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New Jersey Schools Construction Corporation

July 18, 2000 to January 5, 2006

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Enclosed is our report on the audit of the New Jersey Schools Construction Corporation for the period of July 18, 2000 to January 5, 2006. If you would like a personal briefing, please call me at (609) 292-3700.

James B. Patterson  
Assistant State Auditor  
March 8, 2006
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New Jersey Schools Construction Corporation

**Scope**

We have completed an audit of the New Jersey Schools Construction Corporation (the Corporation), a subsidiary of the New Jersey Economic Development Authority for the period July 18, 2000 to January 5, 2006. Our audit included financial activities accounted for in the Corporation’s accounting system which is not part of the state’s centralized accounting system.

Expenditures and commitments during the audit period were $7 billion. The operations of the Corporation are funded primarily from $8.6 billion in bonds. The prime responsibilities of the Corporation are to finance, design, and construct school facilities in the Abbott school districts using a streamlined approach to achieve the timely and efficient construction of quality schools in New Jersey. Our review included activities for managing Abbott school projects totaling $4.5 billion including contracts for project management firms, architects, construction, land acquisition, and demonstration projects. Excluded from our review were the activities involving the non-Abbott school grants, temporary classroom units, and administration expenses.

**Objectives**

The objectives of our audit were to determine whether financial transactions were related to the Corporation's programs, were recorded properly in the Corporation’s accounting systems and whether resources were properly managed.

This audit was conducted pursuant to the State Auditor's responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

**Methodology**

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.
In preparation for our testing, we studied legislation, administrative code, circular letters promulgated by the State Comptroller, and policies of the agency. Provisions that we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our samples of financial transactions. We also read the budget message, reviewed financial trends, and interviewed agency personnel to obtain an understanding of the programs and the internal controls.

A nonstatistical sampling approach was used. Our samples of financial transactions were designed to provide conclusions about the validity of transactions as well as internal control and compliance attributes. Sample populations were sorted and transactions were judgmentally selected for testing.

**Conclusions**

It is management's responsibility to establish and maintain an adequate system of internal controls and to function in the most efficient and economical manner. Controls also facilitate the achievement of management objectives by serving as a system of checks and balances which guard against undesired actions occurring. Good internal controls are essential in achieving the proper conduct of government business with full accountability for the resources made available. Our review found that the financial transactions included in our testing were related to the program and were recorded properly in the Corporation's accounting system. However, the Corporation did not have an adequate system of internal controls to properly manage the projects and function in the most efficient and economical manner. We further noted that the Corporation did not have a project management information system in place which would assist in the proper oversight of its operations. Our conclusions are based on our audit findings which are detailed on the following pages and accompanied by our recommendations for corrective action.
Background

On July 18, 2000, the Educational Facilities Construction and Financing Act (the Act) was enacted, assigning the New Jersey Economic Development Authority (EDA) the responsibility of repairing, renovating and constructing school facilities in Abbott districts determined by the Commissioner of Education to be required to meet educational adequacy standards. The Act further required the State to contribute to the cost of the renovation and construction of new facilities in other districts to ensure a thorough and efficient education in those districts. The Act gave the EDA power to issue bonds for these purposes, with aggregate principal amounts not to exceed $6 billion for the Abbott district projects, $2.5 billion for non-Abbott district projects, and $100 million for county vocational district school projects.

On July 29, 2002, Governor McGreevey issued Executive Order #24, creating the New Jersey Schools Construction Corporation (the Corporation), a subsidiary of the EDA, and charged it with the responsibility of fulfilling the Act’s requirements. The Executive Order further created the Corporation’s Board of Directors to oversee the Corporation. The Corporation’s initial priority was to hasten the work on 400 health and safety projects with construction cost of $650 million, and to accelerate the development of new renovation and construction projects required by the Act.

