases are made. In addition, new SCC management has stated that no new purchases or leases of TCUs are currently necessary or planned.

5. Project Management Firm Site Equipment

Contracts between SCC and PMFs clearly state that PMFs are responsible for the cost of outfitting their construction trailers and site personnel with computers, scanners, copiers, furniture, mobile telephones, and other equipment PMFs deem necessary to perform their work. Instead of supplying their own equipment, some PMFs caused contractors to outfit the PMFs with specific equipment and to include the cost of the equipment in the contractors' bids to do SCC work. Thus, the cost of the PMF equipment was ultimately passed on to SCC, perhaps for a second time if the PMFs included the cost of the equipment in their bids. Moreover, either the contractor or the PMF retained the equipment at the end of a project.

Recommendations:

OIG recommended that SCC direct PMFs to immediately stop the practice of requiring prime contractors to supply the PMFs with equipment. OIG further recommended that SCC conduct a thorough review of documents for all projects to determine the PMF equipment provided using this process and attempt to obtain credits from the PMFs.

SCC Action Taken:

D&C issued a bulletin directing that the PMFs cease the practice of requiring prime contractors to outfit PMF trailers. D&C also asked the PMFs to conduct an inventory of equipment currently in the PMFs' trailers that had been supplied by contractors. This inventory procedure resulted in an estimate of approximately \$263,000 in credits due to SCC from some of the PMFs.

New SCC management has directed that the Purchasing Department conduct a more thorough review of all documented directions to prime contractors – for past, present, and future projects – to demonstrate the amount of PMF equipment required from and

supplied by prime contractors at SCC's expense. The review is currently underway, and OIG is being kept informed of its progress.

6. District Payment of Ineligible Costs

According to DOE regulation, the costs of certain school components are ineligible for Abbott funding, for instance, indoor swimming pools. If an Abbott district determines that it wants such a component in one or more of its schools, the district must pay the ineligible costs offset by prescribed factors. SCC is responsible for determining costs of an ineligible component to be borne by the district.

At districts' requests, SCC has agreed to build four indoor swimming pools. OIG learned that SCC has not established a uniform method for determining the overall cost of the ineligible component and the districts' share after offsets; a procedure for inclusion of ineligible costs in a project; or a procedure for how and when a district pays its share.

Recommendations:

These deficiencies were brought to the attention of SCC management with the recommendation that consistent policies be adopted for future projects including ineligible uses.

7. Emergency Generators

Former SCC management made a policy decision, without Board approval, to install emergency generators in 46 schools at a cost of more than \$5,000,000 claiming that the decision was justified, in part, because the generators would allow the school buildings to serve as emergency community shelters in the wake of emergencies or disasters. Only seven of the 46 schools have thus far been designated emergency shelters.

Recommendations:

SCC should consult with the Attorney General's Office to determine whether its funds can be spent for this purpose. SCC should explore the possibility of obtaining funds for this purpose from the Federal Emergency Management Agency or other agencies.

8. Evaluation of Prime Contractors

The Educational Facilities Construction and Financing Act requires that SCC evaluate prime contractors on SCC projects. SCC adopted a Contractor Performance Evaluation (CPE) process in July 2004. It requires the SCC Project Officer and the PMF representative for each project on which a contractor works to independently provide evaluations: (1) an interim evaluation on contracts longer than one year in duration, when

the work is 50 % complete: and (2) a final evaluation. All evaluations are to be considered if a prime contractor seeks future SCC contracts.

OIG's review found that there were flaws in the process and it was not being utilized effectively. SCC records of the evaluations were incomplete and maintained in a haphazard fashion making their future use difficult. For instance, performance evaluations of prime contractors for 147 projects were maintained by SCC. However, there are indications that prime contractors for numerous other projects were evaluated but results were not maintained in the SCC database designed to track contractor evaluations.

Further, OIG's review uncovered information indicating that even evaluations maintained in the database do not provide credible and useful information for subsequent bid submittals. For instance:

- About half of the time, the SCC Project Officer's score was identical in every respect to that of the PMF representative. (This may have resulted from the Project Officer's lack of experience with the prime contractor.)
- "Unsatisfactory" evaluations have been rare and in all but nine of the recorded evaluations, both the PMF's and the Project Officer's average ratings were 80 % - the minimum "satisfactory" rating - or above.
- Final "Unsatisfactory" ratings were often rendered meaningless because they were deemed incomplete or changed to "satisfactory" when appealed to the Managing Director of D&C as provided by procedures.
- SCC does not maintain minutes of evaluation of appeals.
- Interim evaluations are not consistently considered in bid submissions.

Recommendations:

The statute requires a meaningful evaluation process. SCC management is considering restructuring D&C and placing more responsibility on the Project Officers. Revisions to the CPE procedures should then be considered to take into account the flaws in the current process, including the absence of a documented appeal process, and the new D&C responsibilities.

III. OTHER RECOMMENDATIONS

1. Recommendation for Resumption of SCC Spending

As described above, new SCC management has acted on OIG's April 21, 2005 recommendations. Many recommendations have been satisfactorily implemented and others are in the process of being implemented. SCC actions that are not complete are either awaiting other governmental entities to take required actions before SCC can

proceed or otherwise cannot move forward until SCC is re-organized. The new SCC Board and new SCC management have taken numerous additional actions intended to remedy the weaknesses reported by OIG, and to otherwise improve SCC's fiscal controls and to contribute to the efficient construction of schools.

These conclusions indicate that it is appropriate for SCC to resume spending on future construction projects. This will enable SCC to hire competent personnel to adequately staff the projects and avoid additional costs resulting from unnecessary delay.

2. SCC Inspector General

Because of the numerous issues that have been raised regarding SCC's past operations, OIG recommends that SCC create a staff position of Inspector General. This person should report to the SCC CEO as well as independently report to OIG. The relationship with OIG will bolster the SCC Inspector General's independence. The position will add confidence that SCC is operating with fiscal integrity. This recommendation has been discussed with and approved by SCC senior management.