

Date: October 21, 2009

To: Board of Education

From: Measure BB Citizen's Bond Oversight Committee, a.k.a. Proposition 39 Committee

Subject: Annual Report regarding Measure BB Bond proceeds for the year ended June 30, 2008 and related matters

#### Introduction and Background:

This report represents the conclusions, and findings of the Measure BB Citizen's Bond Oversight Committee (also know as the Proposition 39 Committee) regarding use of Measure BB bond proceeds for the year ended June 30, 2008, as well as related findings, requests and concerns over the longer term.

The Santa Monica-Malibu Unified School District was successful at the November 7, 2006 election (Measure BB) in obtaining authorization from the District's voters to issue up to \$268,000,000 aggregate principal amount of general obligation bonds. The election was conducted under requirements of California Proposition 39 as approved by voters state wide on November 7, 2000, being chaptered as the Strict Accountability in Local School Construction Bonds Act of 2000, according to the District's website. This allowed approval of Measure BB by a 55% majority of the votes cast as opposed to the more difficult to achieve two-thirds of the votes cast, as long as there is a state mandated form of accountability and the voters were advised of such. Pursuant to Section 15278 of the Education Code, the District is obligated to establish a citizens bond oversight committee in order to satisfy the accountability requirement of Proposition 39. The Board of Education of the Santa Monica-Malibu Unified School District established this Committee in December 2006 in compliance with this requirement. As of June 30, 2008, \$60 million of Measure BB bonds were issued in October 2007.

The most important responsibility of the Committee is to make a determination whether the District is in compliance with the requirements of Article XIII A, Section 1(b)(3) of the California Constitution, and to provide a report of its activities leading to this. This is one objective of this report and by doing so the Committee informs the Board and the public concerning expenditures of the Measure BB bond proceeds after reviewing reports provided by the District. The objective of Article XIII A, Section 1(b)(3) is to ensure that bond proceeds are being

expended only for the purposes set forth in Measure BB; and that no bond proceeds were used for any teacher, administrative salaries or other operating expenses.

One objective of this citizens oversight committee is to lobby the Board for strict accountability over Measure BB bond proceeds in keeping within the law, but in addition, keeping within its spirit. In part we seek to accomplish this by determining beyond any reasonable doubts that the District's general obligation bonds as authorized by Measure BB have been expended and disbursed according to Measure BB authorized purposes, as identified by the Measure BB Advisory Committee, and approved by the Board of Education. As this Proposition 39 Committee is comprised of a minimum of 7 citizen volunteers selected by the Board, and is limited to meeting as a body once a quarter, no more than four times annually, this Committee must rely on the work products of the District, its contractors, and independent Certified Public Accountants. In keeping within the spirit of the law the Committee has communicated to the District its opinions regarding financial reporting and related concerns that if addressed by the District would be helpful in meeting the Committee's mission over the short and long terms in establishing beyond any reasonable doubts the District's compliance with Measure BB.

The Committee has met five times since its establishment. Its first meeting on April 9, 2008 was an orientation meeting. The second meeting called by the District was on February 24, 2009 with a presentation on Measure BB project reports prepared by Mr. Tom Tomeoni, Program Manager with Parsons, who provides construction project management services for the District. There were also presentations on the "Audited Financial Statements for Measure BB Bond Building Fund" and the "Independent Auditor's Report on Performance Audit" both covering the year ending June 30, 2008, by James Hawley, CPA and Manager of the District's independent Certified Public Accountants, Nigro, Nigro and White. The third meeting took place on June 29, 2009 and included reports from the Committee's Financial Reporting subcommittee (Laurie Charchut, Jerry Nickelsburg and Robert Tompkins) and its Procedural subcommittee (Neil Carrey, and Ralph Erickson). The fourth meeting took place on September 30, 2009 and included a presentation and discussion of a draft Committee report to the Board of Education, as well as updates from the District on Measure BB projects. At the fifth meeting on October 21 the Committee approved the annual report.

As the Committee was to render an opinion regarding Measure BB Bond Proceeds for the year ended June 30, 2008, we asked ourselves these questions: Do we have all the information

needed to do so? If not what do we need? This report shares our conclusions, findings and concerns after asking those questions.

#### Overall Conclusion:

This citizen's oversight committee cannot state beyond a reasonable doubt the information presented to us by the District for the year ended June 30, 2008 is sufficient evidence that the District is in compliance with the requirements of Article XIII A, Section 1(b)(3) of the California Constitution. It may be or it may not be. We do not have confidence in the Special Audit Report due to it being unable to provide basic information on cash and expenditures as well as containing errors. In addition there has been a Committee request for information on a particular item, with District agreements to respond, which remains unanswered.

