DEPARTMENT OF FINANCE

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Transmitted via e-mail

August 5, 2016

Ms. Lisa Silverman, Executive Officer
Department of General Services
Office of Public School Construction
707 Third Street
West Sacramento, CA 95605

Dear Ms. Silverman:

Final Report—Department of General Services, Office of Public School Construction's Proposition 1D Bond Fund Audit

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its audit of the Office of Public School Construction's (OPSC) Proposition 1D bond funds.

The enclosed report is for your information and use. OPSC's response to the report findings and our evaluation of the response are incorporated into this final report. This report will be placed on our website.

A detailed Corrective Action Plan (CAP) addressing the findings and recommendations are due within 60 days from receipt of this letter. The CAP should include milestones and target dates to correct all deficiencies. Please e-mail the CAP to OSAEReports@dof.ca.gov.

We appreciate the assistance and cooperation of OPSC. If you have any questions regarding this report, please contact Diana Antony, Manager, or Mindy Patterson, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

Jennifer Whitaker, Chief
Office of State Audits and Evaluations

Enclosure

cc: Mr. Daniel C. Kim, Director, Department of General Services
Mr. Rick Asbell, Chief, Fiscal Services, Department of General Services
Mr. Rick Gillam, Chief, Office of Audit Services, Department of General Services
Ms. Eraina Ortega, Chair, State Allocation Board

Audit Report

Office of Public School Construction
Proposition 1D

Prepared By:
Office of State Audits and Evaluations
Department of Finance

151760135

June 2016

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Final reports are available on our website at http://www.dof.ca.gov

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EXECUTIVE SUMMARY

In accordance with the Department of Finance's (Finance) bond oversight responsibilities, the Office of State Audits and Evaluations audited the Department of General Services, Office of Public School Construction's (OPSC) Proposition 1D bond funds expended under the School Facility Program (SFP).

In November 2006, California voters passed Proposition 1D, the Kindergarten-University Public Education Facilities Bond Act of 2006, providing $7.3 billion for SFP projects. As of September 2015, approximately 2,900 projects representing over $6.7 billion have been funded.

The State Allocation Board (SAB) is responsible for authorizing the allocation of bond funds for SFP projects and establishing program policies and regulations. As staff to the SAB, OPSC implements and administers the SFP. OPSC's primary responsibilities include reviewing and processing funding applications, proposing and drafting regulatory and policy changes, and performing expenditure and compliance audits. As such, the SAB and OPSC are jointly responsible for establishing and implementing effective program accountability and oversight.

Our audit focused on reviewing the corrective actions reported to address our June 2011 audit report findings and recommendations. The June 2011 audit objectives included determining if 1) bond funds were awarded and expended in compliance with applicable legal requirements and established criteria, and 2) adequate project monitoring processes are in place to ensure projects are within scope and cost, and achieved the intended outcomes.

We acknowledge OPSC's efforts to implement oversight and accountability measures for Proposition 1D funds, including establishing key bond accountability measures such as comprehensive program guidelines, an audit risk assessment plan, and detailed audit guides and procedures. However, corrective actions for three of the six prior audit findings have not been implemented despite repeat recommendations. The three uncorrected audit findings are as follows:

- Statutorily required expenditure audits have not been performed since the passage of Proposition 1D in 2006. As of September 2015, 1,533 projects representing over $3 billion in Proposition 1D funds have been closed without an expenditure audit to determine program compliance, expenditure eligibility or total project savings. Although OPSC has performed 102 comprehensive project desk reviews, their efforts to conduct on-site expenditure audits have been unsuccessful.

- Regulatory changes to the Financial Hardship program have not been implemented. Since 2006, various state entities have recommended regulatory changes to ensure funds are awarded to only those school districts (districts) that demonstrate *extreme financial hardship* conditions. However, despite OPSC's multiple efforts to bring forth policy and regulatory changes, the recommended changes have not been approved by the SAB and therefore have not been implemented.

- Project savings (unused bond funds) data continues to be inadequately tracked. As of January 2016, OPSC reported over $197 million (state and district share) in unused project savings; however, because OPSC does not audit or adequately monitor usage, the data is inaccurate and unreliable.

To assess the impact of not conducting expenditure audits, we performed a limited review of 19 Proposition 1D funded projects at 10 districts. Based on our reviews, we noted the following:

- Ineligible program costs totaling approximately $3 million were identified in 5 of 10 districts reviewed. We found instances where districts inappropriately used bond funds to purchase a Chevrolet truck, two tractors, four golf carts, iPads, athletic uniforms, band uniforms, a mascot uniform, and custodial/cleaning supplies.

- Although statutorily required, districts are not required to repay ineligible costs identified during an expenditure audit or desk review. Instead, the current practice allows districts to retain ineligible costs as “project savings” for use on future capital projects.

- As a result of the practice above, state bond funds used for ineligible expenditures are included in the current non-financial hardship project savings balance totaling an estimated $192 million (state and district share). The $192 million resides with districts with no timetable for usage. Additionally, project savings retained by a district is not offset against new project funding.

In summary, the audit findings in this report illustrate a lack of fiduciary responsibility over bond funds. SAB and OPSC are jointly responsible for establishing and implementing effective program accountability and oversight, including ensuring corrective actions to address audit findings are timely developed and implemented. Consequently, this SFP governance structure has hindered the efficient and effective implementation of fiscal and accountability controls necessary for bond accountability and oversight. As indicated in the Governor’s 2016-17 Budget, the state has noted significant concerns with the current school facility program and has proposed developing a new program in collaboration with the Legislature and education stakeholders. In doing so, we strongly recommend the audit findings raised in this report be considered during the development of a new school facility program.

However, with approximately $4 billion in Proposition 1D funds subject to audit and over $197 million in unused savings/ bond funds (state and district share), it is imperative that the required statutory audits and oversight activities be performed. Further, because the recommended changes to the financial hardship program have not been made, OPSC should propose the SAB suspend future financial hardship funding until such regulatory changes are approved and implemented.

OPSC must develop a corrective action plan to address the findings and recommendations noted in this report.

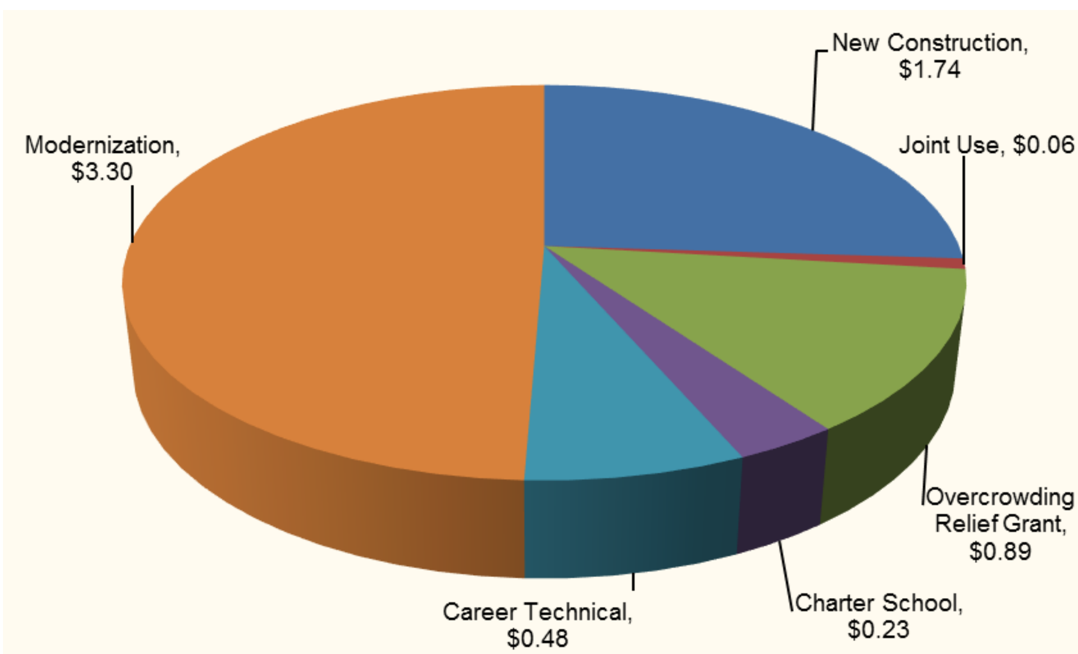
BACKGROUND, SCOPE AND METHODOLOGY

BACKGROUND

In November 2006, California voters passed Proposition 1D, the Kindergarten-University Public Education Facilities Bond Act of 2006, providing $10.4 billion in general obligation bonds for construction and renovation of educational facilities. Of the $10.4 billion, $7.3 billion was earmarked for kindergarten through twelfth grade (K-12) projects.