In late 2004, it became clear to the Corporation that it would not have sufficient funds to finish all of the necessary projects, including some projects already initiated. In the summer of 2005, the corporation determined that there were sufficient funds remaining to complete 75 projects that were in or close to beginning the construction phase and an additional 59 projects that were in preliminary stages. Additional funding would be required to complete any remaining projects and that amount had not been determined.
Strategic Plan and Comprehensive Budget

When the EDA and the Department of Education (DOE) were assigned the task of implementing the requirements of the Act, an overall strategic plan was not formulated to determine how to best spend the $6 billion in the Abbott districts. When the Corporation was created the priority was to get projects started and moving quickly. The Corporation continued the practice of advancing projects on a first-come, first-serve basis. Aside from the previously existing health and safety projects, no statewide priority was placed on which projects to advance and in what order. When the DOE authorized the Corporation to proceed with a project, an in-depth analysis was not performed prior to the project moving forward to determine where the project might fit into a master plan.

In addition, a comprehensive budget and project cost system was not developed, which would permit budget versus actual cost comparisons. The system should identify all cost components associated with the project. Furthermore, the system should be updated timely to reflect known increases in cost. Project budgets should be approved by the board and funds encumbered. This is currently not occurring. However, the board did approve some components of a project as it moved forward, such as land acquisition, design contracts, and construction contracts. Periodic status reports on all ongoing projects should also be prepared and presented to the board. The lack of such a system made it inherently difficult for the Corporation to control individual project costs, and prevented the board from properly monitoring the impact of all project costs, in their totality, on the financial position of the Corporation.

The current project control system is unable to record and track requests for change orders as
they become known. The process can take months depending on the approval requirements. In the interim, there is no record of the change orders with their added costs, other than possibly in the project officer’s files. This may result in an unrecorded obligation or liability and hamper the fiscal monitoring of the project.

These conditions resulted in the Corporation committing to projects that could not be completed within the current funding level. The Corporation’s estimate of cost to complete the 134 current projects had been understated by at least $380 million. In addition, 100 projects have been halted due to a lack of funding with $144 million having already been expended.

**Recommendation**

We recommend that a strategic plan be developed to guide the Corporation as it moves forward. For such a plan to be successful there needs to be more involvement by all parties, including the school districts, the DOE, the Corporation, and perhaps guidelines from the legislature. The plan should establish the order in which schools should be built by evaluating each project and prioritizing the schools most in need.

We further recommend that the Corporation develop a comprehensive budgetary system that would allow it to establish realistic preliminary budgets while a comprehensive project development budget is being developed. Additionally, a real-time project tracking system should be implemented to better reflect changes in scope and estimates, and the status of the project. The system should incorporate all budgeted and actual costs, allowing for better monitoring of each project and the entire program.

Once a comprehensive budget is developed, it should be presented to the board, with the funds for the entire project being reserved upon its approval. As the project progresses, management should provide the board with periodic updates
on each project’s status with regard to time and budget. Decision points need to be put in place allowing management and the board to determine the reasonableness of a project’s total expected cost and whether the project should proceed or be redeveloped. There should be consideration of cost as well as the speed of construction.

**Corporation’s Response**

The Corporation agrees that its activities should be guided by a strategic plan that provides guidance as to priority setting, based upon education needs established by the Department of Education (DOE). Moreover, the criteria to be applied by such a plan must be developed in consultation with all stakeholders, including the DOE and the school districts. The planning for the development of such a plan has commenced and is being facilitated by the Interagency Working Group for School Construction established by Governor Corzine by Executive Order #3. The Corporation anticipates that decisions regarding the establishment of project priorities will be guided by the criteria established through the strategic planning process.

The Corporation agrees that a budget management system is essential to providing appropriate oversight to the Corporation’s operations. The Corporation is implementing a system to monitor project expenditures and identify exceptions to approved plans. In addition, a real-time project management system is currently being evaluated for implementation. That evaluation includes consultation with other state departments and agencies to identify best practices.

