



City of New York

OFFICE OF THE COMPTROLLER

Scott M. Stringer
COMPTROLLER



FINANCIAL AUDIT

Marjorie Landa

Deputy Comptroller for Audit

Audit Report on the School
Construction Authority's Management
and Oversight Over Its
Contract Payment Process

FM15-116A

June 21, 2016

<http://comptroller.nyc.gov>



THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
1 CENTRE STREET
NEW YORK, NY 10007

SCOTT M. STRINGER
COMPTROLLER

June 21, 2016

To the Residents of the City of New York:

My office has audited the New York City School Construction Authority (SCA) to determine whether SCA maintains adequate oversight over its contract payment process for new capacity projects and whether it ensures that payments to contractors are accurate and in compliance with contractual terms and related guidelines. We audit public authorities such as SCA as a means of increasing accountability and ensuring that City resources are used effectively, efficiently, and in the best interest of the public.

This audit found that while SCA maintained adequate oversight over its contract payment process and ensured that payments to contractors were in compliance with contractual terms and related payment guidelines, there are weaknesses in SCA's procedures. In particular, SCA does not have a system in place to ensure the proper closing of its new capacity projects. We found that SCA did not ensure that proper payment review procedures were followed and independent reconciliation was performed before making final contract payments. Further, we found that SCA did not develop a reporting process to monitor the balance of unused budgeted funds related to each project that remained open after the project had been deemed "final financial complete." The absence of such reporting mechanism creates a risk that improper charges could be applied to open projects after they have been determined to be final financial complete. In addition, the practice of rolling forward the unused budgeted funds without an adequate monitoring system may impact SCA's ability to properly account for those funds in a transparent manner.

The audit made three recommendations, including that SCA should develop procedures to close its capacity projects once all final payments have been made. SCA should also perform reconciliation and independent review of each contract before making final payment once the contract is considered final financial complete. Finally, SCA should develop a reporting process to track and monitor the balance of unused budgeted funds for each project that remains open.

The results of the audit have been discussed with SCA officials, and their comments have been considered in preparing this report. Their complete written response is attached to this report.

If you have any questions concerning this report, please e-mail my Audit Bureau at audit@comptroller.nyc.gov.

Sincerely,

A handwritten signature in blue ink, appearing to read "Scott M. Stringer".

Scott M. Stringer

TABLE OF CONTENTS

EXECUTIVE SUMMARY	1
Audit Finding and Conclusion	1
Audit Recommendations.....	2
SCA Response	2
AUDIT REPORT	3
Background	3
Objective.....	5
Scope and Methodology Statement.....	5
Discussion of Audit Results	5
FINDING AND RECOMMENDATIONS	6
SCA Does Not Close Its Capacity Projects.....	6
Recommendations	7
DETAILED SCOPE AND METHODOLOGY	9
ADDENDUM	

THE CITY OF NEW YORK OFFICE OF THE COMPTROLLER FINANCIAL AUDIT

Audit Report on the School Construction Authority's Management and Oversight Over Its Contract Payment Process

FM15-116A

EXECUTIVE SUMMARY

This audit was conducted to determine whether the New York City School Construction Authority (SCA) maintains adequate oversight over its contract payment process for new capacity projects and whether it ensures that payments to contractors are accurate and in compliance with contractual terms and related guidelines. SCA was established by the New York State Legislature in December 1988. Pursuant to its enabling legislation, SCA is responsible for the design, construction, reconstruction, improvement, rehabilitation and repair of the New York City public schools. SCA is also responsible for procuring and entering into contracts with major construction companies, managing and overseeing contractor performance, making contract payments and ensuring payments are properly reconciled and accurately reported.

SCA's operations are funded by appropriations made by the City, and guided by five-year capital plans developed by the New York City Department of Education (DOE). For its Five-Year Capital Plans covering Fiscal Years 2005 through 2009 and 2010 through 2014, SCA's budget was \$13.1 billion and \$11.3 billion, respectively. Upon completion of each of its capital projects, the assets are transferred to DOE. SCA's capital projects include new school constructions, building additions, major modernization and rehabilitation, reconstruction, renovations and system replacements, including electrical, plumbing, elevators, roofs, and security device installations. According to SCA's financial statements, SCA transferred assets valued at approximately \$2 billion to DOE for Fiscal Year 2015.

Audit Finding and Conclusion

Our audit found that SCA maintained adequate oversight over its contract payment process and ensured that payments to contractors were in compliance with contractual terms and related payment guidelines. In addition, SCA ensured retainage amounts were withheld from contractors until the contract completion criteria had been met.