The School Facilities Program (SFP) provides state funding for local education agencies' (LEA)[1] K-12 school facility construction and modernization. The SFP also contains provisions for charter schools, career technical education facilities, overcrowding relief, joint-use, and seismic mitigation. Since 1998, several general obligation bonds have provided over $35 billion for school facilities, including $7.3 billion in Proposition 1D. As of September 2015, Proposition 1D has funded more than 2,900 projects representing over $6.7 billion as shown in Figure 1. Currently, no bond authority remains in the state's primary school facility programs: new construction and modernization.

Figure 1: Fund Expenditures by Program as of September 2015
(Dollars in Billions)



[1] LEAs include all school districts, county offices of education, and charter schools.

State Allocation Board

The State Allocation Board (SAB) is responsible for authorizing the allocation of bond funds for K-12 new construction, modernization, and various other SFP projects. It is also responsible for establishing policies and regulations for the programs authorized under each bond act and administered by the Office of Public School Construction (OPSC). The SAB is comprised of the Director of the Department of Finance, the Director of the Department of General Services, the Superintendent of Public Instruction, three members of the Senate, three members of the Assembly, and one Governor appointee.

Office of Public School Construction

As staff to the SAB, and under the authority of the Department of General Services, OPSC implements and administers the SFP. Some of its primary responsibilities include reviewing and processing funding applications, proposing and drafting regulatory and policy changes, and performing SFP compliance and expenditure audits.

Executive Order S-02-07[2] was signed to establish guidelines and procedures for spending strategic growth plan bond funds efficiently, effectively, and in the best interests of Californians. The executive order directs government agencies administering bond funds to institute a three-part accountability structure that includes front-end, in-progress, and follow-up accountability. In response to the executive order, OPSC developed a three-part accountability plan outlining their audit and oversight policies and procedures.

SCOPE

In accordance with the Department of Finance's (Finance) bond oversight responsibilities, the Office of State Audits and Evaluations audited OPSC's Proposition 1D bond funds expended under the SFP. Our audit focused on reviewing the status of OPSC's corrective actions reported to address our June 2011 audit report findings and recommendations.[3] The June 2011 audit objectives included determining if 1) bond funds were awarded and expended in compliance with applicable legal requirements and established criteria, and 2) adequate project monitoring processes are in place to ensure projects are within scope and cost, and achieved the intended outcomes.

METHODOLOGY

To meet the audit objectives described above, we performed the following procedures:

- Reviewed the applicable Education Code provisions, Proposition 1D bond act, SFP regulations, policies, procedures, and guidelines.

- Interviewed OPSC management and key staff responsible for administering bond funds to obtain an understanding of how OPSC oversees the various project stages and how reported corrective actions have been implemented.

[2] Source: http://gov.ca.gov/news.php?id=5248
[3] An Audit of Bond Funds, Office of Public School Construction Proposition 1D, June 14, 2011, #10-1760-073 can be located at www.dof.ca.gov.

- Selected and reviewed 19 SFP projects[4] at 10 school districts totaling over $300 million in Proposition 1D funding. The projects were selected from the new construction and modernization programs because the two programs accounted for over 71 percent of the K-12 Proposition 1D funding. The reviews were performed to determine if project expenditures were allowable and supported. We did not review information maintained at the contractor/subcontractor level. See Appendix B for a summary of projects reviewed and Appendix C for program criteria used during the project reviews.

- Interviewed school district staff responsible for administering bond funds to gain an understanding of district oversight practices and procedures of the various school construction stages.

- Reviewed OPSC's process to determine project outcomes. OPSC relies on final inspection reports from the Division of the State Architect (DSA) to determine if the project's intended outcome was achieved. We reviewed DSA's signed final inspection reports, notice of completions filed by the school districts, and contractor's final verified reports. In addition, we performed site visits of the 19 projects to verify existence.

- Reviewed the information reported on the Strategic Growth Plan Bond Accountability website and verified the website is regularly reconciled to internal accounting records.

In conducting our audit, we obtained an understanding of OPSC's internal controls, including any information systems controls that we considered significant within the context of our audit objectives. We assessed whether those controls were properly designed and implemented. Any deficiencies in internal control that were identified during our audit and determined to be significant within the context of our audit objectives are included in this report.

In performing this audit, we relied upon reports generated from the SFP project closeout database, eligibility database, substantial progress and expenditure reporting database, CalSTARS, and the financial hardship savings tracking spreadsheet. *Government Auditing Standards* require us to assess the sufficiency and appropriateness of computer processed information that is used to support our findings, conclusions, or recommendations.

To assess the reliability of the reports generated from the various databases and the financial hardship savings tracking spreadsheet, we interviewed OPSC management and staff responsible for maintaining the databases and observed the use and maintenance of the financial hardship savings spreadsheet. Further, we reviewed a selection of site development applications and projects in various stages of review. We also reviewed spreadsheet and report data for missing data and obvious errors and traced a sample of data elements to source documents. When we found discrepancies (such as data entry errors), we brought them to OPSC management's attention and worked with OPSC management to correct the discrepancies before conducting our analyses. With the exception of project savings data, we determined the reports and spreadsheets were sufficiently reliable for the purposes of our report.

[4] The selected projects had not yet been closed by OPSC.

The results of our project savings data testing identified data accuracy errors. Therefore, the savings data was not sufficiently reliable. As a result, we have included the inaccuracy of the data as an audit finding in this report.

Except as discussed in the following paragraph, we conducted this performance audit in accordance with generally accepted government auditing standards. 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 objectives.

Finance and OPSC are both part of the State of California's Executive Branch. As required by various statutes within the California Government Code, Finance performs certain management and accounting functions. Under generally accepted government auditing standards, performance of these activities creates an organizational impairment with respect to independence. However, Finance has developed and implemented sufficient safeguards to mitigate the organizational impairment so reliance can be placed on the work performed.

The Department of Finance, Office of State Audits and Evaluations (Finance), reviewed the corrective actions reported by the Office of Public School Construction (OPSC) to address the six findings and related recommendations identified in Finance's June 2011 audit report.[1] See Appendix A for corrective action detail. Table 1 below summarizes the status of the corrective actions.

The State Allocation Board (SAB) and OPSC have not implemented corrective actions for three of the six prior audit findings despite repeat recommendations from various entities since 2006. The failure to implement corrective actions impedes the SAB's and OPSC's ability to ensure bond proceeds are expended in accordance with statutory and regulatory requirements. The three uncorrected audit findings are considered materially significant because they represent key bond accountability and oversight responsibilities.

We acknowledge OPSC's efforts to implement certain bond oversight and accountability measures. For example, OPSC established several key bond accountability measures, such as a bond accountability plan, comprehensive program guidelines, audit risk assessment plan, audit guide and procedures, *Advisory Action* newsletters to alert school districts (districts) of any new laws and regulations, and conducted statewide workshops and outreach meetings to assist districts. Additionally, OPSC requested and received additional audit positions in fiscal year 2008-09 to address increased audit workload and since then has maintained an average of 36 audit positions through June 2015.

However, as described in Finance's January 2009 report,[2] SAB and OPSC are jointly responsible for establishing and implementing effective program accountability and oversight, including ensuring corrective actions to address audit findings are timely developed and implemented. Consequently, this SFP governance structure has hindered the efficient and effective implementation of fiscal and accountability controls necessary for bond accountability and oversight.

