
CITY OF CRANSTON

ANALYSIS OF SCHOOL BOND FUND

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Foreword

In April 2003, the City of Cranston Finance Director discovered that the City's recordkeeping procedures and internal controls over bond accounts were extremely inadequate. He also found that bond funds earmarked to complete the construction of the Scituate Avenue School had been expended, and the project required additional funding for completion. As a result, the City Council adopted a resolution calling for a voter referendum to approve additional funding to complete the Scituate Avenue School. The City requested that we analyze the information they prepared on bond account balances, with specific emphasis on school bond accounts, and provide comments.

We did not audit the City's bond funds or internal controls over these funds. We relied on information provided to us by the City, School Department and other professionals, to perform our analysis. Our comments, which are advisory in nature, are intended to assist the City in their efforts to correct significant weaknesses in accounting controls. These weaknesses have existed for many years and some were identified by the City's independent auditors in their reports and related management letters over the years.

Some recommendations to strengthen controls have recently been implemented by the City. The Mayor has expressed the intention to promptly correct the poor controls and practices that have lead to the existing problems the City and School Department are confronting regarding bond funds. We believe that it is critical for the City to properly account for, monitor and control bond funds to ensure that they are used for their legally mandated purposes and that cost overruns are promptly identified and managed so as to ensure the efficient completion of necessary projects.

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**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

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CITY OF CRANSTON ANALYSIS OF SCHOOL BOND FUND

History of City's Problems with Bond Funds

The City has experienced a long history of poor controls over accounting for bond fund activity. We found evidence of this in minutes of City Council, City Finance Committee, and School Committee meetings held in 1994. We also noted that the auditors repeatedly cited weaknesses in accounting controls that affected bond funds in their audit reports and management letters during the 1990's.

Appendix I includes extracts from minutes of School Committee, City Council and Council Finance Committee meetings held in 1994, a year when the City and School Department expressed concern over discrepancies in school bond fund balances.

This history of poor controls is at the root of the problems the City and School Department are now facing with respect to funding completion of the new elementary school.

Overview of Analysis

The results of our analysis of school bond fund activity indicates that approximately \$2.7 million remains as an unexpended balance from bonds issued for school projects. However, the City's accounting records indicate that approximately \$354,000 of unexpended cash exists. The difference remains unexplained.

This difference most likely results from years of weak accounting and budgetary controls which included:

- ❑ ineffective procedures for monitoring and controlling costs;
- ❑ a lack of timely reconciliations for cash and interfund transactions;
- ❑ poor controls over loans of bond proceeds to other City funds.

The City's immediate problem regarding its bond funds is to fund the completion of the new Scituate Avenue Elementary School. There have been cost overruns in constructing the new school. Some of the excess costs may have resulted from changes in capacity needs and inflation due to the lapse of time between when the project was presented to the voters in 1996 and construction was started in 2002. Other cost overruns resulted from change orders or from revisions to plans to bring water lines into the school.

The City has chosen to resolve its current problem regarding the completion of the Scituate Avenue Elementary School by seeking voter approval for the additional funding needed. Since the cost to build this school does exceed the original amount of bonds authorized, we do not oppose this as an

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

Overview of Analysis (continued)

approach to resolving the problem. The amount which the City has indicated it will need in additional borrowing is estimated to be paid back over approximately 20 years. This will reduce the impact on the annual budget.

However, if this approach is taken, it is critical that the City promptly adopt strong accounting and budgetary controls over bond fund activities to ensure that funds are used for their legally authorized purpose. In addition, cost overruns should be closely tracked so that decisions can be made promptly to address them as they occur. The City, School Department, and other departments responsible for bond fund activity must all play a role in controlling costs. The department heads should receive information from the city tracking bond activity on a monthly basis. This will enable them to analyze bond activity recorded in their accounts and provide a rapid response to problems and discrepancies as they occur.

**CITY OF CRANSTON
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Procedures Followed in Analyzing Data Provided by City

The City maintains the official accounting records for bond fund activity. The City's computerized accounting records for bond fund activity start with the fiscal year beginning July 1, 1989. The City has advised us that they have no accounting records prior to that date.

The City provided us with an analysis of its school bond fund for nine bond projects with total expenditures of \$48,712,645 between July 1, 1989 and March 31, 2003. We analyzed the data provided to us and made revisions including an additional bond issuance (see ***Analysis of Bond Proceeds*** below) in preparing Schedule I. Since the activity for capital projects funds often spans many years, we considered the impact of the School Bond Fund's ending fund deficit as presented in the City's audit for the fiscal year ended June 30, 1989 as part of our analysis. This deficit appears to result from expenditures recorded as of June 30, 1989 for which related bond proceeds were received in subsequent years (Schedule II).

Analysis of Bond Proceeds

In analyzing the schedule of bond balances prepared by the City we traced bond and BAN proceeds into the City's official statements prepared when the City issues bonds or short term bond anticipation notes. These official statements are prepared in conjunction with the City's fiscal advisor and bond counsel. The City did not have copies of all official statements dating back to the origin of its computerized accounting records (i.e. July 1, 1989). We were able to obtain many of them through the City's fiscal advisor.

The total proceeds received for school bond fund projects during the period beginning July 1, 1989 to date appeared reasonable after we made an adjustment for a bond issued in June 1991 which included school bond fund proceeds of \$2,210,000 for a 1986 bond resolution.

