

## **Chair Report: Response to the Sweetwater Union High School District Proposition “O” Performance Audit for the Fiscal Year Ended June 30, 2012**

### **Purpose and Possible Actions**

The purpose of this report is provide you with my initial draft observations and recommended response to the Performance Audit submitted to the District and posted on the District web site March 5, 2013. This report could be modified or accepted at the Citizen's Bond Oversight Committee (CBOC) meeting, referred back to the Audit Subcommittee and/or tabled until the District response to the Audit. So far the District has not responded to the Audit. There is a recommendation on the April 9, 2013 Agenda to “accept” the Audit.

### **Background**

The Performance Audit and our comments relative to the Audit are one of the most important tools we have as our Committee to comply with our statutory requirements. In fact to put the Performance Audit in context, I believe it is important to remind ourselves why we are here. A Citizen's Oversight Committee and its statutory requirements were the primary condition upon the significant change in the Constitution, which allowed General Obligation Bonds to be approved with a 55% rather than 2/3-voter approval. The lowering of this threshold level is the primary reason we have so many outstanding School Bonds around the State.

In a nutshell as it relates to the Performance Audit and our mission as an Oversight Committee, I provide the following:

1. The purpose of the citizens' oversight committee shall be to inform the public concerning the expenditure of bond revenues. The citizens' oversight committee shall actively review and report on the proper expenditure of taxpayers' money for school construction (Education Code Section 15278(b))
2. The CBOC is supposed to receive and review copies of the annual, independent performance audit required by subparagraph (C) of paragraph (3) of subdivision (b) of Section 1 of Article XIII A of the California Constitution. (Education Code Section 15278 (c)(1))
3. The required annual, independent financial and performance audits shall be conducted in accordance with the Government Auditing Standards issued by the Comptroller General of the United States for financial and performance audits. (Education Code Section 15286)

The Standards for Performance Audits are contained in a Publication by the United States Government Accountability Office “Government Auditing Standards-August 2011”. It is often referred to as the “Yellow Book” referencing its hard paper color. Chapter 7 is devoted specifically to reporting standards for a performance audit.

Compliance with these standards was recently codified with the passage of SB 1473 (Wyland-School Facilities bond proceeds: Performance Audits) and became law January 1, 2012 (Education Code). The legislation was in response to the significant discrepancies in Performance Audits among Bond Oversight Committees and sponsored by the California League of Bond Oversight Committees.

In short, the Performance Audit serves our mission, is required by law, and is conducted in accordance with Auditing Standards developed by the Comptroller General of the United States. It is not an Audit whose standards for performance and conformance can be dictated by the School District.

The report below will be organized into three areas: 1) key audit findings and CBOC response 2) compliance with Nigro and Nigro Scope of Work 3) comparison of GAO performance standards and audit content.

## **KEY AUDIT FINDINGS AND CBOC RESPONSE**

The scope of work for the Audit was ambitious, extensive and based upon a similar scope for West Contra Costa County School District. The former Executive Director and founder of the California League of Bond Oversight Committees recommended this scope. There are numerous audit findings some of which are not covered in this report. The most significant findings, which are believed to require further CBOC review and comment, are as follows:

### **Objective 1.C-Review of Project Budget Analysis**

**Findings and Recommendations:** *We recommend that the District continue to closely monitor projects on a site-wide basis, as well as a project by project basis, and evaluate significant changes in cost budgets as soon as the information is available. Additionally, we recommend that the District break-out monthly project revisions to provide more clarity to the Board on project budgets that are being modified, rather than presenting all revisions to date in a single column.*

**CBOC Comment/Recommendation:** There is a need for more input and guidance from the CBOC regarding project changes in scope, breadth, and budget. It is the norm rather than the exception that the District shares any significant project changes until after the Board has seen the information and in most cases decisions have already been made. It is recognized pursuant to the Education Code that the CBOC has no authority unless granted by the District to approve expenditures. Our role is to report to the public on the proper use of expenditures. However consistent with the Audit's findings stating greater transparency is needed, we recommend that on significant project changes, that District staff report pending changes to the CBOC before it is formally presented to the Board. This will help build greater trust between District staff and CBOC and possibly flush out issues before changes or new projects are made final.