However, SCA does not have a system in place to ensure the proper closing of its new capacity projects. Specifically, we found that SCA did not ensure that proper payment review procedures

were followed and independent reconciliation was performed before making final contract payments. Further, we found that SCA did not develop a reporting process to monitor the balance of unused budgeted funds related to each project that remained open after the project had been deemed “final financial complete.” The absence of such a reporting mechanism creates a risk that improper charges could be applied to open projects after they have been determined to be final financial complete. In addition, the practice of rolling forward the unused budgeted funds allocated to a completed capital project to other capital projects without any monitoring system may have an impact on SCA’s ability to properly account for unused budgeted funds in a transparent manner.

Audit Recommendations

The audit made the following three recommendations:

1. SCA should develop procedures to close its capacity projects once all final payments have been made.
2. SCA should perform reconciliation and independent review of each contract before making final payment once the contract is considered final financial complete.
3. SCA should develop a reporting process to track and monitor the balance of unused budgeted funds for each project that remains open.

SCA Response

In their response, SCA officials agreed with all three audit recommendations, stating that “SCA will remove the budget for unused construction funds for all capacity projects once deemed complete. This change will prevent any additional construction transactions from being processed on these financially complete contracts.”

AUDIT REPORT

Background

SCA was established by the New York State Legislature in December 1988. Under the enabling legislation, SCA is responsible for the design, construction, reconstruction, improvement, rehabilitation, and repair of the New York City public schools. SCA is also responsible for procuring and entering into contracts with major construction companies, managing and overseeing contractor performance, making contract payments, ensuring payments are properly reconciled and amounts accurately reported.

SCA's operations are funded by appropriations made by the City, which are guided by five-year capital plans developed by DOE. For its Five-Year Capital Plans covering Fiscal Years 2005 through 2009 and 2010 through 2014, SCA's budget was \$13.1 billion and \$11.3 billion, respectively. Upon completion of each of its capital projects, the assets are transferred to DOE. SCA's capital projects include new school construction, building additions, major modernization and rehabilitation, reconstruction, renovations, and system replacements, including electrical, plumbing, elevators, roofs, and security device installations. According to SCA's financial statements, SCA transferred assets valued at approximately \$2 billion to DOE for Fiscal Year 2015.

For "new capacity projects," SCA prepares and submits a Certificate to Proceed (CP) to the Office of Management and Budget (OMB).¹ The CP includes an estimate of the cost of construction for each project and initiates the process that will allow City funds to be withdrawn from the City's Financial Management System (FMS) and expended by SCA.² According to SCA's and OMB's procedures, SCA prepares and submits a cash request memo to OMB to request approval to draw down the funds to pay for its capital expenses. OMB reviews each request and upon approval provides the corresponding FMS budget codes, initiates the voucher process in FMS, which must first be approved by DOE, and wires funds into SCA's bank account.

The process that enables a contractor to be paid for work on a new capacity project begins when a contractor submits a Request for Payment (RFP) to SCA. An SCA project officer will then verify the percentage of work completed against the amount requested by the contractor. If the amount requested is determined to be correct, the project officer sends the completed RFP to SCA's Finance Department which reviews it for accuracy and completeness, and enters it into its Oracle system.³ The Oracle system communicates information, including a payment request to FMS, which generates a check from the City. Five percent is withheld on each payment as retainage to help ensure that all of the work is satisfactorily completed.⁴

¹ "New capacity projects" are new schools or additions to existing schools that provide additional seating capacity.

² SCA requests funds through a CP and is responsible for initiating a CP request. There are multiple CPs issued, including a scope CP, which is obtained at the beginning of the Design phase of a capacity project; an operating CP for overall payroll and administrative expenditures; and project CPs for each individual project.

³ Oracle is the financial software used by the SCA's Finance Department to track construction progress and process payments.

⁴ Retainage is money earned by a contractor, but not paid to the contractor until the substantial completion of construction or some other agreed-upon date.

Once the construction of a new capacity project has reached 95% completion, the project is considered to be “substantially complete.” At this point, an SCA project officer will submit an RFP to SCA’s Finance Department along with a Substantial Completion General Release form executed by the Contractor, a Letter of Acknowledgement and a Certificate of Substantial Completion. SCA’s Finance Department then reviews and processes the RFP and updates the information in the Oracle system. Once this process is complete, the new school (or additional space) is available for occupancy by students, even though the project is not yet considered to be final complete.