The Corporation agrees that such project budget and management information should be shared with the Board of Directors or a Committee thereof in a timely manner.
Prudent cost estimates will define the parameters for managing costs.

Cost Estimates

The Educational Facilities Construction and Financing Act (the Act) established a cost allowance in determining a project's preliminary eligible costs (PEC) which is currently $143 per square foot for new construction. The PEC was meant to cover all eligible costs for the project, including construction costs, site development, land acquisition, and professional service fees. The Act does provide that a project's final eligible costs may exceed the PEC, but only if the Corporation determines that any additional costs are the result of factors outside the control of the district or the additional costs are required to meet the facilities efficiency standards. The Corporation, however, has established its own construction cost allowance of between $161 and $218 per square foot, based on the school type and geographical area. The Corporation's cost allowance only includes construction costs. By setting its own construction cost target above the statutory target for all project costs, the Corporation has failed to make an adequate attempt to meet this statutory objective.

Based on estimated construction costs, the architects were required to design projects that would meet the targeted amount. These targets are significant since there are only design and materials minimum standards; there are no maximum standards to restrict project costs. Design and materials can exceed minimum standards provided the total estimated cost does not exceed the target. Nevertheless, construction costs commonly exceeded the allowed cost per square foot. In a report prepared by the Corporation's Design and Construction division, 23 of the 33 projects exceeded the targeted construction costs estimate (CCE). It should be noted that seven of the eight projects initiated after the Act was passed exceeded the targeted preliminary CCE and in two projects the target was exceeded by over 25 percent. Our analysis
of projects not included in the report found that the cost per square foot design estimates were misleading for projects that involved a combination of renovations to the existing building and a new addition. The CCE target should have only been applied to the new construction. For example, one project involved 113,000 square foot costing on average $147 per square foot for both renovation work and an addition, even though the 21,000 square foot addition cost $621 per square foot.

Although the target CCE was based upon design standards, a Design Standards Manual has not been adopted. A manual is being developed, but has yet to be presented to the board. A well designed manual would establish both minimum and maximum standards, thereby ensuring that quality levels for the long life of a building can be achieved, while still controlling maximum costs relative to design approaches and material selections.

**Recommendation**

We recommend that the Corporation enforce the square foot cost allowance provided in the Act and if deemed necessary request that amount be adjusted. Project designs that exceed cost targets should be justified and approved by the board. In addition, we recommend the Corporation complete the Design Standards Manual.

**Corporation’s Response**

The Corporation agrees that the establishment and enforcement of square foot cost allowances is an essential element of managing program costs. The Corporation believes that the preliminary eligible cost allowance cited in the Act was never a realistic amount to cover the totality of costs associated with DOE-approved school construction projects. The Corporation recognizes that adjustments to the cost allowance, based on the DOE-approved scope of activities and market-driven factors, are best established as part of a transparent process that includes stakeholder consultation, with periodic reporting of such
adjustments with recommendations for amendment to the Governor and Legislature.

A draft Design Standards Manual has been developed, is currently being reviewed, and is scheduled to be presented for consideration by the Schools Review Committee of the Board of Directors in the first half of this year.

Uncontrollable variables negated the benefits of the Fastrack methodology.

Fastrack Methodology

In 2003, the Corporation instituted a Fastrack Approach for its construction projects. The Fastrack methodology initiated the design phase of a construction project simultaneously with the site development/land acquisition phase and subsequently commenced the construction bidding sequence prior to the completion of the permit and construction document phases. The overlapping of these various activities was designed to reduce the overall duration of a project by 20 months. Although the Fastrack Approach may have its theoretical benefits, its implementation on the Corporation’s projects was not successful because there were too many uncontrollable variables associated with the initial phases of the project which resulted in additional costs to the project. Problems encountered in the site development or acquisition phases, or changes to the facility plan at times resulted in the need for design changes, and thus, additional design costs. In addition, design consultants (architects) were allowed to proceed through contractual milestones, such as schematic designs, without the required DOE review and approval. This contributed to design change orders totaling more than $67 million, which represented a 16 percent increase to original contract amounts.

