

Herkimer Central School District

2014 Building Renovation Capital Project

NOVEMBER 2022



OFFICE OF THE NEW YORK STATE COMPTROLLER
Thomas P. DiNapoli, State Comptroller

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Report Highlights

Herkimer Central School District

Audit Objective

Determine whether the Herkimer Central School District (District) Board of Education (Board) and officials properly planned and managed the 2014 building renovation project.

Key Findings

The Board and District officials did not properly plan and manage the renovation project. Officials:

- Borrowed \$2 million more than needed for the initial project and used the funds to make other non-voter approved renovations.
- Borrowed project funds early, resulting in about \$89,000 in unnecessary additional interest costs.
- Entered into a project management agreement that did not clearly define the services to be provided and paid related claims that lack sufficient detail. Paid claims exceeded the authorized purchase order by \$95,100.

Release of this report was held in abeyance due to a separate Comptroller investigation involving the former clerk of the works. In March 2022, the former clerk of the works was arrested for defrauding the New York State and Local Retirement System out of \$52,514 in pension payments. In September 2022, the former clerk of the works pled guilty to attempted scheme to defraud and paid full restitution of \$52,514.

Key Recommendations

- Coordinate project borrowing with the work and cash flow.
- Ensure written agreements with service providers clearly define the services to be provided and claims are sufficiently supported.

District officials generally agreed with our findings and indicated they plan to take corrective action.

Background

The District serves the Towns of Herkimer and Little Falls, in Herkimer County. The District is governed by an elected seven-member Board.

The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the District's chief executive officer, Business Official and Purchasing Agent, and is responsible, along with other administrative staff, for the District's day-to-day management under the Board's direction.

Voters authorized a \$10.4 million capital project for work on the Senior/Junior High School, the Elementary School and the Bus Garage. The Board relied upon the Superintendent, Treasurer, Architect and financial consultants to assist them in planning and managing the project.

Quick Facts

Cost of Phase I and II	\$8.1 million
Projected Cost of Phase III	\$2.3 million
Employees	164
Students	1,100

Audit Period

May 1, 2014 – February 1, 2019

2014 Building Renovation Capital Project

How Should a School District Board Plan and Manage Capital Projects?

Proper planning of a capital project (project) requires that the school district board have a thorough understanding of the project's overall scope and cost prior to the project's authorization. Initial estimated costs and project timelines must be realistic so the school district board can properly plan financing and keep the taxpayers informed. The school district board should use competitive bidding when required¹ to ensure the prudent and economical use of public money in the school district's best interests when procuring capital projects.

The school district board can adopt a resolution authorizing the issuance of bonds to finance all or part of a building renovation capital project. Prudent financial management provides that school district officials borrow funds as they are needed so the school district does not incur more interest expenditures than necessary. Local Finance Law, Section 165.00 provides that the proceeds of the sale of bonds or bond anticipation notes (BANs) must be deposited and secured in a special bank account. In addition, interest earned on the investment of proceeds of indebtedness may be applied to either the payment of principal and interest on such debt or for the object or purpose for which the debt was issued. School district officials must maintain a separate accounting record of each issue to ensure that the proceeds are used only for the object or purpose for which the obligation was issued. Generally, the proceeds may not be commingled with other funds of the school district. When a project is complete, any unused bond or BAN proceeds must be applied to the payment of the debt service on that debt.

In general, capital projects involving building renovations also require approval by the school district's voters. Taxpayers should be informed of the project's scope and planned financing before the public vote so they can make informed decisions. In order to receive State building aid, school district officials are also required to propose all phases of a capital project, including details of the scope of the work, to the New York State Education Department (SED) for approval. Additionally, school district officials are required to ensure that all work, as approved by voters and SED, has been completed and no work outside the scope has been performed.

School district officials should prepare an itemized budget for each project that shows all estimated costs and financing sources. Complete and accurate self-balancing accounting records for projects are necessary for project management and proper financial reporting. Because projects are budgeted on an individual project basis, an individual project fund should be established for each authorized project to document the project's complete financial history, including assets,

Prudent financial management provides that school district officials borrow funds as they are needed so the school district does not incur more interest expenditures than necessary.