New capacity projects go through two stages before they can be considered “final complete.” The first stage is “final construction complete.” This occurs once all construction work has been finished. SCA then generates a Notice of Project Transfer letter to DOE stating that the project construction has been completed and all that remains is to complete final payment and officially transfer the asset to DOE within 30 days. The second stage is “final financial complete,” which occurs after the contractor and SCA have resolved all outstanding financial issues, such as unsettled change orders and liens.

Once the financial issues are resolved, SCA’s project officer submits a Final Completion Package to SCA’s Finance Department. The package includes a Final RFP (including the release of retainage), a Final Completion General Release form executed by the contractor, and a Final Completion Worksheet which details the final contract amount expended. This package should be completed and signed by the SCA project officer and chief project officer. SCA’s Finance Department reviews the package and approves it before final payment can be made and the retainage released. After final payment is made, SCA leaves the project budget open and rolls forward unused budgeted funds into other SCA projects.

According to SCA’s Capital Project Report, SCA identified a population of 190 substantially complete projects between January 1, 2008, and June 30, 2015.⁵ The corresponding construction costs totaled approximately five billion dollars. Among these 190 projects, 52 projects were new capacity school projects. Table I which follows identifies the number of new capacity school projects in each completion phase.

Table I

New School Capacity Projects’ Status as of June 30, 2015

New Project Completion Phase	Number of Projects	Percent of New Projects
Substantially Complete	38	73 %
Final Construction Complete	10	19 %
Final Financial Complete	4	8 %
Total New Capacity Projects	52	100%

Thirty-eight of the 52 projects (73%) were at the substantially complete phase and 10 of the 52 projects (19%) were at the final construction complete phase. The remaining four new capacity projects that were at the final financial complete phase were the focus of this audit.

⁵ From January 1, 2008, to June 30, 2015, this schedule listed a total of 190 projects categorized "Demolitions, Leases, Addition and New" with the status of "Construction Completed or Active."

Objective

To determine whether SCA maintains adequate oversight over its contract payment process for new capacity projects and whether it ensures that payments to contractors are accurate and in compliance with contractual terms and related guidelines.

Scope and Methodology Statement

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The scope of this audit covers the period from July 1, 2008, through June 30, 2015. Please refer to the Detailed Scope and Methodology at the end of this report for the specific procedures and tests that were conducted.

Discussion of Audit Results

The matters covered in this report were discussed with SCA officials during and at the conclusion of this audit. A preliminary draft report was sent to SCA and discussed at an exit conference held on May 26, 2016. On June 2, 2016, we submitted a draft report to SCA with a request for comments. We received a written response from SCA on June 15, 2016. In their response, SCA officials agreed with all three audit recommendations, stating that “SCA will remove the budget for unused construction funds for all capacity projects once deemed complete. This change will prevent any additional construction transactions from being processed on these financially complete contracts.” The full text of their response is included as an addendum to this report.

FINDING AND RECOMMENDATIONS

Our audit found that SCA maintained adequate oversight over its contract payment process and ensured that payments to contractors were in compliance with contractual terms and related payment guidelines. In addition, SCA ensured retainage amounts were withheld from contractors until the contract completion criteria had been met.

However, SCA does not have a system in place to ensure the proper closing of its new capacity projects. Specifically, we found SCA did not ensure that proper payment review procedures were followed and independent reconciliation was performed before making final contract payments. Further, we found that SCA did not develop a reporting process to monitor the balance of unused budgeted funds related to each project that remained open after the project had been deemed “final financial complete.” The absence of such reporting mechanism creates a risk that improper charges could be applied to open projects after they have been determined to be final financial complete. In addition, the practice of rolling forward the unused budgeted funds allocated to a completed capital project to other capital projects without any monitoring system may have an impact on SCA’s ability to properly account for unused budgeted funds in a transparent manner.

SCA Does Not Close Its Capacity Projects

SCA does not close new capacity projects upon completion, which leaves a risk that improper charges may be made against projects that have already been determined to be “final financial complete.” Rather than developing a process to remit the unused budgeted funds to the City, SCA leaves the projects open and rolls forward unused budgeted funds into other projects. SCA’s practice of not closing out its projects creates the potential risk that the budgeted funds originally designated to one project, which are reallocated for another project, could be misallocated. As a result, unused budgeted fund balances are at a greater risk of being inaccurately or incompletely accounted for.