### **Objective 1. D-Design and Construction Timelines**

**Findings and Recommendations:** *We recommend that the District continue to work collaboratively with the DSA to ensure efficient delivery of Proposition O projects. We further recommend that the Citizens' Bond Oversight Committee and District personnel continue to evaluate design and construction timelines on an ongoing basis to identify any variances. Lastly, we recommend that the District continue to evaluate, on a project-by-project basis, the best delivery method based on price, perspective, timelines, District personnel capacity, and other qualitative and quantitative measures.*

**CBOC Comment/Recommendation:** The District is to be commended for their Memorandum of Understanding with the Department of State Architect to expedite the review of designs for construction projects with construction cost budgets exceeding \$5 million. The recommended review, in a timely basis, project design and construction timelines is consistent with our recommendation above to have the CBOC flush out project issues before it goes to the Board of Trustees on a significant issue. This would help further toward District transparency and build trust between the CBOC, public and the District.

### **Objective 1.E. Use of Best Practices and Technology Regarding the Planning & Construction of School Facilities**

**Findings and Recommendations:** *We recommend that the District investigate the potential for the two systems to operate in conjunction with each other to reduce the time spent*

***duplicating accounting and financial entries into the systems. This will also help reduce the potential for errors and increase bond program efficiency to assist management in its ability to analyze project progress in a timely manner.***

**CBOC Comment/Recommendation:** The District utilizes project management software, Prolog, to monitor the progress of Proposition O project budgets, timelines, as well as planning and construction documents during all project phases. The District financial system, TrueCourse, is completely isolated from the Prolog system. This requires the District to duplicate the data entry for contractor payments and billings in both systems. The CBOC concurs with this Audit recommendation.

The Chair reviewed some of the internal filing systems and nomenclature (labeling of folders and subfolders and naming consistency) and was appalled at the sloppiness and inconsistency under SGI supervision. In many cases it was impossible to have even a clue of what was contained in a file by the name or folder absent opening it up and reviewing. The question then arises who was responsible for this Supervision of District staff if any, how contract provisions with SGI regarding this matter supervised and monitored by District staff (Finance), and what measures if any were taken to correct deficiencies.

In addition to this finding, there is the question of omission of the Ipad acquisition process in the detailed Audit review specified in the contract with Nigro and Nigro. Rather than choose Ipads as one of the three projects for detailed review the consultant chose Montgomery High School, Hilltop High School, and National City Middle School.

Given the past controversies and CBOC concerns over the planning process that went into Ipad acquisition and our specific recommendation that this issue be reviewed, it is baffling why it was not studied further. The CBOC should demand a further explanation from the Consultant and District staff of why the Ipad acquisition was not chosen for further analysis.

Further in the cover memo to the Audit relative to the three projects analyzed it is stated: "Our audit of compliance made for the purpose set forth in the preceding paragraph would not necessarily disclose all instances of noncompliance." The auditor should provide the reasons for not being able to provide 100% assurance that the district is in compliance.

**Findings and Recommendations:** *We recommend that the District investigate the potential for the two systems (referring to Prolog Project Management system and Truecourse Financial System) to operate in conjunction with each other to reduce the time spent duplicating accounting and financial entries into the systems. This will also help reduce the potential for errors and increase bond program efficiency to assist management in its ability to analyze project progress in a timely manner.*

**CBOC Discussion/Recommendation:** It is absolutely essential that the potential for inconsistency and duplication between the two systems be eliminated. This is consistent with our charge reporting on expenditures to the public. The District should explain what software implementation will take place to ensure that district can track reasons for variances between entries.

#### **Objective 1.F. - Payment Procedures and Processing Time**

**Findings and Recommendations:** *Of the expenditures selected for testing, 38 were missing at least one signature from the vendor invoice approval form. We recommend that the District ensure that all required and necessary signatures be acquired prior to the processing of payment for invoices. This will help ensure that all internal review of payments is authorized and has been reviewed by the necessary individuals.*

**CBOC Discussion/Recommendation:** This identified problem could be a very serious deficiency that should be corrected immediately. It points to the lack of internal controls and a possible disconnect between the Project Planning and Construction Section and District Finance.

