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April 11, 2014

Superintendent John Evans
Members of the Board of Education
Downsville Central School District
14784 State Highway 30
Downsville, NY 13755

Report Number: P4-13-7

Dear Superintendent Evans and Members of the Board of Education:

The Office of the State Comptroller works to help school district officials manage their resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide, as well as compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations and Board of Education governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard district assets.

In accordance with these goals, we conducted an audit of eight school districts in Broome, Delaware, Schoharie, Sullivan and Tompkins Counties. The objective of our audit was to determine whether energy performance contracts (EPCs) entered into by school districts achieved the cost and/or energy savings projected by the vendor who executed the contract. We included the Downsville Central School District (District) in this audit. Within the scope of this audit, we examined the District's EPC, including the Energy Service Company's (ESCO) projections, and reviewed energy consumption and costs for the period April 1, 2000 through August 19, 2013.

This report of examination letter contains our findings and recommendations specific to the District. We discussed the findings and recommendations with District officials and considered their comments, which appear in Appendix A, in preparing this report. District officials generally agreed with our recommendations. Appendix B includes our comments on issues raised in the District's response. At the completion of our audit of the eight school districts, we prepared a global report that summarizes the significant issues we identified at all of the school districts audited.

Summary of Findings

The District is not projected to achieve the energy cost savings guaranteed by the ESCO that executed the EPC. Although the ESCO guaranteed energy cost savings of \$320,500, the actual energy costs are projected to total approximately \$221,900 over the life of the EPC. Additionally, total EPC capital project expenditures were approximately \$216,500, for a total net loss of \$438,400. The District did not receive any State aid or grants associated with the EPC.

Background and Methodology

Article 9 of the Energy Law establishes procedures to be used by school districts in initiating and administering EPCs. An EPC is an agreement by an ESCO for the provision of energy services in which energy systems are installed, maintained or managed to improve the energy efficiency of, or produce energy for, a facility in exchange for a portion of the energy savings or revenues. EPCs are not subject to voter approval or competitive bidding requirements and the length of the contract must not exceed the useful life of the building (which the New York State Education Department has established at 18 years). In addition, school districts should establish procedures to monitor these EPCs. The ESCO may agree to guarantee that the improvements will generate cost savings sufficient to pay for the project over the term of the EPC; however, cost savings are not a requirement for a successful contract. After the EPC ends, the school districts may continue to realize additional cost savings as a result of the improvements.

The District is located in Delaware County and has two buildings in operation. It has approximately 300 students and general fund budgeted appropriations of \$9.6 million for the 2013-14 fiscal year. The District is governed by a five-member Board of Education (Board). The Board is responsible for conducting the business of the District within the laws of the State and regulations of the New York State Commissioner of Education.

In December 2002, the Board entered into an EPC with a 15-year contract term, from April 2004 through March 2019. The current District officials were not in their positions when the EPC was entered into. The related project work was completed in March 2004 and included installing direct digital controls on the heating, ventilation and air conditioning (HVAC) equipment to allow user access to all system data including HVAC control, energy management strategies, alarm monitoring and maintenance management functions related to normal building operations. The EPC guaranteed energy cost savings of \$320,500 over the 15-year life of the building. The EPC project cost totaled approximately \$216,500 as of its completion in 2004.

Further, in February 2004, the District completed a capital project that coincided with the EPC's capital project work and entailed further upgrades to the HVAC system.¹ Additionally, during the 15 years of guaranteed savings, the District completed two additional capital projects. One project, which started in August 2004 and was completed in December 2004, was a classroom renovation. The other project, started in 2010 and completed in 2011, increased the square footage of the buildings. These capital projects were not considered in the EPC, and because the ESCO is not annually monitoring the savings, the ESCO did not take them into account or make

¹ The Buildings and Grounds Superintendent originally told us that the February 2004 project was considered in the EPC but later indicated he was not certain of this.

adjustments to the guaranteed savings. Therefore, these projects may have contributed to the District not achieving the guaranteed energy cost savings.

To accomplish our objective, we interviewed District officials and reviewed the EPC to obtain the scope of the work, the cost of the project, the length of the contract and the guaranteed energy savings. We obtained utility data, including consumption and rates for the base year of April 2000 through March 2001, and verified the reasonableness of the ESCO's base-year calculations. We also verified the ESCO's projected increase in utility rates based on utility costs for New York State from the U.S. Energy Information Administration from 1992 through 2002 and verified that an average annual increase in utilities of 3 percent was reasonable. We calculated the energy savings by subtracting the annual consumption for April 2004 through March 2013 from the base year's consumption. We multiplied the energy savings by the base-year utility rates, which were escalated by 3 percent annually. We then projected these savings out from April 2013 through March 2019 by using the most recent completed year's calculated savings and multiplying it by the average increase of utilities over the life of the EPC. We then subtracted the expenditures related to the EPC from the total cost savings calculated to identify any potential savings. The District did not receive any grants or State aid relating to the EPC.

We conducted our 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Audit Results

The District's EPC is not projected to achieve the ESCO's guaranteed energy cost savings of \$320,500. We were unable to determine if there were any adjustments to the guaranteed energy cost savings because the ESCO went out of business and never provided the District with any reconciliation reports. Although we found that the fuel consumption has decreased, the electricity consumption has increased. Therefore, we projected additional energy costs of approximately \$221,900.² Furthermore, District expenditures to implement the terms of the EPC totaled approximately \$216,500, for a net loss to the District of \$438,400.