For some projects construction costs were also affected since contracts were awarded prior to bid and construction documents being completed and
approved. It has been estimated by the Corporation staff that correcting errors and omissions in bid documents and construction contracts were increasing project costs by five percent. We reviewed the reasonableness of this estimate by testing five projects totaling $55 million that were more than 70 percent complete and found that due to errors and omissions costs increased by eight percent on these projects. Although management halted this practice in mid 2005, over $1.3 billion in construction contracts had been awarded under the Fastrack Approach. If these five to eight percent rates of increase are valid for all contracts, projects costs will be $65 to $105 million higher.

Another repercussion of Fastrack was the increased magnitude of the number of unfinished projects that entered the design phase and had to be suspended when it was discovered that funding to complete the projects was not available. Approximately 100 projects with design contracts totaling $191 million were suspended at various stages of design with approximately $90 million in costs having been incurred to date. If the design contracts are suspended for more than 90 days, the Corporation will have to further compensate the design consultants for costs incurred because of the suspension. If the contracts need to be terminated, it may be necessary to reprocure the project designs, and the Corporation may have to pay for all of these completed services again.

**Recommendation**

We recommend that project and site feasibility be completed before advancing to the design phase. It would be more prudent to decide what and where to build before it is designed. We also agree with management’s decision to discontinue the practice of awarding construction contracts prior to construction document completion. In addition, for the 100 unfunded projects suspended in the design phase, a potential remedy to losing all benefit from the unfinished designs would be
to continue through the construction document phase for those projects deemed to be cost beneficial or of a higher strategic priority. The Corporation could then use the bid documents when construction can be funded. This remedy, however, would cost an additional $45 million if all design contracts proceed to the construction document phase.

**Corporation’s Response**

The Corporation agrees that project and site feasibility should be completed before advancing to the design phase, and had adopted such a policy with the limited exception for approved projects in the Capital Plan where work has already advanced to such a stage that the opportunity to implement this recommendation has passed.

The Corporation agrees that the embedded value in projects for which design work has been suspended should be considered in setting priorities in the event that future funding enables additional projects to proceed. The Corporation agrees that there can be some benefit to completing suspended designs in the event that these projects are ultimately approved for construction. This option was weighed by management and the Board of Directors during 2005; however, a decision was made to suspend these contracts because it was not known if and/or when these projects would move forward. In addition, physical building requirements could change significantly if the projects are delayed for several years, which would require changes in the project designs.

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**Land Acquisition**

**Reducing the time for land acquisition will reduce costs.**

As of October 2005, the Corporation acquired, by agreement or condemnation, 359 properties at a total cost of $225 million. The acquisition process takes much longer than the Corporation’s
timeline which was up to nine months. According to the Corporation's Land Acquisition division, it generally takes 9 to 12 months to complete the predevelopment phase, and an additional 6 to 12 months to acquire the property. Our testing indicated that it takes at least this amount of time for each phase.

Before attempting to acquire a property, the Corporation must complete a Land Acquisition 20 Point Checklist to obtain approval from the DOE. In order to complete many of the checklist requirements, the Corporation must rely on other entities such as local planning boards, the Department of Environmental Protection, and local or county water or sewage agencies. The Corporation does not have control over the time it takes these other entities or agencies to perform their work.

The Corporation also engages in negotiations that exceed the requirements of the Eminent Domain Act of 1971. This act requires that an offer be no less than the appraised amount, and rejection or failure to accept the offer within the period specified is proof that negotiations have failed and condemnation proceedings can begin. Since the Corporation uses offers/counteroffers which prolongs negotiations, the value of the property is allowed to appreciate in value, at times substantially. These factors contributed to the amount spent for these properties being $31 million or 16 percent above the original appraised value.

