State of New Jersey
Office of the Inspector General

Mary Jane Cooper, Inspector General

New Jersey Schools Construction Corporation

Initial Report of Findings

April 21, 2005

State of New Jersey
OFFICE OF THE INSPECTOR GENERAL
PO Box 208
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RICHARD J. CODEY
Acting Governor

MARY JANE COOPER
Inspector General

April 21, 2005

The Honorable Richard J. Codey
Acting 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 the Inspector General conduct a review of the New Jersey Schools Construction Corporation (SCC) to determine whether the previously dispensed portion of their $8.6 billion funding was disbursed in an efficient and appropriate manner and to make recommendations that could result in efficient use of the remaining funds.

In the early stages of carrying out the review, we realized that there were areas of inefficiency and waste in SCC practices that could have impacted past spending and could impact future spending of SCC funds. We made those areas our first priority, and with that in mind, on March 10, 2005, the Office of the Inspector General requested that you direct the SCC 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 the remaining SCC funds.

Attached is a report of our findings and recommendations resulting from our review to date. The Office of the Inspector General respectfully recommends that new school construction involving the SCC resume after the recommendations in the report are implemented to ensure the proper expenditure of public funds.

In the process of our review, we discussed some of the recommended changes with SCC senior management, and they recognized the need for them. All of the recommended changes are critical, feasible, and should be quickly implemented so that the construction of schools can continue in an efficient, non-wasteful manner.

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As you know, my tenure as Inspector General began the same day you asked us to begin the review of the SCC. The initially small but increasing OIG staff was able to conduct the review you requested working with staff supplied by the State Commission of Investigation and the Department of Law and Public Safety who worked under the direction of this office. These entities should be recognized for their cooperation with our mission.

The Inspector General's Office is continuing the review of the SCC and looking into ongoing and past projects and attempting to identify opportunities for the SCC to recover funds. Other findings will be reported in subsequent reports. However, if the continuing review reveals other deficiencies in SCC practices requiring immediate changes, we will bring those practices to your attention forthwith along with associated recommendations.

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

Very truly yours,

Mary Jane Cooper
Inspector General

Preliminary Report

The core mission of the New Jersey Schools Construction Corporation (SCC) is to build public schools in the state's so-called Abbott districts in an efficient and cost-effective manner. An inquiry initiated on February 14, 2005 by the New Jersey Office of the Inspector General has revealed that the SCC as currently structured and constituted suffers from a wide range of internal weaknesses that not only threaten to defeat its core mission, but also make the agency vulnerable to mismanagement, fiscal malfeasance, conflicts of interest and waste, fraud and abuse of taxpayer dollars. The Office of the Inspector General is issuing this preliminary report of findings of structural deficiencies that exist within the SCC organization so that corrective action can be taken immediately and the building of schools can go forward with proper internal controls.

The array of serious problems and issues identified during the course of this inquiry fall broadly into two fundamental areas:

- Weak internal management and financial controls and questionable personnel practices; and
- Lax and/or non-existent oversight and accountability.

As summarized and delineated below, the findings in each of these areas cross an entire spectrum of essential SCC operations and involve the full gamut of school construction phases, from site selection and land acquisition to design and final construction.

Weak Internal Management and Financial Controls and Questionable Personnel Practices

Although the SCC at its creation was empowered and entrusted with the responsibility of disbursing more than $8.6 billion in public school construction bond funds for hundreds of local school construction projects and most of those funds have been disbursed or are designated for use on specific projects, the agency is not properly equipped with the internal management, financial controls, and personnel necessary to ensure that the money is properly and appropriately spent. The SCC does not employ a Chief Financial Officer (CFO), Controller or other senior official directly responsible for the oversight of school project expenditures or matters related to the administration of the corporation's own $35 to $40 million operating budget.

SCC employs approximately 270 staff and pays $16 million in salaries. Questionable personnel practices include in addition to regular salaries and raises, bonus payments for certain employees – a highly unusual perk for governmental entities. According to a review of the corporation's records, for calendar year 2003, $113,500 in bonuses was paid to 43 staff. Of that amount, $32,000 was split between the Chief Operating Officer (COO) and two managing directors. For calendar year 2004, essentially the same amount of bonus money was dispersed but the amount of bonuses was lowered and bonuses were dispensed more widely: 68 staff received bonuses and the COO and certain high level managers received the maximum, $4,000 each.