Analysis of Expenditures

We reviewed vendor invoices for approximately 83% of the payments in the school bond funds during the period July 1, 1989 to March 31, 2003 and found them to be for school bond projects. The remaining 17% represented vendor payments for small dollar amounts (6%) and adjustments to school bond fund accounts (11%).

The School Department provided us with an analysis of bond funds that they had performed last year in conjunction with the City's prior administration. Their analysis resulted from examining and summarizing vendor invoices that they believed to be proper charges to specific school bond fund projects. This

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

Procedures Followed in Analyzing Data Provided by City (continued)

Analysis of Expenditures (continued)

analysis dated February 28, 2002 reported School Bond Fund expenditures for eight projects totaling \$38,189,753.

We compared the detail of the City's current analysis and the School Departments analysis to identify differences.

We found that many of the additional transactions recorded in the City accounting records that were not recorded in the School Department's listing were for invoices paid after February 28, 2002 - the date of the School Department's list. See Schedule III for a summary of differences between the two listings.

Analysis of Unexpended Balance

Our analysis of the City's schedule of school bond fund activity, as adjusted (Schedule I) indicates that some school bond projects have cost overruns. Others such as the 1994 bond which the School Department had anticipated could be used for the additional costs to build the Scituate Avenue Elementary School (resolution 94-3) have an available balance. Although the adjusted schedule shows a net unexpended balance for all school bond projects of approximately \$2.7 million, the City records indicate that the available cash balance is only \$354,220. The difference remains unexplained.

**CITY OF CRANSTON
ANALYSIS OF CITY'S SCHEDULE OF SCHOOL BOND ACTIVITY
July 1, 1989 to March 31, 2003**

Beginning School Bond Fund Deficit July 1, 1989 Prior Bond Activity (6)	A			B		C		D=(B+C)		E		F=(A-D)	
	RESOLUTION NUMBER	ORIGINAL AUTHORITY	ISSUED (2)	BANs OUTSTANDING (3)	TOTAL PROCEEDS	ADJUSTED EXPENDITURES (4)	UNEXPENDED BALANCE (9)	CASH AVAILABLE	REMAINING AUTHORITY				
88-104	\$ 9,300,000		5,410,000		\$ 5,410,000	2,369,573	\$ 3,040,427		1,000				
1988 School Buildings		6,000,000	9,299,000		9,299,000	10,456,857	(1,157,857)	(8)					
1990 Schools		8,500,000	6,000,000		6,000,000	5,637,777	362,223						
1994 School Additions		6,700,000	8,500,000		8,500,000	5,433,066	3,066,934						
1994 Schools		7,975,000	6,700,000		6,700,000	6,481,216	218,784						
1996 School Improvements		725,000	400,000		7,575,000	7,975,000	201,564						
1996 School Improvements		2,545,000	1,452,000		725,000	861,099	(136,099)		1,093,000				
1998 School Buildings		5,975,000	1,200,000		1,452,000	2,357,001	(905,001)						
1998 Cranston High School West - Additions		13,865,000	4,775,000		5,975,000	6,909,594	(934,594)						
2000 School and School Facilities		2,925,000	2,440,865		2,440,865	433,025	2,007,840	354,220	11,424,135				
									2,925,000				
	<u>\$ 64,510,000</u>	<u>\$ 38,961,000</u>	<u>\$ 15,515,865</u>	<u>\$ 54,476,865</u>	<u>\$ 48,712,644</u>	<u>\$ 2,708,959</u>	<u>\$ 354,220</u>	<u>\$ 15,443,135</u>					

Assumptions and Source of Information:

- (1) This schedule was derived from records provided by the City of Cranston and is unaudited.
- (2) Represents total bonds issued July 1, 1989 to March 31, 2003. Source: City's Official Statements.
- (3) Represents total bond anticipation notes outstanding (BANs) as of March 31, 2003. Source: City's Official Statements.
- (4) Represents total expenditures from July 1, 1989 to March 31, 2003 per City's accounting records including BAN interest charged to bond accounts. Expenditures were adjusted to reclassify certain expenditures for a 1986 school bond resolution allocated to other school bond accounts.
- (5) The City's accounting records for bond activity start with the fiscal year beginning July 1, 1989. Therefore, we included the School Bond Fund deficit fund balance at June 30, 1989 from the City's Audited Financial Statements as the balance carried forward. To that we added bond activity which occurred subsequent to June 30, 1989 per accounting data supplied by the City. See Schedule 11.
- (6) Prior Bond Activity represents expenditures for school bond resolutions passed prior to 1988 that were recorded in City accounting records during the period beginning July 1, 1989. The expenditures recorded in the City's records for these projects represent only a portion of the total expenditures authorized by the related bond resolution. Any additional expenditures incurred were recorded in prior periods for which the City no longer has accounting records. Therefore, we could not quantify the expenditures incurred prior to July 1, 1989. A portion of the bond proceeds of \$5,410,000 received after June 30, 1989 relating to the 1980 and 1986 resolutions were used to offset the fund deficit at June 30, 1989 of \$3,055,262.