#### Major Findings related to the Overall Conclusion:

##### 1: Issues related to determination of cash and expenditures

We as citizens have expectations that we can be told how much cash is available and how much was spent. The District cannot identify the cash balances of Measure BB bond proceeds, or the actual expenditures of the bond proceeds on Measure BB projects. Interest revenue earned on bond proceeds cash cannot be ascertained. The reason why this is so is the cash from the original \$60 million of bond proceeds is mixed with \$4 million of Developer Fees transferred into the fund. We do not know which dollars were expended on Measure BB projects or a \$1 million transfer to the General Fund. Was it proceeds from bonds or Developer Fees? This matters, as our mission is limited to oversight over bond proceeds.

Thus we cannot meet our goal of strict accountability, as the variance of estimates of the Bond proceeds cash balance is material, \$4 million as of June 30, 2008. We do not know if cash is \$59,299,943, as the Special Audit Report indicates, or is it \$4 million less (\$55,299,943) or \$3 million less (\$56,299,943) if the \$1 million transfer out to the General Fund was cash from Developer Fees and not bond proceeds cash, or some other number. If the present accounting practices continues over many years than this range of \$3 to \$4 million variance can increase and become more uncertain.

The Special Audit Report indicates that monies were expended properly on Measure BB projects however the District cannot determine the actual expenditures of the portion paid by the bond proceeds for the same reasons as for cash. It might be \$7,675,506 or \$3,675,506 or \$4,675,506 or another number. Lack of such certainty puts doubts into our minds and we as citizens deem this not an acceptable standard of accounting for the total \$268 million of anticipated bond proceeds for the Measure BB program.

It does appear from this evidence Measure BB bond proceeds were expended properly, however we have other issues that raise concerns, as discussed in the following section.

## 2: Issues regarding information presented in the Special Audit Report

We have concerns with the Special Audit Report (<http://www.smmusd.org/measureBB/prop39/pdf/AudBB0708.pdf>) as there are inaccuracies in its title, its footnotes and presentation as an accounting fund, and thus these errors in the Special Audit Report raise concerns with the report as a whole.

A: The Special Audit Report is titled incorrectly as the 'Measure BB Bond Building Fund' because it includes other financing sources unrelated to Measure BB bond proceeds such as \$4 million of Developer Fees. In the future it will include monies from Certificates of Participate (COP) and grants. Our mission is to focus only on bond proceeds related to Measure BB, not all Measure BB approved projects to be financed by non-bond proceeds. Upon first review we thought the Special Audit Report was dedicated only to Measure BB bond proceeds, and would have interest only earned on bond proceeds, but it does not. An example of a more accurate title for the information presented is Measure BB Building Program.

In addition the Committee is put into a position by using this Special Audit Report that it appears to violate the Committee Bylaws as Section 2 refers to "the Committee shall confine itself specifically to bond proceeds generated under Measure BB," and "all monies generated under other sources shall fall outside the scope of the Committee's review." Bylaws Section 3.5 refers to: (a) "Projects financed though ... developer fees, redevelopment tax increment... shall be outside the authority of the Committee." We recommend the Board clarify the meaning.

B: The “Measure BB Bond Building Fund” is represented as an accounting fund but in reality it is not a fund. As citizens it is reasonable to expect all of the funds of the District would be in the District Audit Report (<http://www.smmusd.org/fiscal/pdf/AuditReport0708.pdf>) as both reports refer to presenting financial information by fund, considered to be a separate accounting entity. According to note 1E in the District Audit Report a fund is a “separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures.”

In conversation the District calls this a ‘sub-fund’, thus being within another fund, the Building Fund. Thus the audit report is titled incorrectly. There is every reasonable expectation a fund that by definition is “considered to be a separate accounting entity” should be a fund in a District’s computer accounting system, and be included in the District wide Audit Report, while this appears not to be the case being a ‘sub-fund’. This means Measure BB transactions are commingled with non-Measure BB transactions in the Building fund. It is possible Measure BB monies are being used for non-Measure BB uses. The auditor’s opinion is Measure BB monies were used only on Measure BB projects however according to the Performance Audit they examined \$2.3 million in invoices, only 30% of the \$7.8 million expended on Measure BB projects, based on their evaluation of internal controls. The auditor’s state their audit “would not disclose all instances of noncompliance.” In our opinion Measure BB transactions at a minimum should be separated from non-Measure BB transactions within its own fund so we have more confidence that it is truly a separate accounting entity. This is discussed in more detail later. Labeling the Special Audit Report something it is not alarms us because it gives us a false sense of security and confidence.