Also questionable is the use of SCC funds for four SCC offices. Most SCC employees are housed at SCC's Trenton headquarters, a leased six story building which, according to SCC's records, cost SCC $10 million to renovate and furnish and for which the SCC pays over $1 million per year in rent and utility expenses. In addition to its

headquarters in Trenton, the SCC currently operates three regional offices that, according to SCC records, cost SCC at least $1.5 million to establish. These three regional offices are located in close proximity to each other in northern New Jersey – Jersey City, West Paterson and Newark. The SCC headquarters in Trenton serves as the regional office for central and southern New Jersey – Mercer to Monmouth Counties and all points south – where a significant number of SCC school construction projects are scattered throughout the area.

Other questionable practices include the assignment of state owned vehicles to 17 SCC employees. Similarly, until recently, when Acting Governor Richard J. Codey put an end to this practice, 41 SCC employees were allotted mileage allowances of $450 per month.

In addition to its regular salaried staff, the SCC utilizes the services of at least 22 individuals hired under the terms of a three-year contract worth up to $25 million with an outside employment agency. According to an SCC analysis, these employees are paid approximately triple what SCC would pay comparable state workers. The costs of these contract employees are not reflected in the SCC's operating budget but rather are embedded in the costs of school construction projects.

Of the approximately 270 staff members employed by the SCC, a single accountant/Certified Public Accountant (CPA) – supervised by a non-accountant – is charged with the critical job of reviewing all SCC operating expenses except payroll, and booking entries on the corporation's ledgers. Further, the SCC's Internal Audit Department, responsible for auditing the SCC as well as the entire panoply of school construction projects under its purview statewide, has a staff of just six.

Among the most glaring internal control deficiencies identified in this inquiry is the ease with which an SCC official can unilaterally sign-off on the approval and award of large contracts including contracts for professional services without Board approval. Some examples of this single signature authority include:

CATEGORY	***CHIEF EXECUTIVE OFFICER***	***CHIEF OPERATING OFFICER, SR. V.P. OR MANAGING DIRECTOR***	***DIRECTOR OR REGIONAL DIRECTOR***
CONSTRUCTION CONTRACTS	**$20,000,000** or less	**$10,000,000** or less (Provided not in excess of 120% of the construction cost estimate)	
PROFESSIONAL SERVICES CONTRACTS	**$2,000,000** or less	**$1,000,000** or less	
CHANGE ORDERS	**$500,000** or more	**$500,000** or less	**$250,000** or less
PAYMENT REQUISITION	**$1,000,000** or more	**$1,000,000** or less	**$500,000** or less
NON-PROGRAM DISBURSEMENTS (check signatory authority)	**$100,000** or less	**$100,000** or less	**$50,000** or less

Even when Board approval is required, in some cases management can authorize the use of contingencies increasing by as much as 47 percent (47%) the amount authorized by the Board without subsequent Board approval or notification.

Attempts to review SCC policies and procedures revealed that in many cases the policies were inadequate or not readily available in a cohesive form.

The SCC's loose and inadequate structure of internal controls extends to the school construction projects. In particular, the corporation does not establish budgets for

individual projects, hampering the SCC's ability to forecast the number of schools to be built with available funds as well as its ability to bring proper due diligence to land acquisition, design, construction and other major cost-drivers.

Lax and/or Non-existent Oversight and Accountability

The SCC is fraught with an array of gaps in proper oversight and accountability that seriously threaten its capacity to maintain and ensure the integrity of its activities as a public institution of government. The shortcomings are apparent throughout multiple project phases.

The SCC has minimal guidelines for what constitutes an acceptable site for a school and generally accedes to sites submitted by local school authorities. While some Abbott districts have provided suitable sites, many have opted for locations that must be acquired at substantial cost. To date, the SCC has committed to or paid approximately $328.8 million for the acquisition of sites and associated costs, including relocation costs, for certain Abbott district schools. One particularly egregious aspect of this cost picture is the fact that more than $67 million has been paid by the SCC to local governmental units for the acquisition of school sites on land that is already publicly owned in their communities. In addition, sites selected by local districts often include abandoned properties and the funds used to purchase them as a school construction site are used to pay back taxes owed to the municipality by delinquent owners.

This inquiry also found that districts often select sites that are patently unsuitable for schools or that pose excessive acquisition costs. Sites targeted for school construction have been found to be environmentally contaminated, requiring substantial additional

expenditures for clean-up and remediation. In others, relocation costs alone have turned out to be as much as triple the price of the land parcel itself. A review of costs for site investigations also turned up evidence of duplication of efforts by architects, project management firms and others. In addition, SCC is paying for construction of non-essential school structures such as parking facilities and synthetic turf for athletic fields, and overseeing and fronting the costs of construction ineligible for Abbott funding, such as pools.