Table 1: Summary of Corrective Action Status

June 2011 Audit Finding	Corrective Action Implemented	Reference
Funding Approval Process Needs Improvement	Yes	n/a
Additional Project Closeout Audits Should be Performed	No	Findings 1, 2, 3, 4
Insufficient Tracking and Collection of Accounts Receivable	Yes	n/a
Expenditure Reporting Not Enforced and Project Savings Are Inadequately Tracked	Partial	Finding 4
Improvements Needed to Meet Executive Order Accountability Requirements	Yes	n/a
Prior Follow-Up on Financial Hardship Equity Issue and Need For Regulatory Change	No	Finding 5

[1] An Audit of Bond Funds, Office of Public School Construction Proposition 1D, June 14, 2011, #10-1760-073.
[2] Interagency Agreement Closeout, Office of Public School Construction Training and Interim Project-Monitoring Program, January 16, 2009, #09-1760-004

To assess the impact of not conducting expenditure audits during the project closeout process, we performed a limited review of 19 district projects funded by Proposition 1D. Based on our review, we identified approximately $3 million in ineligible program costs, inadequate accountability of project savings data and several instances of non-compliance with statutory and regulatory requirements as described in Findings 1 through 4 below. Results of the school district reviews are summarized in Appendix B.

Finding 1: No Expenditure Audits for Over $3 Billion Proposition 1D Funding

OPSC has not performed statutorily required expenditure audits since the passage of Proposition 1D in 2006. Despite repeat recommendations to conduct audits by several state entities, as of September 2015, 1,533 projects representing over $3 billion in Proposition 1D funds have been closed without an expenditure audit. Although OPSC has performed 102 comprehensive project desk reviews, their efforts to conduct on-site expenditure audits have been unsuccessful.

Education Code section 17076.10(a) and SFP regulation section 1859.106 require audits to determine program compliance, expenditure eligibility, and total project savings. Specifically, SFP regulation section 1859.106 states, "The projects will be audited to assure that the expenditures incurred by the district were made in accordance with the provisions of Education Code…" In addition, the Governor's Executive Order S-02-07 (bond executive order) requires all departments administering bond proceeds to ensure all bond expenditures are subject to audit.

OPSC Audit Risk Assessment Plan

High = Expenditure audit
On-site audit to verify expenditure compliance with applicable laws and regulations and determine project intended outcome was achieved.

Medium = Desk review
In-office review of requested documents including contracts and invoices. No auditing standards followed.

Low = Management Survey Review (MSR)
Project expenditures accepted as *reported* by the districts. Project is closed without expenditure verification.

In 2008, OPSC developed an audit risk assessment plan to efficiently allocate audit resources to areas deemed as high risk. As noted in the text box, projects identified as high risk require an on-site expenditure audit, medium-risk projects require a desk review, and low-risk projects are closed and accepted as reported by the district.

However, as shown in Figure 2, regardless of the assessed risk level, the majority of projects were closed without an expenditure audit or desk review. Per OPSC's audit risk assessment plan, 581 of the 1,533 closed projects were rated as high-risk; however, the required expenditure audits were not performed. Although OPSC's desk reviews are comprehensive and are a valid form of oversight, the reviews should be performed in accordance with the established risk assessment plan and in addition to expenditure audits. In addition, in accordance with industry best practices, audits should be conducted in accordance with auditing standards which provides a framework for high quality audits.

Figure 2: Proposition 1D Project Closeouts
As of September 2015

	Expenditure Audits	*Desk Reviews*	*MSRs*	*Subtotal*
High Risk	0	95	486	581
Medium Risk	0	1	187	188
Low Risk	0	6	758	764
Total	0	102	1,431	1,533

Source: OPSC Fiscal Services Unit.

The failure to perform statutory audits demonstrates a significant lack of accountability over bond funds and is contrary to the assurances provided in the 2006 Proposition 1D ballot literature, as noted in the text box.[3]

VOTE YES ON 1D: STRICT ACCOUNTABILITY PROVISIONS

Every dollar must be strictly accounted for on a project-by-project basis with independent state and local audits. Misuse of funds is a crime, punishable by imprisonment.

Source: Proposition 1D, Official Ballot Measure Summary

Additionally, the bond executive order specifically requires all agencies administering bond funds to ensure all bond proceeds are spent efficiently, effectively and in the best interests of the people of the State of California.

Further, several state entities have repeatedly recommended OPSC conduct audits in accordance with *Government Auditing Standards* as noted in Table 2. Yet after nine years, on-site expenditure audits following applicable audit standards have not been performed.

Table 2: Repeat Recommendations to Conduct Audits

Date	State Entity	Conclusion and Recommendation
January 2009	Finance	OPSC's desk reviews lack sufficient oversight. **Recommends** OPSC to acknowledge the impediments and make suggestions for improvement. *Audit Report dated January 16, 2009.*
August 2009	California State Auditor	Confirms **audits should follow *Government Auditing Standards*.** *SAB Hearing August 11, 2009.*
January 2010	Attorney General's Office	Confirms OPSC audit authority and concludes OPSC may contract for auditing services. *Letter dated January 25, 2010.*
June 2010[4]	Finance	Concludes no audit "redundancies" exist between the proposed SFP expenditure audits and other required district audits. **Recommends audits in accordance with *Government Auditing Standards***. *Report dated June 18, 2010.*
September 2010	Department of General Services	Directs OPSC to implement an independent audit program **in accordance with *Government Auditing Standards***. *Letter dated September 1, 2010.*
October 2010	SAB (Audit Sub-Committee)	**Recommends audits in accordance with *Government Auditing Standards*.** *SAB hearing November 3, 2010.*
June 2011	Finance	**Recommends audits in accordance with *Government Auditing Standards*.** *Audit report dated June 14, 2011.*

[3] Although audits of local bond funds were performed, expenditures for capital projects funded through State funding sources were specifically excluded in the local bond audit's scope of work.
[4] Management Letter, Department of General Services, Office of Public School Construction School Facilities Program, Review of Potential Audit Duplication, June 18, 2010.

When asked why on-site expenditure audits have not been performed, OPSC stated there were various reasons, including redirection of staffing resources to other program priorities and unavailable external state auditing resources. However, with audit staffing levels averaging 36 staff between 2007-08 and 2014-15, it remains unclear why SAB and OPSC have been unable to conduct on-site expenditure audits. SAB and OPSC have the fiduciary responsibility to comply with program statutes and regulations by developing and implementing effective internal controls including bond accountability and oversight measures.

Auditing provides critical oversight and monitoring, and is essential in providing accountability and transparency over government programs. Audits also provide objective analysis to assist management and those charged with governance in using the information to improve program performance and operations, facilitate decision making, reduce costs, and contribute to public accountability. As of September 2015, approximately $4 billion in Proposition 1D projects remain subject to audit.

Recommendations:

To meet the executive order and statutory requirements, expenditure audits in accordance with *Government Auditing Standards* should be performed. OPSC should work with SAB and Finance to assess and develop a comprehensive plan to audit the remaining bond funds including reevaluating the risk assessment plan to focus on high risk program issues, and clearly define and designate the audit or review activity to be performed for each assessed level of risk.

If OPSC is unable to conduct the statutorily required expenditure audits, auditing services should be contracted with an external auditing entity (state or non-state).

To assess the effectiveness of OPSC's audit activities and ensure program transparency, OPSC should submit an annual report to the SAB, starting with the period July 1, 2016, detailing the following:

- Total SFP Proposition 1D project workload subject to audit, including assigned projects, unassigned projects, and active projects.
- Total on-site expenditure audits and desk reviews performed, the current status (in-progress or complete), and the final resolution and disposition of findings including any questioned (ineligible or unsupported) costs identified.
- If no on-site expenditure audits have been performed, a detailed description of why audits have not been performed including the efforts made to perform the audits and the number of staff positions redirected from performing audits to other program areas.

To promote SFP transparency, all audits and desk review reports issued should be posted to the OPSC website.