We further noted that the estimated cost of remediation is deducted from the settlement or condemnation award amount. However, for reasons often outside the Corporation's control, these estimates are often based on very limited information. Consequently, the actual costs often greatly exceed the initial estimates. For the 25 school sites which have, or are expected to have, the highest remediation costs, this amount is
expected to exceed the estimates by $32 million. Even though the Corporation has recourse in recovering these additional remediation costs after the fact or requesting that the court hold any award amount in escrow, it has not used these methods.

**Recommendation**

We recommend the predevelopment process be streamlined, allowing the Corporation to develop and meet a more reasonable timeline. Additionally, the Corporation should advance to condemnation sooner, limiting negotiations to a period that would minimize the appreciation of property values. Further, in cases where remediation is required, the Corporation should request that the courts hold award and settlement amounts in escrow and be more aggressive in their recovery efforts.

**Corporation's Response**

The Corporation agrees that the predevelopment process employed by the Land Acquisition function can be improved to gain greater efficiencies. This will require system, process, and human resource changes. The Corporation is identifying short-term process improvements while seeking longer-term, systemic changes. To this end, the Corporation has created an Environmental Services division to more effectively utilize our environmental technology resources. This division, which was organized late in 2005, supports both the Land Acquisition and Design & Construction functions.

The Corporation agrees that some land acquisition cases should advance to condemnation sooner than has occurred in the past. To ensure that the Corporation has the appropriate expertise to analyze the costs of condemnation versus negotiation, a Deputy Attorney General with extensive background and experience in condemnation practice was added to the Land Acquisition division during the first quarter of 2005. Additionally, the Corporation is reviewing best practices of other state agencies
pertaining to condemnation activities. The Corporation and the Division of Law have established a procedure to expedite the review, identification, and pursuit of matters appropriate for cost recovery proceedings.

Project Management Firm Costs

When EDA was assigned the responsibility for the school construction program it lacked the professional staffing to adequately control the program. As of December 31, 2001 there were only 50 EDA school construction employees with 13 of them assigned directly to the design and construction of Abbott school projects. Considering the enormity and urgency of the pending school projects, it was determined that the use of project management firms (PMF) was a necessity. These firms managed all of the functions necessary for the advancement and completion of all construction projects. Their responsibilities included managing tasks related to site feasibility and acquisition, design, demolition, and construction management services. They were initially directed to complete $650 million in health and safety projects at 400 schools in the Abbott districts. Subsequently, over 250 construction projects with initial Construction Cost Estimates (CCE) of $4 billion were awarded to PMFs to manage.

Our review noted that the average PMF fee of 11 percent of initial CCE seems high when compared to the average three percent Construction Manager (CM) rate paid by non-Abbott school districts. PMF services, however, are more comprehensive than CM services. PMFs also manage the pre-design and design phases, in addition to the services performed by a CM. However, when factoring in the three and one-half percent rate used for Design Only projects the total rate should be between six and seven percent. We have identified the following
factors which contributed to the current PMF rate.

The procurement of PMF services followed procedures for professional service contracts which do not require awarding the contact to the lowest price qualified bidder. However, we found that fees were not considered in the competitive portion of the procurement process. Qualified vendors were ranked by EDA based on the PMFs’ technical proposals and interviews. It was not until after these rankings were determined that the fee proposals were opened. Although the process allowed for the negotiation of the fees, we found the results of these negotiations to be ineffective in controlling costs. The negotiated savings were primarily the result of reducing the scope of work not the rate. Any savings were negated when the PMFs were awarded change orders for additional hours of work.

Although PMFs are paid on lump sum fixed fee contracts, the fees are based on budgeted hours and hourly rates of PMF personnel. Our analysis of PMF hourly rates indicated that direct salaries were marked up by 94 to 192 percent for the cost of employee benefits, indirect costs, and profit. Although salaries paid by PMFs and the Corporation are comparable, the $182 million staffing costs for the 14 PMF contracts reviewed exceeded the comparable costs of the Corporation’s staff (including benefits) by $59 million or 48 percent. Although there were 276 Corporation employees, of which 88 were assigned to the Design and Construction division as of November 2005, they continue to assign all projects to PMFs rather than manage them in-house.