Meanwhile, although the SCC's Board is charged with approving all land acquisition proposals, the corporation has no mechanism to ensure that the Board is provided with a complete profile of candidate sites or with information on potential alternate sites, or actual cost of properties over and above fair market value price approved by the Board.

With regard to the actual projects, the corporation's primary oversight mechanism in various regions across the state is centered in 13 "Project Management Firms," or "PMFs," selected from a pool of pre-qualified companies in the private sector. The PMFs essentially run the projects and have extensive powers and responsibilities, including the authority to approve contractor requisitions and to review and make recommendations apropos to contractor change orders. The SCC also relies upon the PMFs to monitor the fiscal integrity and construction performance of the prime contractors on every project.

PMFs, in turn, are supposed to be overseen by Project Officers employed as part of the SCC's own regional staff who report to management. However, the effectiveness of this oversight has been called into question. In the one project examined during this

inquiry, despite several days notice of our meeting, the responsible Project Officer essentially was unable to provide accurate information about the status of the months-old project that is forecast to cost in excess of $40 million. Responsible parties at different levels, from the PMF up through SCC management, also provided inconsistent and inaccurate information when questioned separately about the project. The SCC CEO and COO had not been made aware of a $1 million change order about to be implemented although SCC procedures required one of them to approve it.

The inquiry also identified a number of concerns with regard to the sizeable amounts of money paid to PMFs. Under a typical SCC contract, a PMF is authorized to oversee a total construction contract amount ranging from $300 million to $500 million and receives fees equivalent to roughly 10 percent (10%) of the cost of each project it oversees. When several PMFs collected the full amounts under their original contracts, these contracts were extended via "change orders" – so characterized by SCC – with minimal justification. The original total contract fee amount for all PMFs was approximately $244.6 million. Change orders for $217.8 million have boosted these fees to $462.5 million – an increase of 89 percent (89%).

Further, PMFs are inherently conflicted because they are able to serve as SCC prime contractors in regions outside the one in which they ostensibly play a supervisory role. This set up provides the possibility that PMFs will be supervising each other on projects making it difficult for PMFs to perform their review function objectively.

This inquiry also examined the broader landscape of change orders involving actual construction work and found a number of questionable practices and apparent irregularities. To date, 4,457 change orders, including extensions to PMF contracts, have

been approved across the entire spectrum of school construction resulting in approximately $540 million in costs over original contracts. Although construction change orders are subject to review by the PMFs and by the SCC's regional staff, a review of the contract documents suggest instances in which the proposed changes were for duplicative work, for work that had already been anticipated by the original contract, or for work that would typically be the responsibility of the contractor or design professional. In several cases, change orders boosted the original contract price by 50 percent or more, and in some cases, work was completed before the change order was submitted for SCC approval. SCC does not perform an analysis to determine the amount by which the final costs of projects awarded to habitual low bidders are increased as a result of change orders.

To date, contracts awarded to architects for design work on SCC projects have totaled approximately $409 million, not including an additional amount of $55.7 million attributable to change orders. Design and architectural expenditures have been a major driver in the overall cost of school construction because of a number of issues related to poor planning and oversight.

In some instances, projects had to undergo a re-design as a result of the failure by architects to obtain all requisite permits prior to completing the design. In others, costs escalated when local school districts were permitted to input design changes after architectural plans were near completion. Numerous change orders, totaling approximately $22.9 million, were categorized by SCC records as having resulted from architectural design errors or omissions. In such instances, there has been no effort undertaken to recover any portion of the amount paid from the responsible architects.

Further, according to language in the standard SCC contracts with architects, the corporation does not own the resultant plans and designs and thus cannot re-use them elsewhere. This practice is contrary to standard architectural contracts.

This inquiry also determined that many change orders affecting the ultimate cost of individual projects are never brought to the attention of the SCC Board because they fall beneath a dollar threshold – a percentage of the original contract – requiring Board approval. Moreover, information presented to the Board routinely fails to provide a clear and comprehensive picture of the true cost of a given project. Often Board members receive materials related to items represented to be urgent and to be voted on shortly before or as they arrive for meetings not providing sufficient time for review.

Recommendations

Given the scope and severity of the findings to date in this ongoing inquiry, the Office of the Inspector General respectfully recommends that new school construction projects involving the New Jersey Schools Construction Corporation (SCC) resume after the following steps are undertaken to ensure the proper and appropriate expenditure of public funds. In that regard, the Inspector General makes recommendations for immediate implementation in these key areas:

1. SCC Internal Management and Financial Controls

A. Given the blatant absence of any official with primary responsibility for the SCC's internal and project finances, action should be taken immediately to find and place a qualified Chief Financial Officer (CFO)/Controller from outside the SCC on the organization's senior staff who will be responsible for implementing adequate internal financial controls and reporting to the Board of Directors (Board).