¹ New York State, General Municipal Law, Section 103

liabilities, fund equity and results of operations (revenues and expenditures). Project records must be maintained in a manner that allows for a ready comparison of the project's budget to actual financing sources received and expenditures incurred throughout the course of the project.

The school district board should monitor the status of a project by reviewing monthly financial reports that compare actual project revenues and expenditures to the related budget. In addition, all claims against the school district related to the project should be audited and approved prior to payment. An effective claims audit process helps ensure that every claim is subjected to an independent, thorough and deliberate review in a timely manner prior to authorizing payment; that the claim agrees with the purchase order (PO)² and contains adequate supporting documentation to determine the amount claimed represents an actual and necessary project expenditure and is in accordance with any executed contracts.

The Board and District Officials Did Not Properly Plan the Building Renovation Project

In May 2014, the District received voter authorization to embark on a \$10.4 million Building Renovation Project (project) for work to be performed on the high school, elementary school and the bus garage. Prior to the vote, the District's newsletter sent to voters outlined the scope of work to be completed at the three buildings with estimated financing of about \$178,000 in EXCEL aid³ and approximately \$10.2 million in bonded indebtedness, much of which was to be offset by State building aid applied to subsidize annual debt service payments.

The project was presented in two phases. Phase I consisted of replacing a boiler unit in the high school, estimated to cost \$185,000.⁴ Phase II consisted of the work at the three District buildings and was estimated to cost approximately \$10.2 million.

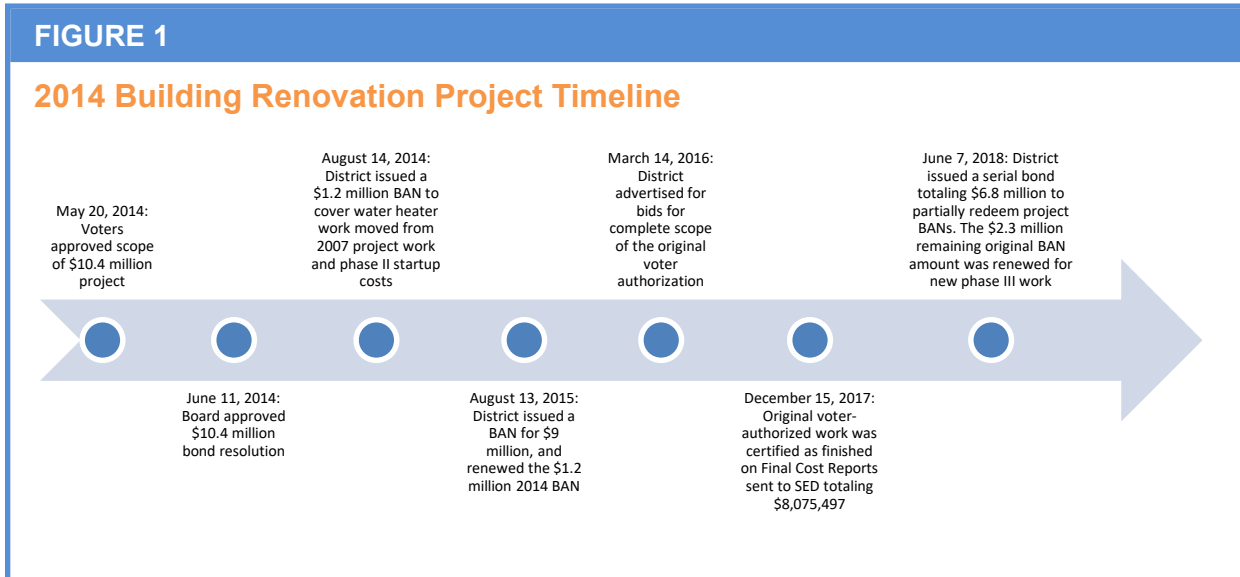
District officials contracted with an architectural firm to provide project cost estimates and also hired financial consultants to assist the Superintendent and Board in the planning of the financing for the project including providing guidance in matters related to the most opportune time to issue debt so as to avoid unnecessary interest charges. Based on our review of project files,

² Purchase orders provide the purchasing agent's approval to make purchases. An effective purchase order process helps ensure that each purchase is necessary, that cost has been evaluated and that budgeted appropriations are not exceeded.