C: The Balance Sheet on page 4 refers to ‘Cash in county treasury.’ It turn out it is not cash but an investment because it lost value. According to Note 2, Deposits and Investments, it appears the fair market value of this ‘cash’ is about \$65,000 less than the amortized book value. There is no fair market value of cash, other than the face value on the cash itself, nor is there an amortized book value, thus it is an investment. Being labeled as cash misinforms the reader who upon knowing this is an investment would be able to analyze the information as an investment and not as cash. It is possible labeling this investment as cash is acceptable as an accounting practice, however we as citizens understand cash to mean cash and such should not lose value, which is a concern of ours discussed later. As it appears to be losing monetary value we deem this not an appropriate use of Measure BB monies. In addition this also

weakened our confidence relying on the Special Audit Report. Most citizens do not read the notes in the report and this is an example as to why they should.

D: Note 1 A, Significant Accounting Policies – Reporting Entity, is materially in error. According to this report “the Committee’s oversight goals include advising on District construction priorities, reviewing construction plans, reviewing project plans and budgets, and ensuring compliance with the conditions of Measure BB.” This committee does not advise on construction priorities, nor review construction plans. It appears to be the description for the Measure BB Advisory Committee, not our Committee. This error does raise a red flag about other errors in the report and contributed to weakening our confidence in the Special Audit Report.

E: The Special Audit Report does not provide any detail report of all of the Measure BB approved projects. It groups all expenditures into three broad expenditure categories; Plant services, Facility acquisition and construction and Debt service-issuance costs. It would be helpful for the report to include a note with a detail listing of all Measure BB projects, the Board approved budget of each and the Expenditures for the time period and to date that would agree in total to the sum of the three broad categories. Budgets are a financial oversight tool to ascertain if actual revenues and expenditures and inter-fund transfers appear to be reasonable, and authorized by the Board of Education. Without this information we do not know if expenditures of Measure BB bond proceeds have been authorized via the budget process other than by the Parsons reports, which have not been audited by the independent CPA firm, as they audit the District’s accounting. We do have the auditor’s assurances the total of the three broad categories were allowable under Measure BB.

### 3: Issue regarding unanswered request for additional information

The Committee has orally and in writing requested additional information regarding the \$1 million transferred to the General Fund from the Measure BB Bond Building Fund. We have not received an answer. According to the Special Audit Report the monies were intended for maintenance expenditures. We want to examine expenditure details to confirm they are allowable under Measure BB and have actually been spent by the General Fund. It appears to us the inter-fund transfer acts as a source of financing for the General Fund and not as a reimbursement of expenditures, and this may be in violation of Article XIII A, Section 1(b)(3) of

the California Constitution. Thus it remains an open issue, and by itself sufficient to support the overall conclusion.

#### Summary related to the Overall Conclusion:

We cannot conclude one way or the other, without reasonable doubts, that the District is in compliance with the requirements of Article XIII A, Section 1(b)(3) of the California Constitution for the year ending June 30, 2008 for the reasons stated above. However, we do point out that from what we did receive we did not find any definitive misuse of Measure BB funds, only that we feel because of the issues raised above, we also cannot say the District is in compliance. We appreciate the efforts of the District management thus far and given this is the first Proposition 39 implementation by the District we recognize, as we hope District management does, that this is a learning experience for all of us. Our expectations as citizens may be different than what is typical for school accounting and reporting practices. We hope we serve the District and community well over the short and long term by giving our honest objective assessment to the best of our abilities.

#### Concerns and Citizen Bond Oversight Committee Requests of the Board:

The following represents our thoughts on a number of matters.

1: Measure BB Cash from Bond Proceeds, losses on investments, under allocated interest, use by other funds and term of Committee

a) We are concerned about potential losses on investments of the bond proceeds as the County Treasury holds the cash; its value is about \$65,000 less than the amortized book value according to the Special Audit Report. It appears Measure BB bond proceeds are not secure and an amount will be lost for use to finance Measure BB purposes. The bonds were issued on October 16, 2007, and might be losing money given the information, as of the June 30, 2008 Special Audit Report, and we have not received updates on this subject.

b) Cash from Measure BB Bond Proceeds may be entitled to more interest earnings. District wide cash is pooled together into one account (commingled) while being held and invested by

the Los Angeles County Treasury. Cash of the bond proceeds as of June 30, 2008 was about half of the total cash of the District, and represents about half of the loss relative to the fair market value. The Measure BB Bond Building Fund may be able to earn more interest being separated from the District wide cash pool and managed by another entity as a fiscal agent. In addition the present practice of pooling of District cash means interest earned on the grand total of such funds needs to be allocated to each and every District fund with a cash balance. There is a risk not all interest revenue earned is being allocated to bond proceeds based on the present accounting methodology. For example if the interest on the total pool is allocated based on the cash balance of each fund at the end of each month the allocation will not be accurate. Segregation of this fund's cash will ensure all interest earned will remain in the fund to be expended on Measure BB projects.

c) The recent Board authorization to temporarily borrow cash from any fund for use for District operations may not be legal under Measure BB.