Bond Proceeds received after June 30, 1989 not reported elsewhere on this schedule:

July 1, 1989 - 1980 RI Public Laws Chapter 119	\$ 910,000
1986 RI Public Laws Chapter 265	<u>2,290,000 (7)</u>
	3,200,000
June 15, 1991 - 1986 RI Public Laws Chapter 265	<u>2,210,000 (7)</u>
	<u>\$ 5,410,000</u>

Expenditures reported in City's accounting records after June 30, 1989 not included elsewhere on this schedule:

1986 RI Public Law Chapter 265 School Bond	<u>\$ 2,369,573</u>
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- (7) Bond Resolution 86-102 (RI Public Law 265) was approved for \$4,500,000. The proceeds from these two bond issuances total the approved amount (\$2,290,000 + \$2,210,000 = \$4,500,000).
- (8) The City of Cranston charged net interest costs of \$1.3 million to this bond project while school department records projected approximately \$600,000. This difference of \$700,000 accounts for over 60% of the cost overrun of \$1,157,857 for this project.
- (9) The unexpended balance for individual bond resolutions represents proceeds minus adjusted expenditures. However, the total unexpended balance of \$2,708,959 includes the beginning fund deficit at July 1, 1989 of \$3,055,262.

CITY OF CRANSTON
ANALYSIS OF COMPARISON BETWEEN UNEXPENDED BALANCE AND CASH
July 1, 1989 to March 31, 2003

	City's Financial Statements (2)	
June 30, 1989		
Capital Projects Fund - School Bond Fund		
Assets		
Cash	\$ 237,182	
Due From Other Funds	536,000	
	773,182	
Liabilities		
Accounts Payable	38,337	
Due To Other Funds	390,107	
Bond Anticipation Note Payable	3,400,000	
	3,828,444	
Fund Deficit	\$ (3,055,262) (7)	
	City's Official Statements (3)	
Beginning Balance July 1, 1989		\$ (3,055,262)
Proceeds from School Bonds Issued	\$ 38,961,000	
Proceeds from BANS Outstanding March 31, 2003	15,515,865	
Total Proceeds Available from Debt Issuance	54,476,865	54,476,865
Less:		
Total Expenditures July 1, 1989 to March 31, 2003 (4)		48,712,644
Unexpended Balance - March 31, 2003		2,708,959
Cash - March 31, 2003 (5)		354,220
Difference (6)		\$ 2,354,739

Sources of Information:

- (1) This schedule was derived from records provided by City of Cranston and is unaudited.
- (2) City's financial statements at June 30, 1989 for Capital Projects Funds - audited by City's independent auditors.
- (3) City's Official Statements for Bonds or Bond Anticipation Notes (BANS) issued from July 1, 1989 to March 31, 2003 prepared by City with it's Fiscal Advisors and Bond Counsel.
- (4) City's prepared summary of expenditures generated from it's detailed accounting records which start with the period beginning July 1, 1989.
- (5) City prepared schedule of available cash on March 31, 2003.
- (6) See **Analysis of Difference** (page 8).
- (7) The fund deficit of (\$3,055,262) is comprised of a reserve for encumbrances of \$1,108,308 and an unreserved fund deficit of (\$4,163,570). Since the reserve for encumbrances represents purchase orders that would generally be included as expenditures subsequent to June 30, 1989, we reflected the total fund deficit net of the reserve for encumbrances as the balance forward.

The fund balance of capital projects funds is designed to reflect net expendable financial resources. A deficit is not necessarily evidence of financial difficulties. The fund deficit appears to be the result of expenditures that were recorded as of June 30, 1989. However, the related bond proceeds were received and recorded in subsequent years.

City of Cranston
Analysis of School Bond Fund

Reconciliation of School Bond Fund Expenditures Between School Department Summary and City Accounting Records

Resolution Number	86-102	88-104	91-3	94-3	94-27	96-118	98-48	98-49	00-40 aka 00-112	02-	Total
Account Number	9043	9064	9070	9138 & 9150	9140	9180	9170	9160	9081		
Bonds Authorized	\$4,500,000	\$9,300,000	\$6,000,000	\$8,500,000	\$6,700,000	\$8,700,000	\$2,545,000	\$5,975,000	\$13,865,000 (4)	\$2,925,000	\$69,010,000
Expenditures per School Department (2)											
Vendor Payments		\$8,678,950	\$4,865,264	\$4,957,105	\$5,945,169	\$1,138,536	\$2,227,405	\$6,717,576			\$34,530,005
BAN Interest, Bonding, Cost of Issuance		621,050	1,219,379	795,271	483,407	369,839		92,057	\$78,745		3,659,748
Total		9,300,000	6,084,643	5,752,376	6,428,576	1,508,375	2,227,405	6,809,633	78,745		38,189,753
					Note A		Note B				
Add (Deduct):											
Land Acquisition Costs for New School				(358,899)		358,899					-
Additional Expenditures per City	2,369,574	360,929	89,106	472,067	41,791	6,762,640	160,092	71,871	319,405		10,647,475
Difference in Interest Expense (net):											
School Dept (Over) Under City		744,738	(563,993)	(449,765)	(335,081)	6,521		128,078	34,873		(434,629)
On City Summary Not on School Summary		44,746	23,863	28,320	1,212,394						1,309,323
On School Summary Not on City Summary				(15,056)	(867,950)	(1,900)	(58,996)	(71,487)			(1,015,389)
Misc. School Bond expenses		6,444	4,157	4,023	1,487						16,111
Reclassification of Expenditures							28,500	(28,500)			-
Expenditures per City Records (3)	\$2,369,574	\$10,456,857	\$5,637,776	\$5,433,066	\$6,481,217	\$8,634,535	\$2,357,001	\$6,909,595	\$433,023	\$-	\$48,712,644

Source:

- (1) This schedule was derived from records provided by City of Cranston and is unaudited.
- (2) Expenditure information was obtained from summary records provided by the City of Cranston Public Schools as of February 28, 2002.
- (3) Expenditure information was obtained from records provided by the City of Cranston Finance Department that summarized information from the City's accounting records as of March 31, 2003.
- (4) As of March 31, 2003, no expenditures have been recorded for this project.