³ Excel aid is State aid awarded for use on an eligible instructional facility for an expansion project, energy project, accessibility project, a health and safety project, or an educational technology project.

⁴ This work was initially scheduled to be included within the scope of a previous capital project approved by voters in 2007; however, the District ran short of funds to complete this work.

the consultants advised the District to only borrow enough in the beginning to cover project startup costs and then incrementally borrow to cover expenditures throughout the project till completion. Instead, District officials chose to borrow the full \$10.2 million well in advance of when it would be needed, resulting in the District incurring unnecessary interest costs. Figure 1 shows a timeline of various stages of the project and debt issuances.



In August 2014 District officials issued a \$1.2 million BAN presumably for phase I work and phase II project startup costs such as architectural and legal fees. Work on phase I and initial costs for phase II totaled about \$770,000 through August 2015 leaving about \$430,000 left over from the proceeds of the BAN. In August 2015, District officials chose to renew the \$1.2 million BAN and issue an additional \$9 million BAN to begin phase II. However, District officials did not advertise for bids for phase II work until March 2016 (seven months later) and construction work did not begin until June 2016. Based on the timing of the project payments, officials could have saved about \$89,000 in interest costs if they had issued BANs for \$5.1 million (half of the \$10.2 million BANs issued) in August 2015 and delayed the remaining debt issuance until the following year.

Phase II work was completed in December 2017 at a cost of approximately \$7.82 million, bringing the total cost of both phase I and phase II to approximately \$8.1 million or approximately \$2.3 million less than estimated. District officials chose to use the remaining \$2.3 million BAN proceeds to perform additional work on District building projects not identified in the May 2014 proposal. The additional work, labeled phase III, included items such as air conditioner units (HVAC), sidewalk work and girls' locker room repairs.

The Superintendent told us he did not believe it was necessary to notify the voters of the excess funds or the expanded scope, since the voters originally authorized up to \$10.4 million for the original project work and there were funds available for additional work. However, the project description that was shared with taxpayers did not show alternate items that would be constructed or repaired in the event that the cost of the original work was less than anticipated. Phase III work was never presented to the taxpayers for a vote.

Because District officials borrowed about \$2 million more than needed for the original project and then decided to use the debt proceeds to do the additional phase III work, the District incurred about \$74,800 in additional interest costs.

In total, District officials' lack of effective planning for the project cost taxpayers about \$163,800⁵ in additional interest expenses through June 2018 resulting from borrowing \$2 million more than was needed and borrowing \$5.1 million a year before the funds were needed.

In June 2018, District officials issued serial bonds to redeem \$6,835,000 of the outstanding BANs and then renewed the remaining \$2,265,000 BAN for which the District will incur a net interest expense of about \$46,000 and will likely incur additional semi-annual BAN interest expense thereafter. Had District officials applied the project's leftover BAN proceeds to further reduce the District's bonded indebtedness (instead of choosing to use it for projects not authorized by the voters), they would not be faced with additional future BAN interest costs and the District's bonded indebtedness would have been reduced.

The Board and District Officials Did Not Adequately Manage the Building Renovation Project

District officials did not establish adequate capital project records necessary to account for and monitor the District's building renovation project, and did not deposit the debt proceeds in a special bank account as required. Also, officials did not provide the Board with sufficient budget-to-actual reports to monitor certain project expenditures, nor did they adequately control and monitor clerk of the works⁶ costs.

Separate Accounting Records – District officials did not maintain separate self-balancing accounting records for each capital project. While District officials tracked the project expenditures for the building renovation project separately,

5 The District invested a portion of the borrowed money in a certificate of deposit and earned \$28,700 in interest revenue.

6 The role of the clerk of the works is typically to act as a liaison between the architects, contractors and the District and inspect and monitor work done on a capital project to ensure adherence to architectural specifications and quality standards.

they did not maintain separate balance sheet accounts to track the assets (e.g., cash), liabilities and fund balance associated with the project. These accounts included activity for all the projects combined.