There are a number of very serious questions among others that arise: 1) Why are there missing signatures at all? 2) Why did those signing checks not ensure that all approving signatures had been obtained? 3) Why did SGI have more instances of missing signatures? 4) Is there any risk that there were misappropriations of assets? 5) Nigro and Nigro reviewed 42 invoices for signature approvals...how many were in the total population? Should more be reviewed?

### **Objective 1. G-Program and Construction Management Structure**

**Finding and Recommendations:** *Due to the limited practical application of the current organizational structure, we recommend that the District conduct an analysis of the cost-benefit of providing an in-house program and construction management program versus the cost of procuring these services through a third-party provider. This analysis should include both quantitative and qualitative measures. The District should also, on a continuous basis, conduct an analysis of the utilization of project managers based on current and future project projections to determine whether or not the District has the optimal utilization of department personnel.*

**CBOC Comment/Recommendations:** The CBOC agrees with eventually conducting such an analysis but not at this time. The change over to District staff appears to have saved substantial funds. This change over needs further time to review. District staff should not have their time diverted in documenting their cost effectiveness during this transition period. In particular the CBOC commends District staff for their vast improvement in the Proposition O web site.

### **Objective 1.I-Construction of Project Delivery Methods and Performance Analysis**

**Finding and Recommendations:** *Design-Bid-Build dominated the delivery method for contracts completed during the 2011-12 fiscal year, accounting for approximately 75% of the total dollar value of completed projects. The project mix in our sample contained a limited number of Lease-Leaseback projects; however, due to the size of the project, the contract accounted for 25% of our total sample. The disparity in sample diversity is caused by the nature and scope of the projects. For all projects in our sample, the District worked with SGI to determine the best delivery method for each project. With the shift of the management of the bond program, District personnel should continue this trend of evaluating the best delivery method on a project by project basis. This will allow the District to run an efficient bond program and strike a balance of high-quality and cost-effective projects, while continuing to meet deadlines and avoiding cost overruns.*

**CBOC Comment/Recommendation:** During the current fiscal year the CBOC should form a Subcommittee to deal with project delivery methods and review particularly the procurement process for selection of lease leaseback firms. Given the size of lease leaseback projects, its partial use of the more subjective quality based selection, and distinct difference from the more traditional design bid build approach, this is an important issue that deserves further study.

### **Objective 2.A-B-Expenditures.**

**Findings and Recommendations:** *We did not find any payments for activities that did not comply with the approved ballot language in our sample. However we did note that five of the expenditures selected for testing were payments to SGI, the District's former construction management company. Upon review of the contractual agreement and the payments, it was noted that SGI was allowed reimbursements. Reimbursements for single*

**items costing over \$500 required written pre-approval by the District. During the review of the five expenditures selected for testing, it was noted that all five payments to SGI included reimbursements for multiple items exceeding the \$500 mark.**

**The documentation did not demonstrate any written pre-approval by the District for the purchases. Upon inquiry, it was noted that only verbal approval was provided for the purchase of the goods. Though the District no longer has SGI as their construction management company, we recommend that all contracts be thoroughly reviewed prior to payment processing, to ensure that all expenditures have been processed according to what has been outlined in the contract. This will help ensure that the funds are only being spent on authorized work and equipment. In the contract, it is specified that any reimbursements over \$500 without written pre-approval must be paid back to the District by the construction management company. We recommend that the District follow all procedures and requirements outlined in the contract with SGI.**

**CBOC Comment/Recommendations:** The Audit findings indicate that there were significant internal control issues relative to the approval of invoices, pre-approval of reimbursable expenditures and contract documents which allowed what could be considered questionable reimbursable expenses that should perhaps have been considered part of the general overhead for SGI staff.

A number of SGI reimbursements over \$500 did not obtain pre-approval. The Auditor mentions that a verbal approval was made. Evidence should be obtained of the verbal approval including the person who approved. Also, information should be provided regarding inappropriate expenditures or any evidence of misappropriation.

The CBOC should demand a further accounting and description of the process that was used for approval of SGI Contract provisions and persons/positions responsible for the signing off on documents. The CBOC must be assured that there are now internal controls and processes to mitigate the misuse of reimbursable expenditures.

