

The School Board of Broward County, Florida  
**AUDIT COMMITTEE**

MINUTES OF AUDIT COMMITTEE MEETING

October 15, 2015

Ms. Mary Fertig, Chair, called the Audit Committee meeting to order at 12:40 p.m. at the Kathleen C. Wright Building in the 1<sup>st</sup> Floor Board Room. Members and guests were introduced.

Members Present:

Mr. Brendan Aloysius Barry, Esq.  
Ms. Earlyn Barton-Oden  
Ms. Mary Fertig  
Mr. John Herbst  
Dr. Nathalie Lynch-Walsh  
Dr. Henry Mack (attended by phone)  
Mr. Robert Mayersohn

Staff Present:

Mr. Robert W. Runcie, Superintendent of Schools  
Mr. Jeffrey Moquin, Chief of Staff  
Mr. Paul Carland, General Counsel  
Dr. Valerie Wanza, Office of School Performance & Accountability  
Mr. James Payne, CTACE Department  
Mr. Brian Little, Warehousing Services  
Mr. Sam Bays, Physical Plant Operations  
Ms. Shelley Meloni, Office of Facilities & Construction  
Ms. Lisa Milenkovic, Math, Science & Gifted  
Mr. Patrick Reilly, Chief Auditor, Office of the Chief Auditor (OCA)  
Ms. Ali Arcese, Manager, Property & Inventory Control, OCA  
Ms. Ann Conway, Manager, Internal Funds, OCA  
Mr. Robert Goode, Manager, Facility Audits, OCA  
Mr. Gerardo Usallan, Manager, Operational Audits, OCA  
Ms. Patricia McLaughlin, Confidential Clerk Specialist C, OCA  
Ms. Megan Gonzalez, Confidential Clerk Specialist B, OCA

Guests Present:

Mr. David Luker, McGladrey, LLP  
Ms. Chantelle Knowles, McGladrey, LLP

## **Old Business**

A motion was made to adopt the agenda. Motion was approved.

A motion was made to approve the minutes from the September 3, 2015 Audit Committee meeting. Motion carried.

## **Follow Up Items**

Mr. Reilly stated “The committee had asked about the status of Miramar and Dillard High Schools, related to the repayment of funds that were incorrectly used during the 2013-14 school year. I determined that Dillard High paid the money back in full, with a final payment of \$6,500 on May 28, 2015. Miramar High paid the final amount of \$9,047 on September 8, 2015.”

## **Regular Agenda Items**

### **Internal Audit Report – Audit of the Internal Funds of Selected Schools**

Mr. Patrick Reilly stated “This report contains internal fund audits of twenty-three schools. All schools complied with the School Board policies and procedures for internal funds.”

Mr. Brendan Barry stated “When we get a report that contains no exceptions for twenty-three schools, that is remarkable. I give a lot of credit and trust to the Audit Department.”

A motion was made to transmit. Motion carried.

### **Internal Audit Report – Property and Inventory Audits of Selected Locations**

Mr. Reilly stated “This report contains forty locations; thirty-seven locations complied with the policies and procedures in Business Practice Bulletin O-100, which deals with Property and Inventory control. There were three locations that had some unaccounted for items that are noted in this report. This report contains twenty-one schools and nineteen departments. For the forty locations, there were approximately 16,000 items reviewed with a historical cost of over \$26 million. There was a total for the forty locations of 63 items with a historical cost value of \$149,000 that were unlocated. On page 17 of the report for the Material Stockroom, we noted there were a lot of items located there that are now off the inventory. They have been residing at the warehouse for over a year. We are recommending that there should be more of a controlled system. Once the items are removed from a school location and brought to the warehouse, the items should be moved out as quickly as possible. The issue is that the items are being purged from the inventory records, although they are still physically at the location. There is a process for auctioning the items and eventually disposing of them. Sometimes other locations may want an item, which would then be transferred to that location. The State Auditors and requirements for the disposal of assets state that you must show how items are disposed of. We did find that of the 1,600 items, there are some that have been sitting there for more than a year. The items should be disposed of before purging from the records.”