Finding 2: Expenditure Reviews Identified $3 Million in Questioned Costs

To assess the impact from the lack of expenditure audits, we performed a limited review of 19 projects at 10 districts using SFP's established program criteria (see Appendix C). See Appendix B for a summary of projects reviewed.

Our review identified 5 of 10 districts reported ineligible and unsupported (questioned) project costs totaling approximately $3 million, as summarized in Table 3.

Although statutorily required, OPSC's current practice will not require the districts referenced below to repay the questioned costs identified. See Finding 3 for further details.

Table 3: Summary of School District's Questioned Costs

School District[5]	Total Questioned Costs	Cost Description
School District A	$ 1,093,414	Furniture and equipment, including a Chevrolet truck, 2 tractors, 4 golf carts, 23 cameras, athletic team apparel & supplies, mascot and band uniforms, student desktops, teacher laptops, custodial/operational supplies, and maintenance equipment (vacuums, carpet cleaners, blowers)
School District B	$ 870,618	District labor, materials, vendor costs, and furniture and equipment (iPads, Apple TV devices)
School District C	$ 405,593	Reporting errors including costs for a different school site and contractor costs claimed twice
School District D	$ 397,308	District labor, materials, vendor costs, furniture and equipment including an industrial floor cleaner and other unsupported items
School District E	$ 213,415	Furniture and equipment, including textbooks, school training fees, and landscaping equipment and supplies
Total	**$2,980,348**	

The following is a detailed description of the questioned costs.

Furniture and Equipment

Districts claimed ineligible furniture and equipment costs totaling over $1.5 million. In some instances, the districts could not provide supporting documentation such as vendor invoices and warrants to verify costs were project related and paid. However, for the majority of instances, districts claimed *ineligible* furniture and equipment.

Education Code sections 17072.35 and 17074.25 outline eligible project costs as those costs that can be reasonably attributed to the construction project. Further, as noted in the text box, specific criteria for furniture and equipment is included in the SFP Audit Guide and the California State Accounting Manual (CSAM) Procedure 770, *Distinguishing Between Supplies and Equipment*. Lastly, OPSC also periodically provided guidance in their *Advisory Actions* district newsletters. The *May/June 2006 Advisory Action* outlined the same criteria noted in the text box, provided examples of eligible and ineligible furniture and equipment, and specifically advised districts to use CSAM as their guide to determine if an expenditure is capital outlay.

Furniture and Equipment Criteria:

- Lasts more than one year
- Typically repaired rather than replaced
- Independent unit
- Exceeds the minimum dollar value of capitalization threshold established by the district (minimum $5,000)

Capitalized equipment is an allowable expenditure; supplies are *not* allowable expenditures.

Source: SFP Audit Guide & CSAM Procedure 770

[5] District names are not included in this report as the scope of this audit is focused on OPSC's administration and oversight of bond funds.

Based on the guidelines, motorized vehicles such as a Chevrolet truck, tractors, and golf carts are not *reasonably attributed* to the construction of a school project. Operational expenses such as athletic uniforms, teacher and student textbooks, and various custodial and maintenance items are supplies, which are ineligible. In some instances, we found that districts recorded the operational costs as supplies in their accounting records; however, the districts reported these same costs as “capitalized items” for SFP purposes.

Lastly, the unit cost of an iPad and/or laptop falls below the $5,000 capitalization threshold, thus making it ineligible. Although districts may choose to capitalize large groups when furnishing a newly constructed library or computer room, the questioned costs noted in Table 3 were not related to the construction or modernization of a computer room. Specifically CSAM 770 states:

> *LEAs may choose to capitalize groups of items acquired at the same time that do not meet the threshold for capitalization individually. Examples might include major acquisitions of library books for a new library or large quantities of computers for an entire computer laboratory. However, <u>unless the group of items would represent a very significant</u> asset for the LEA, <u>it is not recommended that groups of items whose unit cost does not meet the capitalization threshold be capitalized</u>.*

In summary, if the per unit cost is below the capitalization threshold, it is considered materials and supplies, not capital outlay. Moreover, using long-term financing to purchase short life cycle items is not fiscally prudent given that taxpayers will be paying for debt financing for over 30 years, which is long after the 3- to 5-year useful life of electronics such as iPads and laptops.

As noted in the text box, the state’s current economic condition warrants the establishment and implementation of prudent fiscal policies by all state agencies administering bond funds.

$50 Billion Owed on K-12 Facility Bonds

As of 2015, the state still owes more than $50 billion in principal and interest on K-12 school facility bonds dating back to 1988. According to the state Treasurer, the state will pay an average $1.7 billion in General Fund revenue annually until the outstanding debt is paid off (expected to occur in 2044).

Source: The 2015-16 Budget: Rethinking How the State Funds School Facilities, Legislative Analyst Office, February 2015

District Costs

Districts claimed various unsupported costs totaling over $1 million. For example, one district claimed estimated maintenance costs rather than using actual costs incurred. According to the district, they have historically used the quoted and/or estimated costs, specifically stating that this was their standard practice. In another case, the district stated the expenditure records were destroyed in accordance with their record retention policies. Additionally, one district claimed labor costs but could not support the costs with timesheets or other personnel activity reports.

SFP regulation 1859.106 requires districts to maintain all appropriate records that support all district expenditures associated with SFP projects for a period of not less than four years from the date the notice of completion is filed for the project in order to allow other agencies, including, without limitation, the California State Auditor and the California State Controller to perform their audit responsibilities.

CSAM Procedure 905, *Documenting Salaries and Wages Charged to Restricted Programs,* requires specific documentation to support charges to specific funding sources (resources), instructional settings (goals), and activities (functions). Specifically, it requires some level of formalized time documentation and reminds districts that written policies and procedures are essential to implementing an effective labor distribution system. Districts must develop a time documentation process that meets their particular needs (e.g. employee training forms, timekeeping internal controls, and compliance checks).

The lack of on-site expenditure audits increases the risk of fraud, waste, and abuse and greatly compromises the SAB and OPSC's ability to ensure state bond funds are spent in accordance with statutory and regulatory requirements.

Recommendations:

We reiterate the necessity of conducting expenditure audits and implementing effective oversight activities as denoted in Finding 1. Further, the districts should be required to repay the $3 million in questioned costs identified during our reviews, unless statutorily prohibited due to passage of time.

Finding 3: Questioned Costs Identified Are Not Required to be Repaid

Although statutorily required, OPSC does not recommend school districts repay questioned costs found during an expenditure audit or desk review. As reported in Finding 2, we identified approximately $3 million in ineligible costs at five districts; however, OPSC will not recommend repayment of the ineligible costs. Moreover, under certain circumstances, OPSC may determine the state owes a district additional bond funding instead of offsetting against identified questioned costs.

Districts are required to submit a final expenditure report detailing final project costs. In some instances, when expenditures exceed the project budget, districts report an "overspent amount." Conversely, when expenditures are less than the project budget, districts report "project savings." In either circumstance, if an audit or desk review identifies questioned costs, the district will not be required to repay the questioned costs. Instead, OPSC will subtract the questioned costs from the reported project expenditures thus creating either a greater amount of savings or reducing the overspent amount.[6]

For example, in 2013, School District A reported total project savings of $14.8 million for the projects we reviewed (see Table 4); however, the school district will not be required to repay the $1.1 million questioned costs identified in Finding 2. Instead, following its current practice, OPSC will reduce total reported project expenditures by the questioned amount (called "audit adjustment"), thus increasing the amount of project savings. School District A's total project savings will increase from $14.8 to $15.9 million. As a result, despite having used SFP funding for ineligible expenditures, the district will be allowed to retain the $15.9 million for future capital needs.

[6] The audit adjustments do not include any site-related adjustments.