Our review of four sampled capacity projects identified a total of \$12.4 million in unused funds related to projects that had been deemed to be “final financial complete” but that had not been closed in SCA’s books. We found that while one of the projects was listed as final financial complete in June 2011, it still had \$1.9 million in unused funds remaining as of December 31, 2015. Since this project was still open on its books, notwithstanding the fact that “final payments” were made to the contractors and releases signed, SCA was able to make a \$28,500 payment four years later from those encumbered funds to one of the contractors assigned to the project. In connection with this payment, SCA re-issued the Final Completion Package to this contractor even though both SCA and the contractor had previously agreed that it had been paid in full under the contract.

When we questioned the validity of the payment, an SCA official explained that an internal review of the project found a discrepancy due to a change order accidentally being omitted from an RFP, which resulted in an underpayment to the contractor. Had SCA officials conducted the proper reconciliation and independent review of each contract before making final payment, this error would have been recognized by SCA at the time the project was determined to be final financial complete. Instead, SCA adjusted the final contract value on the final completion worksheet by subtracting the discrepancy as an amendment. This record keeping practice raises concerns about the adequacy of SCA’s tracking of project expenditures. Further, we question the propriety

as well as the legal basis for this payment given that releases had been received from the contractors.

According to an SCA official, SCA leaves the capacity projects open because unused funds may be needed for future unforeseen issues such as the one cited above. SCA maintains that if it was to close these projects, it could inhibit its ability to make payments in a timely manner. However, as noted, both SCA and the contractor agreed that the Final Completion Package should reflect the final contract value. Therefore, since SCA can re-issue the package whenever there is an additional payment, we question the integrity and the real purpose of the Final Completion Package as well as the quality of SCA’s review and reconciliation that should have been conducted prior to the final closeout. By allowing projects to remain open, SCA remains vulnerable to inappropriate charges being drawn down against a project’s unused funding.

Table II shows the \$12.4 million in unused funds, ranging from \$1.6 million to \$4.5 million, for the four final financial completed projects we reviewed.

Table II

Remaining Funding of Four Capacity Projects as of December 31, 2015

Capacity projects	Project Q273	Project X169	Project M876	Project X465	Total
Total OMB Approved	\$33,224,143	\$33,954,197	\$49,955,337	\$69,789,887	\$186,923,564
Total Spent	\$31,592,122	\$31,988,697	\$45,755,423	\$65,197,802	\$174,534,044
Unused Funds	\$1,632,021	\$1,965,500	\$4,199,914	\$4,592,085	\$12,389,520

Given the significant amount of capital funds SCA manages, SCA should develop a reporting process to properly monitor each unused budgeted fund, perform reconciliations and independent reviews, close its projects when a newly constructed school is deemed to be final financial complete, and not make additional contract payments to contractors who have acknowledged that they have been paid in full.

Recommendations

SCA should:

1. Develop procedures to close its capacity projects once all final payments have been made.

SCA Response: “SCA agrees with this recommendation and will develop procedures to close capacity construction contracts once all final payments have been made.”

2. Perform reconciliation and independent review of each contract before making final payment once the contract is considered final financial complete.

SCA Response: “SCA agrees with this recommendation and will perform a reconciliation and independent review of each capacity construction contract before making final payment.”

3. Develop a reporting process to track and monitor the balance of unused budgeted funds for each project that remain open.

SCA Response: “The SCA will develop a reporting process to track and monitor the balance of unused budgeted capacity project funds. Additionally, while the SCA believes the appropriate internal controls are in place to prevent inappropriate charges, to further minimize any potential risk, SCA will remove the budget for unused construction funds for all capacity projects once deemed complete. This change will prevent any additional construction transactions from being processed on these financially complete contracts.”

DETAILED SCOPE AND METHODOLOGY

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The scope of this audit covers the period from July 1, 2008, through June 30, 2015. To achieve our audit objectives, we reviewed the New York School Construction Authority Act–PBA Article 8 Title 6, the Five-Year Capital Plans, Certified Financial Statements and Management Letters, SCA Quarterly Schedule and Budget Reports (Quarterly Reports), and the policy and procedures for processing payments to contractors.

To gain an understanding of SCA’s processing of capital planning, budget allocation, funding requests and payments to contractors, we interviewed the SCA Comptroller, Vice President of Capital Plan Management, Senior Director of Project Budgeting and Financial Analysis, Director of Project Budgeting, Accounts Payable Finance Manager, and Directors of the Contract and Change Order Units. In addition, we conducted system walkthroughs of Primavera Contract Management (PCM) and Oracle systems that SCA used for the contract payment and change order process. The results were documented in memoranda and flowcharted.