Dr. Nathalie Lynch-Walsh asked “For Custodial Grounds, what are the missing items on page 13 for \$12,000 and a couple more for \$6,000 each?”

Mr. Sam Bays responded “The items in questions are for \$50,000 in servers from the Sawgrass Office Complex. Those were relocated around the District by another department and we were just notified today (by the Office of the Chief Auditor) that one was found at McNab Elementary School. Those make up the vast majority of the original cost of \$74,000.”

Dr. Nathalie Lynch-Walsh asked “Is Custodial Grounds (9608) a location that’s assigned to PPO?”

Mr. Bays replied “There are several locations assigned to PPO. One hundred and eighty employees in the Custodial Grounds Department are assigned at numerous locations across the District.”

Mr. Robert Mayersohn stated “All these schools with no exceptions should be commended. The ESE Department, which has come under some scrutiny, has no exceptions.”

Ms. Fertig asked “I know Stranahan redid their culinary suite with equipment from B-Stock. When an item goes to the warehouse and then comes back to Stranahan, how is that accounted for?”

Mr. Reilly replied “The item would have been removed from Stranahan’s inventory. When it’s brought back, it would be added again to the school’s inventory.”

A motion was made to transmit. Motion carried.

### **Internal Audit Report – Review of Construction Change Orders Categorized as Architects’ and Engineers’ Errors and/or Omissions**

Mr. Reilly began “This is an audit that was part of our 2015-16 Audit Plan. We performed a review of the Errors and Omissions Change Orders. We reviewed the policies and procedures. We reviewed 128 change orders to see how they handled the process and whether any recoveries were made from any design defects from outside Architects/Engineers due to their design Errors and/or Omissions. In March 2010, at a Board Workshop, the Board requested that OFC ‘*develop contract language that clearly defines terms essential to the identification, calculation, and method of recovery of additional costs resulting from Errors and Omissions. The contract should be clear and equitable so everyone can adhere to the process.*’ That’s what triggered it. We’ve had a couple of policies put in place. The outside firm of McGladrey performed an operational review and assisted the Facilities Department with implementing an eight step procedure on how to handle the errors and omissions process. We found that the Facilities Department did not consistently provide the documentation and comply with their construction bulletin on handling the recovery of errors and omissions. We had a schedule provided that showed the ones we looked at. We covered the 2012, 2013 and 2014 calendar years. We determined that there was approximately \$251,000 in recoverable amounts of errors and omissions that were calculated by OFC. There was a settlement for four projects totaling approximately \$40,000. Our point was that management needs to speed up the process of sending demand letters with their projected figures. That would be the starting point for handling errors and omissions. Based on the requests in 2010, we saw other Districts and entities that have in their contracts a clear distinction on how to define and handle errors and omissions and what percentage of errors and omissions the District would pursue. The report has a couple of good examples of the differences between errors and omissions and what constitutes determining how much could be recovered. For example, if a door was omitted, you wouldn’t get the door for free, but you would get the difference of what the additional cost would have been. If

there is a change order for \$8,000, that doesn't necessarily mean you would get \$8,000 back. You have to determine the correct amount of errors and/or omissions that would be calculated."

Dr. Lynch-Walsh stated "Great report. On page 2, it states 'currently, the District does not have a Board policy that deals with recovering damages from architects and engineers due to their errors and/or omissions'. They have procedures, but no policy. The Facilities Department has this eight step process with procedures that they're not following, but the Board does not have a policy. Are we trying to get a policy? There seems to be some debate by the Office of Facilities & Construction. They're not following recommendations made by the Office of the Chief Auditor or McGladrey. On page 8, there's a comment that states 'under the current process, once a change order is approved, OFC may issue a demand letter to the consultant seeking a specified amount in recoveries. The process defined under the existing model does not offer due process leaving little opportunity to discuss the recovery with the consultant'. The Auditor's office responded that the District requires architects and engineers to provide the errors and omissions Professional Liability Insurance. This requirement is in Article 9.2.2 of the Professional Services Agreement. In accordance with OFC's procedures, sending a demand letter to the A/E initiates the process of calculating and recovering damages due to errors and omissions. I don't understand why there's a dispute."