Note A = The School Department List for Resolution 94-27 reports a total of \$6,495,240. However, this total is overstated by \$66,664. The list sums to \$6,428,576.
 Note B = The School Department List for Resolution 98-48 reports a total of \$2,145,405. However, this total is understated by \$82,000. The list sums to \$2,227,405.

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

Analysis of Difference between Unexpended Balance and Cash

We did not perform an audit of the City's records and it is not evident from our limited analysis of school bond funds what has caused the difference between cash and the unexpended balance.

- The difference identified in Schedule II may have occurred years ago as evidenced by similar concerns expressed by the School Committee in their minutes dated August 30, 1994 (see Appendix I).

The minutes indicate that in 1994 the City and School Department requested the independent auditors to analyze school bond balances and determine if funds were owed to the school bond fund from other funds. The School Department advised us that subsequent School Committee minutes do not provide evidence of a follow-up discussion or resolution for this issue. Neither the City nor the School Department can produce the report resulting from the auditors 1994 analysis. Although the auditor's recall being asked to analyze bond balances in 1994, they could not locate the resultant report and it may have been discarded due to their record retention policy.

- The variance between the unexpended balance and cash identified on Schedule II is not necessarily due to school bond funds being loaned to other City funds and not returned. The independent auditors who were asked to investigate the issue in 1994 continued to be the City and School Departments auditors in 1995, 1996, 1997 and then again in 2001 and 2002. Although the results of the auditors 1994 analysis cannot be located, it would appear that they would have advised the City and School Department of material inappropriate charges if detected, and would have proposed adjustments to the financial statements.

There were many weaknesses in the City's accounting controls over the past 13 years (the years for which records are available), which make it difficult to determine the exact cause of the difference. The following are some of the weaknesses:

- According to prior audit reports, the City previously used bond funds to provide interfund loans to other funds for cash flow purposes. Sometimes these loans were not paid back for years. Records indicate that the City's bond counsel advised that loans of bond funds between City funds for cash flow purposes would not be in violation of the bond agreement provided they were temporary in nature and were paid back.

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

Analysis of Difference between Unexpended Balance and Cash (continued)

The auditors cited the City for this weakness repeatedly in the early and mid 1990s. The City subsequently amended the City charter by establishing restrictions on temporary interfund bond transfers. Auditors have not identified loans of bond funds as a problem in recent audit reports.

- ❑ Over the past 10 years, the auditors have also repeatedly cited the City for not performing monthly reconciliations of interfund payable and receivable accounts. It is the City's practice to pay bond expenses from the general fund and then reimburse from the bond funds. In some instances bond or BAN proceeds have been temporarily recorded in the general fund. This can create interfund receivables and payables that must be reconciled monthly in order to ensure proper accounting between the funds. In prior years, the auditors reported significant unreconciled interfund balances. However, the City is now reconciling interfund balances monthly.
- ❑ In prior years, the City has also been cited for significant unreconciled differences in its pooled cash accounts and for not performing monthly cash reconciliations. The City currently performs monthly cash reconciliations.
- ❑ Many of the City's trial balances during the period from July 1, 1989 to present do not agree to the audited financial statements. In addition the City trial balances from 1990 to 1996 do not balance. The current City administration was not in control during those periods and was unable to provide information that would reconcile the trial balances of earlier years to the financial statements. The accounting system underwent a conversion in 1996 that further complicates this process. We consulted the current auditors who have audited seven of the past 10 years. They could not provide additional information for earlier years that exceeded their record retention policies.

Due to weaknesses in accounting controls cited above, the variance could have been caused by a variety of reasons including:

- ❑ Cost overruns in school bond projects that date back more than thirteen years;

The most recent thirteen years did not show evidence of a pattern of continuous overspending in school bond projects although some projects were overspent. The amount of BAN interest charged to the account could explain some of the overruns.

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

Analysis of Difference between Unavailable Balance and Cash (continued)

Interest expenses on BANS charged to school bond projects sometimes exceeded what was anticipated when the total project costs were estimated for purposes of the voter referendum. The School Department did not exercise control over how much BAN interest expense was incurred by the City. The interest expense incurred is a product of various factors such as the amount of proceeds borrowed, the expected timing of the borrowing, the interest rates charged which can be affected by the City's bond rating, and the number of times the short term notes are renewed prior to issuing long term debt.

The City records indicate that the 1988 school bond fund project was overspent by \$1.1 million. However, over \$1.3 million of net BAN interest was charged to this account. The School Department anticipated approximately \$600,000 in BAN interest. Therefore, at least \$700,000 or 60% of the over expenditures in this account results from BAN interest charged by the City that exceeded the amount the School Department estimated as part of total project costs.

The City and School Department need to work together in the future to more accurately project the amount that should be included in estimated project costs for BAN interest. They should also monitor the amount charged to each project in comparison to those estimates in an effort to control costs.

- Interfund loans that were not properly reimbursed;

Short-term interfund transactions occur between the general fund and bond funds since bond fund expenditures are initially paid from the general fund and then reimbursed with bond funds. As mentioned earlier, the City has recently strengthened its internal controls by implementing the auditor's recommendation to reconcile interfund activity monthly. The City discontinued a practice spanning at least 10 years that had resulted in large unreconciled balances at year-end.