To determine whether the Quarterly Reports were accurate, we reviewed the four final financial completed school projects from SCA’s Capacity Projects Report as of June 30, 2015. We analyzed the amounts on the Quarterly Reports to the Five-Year Capital Plans, Scope CPs, individual project CPs, CP worksheets and reconciliation schedules of payments. We also traced the Cash Request Memo amounts to the bank statements and FMS to ensure the funding appropriations were accurate and complete. In addition, we conducted an analysis of invoices to see if payments were accurately recorded in the Oracle system and were recorded in the bank statements.

To obtain reasonable assurance that payments to the contractors were accurate and completed in compliance with the contract terms, we judgmentally selected the contractor with the highest construction payments from the reconciliation report for each of the four selected school projects. We reviewed the RFPs associated with the four school projects, ensured if proper sign-offs were in place, and if the amounts and descriptions of the contracts and change orders corresponded with the RFPs. We also confirmed that all approved change orders were included in the RFP’s.

To conduct a test of the SCA’s policies and procedures for closing-out construction contracts, we obtained the Final Completion packages for each of the four school projects to ensure that appropriate documentation was attached, signed, notarized and included the final contract amount. We also reviewed the Final Completion package total amounts and compared with the reconciliation schedules of payments. However, we were unable to review SCA’s policies and procedures for project close-out because SCA does not close out its projects upon final payment.



Lorraine Grillo
President & CEO
lgrillo@nycsca.org

June 15, 2016

Ms. Marjorie Landa
Deputy Comptroller for Audit
Municipal Building
1 Centre Street, Room 1100
New York, NY 10007

Dear Ms. Landa:

We have reviewed your draft document titled "Audit Report on the School Construction Authority's Management and Oversight over its Contract Payment Process" dated June 2, 2016 and have attached a document containing our comments and responses to the recommendations.

If you have any questions, please feel free to call Marianne Egri, Vice-President of Finance & IT, at 718-472-8012.

Sincerely,

A handwritten signature in blue ink that reads "Lorraine Grillo". The signature is written in a cursive, flowing style.

Lorraine Grillo
President and CEO,
New York City School Construction Authority

New York City School Construction Authority

**Response to Recommendations contained in “Audit Report on the School
Construction Authority’s Management and Oversight over its Contract Payment
Process”**

June 15th, 2016

Page 2, 1st paragraph &

Page 6, 2nd paragraph

Comptroller’s Office comment:

“Further, we found that SCA did not develop a reporting process to monitor the balance of unused budgeted funds related to each project that remained open after the project had been deemed “final financial complete.” The absence of such reporting mechanism creates a risk that improper charges could be applied to open projects after they have been determined to be final financial complete. In addition, the practice of rolling forward the unused budgeted funds allocated to a completed capital project to other capital projects without any monitoring system may impact SCA’s ability to properly account for unused budgeted funds in a transparent manner.

SCA response:

While the SCA believes the appropriate internal controls are in place to prevent inappropriate charges, to further minimize any potential risk, SCA will remove the budget for unused construction funds for all capacity projects once deemed complete. This change will prevent any additional construction transactions from being processed on these financially complete contracts.

The later part of the paragraph (“practice of rolling forward the unused budgeted funds allocated to a completed capital project”) refers to the SCA’s capital planning process. Unused capital funds are re-allocated into the Five Year Capital Plan. The Five Year Capital Plan and its annual amendments are prepared and submitted for public hearing and comment in accordance with Education Law Section 2590-p.

Recommendations

1. Develop procedures to close its capacity projects once all final payments have been made.

SCA Response: SCA agrees with this recommendation and will develop procedures to close capacity construction contracts once all final payments have been made.

2. Perform reconciliation and independent review of each contract before making final payment once it is considered final financial complete.

SCA Response: SCA agrees with this recommendation and will perform a reconciliation and independent review of each capacity construction contract before making final payment.

3. Develop a reporting process to track and monitor the balance of unused budgeted fund for each project that remain open.

The SCA will develop a reporting process to track and monitor the balance of unused budgeted capacity project funds. Additionally, while the SCA believes the appropriate internal controls are in place to prevent inappropriate charges, to further minimize any potential risk, SCA will remove the budget for unused construction funds for all capacity projects once deemed complete. This change will prevent any additional construction transactions from being processed on these financially complete contracts.