Table 4: Disposition of Questioned Costs for School District A

School Site	Project Funding* A	Reported Expenditures B	Savings C=(A-B)	Audit Adjustment (Questioned Costs) D	Revised Expenditures E=(B-D)	Increased Net Savings F=(A-E)
Project A.1	$106,879,524	$ 93,953,349	$ 12,926,175	($1,001,284)	$92,952,065	$13,927,459
Project A.2	5,673,616	4,113,429	1,560,187	(92,130)	4,021,299	1,652,317
Project A.3	4,634,265	4,338,864	295,401	0	4,338,864	295,401
TOTAL:	**$117,187,405**	**$102,405,642**	**$ 14,781,763**	**($1,093,414)**	**$101,312,228**	**$15,875,177**

*Amount includes interest earned on state funds.

We question OPSC's practice and the lack of compliance with SFP statutory requirements. Education codes and SFP regulations require repayment of questioned costs identified during a desk review or expenditure audit.

Education Code section 17076.10(c)(1) states, "If the board, after the review of expenditures or audit has been conducted pursuant to subdivision (a), determines that a school district failed to expend funds in accordance with this chapter, the department shall notify the school district of the amount that must be repaid…"

Additionally, the SFP Application for Funding form (SAB 50-04) specifically states, "The district understands that some or all of the State funding for the project must be returned to the State as a result of an audit pursuant to sections 1859.105, 1859.105.1, 1859.106…"

SFP regulation 1859.106.1 states, "Upon adoption of the audit findings by the Board and in lieu of the collection procedures outlined in Education Code section 17076.10(c)(1), a school district, county office of education, or Charter School may request a repayment schedule of up to five years, in equal annual installments, if the total repayment of State funds within 60 days of the Board action would cause the school district, county office of education, or Charter School to fall into fiscal distress. School districts (et al) requesting a repayment schedule must be in a severe hardship condition…. The repayment schedule shall include interest at the same rate as that earned on the State's Pooled Money Investment Account on the date a repayment schedule is approved by the Board."

Further, project savings is intended to be an incentive for those districts that implemented cost efficiencies. Specifically, Education Code section 17070.63(c) states, "Any savings achieved by the district's <u>efficient and prudent expenditure</u> of these funds shall be retained by the district in the county fund for expenditure by the district for other high priority capital outlay purposes." Allowing districts to retain questioned costs is not an efficient or prudent use of bond funds and is in direct conflict with statutory requirements.

When asked how the statutes above are implemented, OPSC stated that their practice is to focus on the "eligible expenditures." According to OPSC, repayment of questioned costs would come in the form of additional savings to be used by the districts on future projects. This practice conflicts with SFP statutes and regulations and decreases districts' incentive to ensure all bond funds are spent only on eligible and allowable program costs.

Moreover, as described below, under certain circumstances, a district that used bond funds on ineligible items may receive additional state funding for the same project.

Districts May Be Eligible for Additional Funding Despite Having Used Funds for Ineligible Items

Under OPSC's current practice, a district who is found to have used bond funds on ineligible items may receive additional state funding based on a review of the district's site-related costs. Although SFP regulation 1859.106 allows for adjustments for any differences between the budgeted and actual site-related costs, OPSC does not offset questioned costs with additional site-related funding identified during the same project expenditure review.

In School District A's example, the district reported additional site-related costs that could potentially increase their funding by $720,336. However, instead of offsetting the additional site-related costs with the district's accrued project savings of over $15 million,[7] OPSC will recommend the state provide additional funding of $720,336.

OPSC's practice of not collecting or offsetting questioned costs identified during a review of expenditures conflicts with statutory and regulatory requirements and is not a fiscally prudent practice. Further, no financial consequences exist for districts that spend bond funds on ineligible or unallowable program costs.

Recommendations:

OPSC should ensure compliance with the existing Education Code and SFP regulations that require identified questioned costs be repaid to the state.

Additionally, to determine the impact of not complying with statutes and regulations, OPSC should submit a report to SAB and Finance no later than August 1, 2016, detailing the total questioned costs identified during its desk reviews and the final disposition.

OPSC should offset questioned costs identified during an expenditure desk review or audit with a project's site-related adjustments.

Finding 4: Inadequate Accountability and Oversight of Project Savings

Project savings data (unused bond funds) continues to be inadequately tracked. As of January 2016, OPSC reported over $197 million (state and district share) in unused project savings. We found the savings data maintained by OPSC to be unreliable and inaccurate.

Specifically, the project savings data maintained by OPSC is based on districts' self-reported information that is not always verified at the completion of a project. Additionally, after project completion, districts are required to annually report expenditures until all state and district funding, including savings, are expended. Again, OPSC relies on districts' self-reported information and does not routinely verify, as noted in Finding 1, if districts are using savings in compliance with program statutes. We also observed numerous data entry errors including errors in recording the districts' usage of project savings.

The lack of accountability and oversight of project savings increases the risk that unused bond funds may be inappropriately used. For example, in 2010 OPSC performed a review of one district's outstanding project savings. The district reported project savings totaling $57 million for 103 completed projects. Based on a sample review of 19 projects, OPSC found the district inappropriately transferred $6.5 million in Proposition 1D funds to pay for local debt service. When asked, the district stated the funds were temporarily used and had planned to reimburse the originating fund.

[7] Accrued project savings includes questioned costs as noted in Table 4.

Additionally, under current program statutes, districts are allowed to retain non-financial hardship project savings indefinitely. For example, of the estimated $197 million in project savings noted above, $5 million is related to financial hardship projects, which have a three-year time period for usage. The remaining $192 million has no timetable.

Education Code section 17070.63(c) allows any savings achieved by the *district's efficient and prudent expenditure* to be retained for use on the district's other high priority capital outlay needs; however, there is no timetable to use or declare savings. OPSC records indicate instances where project savings have been outstanding since 2009. In contrast, for financial hardship projects, SFP regulation 1859.103 stipulates a three-year period to use or remit to the state.

Further, a district's unused project savings are not offset against new project funding. OPSC's current practice allows districts to apply and obtain bond funding for new projects without offsetting against the district's unused project savings.

The lack of accountability and oversight of unused project savings, lack of a timetable to declare savings, and not offsetting unused savings against new project funding increases the risk of bond fund misuse and decreases funding opportunities for other districts that have immediate capital project needs.

Recommendations:

To improve accountability and safeguarding of bond funds, OPSC should review and confirm all outstanding project savings for the closed Proposition 1D projects. In addition, for the remaining projects subject to audit or desk review, OPSC should perform procedures to 1) determine the accuracy of self-reported project savings, and 2) verify use of project savings complies with statutes.

To maximize the availability of bond funds for districts with immediate high priority capital needs, OPSC should propose changes to the SFP statutes and regulations. At a minimum, regulatory changes should include a strict timetable for usage of non-financial hardship project savings similar to the financial hardship program.

OPSC should offset new funding requests with a district's unused project savings.

Finding 5: Financial Hardship Equity Issue Not Resolved

The financial hardship program equity issues and regulatory changes have not been resolved or implemented.

The financial hardship program is intended to provide funding to those districts determined unable to provide their matching share of project costs. The program is specifically intended to assist cases of *extraordinary circumstances* and must meet certain criteria as noted in the text box on the following page.

For example, in 2007, the Macias Consulting Group (Macias) reviewed the overall efficiency and effectiveness of the financial hardship program. The report highlighted the following four areas of concern:

- Lack of equity and fairness in the distribution of state facility construction funds. Specifically noting that the current condition was more beneficial to larger districts than smaller districts.

- Indebtedness requirements that caused applicants to unnecessarily take on more debt to qualify for state construction funding.
- Inability to determine the accuracy of financial data submitted by applicants.
- Outdated review process administered by the OPSC reviewers.

Financial Hardship

Education Code 17075.10 states that a school district may apply for hardship assistance in cases of extraordinary circumstances. A school district applying for hardship state funding under this article shall comply with either paragraph (1) or (2).

(1) Demonstrate both of the following: (A) due to extreme financial, disaster-related, or other hardship the school district has unmet need for pupil housing, (B) the school district is not financially capable of providing the matching funds otherwise required for state participation, that the district has made all reasonable efforts to impose all levels of local debt capacity and development fees, and that the school district is, therefore, unable to participate in the program pursuant to this chapter except as set forth in this article.