These are some possible causes for the variance. However, as stated previously, the history of weak accounting and budgetary controls over bond funds activity, combined with the absence of City records prior to fiscal 1990, make it difficult to determine the exact cause.

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

Analysis of Difference between Available Balance and Cash (continued)

We recommend that the City continue to be diligent in performing monthly reconciliations of interfund activity to prevent future problems from occurring in bond funds or other funds.

The City should also continue to reconcile its cash accounts monthly to identify any variances between the bank balance and accounting records in the bond funds.

The following section provides recommendations to further strengthen controls over accounting for all bond funds in order to avoid the problems it has experienced over the years.

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

Recommendations to Strengthen Controls over Bond Funds

Control Project Costs

In 1996, voters authorized the City to issue bonds totaling \$7,975,000 to finance construction of a new elementary school. School Department officials advised us that the City solicited bids in December 2001 and awarded a construction contract in August 2002 – six years after the voters approved the bond issue. By that date the cost of construction had increased from the estimate of \$7,975,000 to \$8,660,000. The School Department (and possibly the prior City administration) believed that bond funds available for this project included the \$7,975,000 for new construction from the 1996 authorization and approximately \$2.7 million remaining in unexpended funds from a 1994 authorization. As of May 1, 2003, the City estimated that project expenditures for the new elementary school that include land acquisition, construction and change orders would total over \$11 million.

Both the City and the School Department have expressed concern about the cost overruns that resulted from not including installation of water lines as part of the initial contract. The School Department indicated that the City's prior administration removed the installation of water as part of the contract because the former Mayor was in the process of contracting with the Providence Water Supply Board to install the water lines as part of a larger project in western Cranston at a reduced cost. The School Department provided us with the former Mayor's press release dated October 31, 2001 announcing that the Providence Water Supply Board and the City of Cranston were entering into a cooperative agreement to share the cost to install a water line and pump station to the new elementary school on Scituate Avenue, substantially reducing the costs of the project for the School Department.

According to the School Department, the project with Providence Water Supply Board did not materialize and the costs to install water lines were recently added back by the City to the new school project costs in the form of a change order for over \$400,000.

City and school officials are troubled over the cost overruns for the new elementary school project but they do not agree on who was responsible for monitoring and controlling project costs. School officials advised us that the City has responsibility for this function. However, City officials have indicated that they have not exercised the degree of control stipulated in the City charter and have deferred to the School Department and the School Buildings Committee in managing school construction projects.

The City solicitor recently provided a written opinion that the City Board of Contract and Purchase and not the School Buildings Committee had authority

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

Recommendations to Strengthen Controls over Bond Funds (continued)

Control Project Costs (continued)

to approve change orders for school construction contracts. This opinion concluded that over time, both City and school officials have allowed the committee to exert more authority over school construction contracts than the City charter has granted to the committee. The charter provides certain responsibilities and authority to the School Buildings Committee and the City Board of Contract and Purchase. The opinion also concluded that existing practices for approving change orders does not comply with legal requirements spelled out in the City charter. As a result, the City does not follow the procedures outlined in the charter to monitor and control contract costs for school construction projects to prevent or reduce cost overruns.

Section 11.03 of the City charter provides that the School Buildings Committee be comprised of seven members, including two members of the City Council, two members of the School Committee, the Director of Public Works, the Superintendent of Schools and a qualified elector of the City, appointed by the Mayor. The Committee's responsibilities include:

- ❑ Obtaining tentative estimates of cost from the engineering division of the Department of Public Works;
- ❑ Determining a list of projects for the capital budget and sponsoring such projects;
- ❑ Approving consulting architects;
- ❑ Approving plans and specifications before the City advertises for bids.

Section 7.07 of the City charter provides that the Board of Contract and Purchase shall consist of seven members, including the Director of Public Works, Director of Finance, President of the City Council, a member of the minority party of the City Council and three private citizens. Section 7.07 (f) of the City charter requires the Board of Contract and Purchase to approve contracts and change orders for all City departments.

The City Solicitor concludes that under the charter, once the School Buildings Committee approves plans and specifications, and the City Council approves the amount to be spent, the project becomes the responsibility of the City. The City, through its Director of Public Works and City Engineer, is responsible for administering the construction project, and the Board of Contract and Purchase is responsible for approving change orders. Accordingly, the City should monitor and control contract costs.

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

Recommendations to Strengthen Controls over Bond Funds (continued)

Control Project Costs (continued)

RECOMMENDATIONS

Establish procedures to monitor and control construction costs and track related bond proceeds by individual bond resolution:

1. Prepare monthly management reports for all bond fund activity as a tool to monitor and control costs. The reports should identify, for each individual bond resolution, the resolution number, bond proceeds, expenditures, and unexpended balance. Reconcile the unexpended balance to the cash balance. Distribute the reports to the managers responsible for each project including the School Department. Resolve discrepancies promptly.
2. Follow the legal requirements of the City charter that require the Board of Contract and Purchase to approve all change orders based upon the advice and information provided by the Director of Public Works and/or City Engineer.
3. Ensure that all costs are included in the budgeted project costs that are submitted to the City Council and the voters for approval. Require the City Finance Director and School Business Administrator (for school bond projects) to evaluate the estimates received as stipulated in the City charter to ensure completeness.
4. Improve coordination between the City and School Department by ensuring that current cost information is available to both City and School Department officials.