Mr. John Herbst stated "Does OFC represent the District or do they represent the consultant? That's an argument that the consultant's attorney can put forward. We shouldn't be putting it forward on their behalf."

Dr. Mack agreed with Mr. Herbst's comments.

Mr. Runcie stated "Regardless of what policies this organization has, what's important is what's in the contract itself. We bring matters to the Board on a regular basis to resolve these issues, based on the terms of the contract. The contract drives and defines what actions we are to take. One thing that came out of the McGladrey review was to work with our Legal Department to tighten up our contracts to ensure that the terms in those contracts best represented and protected the District and taxpayers. That's what we have been doing. It's really about how the contract is structured; not about some policy. We've been working with Legal to bring these contract templates to the Board for approval, which sets the standard by which the contracts are structured. Furthermore, the Board reviews and approves these contracts in a manner that's consistent with the guidelines that they've approved."

Ms. Fertig stated "We have a situation where the contract is not really being followed, because it gives the District the ability to issue a demand letter. If I'm reading this correctly, the Office of Facilities and Construction is proposing a change to that, but the current contract does include that, and that's what you audited. Is that correct?"

Mr. Reilly stated "We felt it was much stronger to have that in the contract, which is approved by the Board, rather than a policy. You could have both, but I think the stronger part would be to have it in the contract. The language in the contract needs to be much clearer than it is right now. As our recommendation states, they need to clearly identify how to calculate and recover additional costs, what the percentage is, etc. Sometimes with a policy, people are only concerned with the allowable percentages, for which they would not be responsible."

Mr. Paul Carland stated “I’ve already given direction to Mr. Cooney that by the time this goes to the Board on November 3, 2015, he will have transmitted to Facilities and Audit Departments a draft of the proposed language, so that those two departments can begin those discussions.”

Ms. Fertig stated “I’m unclear as to whether demand letters are going to be sent out pursuant to the contract or if you’re going to wait.”

Mr. Carland stated “Regarding demand letters, if we believe we have a cause of action or a claim, that doesn’t have to wait for specific contract language.”

Dr. Lynch-Walsh stated “With regard to policy, one of the problems this District has, is that it commingles policies with procedures. The contract speaks more to the procedure. The two are not mutually exclusive. You can have a policy that provides guidelines, without getting into the nitty-gritty specifics that are in the contract. That isn’t even the issue here. I agree with Dr. Mack. We have a policy for everything else, so why not for this? Also, my concern, in the interim, is if the Office of Facilities and Construction thought that the Audit Committee was being too hard on consultants, my exact concern, based on the statement that it doesn’t offer due process, is that the Office of Facilities and Construction is seeking to return to that and sort of undermine the District’s ability, which begs the question ‘Who does Facilities and Construction represent, the District or the Consultant?’ My thought would be that they represent the District’s interest.”

Dr. Mack stated “Page 17 refers to Exhibit K, but there is no Exhibit K in the report.”

Mr. Reilly stated “Page 17 is an excerpt of the February 27, 2014 response from management; however, Exhibit F in our report is the Design and Construction Bulletin, which is the same document.”

Ms. Shelley Meloni stated “We do work for the District and have the interest of the District at heart. The approach that we’ve been attempting to adopt with respect to recovery is to align more with the industry standard, in terms of standard of care and being more in alignment with what typical agencies would seek, in other words, establishing a threshold. Right now, our practice is to seek recovery on every item and we were looking for something that would align more with establishing what that threshold may be, more in terms of what the standard industry practice is and adopting something similar. Our work so far on this issue has been in terms of researching other Districts, other agencies, to look at what their practices are and adopting that. We’re also in discussion with the Legal Department as to what would present itself as the proper language to use within our contracts to put forth a procedure that aligns more with industry standards.”