(2) Demonstrate that due to unusual circumstances that are beyond the control of the district, excessive costs need to be incurred in the construction of school facilities

The Macias report recommended revamping the financial hardship framework, training applicants, implementing program policies, revamping worksheets and instructions, and implementing process improvements. To date, the recommendations have not been implemented.

Additionally, the SAB also recognized the need for policy and regulatory changes and requested OPSC to gather information, develop recommendations, and provide solutions to address the financial hardship inequity issues. Between February 2005 and August 2010, following the guidance from the SAB, OPSC testified on 15 separate occasions to the SAB and Implementation Committee proposing policy and regulation changes. However, despite OPSC's multiple efforts to bring forth policy and regulatory changes, the recommended changes have not been approved by the SAB and therefore, have not been implemented.

Several entities identified the need for regulatory changes; however, to date no significant policy or regulatory changes have occurred, as shown in Table 5.

Table 5: History of Financial Hardship Program Recommendations

Year	Entity	Comments
2005	OPSC	Between February 2005 and October 2005, SAB and OPSC meet multiple times to discuss the financial hardship program inequities.
2007	Macias Consulting Group	Audit report recommends revamping the financial hardship framework, training applicants, implementing program policies, revamping worksheets and instructions, and implementing process improvements.
2008	Legislative Analyst Office	The Legislative Analyst Office's "Analysis of the 2008-2009 Budget Bill" dated February 20, 2008 notes a different approach is needed for the financial hardship program.
2008	OPSC	Between April 2008 and December 2008, OPSC meets with various stakeholders including county offices of education, and school districts to discuss financial hardship program changes needed.
2009	Finance	Finance report dated January 16, 2009 identifies the existence of system control overrides within the financial hardship program.
2011	Finance	Finance audit report dated June 14, 2011 notes no changes have been made to the financial hardship program.

Inequitable distribution of financial-hardship funding decreases available funding for those districts with an immediate capital funding need.

Recommendations:

Implement the proposed regulatory and policy changes to the financial hardship program. OPSC should propose the SAB suspend future program funding until the recommended regulatory changes are approved and implemented.

Conclusion

We acknowledge OPSC's efforts to implement oversight and accountability measures for Proposition 1D funds, including addressing three of the six prior audit findings. However, the failure to implement corrective actions for three significant prior audit findings, instances of non-compliance with statutory and regulatory requirements, and weaknesses in fiscal practices illustrate a significant lack of fiduciary responsibility over Proposition 1D funds.

SAB and OPSC are jointly responsible for establishing and implementing effective program accountability and oversight, including ensuring corrective actions to address audit findings are timely developed and implemented. Consequently, this SFP governance structure has hindered the efficient and effective implementation of fiscal and accountability controls necessary for bond accountability and oversight. As indicated in the Governor's 2016-17 Budget, the state has noted significant concerns with the current school facility program and has proposed developing a new program in collaboration with the Legislature and education stakeholders. In doing so, we strongly recommend the audit findings raised in this report be considered during the development of a new school facility program.

With more than $4 billion in Proposition 1D funds subject to audit and over $197 million in unused project savings/bond funds (state and district share), accountability and oversight must be strengthened to mitigate the risk of fraud, waste, and abuse. It is imperative that required statutory audits and oversight activities be implemented. Additionally, because the recommended changes to the financial hardship program have not been made, OPSC should propose the SAB suspend future financial hardship funding until the regulatory changes are approved and implemented.

Office of Public School Construction (OPSC)
Corrective Action Plan Summary For June 14, 2011 Audit

Audit Observation Reference	Audit Recommendation	OPSC Corrective Action Response and Status[1]	Corrective Action Implemented[2]	Comments
1. Funding Approval Process Needs Improvement	A. Follow the established appeals process for all funding applications.	OPSC has developed additional operating policies and practices which include requirements for thoroughly documenting decisions in OPSC's files. Additionally, the State Allocation Board (SAB) has adopted a formalized appeal process that includes specific benchmarks within the appeals process timeline. OPSC has implemented the appeal process timeline for processing appeals to the SAB. Part of the appeal process is the implementation of a published 90-day workload accessible to stakeholders. Status: Complete	Y	
	B. Develop additional fiscal and programmatic controls to reduce non-compliance.	OPSC has formed a team to reevaluate its existing processes to determine if additional intake activities can be implemented to quickly identify inaccurate, missing and/or incomplete data on an LEA's application submittal prior to forwarding the funding request to professional staff within OPSC's Plan Verification Team. This will allow applications to be corrected and/or rejected in a timely manner. Status: Complete	Y	
	C. Expand outreach to promote a better understanding of the SFP regulations, application review process, required documents, and allowable costs.	OPSC expanded its outreach efforts through the use of Town Hall meetings and webinars in addition to continuing to provide publications and reference materials through its website. OPSC has formed an outreach team whose purpose is to provide assistance to LEA's in submitting accurate funding applications. Status: Complete	Y	

[1] Information reported in OPSC Corrective Action Plans from August 20, 2011 through May 1, 2013.
[2] Legend: Y = Yes, N = No, P = Partially.

Audit Observation Reference	Audit Recommendation	OPSC Corrective Action Response and Status[1]	Corrective Action Implemented[2]	Comments
2. Additional Project Close-Out Audits Should be Performed	A. OPSC should perform more audits as required under SFP regulations and established criteria.	OPSC met with OSAE to seek additional guidance on the number of annual audits that would be considered reasonable based on OPSC's current operating environment. As a result of feedback from the meeting, OPSC revised its risk assessment model and audit program to focus existing audit resources to the highest risk projects. Also, OPSC has identified additional staff resources that can assist audit staff in conducting more audits. Status: Incomplete	N	No expenditure audits have been performed. See Finding 1 in Results Section of this report.
3. Insufficient Tracking and Collection of Accounts Receivable	A. Confirm accounts receivable balances for all bond programs and perform timely reconciliations.	OPSC has established policies and procedures to ensure the maintenance of up-to-date accounts receivable information. Status: Complete	Y	
	B. Collect delinquent receivables and/or offset the LEA's next apportionment.	OPSC continues to verify and pursue receivables that are over 60 days. Status: Complete	Y	
	C. Maintain supporting documentation for all receivable collections, adjustments, and postings.	OPSC has implemented procedures which ensure the maintenance of documentation for all receivable collections, adjustments, and postings. In 2013, OPSC was actively working on the transition to CALSTARS as the replacement for the accounting system. Status: Complete	Y	
4. Expenditure Reporting Is Not Enforced and Project Savings Are Inadequately Tracked	A. Enforce LEA annual expenditure reporting.	A team is evaluating current report oversight processes to identify areas for improvement that can be adopted administratively and to pursue statutory and regulatory changes. Additionally, a communication plan to stakeholders concerning reporting requirements will be developed and implemented. Some methods for communication to stakeholders will include e-mail notifications, content on OPSC website, and articles in various OPSC publications. Status: Complete	Y	
	B. Review and confirm all outstanding project savings and ensure data is periodically reconciled to the accounting records.	OPSC has implemented additional policies and procedures to ensure staff monitors outstanding financial hardship project savings. This process includes audit and accounting staff working closely to ensure that applicable records accurately reflect outstanding balances. Status: Partial	P	Projects savings continues to be inaccurate. See Finding 4 in Results Section of this report.
	C. Timely collect financial hardship (FH) project savings outstanding for more than three years.	OPSC has contacted all districts with FH savings over 3 years for the recoupment of funds due back to the State. OPSC is actively monitoring and enforcing the collection of FH savings that have been retained for over 3 years. Status: Complete	Y	

Audit Observation Reference	Audit Recommendation	OPSC Corrective Action Response and Status[1]	Corrective Action Implemented[2]	Comments
5. Improvements Needed to Meet Executive Order Accountability Requirements	A. Develop additional performance measures that focus on program outcomes related to the beneficiaries of the SFP in order to assess how effective programs are meeting their goals. Performance measures, such as the number of classrooms built or modernized, should be included in the metrics to realize desired results of the SFP.	OPSC has established a team that will review and update the OPSC Strategic Bond Plan to include program goals and developing program metrics. Status: Complete	Y	
	B. Timely post complete project status data on the bond accountability website and reconcile data to internal fiscal and accounting records to ensure accuracy.	OPSC, in conjunction with DOF's Capital Outlay Unit, has linked internal fiscal and accounting data to the bond accountability website. OPSC is taking action to ensure that project specific status information is accessible on the bond accountability website. Programming, testing, and implementation to be complete by June 30, 2013. Status: Complete	Y	
6. Follow Up on Previously Reported Financial Hardship Equity Issue and Need for Regulatory Change	The report recommended the SAB resolve the financial hardship equity funding issues to minimize the risk of inequitable funding.	No changes have been made to the financial hardship program. Status: Incomplete	N	See Finding 5 in Results Section of this report.