In past years, the City did not monitor expenditure balances to control spending in bond accounts. For example, over a four-year period, the City recorded expenditures totaling \$11,694,849 in an account established for a bond authorized for \$2,545,000. The City subsequently transferred excess expenditures to other school bond accounts (via system adjustments totaling \$3,569,799 and manual adjustments totaling \$5,768,049) to reduce expenditures recorded in this bond account to \$2,357,001. This practice is inefficient and precludes the City from making meaningful comparisons of budget to actual results for school bond accounts.

RECOMMENDATIONS

5. Utilize controls to flag bond expenditures that exceed the authorized appropriation to assist in monitoring and controlling costs.

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

Recommendations to Strengthen Controls over Bond Funds (continued)

Control Project Costs (continued)

RECOMMENDATIONS (continued)

6. Ensure that expenditures are recorded in the proper account.

Estimate and Monitor Bond Anticipation Note Interest Expense

In some instances, BAN interest was charged to the individual bond resolution accounts and in other instances it was charged to a separate account.

In one instance BAN interest totaling approximately \$1.5 million, which the City believed had accumulated over years, was charged to a separate interest account. The City had to judgmentally allocate this amount to various school bond projects in order to determine individual project costs. The City should record BAN interest expense in the specific bond account for which it was incurred. This would enhance timely tracking of total project costs.

RECOMMENDATION

7. Record BAN interest expense in the specific bond account for which it was incurred.

In some instances, the City has charged BAN interest expense to school bond accounts that exceeded School Department estimates. The City should estimate BAN interest costs to be included in total estimated project costs by factoring in its policy and practices for rolling over short-term debt. It should ensure that interest expense is included as part of total estimated project costs for each resolution and should monitor interest costs incurred as well as other project costs.

RECOMMENDATIONS

8. Estimate the amount of BAN interest costs to be included as part of total project costs by considering:
 - a. the City's policy and practices for rolling over short-term debt;
 - b. the anticipated time span between when the costs are estimated and the proceeds will be issued;
 - c. estimated interest rates.

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

Recommendations to Strengthen Controls over Bond Funds (continued)

Estimate and Monitor Bond Anticipation Note Interest Expense (continued)

RECOMMENDATIONS (continued)

9. Include estimated BAN interest as part of total estimated project costs for all resolutions.
10. Monitor actual BAN interest costs as compared to estimated costs to determine if cost overruns will be incurred.

Audit Bond Funds

As part of an overall plan to strengthen internal controls over accounting, the City should consider contracting with its independent auditor to perform periodic audits of bond fund activity in more detail than required within the scope of the annual audit of the City's basic financial statements. This could be done periodically (i.e. not annually) to detect weaknesses in these areas that might otherwise go undetected.

RECOMMENDATION

11. Contract with independent auditor to audit internal controls over bond funds periodically.

In addition, the internal audit position which we recommended that the City Council establish as a control in our previous report to the City of Cranston dated July 2002 could further serve as a means of reviewing controls over bond fund activity.

RECOMMENDATION

12. Require the City Council Internal Auditor to perform periodic audits of internal controls over bond balances to detect potential weaknesses which should be corrected.

Prepare a Comprehensive Annual Financial Report

We reviewed school bond fund financial information from the City's audited financial statements for the fiscal years ended June 30, 1990 to June 30, 2002. As a result we noted that the City presented Comprehensive Annual Financial Reports (CAFRS) for eight of those thirteen years and then chose to issue only the "liftable" general purpose financial statements from June 30, 1998

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

Recommendations to Strengthen Controls over Bond Funds (continued)

Prepare a Comprehensive Annual Financial Report (continued)

going forward. A CAFR presents not only the data for activity of combined funds, but also presents the activity of individual funds after the notes to the financial statements. This level of detail is valuable to the City as well as various users of financial statements. For example, it presents the activity of the individual bond funds rather than just combining that activity with other funds as is appropriate in the entity-wide financial statements.

Presenting the individual fund statements as part of a CAFR will better enable the City, its various departments including the School Department, and other users to analyze and monitor that activity. We recommend that the City of Cranston revert to its prior practice of issuing Comprehensive Annual Financial Reports when it next solicits bids for financial auditing services.

RECOMMENDATION

13. Prepare a Comprehensive Annual Financial Report that includes detailed financial information on bond funds.

Record Bond Project Information on Vouchers

During the early 1990's, the City recorded the bond account number and bond resolution number on the face of a bond expense voucher, but did not record the voucher number. During fiscal year 1996, the City changed its practice and recorded the voucher number but not the bond account number or bond resolution number. These practices impeded the City's ability to retrieve source documents and determine for which bond project the payment was intended. The City should record the bond account number and bond resolution number on the face of each bond expense voucher. This would facilitate determining if an expenditure is posted to the proper school bond account.

RECOMMENDATION

14. Record the bond account number and bond resolution number on the face of each bond expense voucher.

Retain Documentation for Adjustments

The City processed school bond account adjustments totaling \$5,573,316 between July 1, 1989 and March 31, 2003. City finance department officials advised us that they could not locate supporting documentation for any adjustments prior to fiscal year 2001 and that the brief description electronically

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

Recommendations to Strengthen Controls over Bond Funds (continued)

Record Retention for Adjustments (continued)

recorded in the accounting system is the only information available. However, in most instances the electronic information does not fully describe the detail components and reason for the adjustment.

RECOMMENDATION

15. Retain source documentation supporting adjustments to bond accounts until the project is completed or audit is complete, whichever is later.