Ms. Fertig stated “Are you currently not issuing demand letters, pursuant to the contract? Are you making a decision not to issue certain demand letters?”

Ms. Meloni replied “We’ve actually settled a few of them in the last couple of years. We’ve done settlements with consultants. They may not have been in the form of a demand letter, but we’ve brought them to the table and told them the amount they have in recovery. We did a number of them with the consultants. A few months ago, we took them to the Board. Unfortunately, in the end, we ended up having to pay, because we had additional services owed to the consultant. We negotiated and settled on an amount, which was leveraged against what we owed them. Eventually, we took the items to the Board. Several were taken to the Legal Department. We’re not ignoring this process or making decisions not to follow these processes; it’s the process we’ve been doing.

We have an issue with demand letters, but we've brought the consultants in to have discussions to try to close out some of these projects.”

Mr. Runcie stated “We try to settle these things in an efficient manner, so we're not spending enormous amounts of money in legal fees. When I came to the District, there were cases where someone owed us \$5,000 or \$10,000, but we paid \$60,000 to \$70,000 in legal fees, which made no sense. We try to settle, in cases where we can, with the assistance of the Legal Department, but we have issued and will continue to issue demand letters, per what's written in the contract.”

Ms. Fertig asked if the Committee would like to send a recommendation to the Board with the transmittal.

Mr. Mayersohn stated “I certainly understand what everyone is saying. From an audit perspective, how do you go forward when there seems to be two trains of thought; one being to send a demand letter and the other not to send a demand letter?”

Mr. Reilly stated “On page 21, the process of Facilities sending a demand letter and requesting recovery is step one. If that doesn't get anywhere, then it should be referred to Legal. There is a process and the architect is given an opportunity, by the demand letter, to see our position. I think the steps they should be following are already there.”

Mr. Mayersohn stated “Is that an acceptable process for the Facilities Department?”

Ms. Meloni stated “Well, that is the process. We were attempting to have the conversation first, as the first step, then if we got no response, we would issue a demand letter.”

Mr. Mayersohn stated “So, you're not in agreement with the process. You want to ask first?”

Ms. Meloni replied “I want to ask first.”

Mr. Mayersohn stated “It says here it's going to go before a workshop. I would like to see that expedited. Again, we're sitting in an area of abeyance. Facilities has one response, Auditing has another response. How do we continue to audit?”

Mr. Reilly stated “We established that the language in the contract is much stronger than the policy. You can have both, but I think everyone agrees that the contract needs to spell out what percentage we will pursue.”

Mr. Herbst stated “The demand letter should go out automatically. You always have time to negotiate after the demand letter goes out. If you wait to negotiate and then you send out your demand letter, all you've done is delayed the process. We experienced this a couple of years back when we were involved with one of our other audits that resulted in litigation, where we were waiting and waiting and the Audit Committee kept asking when the District was going to send a demand letter. It stretched on for years and was non-productive. The demand letter does not preclude negotiation, but the other way around does not advance the agenda in a timely fashion.”

Mr. Runcie stated “I agree with that. I think we can strike a balance in improving relationships that we have with our contractors so that we get work done in the best interest of the District and taxpayers. I would agree if we recognize that there is an issue, we should have a mechanism to alert the contractor immediately, and that's the purpose of the demand letter. Secondly, on page

40, it states ‘the new model being proposed by OFC initiates the process by ensuring due process to the consultant’, I’d like to have staff modify that. The tone of that suggests what Mr. Herbst had indicated; who are we actually representing? I’d like to have staff modify that wording before final submission.”

Dr. Lynch-Walsh stated “Having been on the Facilities Task Force and having gone through a Program Manager selection process that bypassed QSEC because the policy wasn’t clear, we have staff identifying that there is no governing policy. The Board’s number one job is to establish policy. We make recommendations to the Board. The policy does not have to get into the nitty-gritty details of the contract, but there ought to be a policy; especially when we are about to embark on this \$800 million bond program. There will be more architects; there will be more errors and omissions. Things are much more amicable when everyone knows the rules.”