#### **Objective 2.A-B-Expenditures.**

**Findings and Recommendations.:** *For a decrease in costs and an increase in efficiencies, we recommend that the District Governing Board approve the District to operate under Uniform Construction Cost Accounting (UCCA) guidelines and regulations. The main advantage to operating under the UCCA regulations is an increase in the bid threshold for construction projects from \$15,000 to \$175,000. This could significantly reduce the total project delivery time and streamline the award process for the District's smaller construction projects.*

**CBOC Comment/Recommendation:** This may be a prudent method/policy. However given the past controversies and questionable procurement practices of this District, there should be a slow approach. Prior to requesting Board of Trustee approval, the CBOC should be presented with a report on how this would be implemented. I have directed that these Guidelines be posted on the Proposition O web site.

#### **Objective 2. C.-Change Orders**

**Findings and Recommendations:** *We noted that one of the contracts tested had change order amounts totaling 15.88%, which exceeds the maximum allowable change order percentage. The original contract price was \$12,657,000, and multiple change orders totaling \$2,010,266 were approved. The District did not comply with the requirements of Public Contract Code Section 20118.4 for this contract and should have stopped construction in order to allow the District to collect bids through a competitive process for*

***the additional work required. It is essential that District employees are aware of this requirement, and that change orders exceeding 10% of the contract price are not approved unless the proper procedures have been followed.***

**CBOC Comment/Recommendation:** The issue of change orders is by its nature a problematic issue. Change orders can be common in projects particularly when there are unforeseen site or building conditions in the case of remodels/refurbishment. The public, our constituency who monitors such issues, has been vocal about the change orders. The District makes matters worse when Board meetings/actions get delayed and yet projects must proceed. This however is not a total excuse for non compliance with the law i.e. the Public Contract Code.

In the District response to this Audit the specific responsible parties for this violation of the contract code should be held accountable and greater justification for the reasons for the actions should be justified. Much more information on the particulars of this situation must be provided. Any other projects, which exceeded the 10% level, should be provided the CBOC. Issues relative to the violation of the Public Contract Code should be incorporated into the CBOC Annual Report.

The District should not either in actuality or by appearance modify/bifurcate contracts so as to avoid exceeding the 10% threshold approval requirement. It is recommended that the District do a better job up front in informing the CBOC on change orders so that we can understand what is upcoming rather than after the fact. This is consistent with the increased transparency theme in the Audit and this report.

### **Objective 3.B-Bond Program Transparency**

**Findings and Recommendations:** *The District should continue to strive for increased levels of fiscal transparency. The key is to determine how best the information can and should be shared with the taxpayers and public at-large. The goal should be to shine a light on the true costs of the construction, so that taxpayers and their elected representatives can be held accountable. The District should establish timelines to ensure that the information received and reviewed by the CBOC is the most current information available. Currently, policies by the District only require that the following be posted: minutes of the Oversight Committee meetings, reports issued by the oversight committee and documents formally received by the Oversight Committee.*

**CBOC Comment/Recommendation:** This had been a constant theme throughout this CBOC or the lack thereof when it comes to transparency. Major project initiatives (eg. increased expenditure on Ipads) was told to the entire CBOC only after the Board of Trustees acted. The District knew Ipads was a big issue with the CBOC.

Initially the District said that they had no Capital Appreciation Bonds. It was only when the CBOC checked the emma.org web site that we found out that there were CAB's for Proposition BB. While there have been some improvements particularly in the web site, there is a long way to go with respect to transparency.

### **COMPLIANCE WITH THE REQUEST FOR PROPOSALS/CONTRACT SCOPE OF WORK**

After a competitive process the Board approved on November 13, 2012 an award of a contract with Nigro and Nigro for a cost of \$18,675 . Presented below is an excerpt of the project scope:

“The objective of the Performance Audit is to review the Proposition O bond program for compliance with the bond language and Proposition 39. To accomplish that objective, the auditor shall provide an independent review and evaluation of the following issues, at minimum, and recommend improvements where appropriate:

1. Review of Financial and Performance Audits to Date

2. Review of the Management Program and Plan for the current Bond Program
3. Review of the Project Budgets including the proper authorization and approvals including comparison of actual expenditures to date to approved budgets.
4. Review of sound statistical sampling of expenditures including detailed expenditures by project to ensure compliance with ballot language and Proposition 39. A minimum of three (3) projects must be reviewed in depth.
5. Compliance with District policies and State Laws and regulations regarding expenditure of bond funds.
6. Design and construction timelines which include benchmarking to industry standards or averages
7. Use of Best Practices and Technology Regarding the Planning and Construction of School Facilities
8. Payment Procedures and Payment Processing Time
9. Program and Construction Management Structure including consultants, district staff, and fees
10. Change Order Procedures and Results which include benchmarking to industry standards and averages
11. Construction Project Delivery Methods and Performance Analysis
12. "Best Practices" for Procurement of Contractors and Professional Service and compliance with the contracting code.
13. Evaluation of Public Outreach and Communication Program
14. Evaluation of Overall transparency of Bond Program, including but not limited to the evaluation of the bond site website information.
15. Compliance with legal requirements for prevailing wage compliance
16. Review performance of Independent Citizen's Bond Oversight Committee

**CBOC Comment/Recommendation:** It is believed that the consultant technically met all of these requirements. However there was a wide variance in the specificity and depth of analysis. This undoubtedly was driven by the amount of time and related cost allocated for this Performance Audit. The total contract amount was \$18,675 compared to over a \$100,000 estimate based upon a similar scope of another District. There is much more work that needs to be done in the areas of procurement policies (e.g. lease leaseback, design build), best practices and technology for the planning for future construction, improving the transparency of the District, and payment procedures by the District.

**COMPLIANCE WITH GENERAL ACCOUNTING-GOVERNMENT AUDITING STANDARDS (YELLOW BOOK)-CHAPTER 7 REPORTING STANDARDS FOR PERFORMANCE AUDITS**

The purpose of this section is to point out by exception where it is believed that the Performance Audit may not comply with the Standards. As none of the CBOC members are CPA's and the

Committee does not have an independent financial advisor to assist in the review, these comments require a response from the District and Nigro and Nigro:

**Section 7.08 Report Contents States that:** "the Audit should contain: (4) a summary of the views of responsible officials; and (5) if applicable, the nature of any confidential or sensitive information omitted."

**CBOC Comment/Recommendation:** The Superintendent and/or his direct Management team with the authority should present their views and have them incorporated in the Audit. The nature of confidential material omitted should be stated.

**Section 7.11 States Objectives Scope and Methodology:** "Auditors should also report any significant constraints imposed on the audit approach by information limitations or scope impairments, including denials or excessive delays of access to certain records or individuals."

**CBOC Comment/Recommendation:** Nigro and Nigro should explicitly report that there were no such constraints and/or report any access to information issues.

**Section 7.23 Fraud, Non Compliance with Provisions of Laws and Regulations, Contracts, and Grant Agreements and Abuse states in part:** "*When fraud, noncompliance with provisions of laws, regulations, contracts, or grant agreements, or abuse either have occurred or are likely to have occurred, auditors may consult with authorities or legal counsel about whether publicly reporting such information would compromise investigative or legal proceedings. Auditors may limit their public reporting to matters that would not compromise those proceedings and, for example, report only on information that is already a part of the public record.*"

**CBOC Comment/Recommendation:** Without revealing specifics consistent with the above language, the District should indicate where this Section applies to any of the Audit work.

**Section 7.24 Reporting Views of Responsible Officials states:** "*When auditors receive written comments from the responsible officials, they should include in their report a copy of the officials' written comments, or a summary of the comments received. When the responsible officials provide oral comments only, auditors should prepare a summary of the oral comments and provide a copy of the summary to the responsible officials to verify that the comments are accurately stated.*"

**CBOC Comment/Recommendation:** The report should include such information.

**Reporting Confidential and Sensitive Information Section 7.39 States:** "*If certain pertinent information is prohibited from public disclosure or is excluded from a report due to the confidential or sensitive nature of the information, auditors should disclose in the report that certain information has been omitted and the reason or other circumstances that make the omission necessary*"

**CBOC Comment/Recommendation:** The Performance Audit should state the facts relative to this requirement.