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

APPENDIX I

**Summary of Selected Minutes to Meetings Held in 1994 to Discuss
Concerns Over School Bond Balances**

The following is a synopsis of discussions included in minutes of School Committee, City Council and Council Finance Committee meetings in 1994, a year when the City and School Department expressed concern over discrepancies in school bond fund balances.

**August 30, 1994 - School Committee Minutes
Work Session on School Bonds**

- The City's Director of Administration indicated that concern over school bond balances was not a new issue from the City administration's point of view. The City's independent auditors raised concerns indirectly in June 1993. Several meetings were held which did not result in a reconciliation of a discrepancy. Subsequent to a meeting attended by representatives of the City and school administration and the independent auditors, the Mayor engaged the audit firm to get to the bottom of the discrepancy. The Director of Administration stated that the final report had not yet been received.
- A school committee member stated that she had been involved in this since approximately 1985 and agreed with the City Director of Administration that this was not a new issue, but in her opinion it had taken on a new dimension. She observed that the school system would not have missed the fact that \$2.5 million had been diverted out of bond money into other funds, if they had access to something more extensive than the school financial report. One of her major concerns was that the school system has requested another bond because they were informed that there was no more money in the bond fund.
- The school committee member referred to a meeting she participated in several years earlier attended by the City Finance Director and bond counsel and her concern at the time was that the City was using new bond funds to repay old bond funds. She was told at the time that this was an allowable practice because it was for the same purpose. However, it was stated that school bond money could not be used for anything but schools.
- The school committee member asked a representative from the audit firm how much money remained in each bond resolution. The auditor informed her that as far as she knew there was no breakdown of bond funds by resolution. The School Committee member believed that a breakdown did

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

APPENDIX I (continued)

**Summary of Selected Minutes to Meetings Held in 1994 to Discuss
Concerns Over School Bond Balances**

exist, having received one in 1992, and it reported the original bond amounts. She questioned from which bond fund the money was diverted.

- The school committee member interpreted a finance report to indicate that when the money was diverted and bond anticipation notes (BANS) were issued, the cash was put into the enterprise fund. Her concern was that the City was issuing bond anticipation notes for school projects and generating interest. She believed a consistently high amount of interest was being charged to the school bond fund. She asked if the interest on the funds under discussion were being charged to the school bond fund.
- The City's Director of Administration explained that the independent auditor was working on the answer. He observed that it is potentially true that more BANS were borrowed than necessary, and if that was the case, and the interest was charged to the school bond fund they will take remedial action. However, this could not be determined until the City's independent auditors had completed their work.
- The school committee member's complaint was that the schools sought approval of another school bond because of a lack of funds. Again, the City's Director of Administration stated that if funds were diverted, and they do not know that yet, the City will take remedial action at the appropriate time.
- The school committee member requested assurance that no more money would be moved from the school bond funds. The City's Director of Administration stated that he could not guarantee from the standpoint of practicality that this would never happen again, because it is allowable to move funds for cash management. However, he stated that it is imprudent not to repay the fund from which they have borrowed.
- The school committee member asked the City's Director of Administration if the City had informed the state Department of Education that \$2.5 million would be diverted to the enterprise fund, and did he think the Department of Education would have approved the practice if they had. The City's Director of Administration responded that they may not have approved, had they been informed, and he is not aware that they were, but they know it is done. He pointed out that they do not know for certain that there is a deficit

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

APPENDIX I (continued)

**Summary of Selected Minutes to Meetings Held in 1994 to Discuss
Concerns Over School Bond Balances**

in the bond fund, or if, in fact, additional payments were borrowed and interest logged to the bond fund, but if it is proven to be true, those funds will be moved back to the school bond fund.

- Another school committee member asked if the practice of borrowing from fund to fund is legal and bond counsel assured her that it is. He further stated that ultimately the proceeds of the bonds must be used as intended, but it is legal to move them around temporarily. This school committee member pointed out that no one knew about this and it had not been documented. She wondered how the City documented the fact that they borrowed \$2.5 million and how they anticipated repaying it. The City's Director of Administration observed that this is an auditing function and he questioned the veracity of the previous auditors. He added that this is not the function of the city council or the administration, and the City's independent auditor made them aware of the discrepancy in their management letter. The bond counsel observed that it would be difficult to prove that something that is legally permitted was diverted, but added that there should be a paper trail indicating that the enterprise fund recorded the receipt of this money.
- A representative from the audit firm indicated that by looking at the records that have been kept, there should be a trail and it should not be difficult. He also added that they would go back through the audit numbers until they found a point where both numbers matched and they would look at average interfund borrowings to arrive at an equitable amount, assuming that everything was done properly. The auditor indicated that they did not have a timeline as to when the possible diversion of funds took place, but they were working on it.
- A school committee member commented that in previous years, projects were postponed to the following year because the City did not have the money to withstand the debt.
- A school committee member asked how much interest was charged while the School Department did not have use of the money. Another school committee member indicated that sometimes they had received an interest assessment, but not always, adding that they had requested a specific item-by-item sheet on what was spent from the bond. She thought reports were posted by hand and that the information was not going into the computer. She indicated that all of the project work revolved around the

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

APPENDIX I (continued)

**Summary of Selected Minutes to Meetings Held in 1994 to Discuss
Concerns Over School Bond Balances**

money and there were times when the interest was considered and times when it wasn't.