Appendix B

Summary of Projects Reviewed

SFP Project by School District	State Share[1]	Project Funding[2]	Reported Expenditures[3]	Questioned Amount
School District A				
Project A.1 (NC)	$ 52,946,661	$105,893,322	$ 93,953,349	$ 1,001,284
Project A.2 (NC)	2,814,000	5,628,000	4,113,429	92,130
Project A.3 (NC)	2,286,900	4,573,800	4,338,864	0
			Subtotal, School District A	$ 1,093,414
School District B				
Project B.1 (M) (FH)	$ 6,131,277	$ 6,178,047	$ 6,205,168	$ 185,183
Project B.2 (M) (FH)	5,184,318	5,300,275	5,375,761	347,335
Project B.3 (M) (FH)	25,815,760	25,815,760	25,811,599	338,100
			Subtotal, School District B	$ 870,618
School District C				
Project C.1 (NC)	$ 23,938,043	$ 47,876,086	$ 61,302,449	$ 405,593
School District D				
Project D.1 (M)	$ 15,115,792	$ 25,192,987	$ 22,156,797	$ 9,058
Project D.2 (M)	14,864,719	24,774,532	24,792,645	375,400
Project D.3 (M)	10,046,260	16,743,767	13,916,742	12,850
Project D.4 (M)	1,627,180	2,711,967	3,649,276	0
			Subtotal, School District D	$ 397,308
School District E				
Project E.1 (NC)	$ 7,957,039	$ 15,914,078	$ 20,177,180	$ 213,415
School District F				
Project F.1 (NC) (FH)	$ 54,956,418	$ 70,382,028	$ 76,918,757	$ 0
School District G				
Project G.1 (NC) (FH)	$ 31,394,077	$ 32,099,762	$ 33,092,663	0
Project G.2 (NC) (FH)	15,506,604	15,511,604	15,862,577	0
			Subtotal, School District G	$ 0
School District H				
Project H.1 (M) (FH)	$ 1,097,553	$ 1,689,005	$ 2,226,523	$ 0
Project H.2 (NC) (FH)	21,296,018	21,296,018	21,524,142	0
			Subtotal, School District H	0
School District I				
Project I.1 (NC) (FH)	$ 20,246,903	$ 20,394,236	$ 19,790,892	$ 0
School District J				
Project J.1 (NC) (FH)	$ 17,105,636	$ 18,229,628	$ 18,485,732	$ 0
Total	**$330,331,158**	**$466,204,902**	**$473,694,545**	**$2,980,348**

FH = Financial Hardship, NC = New Construction, M = Modernization, N/A = Not applicable

[1] State share includes Financial Hardship grant provided by Proposition 1D funds.

[2] Project funding amount includes state and district share. It does not include interest earned on SFP funds.

[3] Source: District 50-06 expenditure reports submitted to OPSC.

Appendix C

Criteria for Evaluating School Facility Program Projects

Category	Criteria	Passing Criteria
Expenditures		
Funding of Project Expenditures	Education Code 17072.35, 17074.25, 17076.10 School Facility Program (SFP) Regulation 1859.79.2, 1859.106, 1859.106.1 California State Accounting Manual Procedures 770 and 905	Expenditures are project-related and comply with SFP regulations and other applicable laws. Matching contributions are project-related and comply with applicable laws and regulations.
Compliance		
Reporting Requirement	Education Code 17076.10; SFP 1859.2, 1859.104	School districts submitted all expenditures reports.
Competitive Bidding Requirement	Department of General Services, State Contracting Manual Chapter 5: Competitive Bidding Methods	Selection of contractor(s) was/were in compliance with SCM and other applicable laws and regulations.
Construction Contracts in Place	Education Codes 17070.50, 17072.30, 17074.15, 17074.15 SFP 1859.2 (Form 50-05)	Binding construction contracts are in place prior to funding release for at least 50 percent of the construction.
Records and Supporting Documents	SFP 1859.106	School districts maintained adequate accounting records and supporting documents for the project expenditures and matching contributions.
Financial Hardship	Education Code 17075.10, 17075.15 SFP 1859.81	Encumbrances reported in financial hardship approval review were liquidated and fund balances were accurately reported.
Project Savings	Education Code 17070.63 SFP 1859.103	District reported project savings usage.
Interest Earned	SFP 1859.2 (Form 50-06)	District reported interest earned on SFP bond funds. Interest earned agreed to district's accounting records.
Deliverables/Intended Outcome		
Construction and modernization of school facilities	State Allocation Board (SAB) agenda and California Department of Education (CDE) approval letter	Intended outcomes listed in SAB agenda and CDE approval letter were consistent with DSA final inspection reports, notice of completions filed by school district, and contractor verification reports.

RESPONSE

DGS
GENERAL SERVICES

MEMORANDUM

Date: July 6, 2016

To: Cheryl L. McCormick, CPA, Assistant Chief
Office of State Audits and Evaluations
Department of Finance
915 L Street
Sacramento, CA 95814

From: **Department of General Services**
Office of Public School Construction

Subject: **RESPONSE TO AUDIT OF PROPOSITION 1D BOND FUNDS**

Thank you for the opportunity to respond to the Office of State Audits and Evaluations' (Finance) audit of the Office of Public School Construction's (OPSC) Proposition 1D bond funding program. The following response addresses each of the recommendations.

OVERVIEW OF THE REPORT

OPSC appreciates Finance's in-depth and professional audit of its accountability processes and controls established for state bond funding provided to local education agencies for K-12 school construction and modernization. As noted in the report, the State Allocation Board (SAB) and OPSC are jointly responsible for establishing and implementing effective program accountability and oversight, including ensuring corrective actions to address audit findings are timely developed and implemented. As part of its continuing efforts to improve operations, OPSC will take appropriate actions to address the areas for improvement presented in the report. As staff to SAB, OPSC is committed to efficiently and effectively implementing and administering the School Facilities Program (SFP), including Proposition 1D bond funds. Since the inception of the SFP in 1998, SAB has apportioned and/or provided unfunded approvals of almost $34 billion to more than 11,000 projects.

In summary, Finance acknowledges OPSC's efforts to implement certain bond oversight and accountability measures related to previous audit findings. However, Finance concluded that additional actions should be taken to ensure the implementation of fiscal and accountability controls necessary for bond accountability and oversight.

Based on the results of its fieldwork, Finance developed the following recommendations to further improve OPSC's bond oversight process. Over the last few years, there have been significant reductions in OPSC's budget to align resources with projected workload. Overall, to ensure the efficient and effective use of state resources, OPSC believes it is prudent to defer any action that may be taken on most of Finance's recommendations pending the results of the November 2016 vote on the K-12 bond initiative.

RECOMMENDATIONS

Finding 1: No Expenditure Audits for Over $3 Billion Proposition 1D Funding

RECOMMENDATION 1: ***To meet the executive order and statutory requirements, expenditure audits in accordance with Government Auditing Standards should be performed. OPSC should work with SAB and Finance to assess and develop a comprehensive plan to audit the remaining bond funds including reevaluating the risk assessment plan to focus on high risk program issues, and clearly define and designate the audit or review activity to be performed for each assessed level of risk.***

RESPONSE 1:

If the K-12 bond initiative is approved in November, OPSC will initiate discussions with Finance to reevaluate the current Risk Assessment Model to ensure a focus on high risk program issues. Regarding the issue of including audits in this model, as Finance is aware, OPSC has on a number of occasions pursued the implementation of an on-site expenditure audit activity within the SFP.