The Board adopted Resolution 09-10 – 'Temporary Interfund Cash Borrowing' at its September 3, 2009 meeting. (<http://www.smmusd.org/brd0910/min090309.pdf> page 30) This allows the school to borrow up to "75% of available resources in any Fund" if there is "not enough cash to meet fiscal obligations in the General or other operating Funds due to the shortage of funds created by the deferral of the July apportionment payment or lack of" a state budget delaying any state funds normally received by September 30th. This can impact on the use of Measure BB bond proceeds as its cash can be used for non-Measure BB purposes.

Pooling of such cash with other District cash may not be legal under Measure BB even though cash pooling may be a widely accepted school district practice. If any fund has a negative cash balance at any time, the pool has financed its expenditures. Thus in the future the District may be using Measure BB bond cash for non-Measure BB purposes without knowing so until after the fact.

d) We respectfully request the Board request staff to provide a timely quarterly treasurer's report of bond proceeds available cash, and investments including amortized book value and market value on a timely basis so the Committee may monitor cash and investments.

e) The District being unable to determine cash balances of bond proceeds has an adverse side effect regarding when to terminate the Committee. Bylaws Section 11 states, "The Committee shall automatically terminate and disband 180 days after all Measure BB bond proceeds are spent." Thus many years from now under current accounting practices the District cannot know exactly when all the bond proceeds has been expended and when a Proposition 39 Committee is no longer legally required. It is possible the Committee could needlessly meet for many years, producing many needless annual reports presented at many Board meetings wasting many people's time.

## 2: Establish a restricted fund to be in annual District Audit Report

We respectfully request the Board to request staff to establish a restricted fund for Measure BB, with a separate cash account for only bond cash. This fund would be presented in the annual District Audit Report, and be a separate fund in the District accounting system, not a sub-fund. In addition our judgment is such cash from Measure BB bond proceeds may not be legally loaned to another District fund under any situation because Measure BB itself did not give express approval as the voters might have voted otherwise had Measure BB stated so. Pooling of Measure BB bond cash with other District cash, such as with the Los Angeles County Treasurer may not be legal for the same reasons, as for the possibility of 'informal' loans between funds. Thus it appears to us Measure BB bond proceeds is legally restricted for use only for Measure BB authorized uses and its cash and investments should be segregated from other District cash and investments in a separate fund.

## 3: Special Audit Report

We respectfully request the Board request staff to improve the Special Audit Report for the year ending June 30, 2009:

a) To include a section called "Management's Discussion and Analysis" that would focus only on Measure BB bond proceeds. An example of this is found in the District Wide Audit Report. It would help our understanding and thus raise the confidence level of the committee and the public in the report.

b) To provide statements of bond proceeds cash flows as supplemental schedules. It would show the beginning cash balance from bond proceeds, and summary of transactions to the ending cash balance from bond proceeds. This will help us understand better where the bond proceeds cash came from and where it went.

#### 4: Independent Auditor's Report on Performance Audit

The Performance Audit should provide additional assurances that bond proceeds were expended appropriately on the specific projects that are eligible as well as approved by the Board of Education. The report provided to the Committee appears to be a variation of the Special Audit Report as it basically states Measure BB monies were spent properly, the procedures followed specific to the measure and as such provides additional assurance. It refers to a bond fund yet this fund is not purely a bond fund being it contains other revenue sources besides bond proceeds. However the report lacks a detail listing of approved projects by school.

Parsons reporting can be useful for details and the special audit report can be useful at a more summary level format after being certified by an independent CPA. However there is no mechanism or review process to relate the two given there are different categories and definitions, except at the level of aggregation of the totals. Thus there may be material misstatements in the Parsons report that will not be discovered by the independent auditors because it is not included in their audit test programs, or by the Committee, yet the Committee must rely on the Parsons reports.