- The auditor was asked for a timeframe for completion and he responded a few weeks.
- The School Superintendent hoped that as a result of the discussions an itemized, periodic report would be produced on a monthly or quarterly basis that would satisfy both the School Committee and himself as to the status of the bond funds and how much was remaining. He observed that if a reporting system were not instituted that made sense, they would be back having the same discussions a year from now.
- The City Director of Administration offered an annual or bi-annual meeting to provide the information that the School Department was seeking. He stated that construction of the past records was difficult and they were relying on the auditor. He stated that their previous auditor did not identify the systematic failure and nothing will change that.

COMMENT: *The current School Business Administrator advised us that he found no additional minutes of school committee meetings that address this matter. He also could not locate the report by the auditors referred to in the 1994 minutes that addressed concerns raised about school bond funds.*

**June 9, 1994 - Letter to City Council from
Auditors included with City Council Minutes**

- The letter was in response to the Council's request of June 7, 1994 asking the firm to verify whether or not any funds from the Capital Bond Funds were loaned to the sewer and water enterprise funds for operating purposes during the fiscal year ended June 30, 1993.
- The audit firm stated that based on a review of their work papers, it appears that the Capital Bond Funds did not make any loans to the sewer and water enterprise funds during the fiscal year ended June 30, 1993. However, they reminded the Council that the following interfund balance did exist in the sewer and water enterprise funds at June 30, 1993:

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

APPENDIX I (continued)

**Summary of Selected Minutes to Meetings Held in 1994 to Discuss
Concerns Over School Bond Balances**

	<u>SEWER</u>	<u>WATER</u>
Due to Capital Bond Funds (net)	\$2,397,000	\$212,225

COMMENT: *This letter precedes the August 30, 1994 school committee meeting during which the auditors were requested to analyze the bond balances.*

April 26, 1994 - Special Finance Committee Meeting

- The School Business Administrator stated that he met with the auditors and the School Superintendent met with the City Director of Administration. They had scheduled a meeting between the School Department and the City on a procedure of checking balances of bond money quarterly.

COMMENT: *We found no other finance committee minutes in 1994 or 1995 addressing these procedures or the outcomes of a requested auditors evaluation of bond balances.*

Discussion with City Auditors

We met with the City's current auditors on June 4, 2003 along with the City Finance Director and Controller. The current auditors are the same auditors that were requested to perform an assessment of school bond balances in 1994. Due to the auditors record retention policy, they no longer had a copy of the results of that assessment.

We also asked the City Clerks office if a copy of the 1994 auditor's assessment of bond balances had been filed with them but they could not locate it. The City Clerk's office also advised us that it did not have a copy of the audit of the City's financial statements for June 30, 1994 since these reports were not always filed with the City Clerk's office in the past. However, the current City Clerk now receives copies of audit reports.

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

UNAUDITED

APPENDIX II

Summary of School Bond Descriptions by Resolution

Source: City Council Resolutions or related RI Public Laws

Resolution 86 - 102

Loan order authorizing the issue of \$4,500,000 bonds of the City for providing for the construction, equipping, repairing and renovation of school buildings in the City; authorizing the City to apply for Federal and State advances for that purpose; authorizing the issue of \$4,500,000 temporary notes for that purpose; and authorizing advances from the General Treasury for that purpose.

Resolution 88 - 104 – Chapter 91 - 1988

An act providing for the construction, equipping, repairing and renovation of school buildings in the City of Cranston, and authorizing the finance thereof by the City of Cranston, including the issue of not more than \$9,300,000 bonds and notes.

Resolution 91 - 3 – Chapter 264 - 1990

An act providing for the renovation, equipping and repairing of school buildings in the City of Cranston and authorizing the financing thereof by the City of Cranston including the issue of not more than \$6,000,000 bonds and notes.

Resolution 94 - 3 – Chapter 22 - 1994

An act authorizing the City of Cranston to finance the construction, equipping and acquisition of property for new educational facilities and additions in the City and to issue not more than \$8,500,000 bonds and notes.

Resolution 94 - 27 – Chapter 290 - 1994

An act authorizing the City of Cranston to finance renovation, equipping and repairing of school buildings and to issue not more than \$6,700,000 bonds and notes.

**CITY OF CRANSTON
ANALYSIS OF SCHOOL BOND FUND**

UNAUDITED

APPENDIX II (continued)

Summary of School Bond Descriptions by Resolution

Resolution 96 - 118 – Chapter 118 - 1996

An act authorizing the City of Cranston to issue \$8,700,000 bonds and notes for school purposes (\$7,975,000 of which shall be for the construction and equipping of a new elementary school, and \$725,000 of which shall be for improvements to the telecommunications network for secondary schools throughout the City).

Resolution 98 - 48 – Chapter 98 - 1998

An act authorizing the City of Cranston to issue not more than \$2,545,000 bonds and notes for renovation, mechanical equipment improvements and repairing of school buildings in the City of Cranston.

Resolution 98 - 49 – Chapter 154 - 1998

An act authorizing the City of Cranston to issue not more than \$5,975,000 bonds and notes for the construction and equipping of additional classrooms and building renovations at Cranston High School West.

Resolution 00 - 40 – Chapter 112 - 2000

An act authorizing the City of Cranston to finance the renovation, rehabilitation, repair, improvement, furnishing and equipping of schools and school facilities including, but not limited to, additions at Cranston High School East and the Western Hills Middle School and improvements to the Park View Middle School in the City by the issuance of not more than \$13,865,000 bonds and notes.