B. The accounting staff for the review of expenses and the booking of ledger entries should be augmented as soon as practicable and this staff should report to the CFO/Controller. Similarly, the Internal Audit Department should be expanded and given the tools to carry out its mission to audit the SCC and its various construction cost components in a meaningful way. The Internal Auditor should be required to report directly to and meet privately with the non-management members of the Audit Committee of the Board of Directors.

C. The SCC should implement procedures that bring it into full and complete conformance with accounting and auditing standards enunciated in Sarbanes-Oxley legislation in an effort to ensure protection of funds entrusted to it.

2. Contract Approval Procedures

A. No single individual employee of the SCC should be empowered to unilaterally approve the award of contracts or payment of requisitions for any purpose. This practice should be discontinued immediately and procedures should be established to provide for adequate review and handling of contracts and disbursements to ensure the ultimate integrity of the procurement process.

B. Management's ability to increase the amount of Board approved expenditures by use of contingencies should be allowed only on a case by case basis when specifically authorized by the Board; and in those cases the Board should be subsequently informed of the final amount of the expenditure.

3. Employee Bonuses

The SCC's approximately 270 employees are personnel of a public government agency and should not be routinely provided with bonuses or any other emoluments beyond the standard salary and benefit structure that applies to all other public employees. The practice of making such payments is arbitrary and inappropriate and should be discontinued immediately.

4. SCC Regional Offices

A review should be conducted to determine whether the SCC northern regional offices should be consolidated, and a regional office established in a more central location in the southern portion of the state in order to facilitate the SCC's ability to preside over the timely and cost-effective completion of school construction projects under its purview throughout the state.

5. Outside Employment Contracts

Immediate steps should be taken to evaluate discontinuing the use of outside employment contracts. Similar contracts should be undertaken in the future only under extraordinary circumstances and with full review and approval by the SCC Board.

6. SCC Board of Directors

A. The SCC Board should be strengthened and made more independent with the appointment of two additional public members with financial management background and no personal or professional interests in either the education community or the construction industry.

B. Additionally, procedures should be established and enforced requiring that all Board meeting agenda items and supporting materials be submitted to Board members at least one week prior to the scheduled meeting so that there is adequate time for review prior to any formal discussion and action. Further, the

agenda items and supporting materials should be presented in a cogent and comprehensive format to ensure that all Board members are properly and fully apprised of the issues coming before them.

Implementation of the internal controls recommended herein should ensure that the Board is provided with the information and expert guidance needed to oversee the SCC.

7. Disbursement Recovery and Change Order Policy

A. The SCC should immediately seek to recover monies disbursed as a result of design errors or omissions.

B. Under the direction of the new CFO/Controller, the SCC should undertake a thorough overhaul of its policies and procedures governing the review and approval of all change orders. At a minimum, (1) previously approved change orders should be reviewed for appropriateness and when indicated, effort should be made to recoup funds dispensed as a result of improperly approved change orders; (2) future change orders should be reviewed and approved by the CFO/Controller; (3) future change orders valued in the aggregate at more than five percent (5%) of the original contract amount should be approved by the Board; and (4) in the future, only in emergency circumstances should change orders be submitted for work already completed and then, the PMF should provide written justification for the emergency work authorization.

8. Ownership of Architectural Designs

Architectural contracts should be re-written so that the SCC becomes owner of the designs and can re-use them as prototypes for multiple projects as well as to eliminate duplication of responsibilities. Prototype designs should be utilized for future projects and guidelines established for appropriate design, construction and material.

9. Project Management Firms

Firms acting as PMFs on any SCC project should be prohibited from acting as prime or sub on any contractor work involving the SCC. The responsibilities of PMFs for projects should be scaled back with the goal of replacing them with qualified construction managers with less responsibilities and adequate levels of oversight. Consideration should be given to the hiring of Project Managers as SCC staff.

10. Land Acquisition

A. To the extent feasible, land acquisition for future SCC-sponsored school construction projects should be temporarily suspended. The SCC should immediately undertake an extensive review to establish appropriate guidelines for selection of property suitable for school construction. Concurrent with that review, appropriate steps should be taken to require that, in situations where appropriate construction sites include property already owned by the public, local

governmental units donate that land for use by the SCC. An evaluation of sharing some projects costs, such as land acquisition or remediation, school furnishings or a percentage of overall project costs, with local districts should be undertaken.

B. The SCC should have the authority to reject candidate sites due to environmental contamination or under other circumstances requiring excessive relocation and remediation costs.