RECOMMENDATION 2: ***If OPSC is unable to conduct the statutorily required expenditure audits, auditing services should be contracted with an external auditing entity (state or non-state).***

RESPONSE 2:

If the K-12 bond initiative is approved in November, OPSC will explore the various methods for auditing/reviewing the proper use of bond funds based on the resources available for this activity. In the past, OPSC has been unsuccessful in contracting with Finance and the State Controller's Office to perform on-site expenditure audits.

RECOMMENDATION 3: ***To assess the effectiveness of OPSC's audit activities and ensure program transparency, OPSC should submit an annual report to the SAB, starting with the period July 1, 2016, detailing the following:***

- ***Total SFP Proposition 1D project workload subject to audit, including assigned projects, unassigned projects, and active projects.***
- ***Total on-site expenditure audits and desk reviews performed, the current status (in-progress or complete), and the final resolution and disposition of***

findings including any questioned (ineligible or unsupported) costs identified.

- ***If no on-site expenditure audits have been performed, a detailed description of why audits have not been performed including the efforts made to perform the audits and the number of staff positions redirected from performing audits to other program areas.***

RESPONSE 3:

If the K-12 bond initiative is approved in November, OPSC will initiate discussions with SAB on its interest in the recommended annual report on OPSC audit/review activities. If SAB decides that the report would add programmatic value, OPSC will begin collecting data and submit a report to SAB based on a to be determined timeline.

RECOMMENDATION 4: ***To promote SFP transparency, all audits and desk review reports issued should be posted to the OPSC website.***

RESPONSE 4:

In the near future, OPSC will begin posting all desk reports to its website.

Finding 2: Expenditure Reviews Identified $3 Million in Questioned Costs

RECOMMENDATION: ***We reiterate the necessity of conducting expenditure audits and implementing effective oversight activities as denoted in Finding 1. Further, the districts should be required to repay the $3 million in questioned costs identified during our reviews, unless statutorily prohibited due to passage of time.***

RESPONSE:

OPSC will follow-up with the districts audited by Finance to resolve any outstanding issues and close the projects. OPSC will also conduct an analysis to identify questioned costs that may be statutorily prohibited from recovery due to the passage of time.

It should be noted that the current statutory construct of the SFP does not provide the authority to require repayment of questioned costs (districts are required to use the funds on another capital outlay project, but are not required to return the funds to the state). However, for Financial Hardship projects, in some cases, questioned costs may have an impact on the amount of savings that is returned to the state.

Finding 3: Questioned Costs Identified Are Not Required to be Repaid

RECOMMENDATION 1: ***OPSC should ensure compliance with the existing***

Education Code and SFP regulations that require identified questioned costs be repaid to the state.

RESPONSE 1:

As part of its oversight responsibilities, OPSC has been diligent in its review activity to ensure that the expenditures listed in the projects are in compliance with existing Education Code and SFP regulations. This process is well established and includes detailed supervisory review of staff work. In some cases, within the construct of the statute related to savings, districts that are non-financial hardship have the ability to retain savings and the corresponding costs are reduced from the project expenditures and increases the savings reported with no monetary effect to the grant.

RECOMMENDATION 2: ***Additionally, to determine the impact of not complying with statutes and regulations, OPSC should submit a report to SAB and Finance no later than August 1, 2016, detailing the total questioned costs identified during its desk reviews and the final disposition.***

RESPONSE 2:

OPSC strongly believes that it has been complying with applicable statutes and regulations and, therefore, believes the requested report is unnecessary. However, if the K-12 bond initiative is approved in November, OPSC will initiate discussions with Finance to further discuss this issue.

RECOMMENDATION 3: ***OPSC should offset questioned costs identified during an expenditure desk review or audit with a project's site-related adjustments.***

RESPONSE 3:

OPSC strongly believes that statute does not provide it the authority to offset questioned costs against a project's site-related adjustments. However, if the K-12 bond initiative is approved in November, OPSC will initiate discussions with Finance to further discuss this issue.

Finding 4: Inadequate Accountability and Oversight of Project Savings

RECOMMENDATION 1: ***To improve accountability and safeguarding of bond funds, OPSC should review and confirm all outstanding project savings for the closed Proposition 1D projects. In addition, for the remaining projects subject to audit or desk review, OPSC should perform procedures to 1) determine the accuracy of self-reported project savings, and 2) verify use of project savings complies with statutes.***

RESPONSE 1:

OPSC will establish a work plan to determine the accuracy of self-reported project savings and to verify that the use of project savings complies with statutes. The work plan will take into account the OPSC's available resources and the level of risk that exists from not directly reviewing and confirming ***all*** outstanding project savings.

RECOMMENDATION 2: ***To maximize the availability of bond funds for districts with immediate high priority capital needs, OPSC should propose changes to the SFP statutes and regulations. At a minimum, regulatory changes should include a strict timetable for usage of non-financial hardship project savings similar to the financial hardship program.***

RESPONSE 2:

If the K-12 bond initiative is approved in November, OPSC will initiate discussions with Finance to further discuss this issue.

RECOMMENDATION 3: ***OPSC should offset new funding requests with a district's unused project savings.***

RESPONSE 3:

As discussed during the audit, existing statutes do not provide the authority to allow an offset of new funding requests with a district's unused project savings. However, as noted in response to the previous recommendation, if the K-12 bond initiative is approved in November, OPSC will initiate discussions with Finance to further discuss this issue.

Finding 5: Financial Hardship Equity Issue Not Resolved

RECOMMENDATION: ***Implement the proposed regulatory and policy changes to the financial hardship program. OPSC should propose the SAB suspend future program funding until the recommended regulatory changes are approved and implemented.***

RESPONSE:

As noted in the report, the SAB is fully aware of the various proposals for regulatory and policy changes to the financial hardship program. If the K-12 bond initiative is approved in November, OPSC will seek direction from SAB regarding future program funding.

Appendix B: Summary of Projects Reviewed

OPSC will follow-up with the districts audited by Finance to resolve any outstanding issues and close the projects.

CONCLUSION

OPSC is firmly committed to ensuring that bond funds are expended in accordance with applicable laws and regulations. As part of its continuing efforts to improve operations, OPSC will take appropriate actions to address the issues presented in the report.

If you need further information or assistance on this report, please contact me at (916) 375-5959.

Original Signed By:

LISA SILVERMAN, Executive Officer
Office of Public School Construction

cc: Daniel Kim, Director, DGS
Eraina Ortega, Chair, SAB
Brent Jamison, Deputy Director, Interagency Support Division, DGS

Evaluation of Response

The Office of Public School Construction's (OPSC) response to the draft report has been reviewed and incorporated into the final report. The audit recommendations are intended to improve accountability and oversight of bond funds. We acknowledge OPSC agreed to post all desk review reports to its website and establish a work plan to determine the accuracy and compliance of all project savings.

However, for a majority of our recommendations, OPSC is proposing to defer corrective actions pending the results of the November 2016 K-12 bond initiative. If passed in November 2016, the proposed K-12 bond measure will authorize $9 billion in general obligation bonds for school construction. Specifically, the bond measure will allocate an additional $7 billion in bond proceeds to the current School Facility Program with no programmatic changes.

With $4 billion in Proposition 1D bond funds currently subject to audit and over $197 million in unused savings/bond funds (state and district share), it is imperative that the required statutory audits and oversight activities be performed. Deferring corrective actions, as proposed by OPSC, will subject an additional $7 billion in new bond proceeds to the lack of accountability and oversight outlined in this report. We continue to recommend OPSC take immediate corrective actions to remedy the significant deficiencies identified and improve its accountability and oversight of bond funds.