As of January 2006 PMFs have been contracted to perform $540 million in professional services and have been paid $283 million of that amount. There have been 24 contracts with 12 different PMFs. To limit the size of PMF contracts, in
addition to a three-year duration restriction, a maximum construction cost cap was established. However, in order to continue to award projects to PMFs who were approaching their cap, additional assignments were designated as Design Only projects. It was interpreted that since the scope of work of Design Only projects stopped after the design stage, they did not violate the construction cost estimate cap. Three PMFs were awarded $23 million in fees to manage such Design Only projects.

We further noted that the review criteria used by the project officers for determining the accuracy of the PMF invoices were not always adequate or consistently applied. As a result, invoice payments were made prior to the completion of services or were not justified by the contractual terms. The following are examples of advance payments.

A PMF was paid $1.9 million, or 89 percent of a project’s construction phase fee, even though the construction phase was only 62 percent complete per the construction contractor’s billing. This indicates an advance payment of $580,000.

For two other projects the PMF was paid $2.1 million, or about 40 percent of their construction phase fees, even though the primary construction contracts for these two projects have not yet been awarded.

In each of these examples, the erroneous billings were a product of predetermined project payment schedules rather than the actual status of the project. When the project was delayed, the billings were not properly adjusted, and so the services for which payment was sought may not have been completed and should not have been paid.

**Recommendations**

We recommend that the Corporation evaluate managing new projects utilizing their in-house
staff rather than automatically awarding them to project management firms. If it becomes necessary to utilize PMFs on future projects, we recommend that they be procured using a methodology that considers both qualifications and cost. In addition, instruction should be given to all personnel approving PMF invoices to ensure the proper application of contractual terms.

**Corporation's Response**

The Corporation agrees with the recommendation that other project management methods should be considered. The historic model that incorporates the use of PMFs to oversee and manage all phases of construction is being reassessed with the objective of developing a suite of options so that project management structures can best match the specific circumstances of each project. Potential alternatives include the utilization of in-house staff to manage some or all of the current PMF functions, the use of Construction Managers, at-risk contracts, or a combination of these and other options. We agree that the procurement methodology related to PMFs should be re-evaluated. We also agree that additional instruction to the staff is required regarding their management of the PMFs, including proper review and approval of PMF invoices to ensure appropriate application of contract terms. Such training will commence by March 31, 2006.

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**Project Management Firms - Change Order Fees**

As of January 2006, 343 change orders totaling $296 million were awarded to PMFs. Change orders were used in all instances when the PMF fee was adjusted. Many change orders, such as assigning additional school projects to the PMF, were appropriate under the contractual terms. Others, however, were the result of inconsistent
application or interpretation of the original contract terms by the PMF and the Corporation's Design and Construction staff who recommended and authorized the fee increase. This can be partially attributed to a lack of written guidance on the eligibility of the various PMF change orders. In addition, no formal training has been given to the project officers on this subject. Furthermore, there has not been an adequate process to independently review PMF change orders outside of the Design and Construction division.

We reviewed the contract and change order activity of ten PMF contracts which contained 181 change orders totaling $185 million. Sixty change orders totaling $45 million were the result of contract term and scope interpretations which were questionable. We further noted that such interpretations varied depending on the regional office, PMF, or the Corporation's project officer involved.

We found that 27 change orders totaling $15 million erroneously cited an additional assignment or an increase in scope of work as the cause for additional fees. These change orders cited additional construction cost estimate (CCE) for such things as land purchases, demolition costs, and upgrades in parking facilities even though they either have nothing to do with the CCE, such as land purchases, or they were already included in the original CCE, such as demolition and parking facility costs. The use of the PMF fee schedule was unwarranted in these cases. If it was determined that services rendered by the PMF were outside of the original scope of the project, the contract allows for amendments for additional services beyond those provided for in the lump sum fee. These additional services should be compensated in accordance with the PMF's table of hourly rates by title and supported by detailed documentation of the time spent by PMF staff. There was no such supporting documentation for any of these questionable
change orders. However, even though the contract does not allow for additional services to be added to the CCE of an already assigned school facilities project, this method of determining compensation for additional work was the most expedient.