When separate accounting records are not maintained for each capital project, it is difficult to effectively monitor the financial position of each project and to ensure that money allocated to the project, as approved by the voters, is used as intended.

Special Bank Account for Debt Proceeds – District officials did not deposit the bond and BAN proceeds into a special District bank account, and did not maintain adequate records to track each debt issuance. As a result, District officials cannot calculate the interest earned on the investment of each debt issuance and the Board cannot ensure that debt proceeds and associated interest earnings are only used for the object or purpose for which the debt was issued, and that unneeded debt proceeds and interest earnings are used to pay off the associated debt.

Budget-to-Actual Reports – We reviewed all available budget-to-actual reports for the \$10.4 million project and found that reports did not show budget-to-actual comparison amounts for \$1.3 million of incidental project costs such as fees for architects, attorneys, consultants and the clerk of the works until January 2017, more than two years into the project. Prior to that, reports showed all incidental costs in aggregate. This did not provide the Board with sufficient information on the estimated costs for each type of expenditure or enable it to effectively monitor the actual costs for each expenditure category in comparison to budget estimates.

Payments for Clerk of the Works – District officials did not adequately monitor and control expenditures for the clerk of the works. The District hired an individual to serve as the clerk of the works for phase II of the project. The written agreement provided for the District to pay \$45 per hour, but it did not provide a maximum cost that the District would pay. In addition, the written agreement lacked sufficient details as to expected service. For the clerk of the works duties, the agreement referred to a reference document issued by the American Institute of Architects (AIA) that includes “sample” or suggested contract language that can be used in a contract – it was not modified for the District’s needs. For example, the AIA suggested contract language is meant to be used when the Architect’s representative is assigned to oversee the project, which is not the case here. It consistently sets forth that the representative is to report to the Architect and that this individual will assist the Architect. It makes no mention of reporting to the Board.

The clerk of the works started working for the District in April 2016 just prior to construction work. District officials created an open PO⁷ in July 2016 for a maximum of \$49,000. However, by December 2016, payments to the contractor had already exceeded the authorized PO amount by \$6,958.

In total, during our audit period the District paid 23 clerk of the works invoices (claims)⁸ totaling about \$144,100, which exceeded the PO by \$95,100 (194 percent). Furthermore, the initial budget for the project did not include an appropriation line item for the clerk of the works. Officials essentially allowed the contractor to bill the District at a rate of \$45 per hour without comparison to an amount budgeted for the service.

In addition, the clerk of the works claims generally did not provide a description or explanation of the work performed. Most claims only showed dates and times worked for the project and the amount billed each day.

When written agreements do not clearly define the services to be provided and claims lack sufficient detail and are not compared to authorized POs, it is difficult for officials to determine whether they are receiving an adequate service for the amount charged, and there is an increased risk that the District could pay for services not received.

What Do We Recommend?

The Board and District officials should:

1. Establish a realistic timeline for each capital project and coordinate project borrowing to the commencement of work and cash flow needs associated with that project.
2. Ensure that all project work stays within the scope of the approved capital project. Apply excess debt proceeds and interest earnings to the payment of principal and interest of such obligations. If the Board and District officials wish to complete additional work outside of the scope of a project, they should do so in a transparent manner and seek prior voter approval.
3. Ensure that District personnel establish and maintain separate accounting records for each capital project.
4. Deposit debt proceeds in a special bank account separate from other District funds and maintain separate records to track each debt issuance.

...[T]he clerk of the works claims generally did not provide a description or explanation of the work performed.

⁷ The open PO was signed by the Superintendent who serves as the District's purchasing agent.

⁸ 20 invoices totaling about \$137,600 for phase II work and three invoices totaling about \$6,500 for phase III

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5. Ensure budget-to-actual reports are sufficient to allow the Board to effectively monitor the actuals costs for each expenditure category.
 6. Ensure written agreements with service providers provide an adequate description of the services to be provided and consider including a maximum contract amount when services are billed hourly.
 7. Ensure that all claims submitted for services provide a full description of the services billed and are authorized by a PO.