The District's capital project (completed in 2011) increased the square footage of both buildings by 19 percent, which may have contributed to the increases in energy costs. However, even before that capital project was completed, the District was still not achieving the energy cost savings guaranteed by the EPC.³ Additionally, the current District officials were not in their

² To calculate the projected energy costs and potential loss, we utilized the actual energy cost prior to the EPC for the base year of April 2000 through March 2001 with annual 3 percent increases in the utility rate for the life of the project. We then multiplied the actual consumption from April 2004 through March 2012 by the escalating base-year utility rates to determine the actual energy costs after the EPC was completed. We then used the April 2012 through March 2013 calculated energy costs and projected costs out for the remaining six years (April 2013 through March 2019) of the EPC.

³ The District's electricity supply increased by about 49,700 kilowatt hours (equivalent to \$7,600) during the period April 2004 through March 2009 (the time period before the capital projects could have affected the EPC performance). We calculated this cost using the base-year utility rate with an annual 3 percent increase.

positions when the EPC was entered into. They informed us that the capital project that coincided with the EPC's capital project may not have been taken into consideration when the ESCO calculated the potential energy savings. This capital project required additional motors to continuously run and, therefore, may have caused the additional electricity consumption.

The District also does not have any monitoring procedures in place related to the EPC. The Building and Grounds Superintendent does keep a log of the fuel deliveries, including the date and quantity delivered, but does not track the price or total cost of deliveries. Additionally, there is no one tracking the electricity consumption. Further, according to the District Treasurer and the Building and Grounds Superintendent, the ESCO did not provide any reconciliation or monitoring reports. The ESCO went out of business shortly after the EPC project work was completed in 2004, and the District did not hear from it again.

Recommendations

1. Before considering an EPC in the future, District officials should perform a cost-benefit analysis based on the ESCO's projected energy cost savings and negotiated contractual terms to determine if the investment in energy upgrades is beneficial.
2. District officials should implement monitoring procedures to include timely reviews of the District's electricity and fuel oil consumption and the related costs and compare their reviews to the annual guaranteed energy cost savings to ensure those guarantees are being met.
3. District officials should consider consulting the District's legal counsel to determine whether they should take action to recoup the difference between the amount of cost savings that was guaranteed by the ESCO and the District's actual savings/losses.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, Section 2116-a (3)(c) of the Education Law, and Section 170.12 of the Regulations of the Commissioner of Education, a written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and forwarded to our office within 90 days. 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 Board should make the CAP available for public review in the District Clerk's office.

Our office is available to assist you upon request. If you have any further questions, please contact H. Todd Eames, Chief Examiner of the Binghamton Regional Office, at (607) 721-8306.

Sincerely

Gabriel F. Deyo

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

The District officials' response to this audit can be found on the following page.

Downsville Central School

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www.dcseagles.org

Timothy McNamara
Principal

John P. Evans
Superintendent

Robert Rhinehart
Administrator/Guidance

November 21, 2013

Mr. Andrew A. SanFilippo
State of New York
Office of the State Comptroller
110 State Street
Albany, NY 12236

Report Number: P4-13-7

Dear Mr. SanFilippo:

The Downsville Central School Board of Education disagrees with the NYS Comptroller's assertion that it sustained a net loss of \$438,400 by entering into an Energy Performance Contract (EPC) in 2002. We do not believe that the effects of the 2010 capital project were incorporated into the NYS Comptroller's calculation of energy used. That project had a profound impact on the total amount of energy consumed and adjustments should be made, since that project was not part of the baseline data or the guaranteed savings calculation in the EPC.

See
Note 1
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The expectation for the EPC was to pay \$216,500 to achieve energy savings of \$320,500 over a 15 year period, a net gain of \$104,000 (approx. \$6,933 per year). If the energy consumption effect that occurred for the first five years after the 2004 capital project and before the expansion that occurred as part of the 2010 capital project would have continued for the full 15 years of the EPC project, the district believes that it will exceed the guaranteed cost savings. The net gain for the project could be \$227,919 (\$444,419 projected cost savings minus \$216,500). The EPC only references a guaranteed savings amount and does not guarantee a reduction of electricity and/or fuel oil consumption to a certain level. Both the consumption level and the unit cost have a significant impact on the actual money paid out for utility services by the school district. The district did not reduce its consumption to a level that would have been required to meet the guaranteed savings had the price per unit stayed the same as projected in the baseline. However, the reduction in the actual fuel oil consumption from the baseline amount was enough, when coupled with the significant increase in the actual cost of the fuel oil, to at least achieve the savings guaranteed by the EPC. The substantial savings reported by the District is primarily due to the large increase in fuel oil prices from what was projected in the EPC. The price increase for fuel oil increased so dramatically in the years following the completion of the 2004 capital project that had the District not employed the cost savings measures included in the EPC to decrease their annual fuel oil consumption, the effects could have been financially devastating to the District.

See
Note 2
Page 7

See
Note 3
Page 7

Sincerely,

John Evans
Superintendent

We, the Downsville Central School Community, will be a high achieving, evolving educational environment responsible for building a foundation of trust, fairness, and consistency by working collaboratively to inspire and nurture each individual's passion, voice, and character for life-long success.

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

The report states that these projects may have contributed to the District not achieving the guaranteed energy cost savings. However, because the ESCO is out of business and, therefore, not providing annual reconciliations and the District is not monitoring the EPC, we were unable to incorporate any adjustments for these capital projects.

Note 2

The calculation provided by the District does not follow the agreed-upon terms of the EPC for determining cost savings. Our methodology to calculate the net cost savings followed the contract terms.

Note 3

OSC agrees that fuel oil consumption has decreased since the EPC was completed; however, the terms of the EPC included electricity consumption, which has increased since the EPC was completed and caused the net loss we referred to in our report.