In addition, three change orders requested by one PMF totaling $5.7 million cited delays in the project beyond their control. Additional compensation is allowable, but only for those costs the PMF actually incurred as a direct result of such delays. Our review found the supporting documentation for the added compensation was not in compliance with the contract because the determination of the amount was based on budgeted hours rather than actual hours or costs incurred. In addition, the approval of these change orders is questionable because most regional directors deny this type of change order request since the PMFs should be in complete control of the project and their staff scheduling.

In another example, a PMF in the final year of a three-year contract, through the change order process, received an additional one and one-half percentage points to the CCE rate on all past and future additional assignments. This added $3.4 million in PMF fees for the additional assignments. The justification for this change was that the originally contracted CCE rate did not include funding for other direct costs incurred by the PMF, such as a regional office and equipment leases. There was not adequate documentation to support this increase. Furthermore, this change order, which actually modified the terms of the contract, was not presented to the board for approval.

Additionally, change orders were also approved increasing the CCE values of four previously assigned projects to new square footage rates, even though the contract stipulates that the CCE value at the time of the award was to be used in determining the PMF fee. The resulting fee
increase for these projects totaled $725,000. This was not the regular practice and resulted in unnecessary additional costs.

**Recommendation**

We recommend that:

A legal opinion be obtained from the Attorney General’s Office clarifying the terms, requirements, and scope of the PMF contract, and the appropriateness of the questionable change orders identified above. If necessary, corrective actions should be taken and collection efforts should be initiated for those change orders deemed inappropriate.

All staff involved in the change order process should be trained on the proper implementation of the contract.

A process to independently review PMF change orders for appropriateness should be developed. In order to assure the proper review of these PMF change orders, adequate documentation must accompany these change order requests and the reviewer must be properly trained and be independent of the Design and Construction division.

**Corporation’s Response**

The Corporation agrees with the recommendation and is obtaining the advice of the Attorney General regarding contract requirements, contract management, and the initiation of recovery actions where appropriate.

The Corporation agrees that staff involved in the change order process should be trained on the proper implementation of the contract and will commence such training by March 31, 2006.

The Corporation agrees with the need for a review of change orders. Management has created a Change Order Review Unit (CORU) to provide an independent review of change orders.
Policy enhancements will ensure independent control, monitoring and review over all change orders.

for compliance to corporate policy, and process improvements are being implemented.

Change Order Processing

The policies and the contractual terms related to construction state that all change orders must have the prior written consent of the Corporation before work proceeds. This consent should be documented in a properly executed and approved Request for Change Order. The Corporation’s current policy regarding change orders, including construction change requests, is to not go forward with the work until the change order goes through all required levels of approval, including the Change Order Review Unit. This process can be lengthy and have a negative impact on construction. As a result, project officers and their supervisors have exceeded their procedural authority and have authorized work to commence before all approvals are obtained. In one example, seven change orders totaling $3 million for design or construction contracts were presented for approval at the board’s recent School Review Committee meeting. It was noted that most of the work had been completed months ago, and in one instance, years ago.

Authorizing the commencement of work prior to the required approvals being received negates the control that the approval requirements may offer. However, enforcement of this control without affording timely resolution to emergent situations may be too restrictive, inefficient, and ultimately costly. The slowness of this process may have encouraged consultants and contractors to delay the formal change order request knowing they can receive tacit approval to proceed. A proper balance of flexibility to deal with an emergent situation must be countered with appropriate controls.
**Recommendation**

We recommend that the change order approval process be amended to give appropriate flexibility for field staff to deal with emergent situations at construction sites that require immediate authorization of change orders, while still ensuring independent control, monitoring and review over all change orders. We also recommend that instruction for the proper implementation of the contractual terms be given to all personnel with operating authority approval. Additionally, adequate supporting documentation should accompany the change order document, so an informed, independent judgment on its accuracy and appropriateness can be made by subsequent reviewers.