Appendix A: Response From District Officials

HERKIMER CENTRAL SCHOOL DISTRICT

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Superintendent of Schools
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November 15, 2022

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Unit Name: Herkimer Central School District
Audit Report Title: 2014 Building Renovation Capital Project
Audit Report Number: 2020M-136

RE: Response to Audit Findings


Dear Ms. Wilcox,

On behalf of the District, I would like to thank you for meeting with us on October 28, 2022 and providing comments and recommendations resulting from the recent OSC 2014 Building Renovation Capital Project review.

We appreciate our partnership with the Office of the New York State Comptroller and respect their role in assisting public school districts by identifying opportunities for improvement and recommending best practices. We would like to express our appreciation for your staff's professionalism and expertise throughout this examination process.

The District agrees with the audit findings and appreciates the recommendations made. This was a beneficial learning experience for our District and helped us to ensure and solidify that our practices are sound moving forward. The audit findings and recommendations will serve as a foundation as we plan future capital projects.

Sincerely,


Kathleen A. Carney
Superintendent of Schools
Herkimer Central School District

Appendix B: Audit Methodology and Standards

We conducted this audit pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law. To achieve the audit objective and obtain valid audit evidence, our audit procedures included the following:

- We interviewed District officials and reviewed the Board meeting minutes to determine whether the Board adopted a resolution at the inception of the project that identified the project, authorized the maximum estimated cost and established how the project would be financed, and whether they prepared an itemized budget for the project.
- We reviewed copies of legal notices placed in the newspaper, submitted bid documents, bid summary sheets and Board meeting minutes approving the bids to determine whether District officials put the various contracts up for bid.
- We assessed the adequacy of the monthly financial reports the Superintendent provided to the Board during the audit period.
- We reviewed 31 claims totaling about \$1.54 million, out of a total of \$8.3 million paid for phases I through III of the capital project during the audit period to determine whether the corresponding claims for these disbursements were supported by adequate documentation, for appropriate purposes and audited and approved before payment. We extended our testing to review all the claims for the clerk of the works during our audit period, which totaled about \$144,100.
- We reviewed the District's accounting records during the audit period to determine whether separate accounting records including assets, liabilities, fund equity, revenues and expenditures were maintained for the project.
- We reviewed debt proceeds related to the project during the audit period to determine whether they were deposited into a separate bank account or commingled with other District funds.
- We reviewed all capital project bank statement activity from July 1, 2014 through December 31, 2018, and compared them against the project expenditures that the District specified were related to the project. We identified any project expenditures that were not in the bank activity and followed up on them. We also identified any bank activity that was not in the project expenditures and followed up on it.

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value and/or size of the relevant population and the sample selected for examination.

The Board has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and provided to our office within 90 days, pursuant to Section 35 of General Municipal Law, Section 2116-a(3)(c) of New York State Education Law and Section 170.12 of the Regulations of the Commissioner of Education. To the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The CAP should be posted on the District's website for public review.

Appendix C: Resources and Services

Regional Office Directory

www.osc.state.ny.us/files/local-government/pdf/regional-directory.pdf

Cost-Saving Ideas – Resources, advice and assistance on cost-saving ideas

www.osc.state.ny.us/local-government/publications

Fiscal Stress Monitoring – Resources for local government officials experiencing fiscal problems

www.osc.state.ny.us/local-government/fiscal-monitoring

Local Government Management Guides – Series of publications that include technical information and suggested practices for local government management

www.osc.state.ny.us/local-government/publications

Planning and Budgeting Guides – Resources for developing multiyear financial, capital, strategic and other plans

www.osc.state.ny.us/local-government/resources/planning-resources

Protecting Sensitive Data and Other Local Government Assets – A non-technical cybersecurity guide for local government leaders

www.osc.state.ny.us/files/local-government/publications/pdf/cyber-security-guide.pdf

Required Reporting – Information and resources for reports and forms that are filed with the Office of the State Comptroller

www.osc.state.ny.us/local-government/required-reporting

Research Reports/Publications – Reports on major policy issues facing local governments and State policy-makers

www.osc.state.ny.us/local-government/publications

Training – Resources for local government officials on in-person and online training opportunities on a wide range of topics

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