We respectfully request the Board to request staff to have the June 30, 2009 Special Audit Report or the Performance Audit Report include a note or supplemental information as a schedule detailing all the Measure BB allowable projects and/or expenditures by fund showing a project level or organizational level account code, its title or description, a project budget, annual budget, as well as revised budgets, and expenditures for the year, as well as expenditures to date, given these are multiyear projects, commitments as of year end and total expenditures to date plus commitments. In addition we request that projects manager(s) provide each an estimate of percentage of completion for each project. This estimate is not to be calculated based on expenditures as compared to project budget, but provided as a construction engineer or an architect would, based on actual completion.

## 5: Parson Reports

We respectfully request the Board to request staff to have Parsons reports beginning after September 30, 2009 organized as the schedule discussed in the Performance Audit section but with more detail by line item. The total of each project should be the same total on the above schedule. The percentage of completion need not be provided in the details, but only to the project level as a whole. It would be helpful to have these reports at least on a semi-annual basis if not quarterly.

## 6: Indirect Administrative Overhead Expenses

We respectfully request the Board to request staff to ask the auditors establish audit procedures to ascertain bond proceeds have not been used on Indirect Administrative Overhead Expenses and that future audit reports make a declaration if that has been the case, beginning with the year ending June 30, 2008. These expense are not allowable under Measure BB but are not explicitly made reference to in either the Special Audit Report or the Performance Audit report.

## 7: Timely and Useful Reports from the District

a) We respectfully request the Board to request staff to prepare timely quarterly reports and annual reports. These reports should provide the level of detail as referred earlier. Currently annual reports appear not to be available until February of the following year. Given the year-end is June 30 it seems to us receiving a report 7 or 8 months after the end of the year is not timely, yet because our role is to draw a conclusion as to compliance with Article XIII A, Section 1(b)(3) time is not critical, unless there is a shortage of District funds to replace improper expenditures. Thus we would hope the Board requests of the District to provide us with quarterly reports with sufficient detail so we can monitor the use of bond proceeds while waiting for the annual reports. Having quarterly reports would help us in reviewing annual reports.

b) We respectfully request the Board to request staff to distribute in a timely manner beginning November 1, 2009 to our Chairperson (or designee) one copy of all District information and reports provided to the Measure BB Advisory Committee, as well as reports completed by that Committee to the District. Being so informed can only strengthen our citizen oversight capacity.

c) At its first meeting on April 9, 2008 the Committee was given the SMMUSD Draft Standardized Account Code Structure and there have been several requests since then that the final version be distributed to the Committee, and it has not.

#### 8: Inspections of Measure BB projects

The Committee thus far has not inspected school facilities and grounds for this time period being the start up first year. Our main focus has been elsewhere, as this report discusses. Our future plans are to include such inspections.

#### 9: Committee is officially known by two different names

The Special Audit Report makes reference to us being the 'Measure BB Citizen's Bond Oversight Committee', and this is consistent with the original Board resolution establishing this committee and as such the report is correct. Yet the School web site, and many District references, including minutes of our meetings, has been identified as the 'Proposition 39 Oversight Committee'. The name of the Committee is not consistent and can lead to confusion by the public as to our basic identity. However using that name may cause confusion with the 'Measure BB Advisory Committee'. We should only be referred to formally as the 'Measure BB Citizen's Bond Oversight Committee' as the Board intended. This would be useful if there are future bond issues that require citizen's bond oversight and distinction between measures. All future voter approved measures should not be referred to as the Proposition 39 Committee unless all such bond issues were brought under their oversight responsibility.

#### 10: Meetings

Until October 15, 2009, the Committee was limited to meeting four times a year, or one meeting per quarter. We found this to be a constraint causing delays in meeting our mission on a timelier submission of this report.

### Overall Summary:

While we did not find any evidence that any Measure BB Funds were not properly spent, we cannot conclude with certainty one way or the other if the District is in compliance with the requirements of Article XIII A, Section 1(b)(3) of the California Constitution for the year ending June 30, 2008. The District cannot identify the amounts of bond proceeds cash balances, nor bond proceeds expenditures on Measure BB projects due to the commingling of bond proceeds with non-bond proceeds sources of financing such as Developer Fees.

In the Committee's opinion we have identified material errors in the Special Audit Report that weakened our confidence relying on its information that need to be corrected in future Reports to be more useful and accurate. We are concerned about investments of cash, under allocation of interest earnings, and borrowing of such cash by the District for non-measure BB uses. We therefore recommend that District check with legal counsel relative to cash, investments of cash and the scope of the Committee's oversight responsibilities, as well as segregation of cash from other District cash, and establishment of a restricted Measure BB fund that would be presented in the annual District Audit Report. Certain information requests that the District committed to have not been received including details of one million dollars transferred to the General Fund.