**Corporation's Response**

The Corporation agrees with the recommendation. As noted, management has created a Change Order Review Unit (CORU) to provide an independent review of change orders for compliance to corporate policy, and process improvements are being implemented. However, management believes that a complete evaluation of the entire change order process is required, including the issue of responding to emergent situations, so that appropriate policies, training, and other control measures can be developed. That review is scheduled to be completed by April 13, 2006.

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**Other Matters**

**Cash-on-Hand**

Corporate receipt logs indicated that employees handle $993,000 in cash for the period January 2004 to June 2005. These included cash receipts from bid document fees, land acquisition settlement refunds and energy rebates, and Corporation checks being held for third parties. Our review found that the corporation lacked adequate written policies and procedures...
concerning the collections and recording of revenue. Such policies are critical because numerous employees routinely handle cash in the normal course of business. As a result, we performed a count of checks and cash in June 2005. We noted that receipts were not deposited timely and reconciliations were not performed to verify the proper collection, depositing, and recording of receipts. In addition, mail logs were not adequately maintained and checks were not restrictively endorsed when received. We also noted that checks were left unsecured on desks and in the possession of employees for an extended period of time. We found $167,000 on-hand at the corporation and in possession of employees. This count included 40 checks totaling $105,000 deemed untimely. Eight checks totaling $42,000 were between one week and a month old, four checks totaling $48,500 were two months old, 11 checks totaling $8,000 were between three and six months old; and 17 checks totaling $6,500 were stale dated since they were over 18 months old.

When we brought the above matters to the attention of management, the Corporation developed a revenue processing policy. The policy, however, did not limit the number of employees handling cash, did not require reconciliations with the mail logs, and did not include a process to ensure that receipts were deposited timely.

Energy Rebates

Our review noted the New Jersey SmartStart Buildings Program made $34 million available through utility companies to provide energy efficiency rebates to districts who build new schools. The Corporation has not monitored this program to ensure that all available funds have been applied for. Applications were to be completed and submitted by PMFs, but the rebate receivables are not recorded or tracked by the
Corporation. As a result, the amount of outstanding rebates was not known.

Demonstration Project Consultant

We found that the Corporation had paid a consultant $254,000 from January 2004 through November 2005 to perform part-time duties of a project manager for demonstration projects. The payment terms were $675 for a full day, and $350 for a half day, plus a monthly train pass. The contract did not define the scope of the work to be performed, nor did it contain performance clauses or provisions for sanctions. Billings did not itemize the services provided. As a result, we could not determine if the payments were justified.

Recommendation

We recommend that the corporation modify their cash receipts policy and implement internal control procedures to improve the safeguarding of the assets. We also recommend that the Corporation should record, track, monitor, and collect energy rebates. We further recommend that the Corporation modify the contract with the demonstration project consultant to identify specific work to be performed, fees, terms and conditions. In addition, all bills submitted should be itemized and reviewed for compliance with the contract prior to payment.

Corporation's Response

The Corporation agrees with the recommendations.

The Corporation has implemented enhanced procedures to ensure the timely deposit of checks upon receipt, and will ensure that a reconciliation of the cash receipts log and deposits is performed monthly. These procedures will be reviewed, as appropriate, to ensure compliance.

The Corporation will review the available energy rebate programs and will implement effective strategies to assure that the Corporation receives all rebates which it is entitled. In addition, the
Corporation recently implemented a log of energy rebate applications that have been submitted to ensure proper tracking and receipt of such rebates.

The contract with the demonstration project consultant referred to in this report is currently being reviewed and appropriate action will be taken.