Mr. Runcie stated “I would like staff to have the opportunity to amend the report. The governing document for the relationship between the District and the contractor is the actual contract itself, notwithstanding whatever policies you have. Secondly, the Board approves and effectively sets policy by determining what the structure of those contracts looks like, and thirdly, the Board actually approves all of these contracts to ensure that you’re consistent with the terms that they have established as an entity. I don’t see what the policy provides, when, in effect, the Board has instituted the policy and direction that they want staff to pursue within the actual contract template itself.”

A motion was made to table this report until the next meeting to allow the proposed amended response. Motion was seconded and approved.

### **McGladrey, LLP – Construction Closeout Audit – Boyd H. Anderson High School**

Mr. Reilly stated “This review was a Construction Management at Risk project for Boyd Anderson High School. It was requested by the Office of Facilities & Construction. It’s an older project that included a lot of work where the General Contractor self-performed work. That was the area that we wanted reviewed. We engaged McGladrey to review that project. Mr. David Luker from McGladrey, is here to present the report to you.”

Mr. David Luker stated “As a part of our work, one of the primary procedures that we perform is reconciling the total amount paid for sample subcontractors against the pay applications. The scope limitation that is of primary interest is that the subs for this project and the CM had not been paid their final payment. That part of our test work was unable to be performed; however, we did conduct that same procedure through October 31<sup>st</sup>, which was not the final payment, but was through the most current pay application that we had executed. The first three findings, as Mr. Reilly mentioned, are associated with the self-performed work. The Counsel here at the District let us know, and as we’ve talked about before, we treat this work as truly cost reimbursable, meaning that any overhead or profit or any other non-truly incurred cost associated with performing that piece of work are disallowable, based on the terms of the contract. The first three findings relate to that. Finding #1 is that the actual job cost records that the contractor provided us related to that self-performed piece of work were \$51,000 less than what they billed for that work. Our initial finding was that there was \$51,000 of excess billings, in excess of the costs that were represented. Finding #2, included in those costs that were represented, were actual mark-ups on that work, so \$108,000 of mark-ups, on top of the actual CM fees that were built into that contract,

were applied to that self-performed item. We've removed those, as well. Finally, project operating expenses; that was a specific line item in the contractor's job cost schedule, where there were multiple transactions. This is the sum of those transactions. We requested support for that. Typically, when you see a line that is repetitive over time, it's not indicative of a single actual transaction; it's usually some type of allocation. We requested support for that information, but the contractor did not provide any documentation. That \$161,000 is also being removed. All three of those relate to self-performed work. The 4<sup>th</sup> finding was related to certain costs that we test as part of our procedures. We drill down into the contractor's accounting records; there are transactions of interest that we select. The \$11,000, part of that actually Pat and his team worked with us to identify. We requested supporting documents for those, but they were not provided. Observation #5, as you know, the District utilizes the direct owner purchase program. This \$58,000 represents the sales tax savings of the direct materials that were purchased. The materials were purchased and deducted appropriately from the Schedule of Values, but the taxable portion of that is supposed to also be deducted through a negative change order, and that wasn't done. The 6<sup>th</sup> finding – there is a contract article that states that if findings from an audit like we performed exceed a certain threshold (2%), the fees for our engagement would be paid for, so those fees amounted to \$45,000. That brings the total to \$436,000 of reimbursement that we identified.”

Dr. Lynch-Walsh asked “What happens next? Does the District ever see these reimbursable funds?”

Mr. Reilly stated “The vendor (Padula Wadsworth Construction) is not operating anymore. They started a new company. The next step is to close out the audit. We have a retainage amount remaining on the project. The amount that McGladrey found in overpayments is almost a wash with the retainage. I don't know if there are any other legal problems associated with this project.”

Ms. Meloni stated “We will be working with the Legal Department on this close-out.”

A motion was made to transmit. Motion carried.

Meeting adjourned at 1:35 p.m.