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**San Jose Unified School District**

**Final Measure F Bond Fund Performance Audit Report**  
**For the Fiscal Year Ended June 30, 2004**

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**Executive Summary**

The San Jose Unified School District (the District) has implemented controls covering the use of school construction Bond proceeds that comply with Measure F requirements. The Measure F Construction Bond Program (Bond Program) is in the second year of implementation. Our review of the Fiscal year June 30, 2004 bond program fund expenditures of \$25,651,025 found no discrepancies in the use of expenditures for approved Bond fund purposes.

The District has implemented plans for the prudent use of Bond program funds and has properly considered the student's need for a safe and secure learning environment. The District's use of Bond program proceeds has properly considered classroom space requirements and technology needs. The scope of the Bond Program has been defined and communicated to District stakeholders in developing and deploying the Measure F Facilities Construction Implementation Plan (Implementation Plan).

Construction program control practices have been improved and are properly documented in the Implementation Plan to help ensure consistent and efficient application of best school construction practices. A new Program Manager (PM), Kitchell CEM, was selected in January 2004. The Implementation Plan prepared in 2003 had budget discrepancies between the Master, Budget and Individual Schedules. The total amount of these discrepancies was \$1,747,957. The PM corrected these discrepancies by using the individual site schedule as the baseline for all costs. The Implementation Plan was modified, changes to the Implementation Plan were communicated in the 2004 Revision and modifications to the Implementation Plan were approved by the Board of Education (Board).

The District has addressed prior year improvements opportunities. Specifically, the District has improved the Bond Program reporting controls. The District is now able to extract information from the general ledger program into a database program to reduce manual data extraction. The District has updated and completed its policies and procedures manual to include documentation on procedures covering the evaluation of professional service contracts, change order processing and contract payment controls.

A committee consisting of members of the Citizens Bond Oversight Committee (CBOC) and District Staff has been established to review Facilities Construction policies and procedures and to ensure appropriate controls are applied. These members meet monthly to review the District's facilities construction and the Committee was approved by the Board of Education.

We have identified improvement opportunities in the current year that the District should address. We found instances where projects were started before Board approval. The work on these projects was started in the month prior to Board approval. The contractors were performing work without contract protections needed to ensure proper payment for services provided.

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While the District has made progress in hiring needed Facilities Construction Program Staff, current District staffing remains at an inadequate level to properly implement Bond Program controls as facilities improvement construction activities and expenditures increase. Based on prior year's recommendations, the District has hired a secretary for the Director of School Construction, a Senior Contract Specialist, and a Facilities Administrator. The open positions that were recommended last year include a Supervisor for School Construction and an Office Technician.

The District is preparing a plan that addresses deferred maintenance needs to protect the Measure F facilities investment. This plan should identify both facilities maintenance needs as well as funding available to meet those needs. The District should continue to increase public awareness of school facility needs and actions taken and needed to obtain resources necessary to maintain the public investment in school facilities.

### **Objectives and Scope**

Our performance audit evaluated the bond program compliance, effectiveness, program performance controls and efficiency. In order to do so, we reviewed key documents, conducted in-depth interviews and focused on the expenditures for the fiscal year to determine if funds were being used for specified Bond Program purposes. The key documents we received from the District included:

- Student headcount planning documents
- Voter materials and bond documents
- Procurement bid and award documentation
- Implementation Plan and workflow scheduling documentation
- Cash flow forecasts
- A Sampling of actual contracts
- A Sampling of actual payment applications and invoices
- Relevant policies and procedures
- Relevant financial records and transaction support
- Board and CBOC reports (including those from District and County Counsel, etc.)

### **Background Information**

In 2002, voters approved a \$429 million bond Measure F to provide additional improvements to the District's facilities. The Measure F school construction bond funds are to be used for school repairs, rehabilitation, health and safety needs at the District's 48 local schools over the next 7 to 8 years. Bond programs of this size and complexity require appropriate financial processes and operational controls to ensure program compliance, effectiveness, cost, schedule, quality and efficiency goals are achieved. Proposition 39 requires an annual Bond Program performance audit. Moss Adams was engaged to assist the District in developing construction program management processes and to perform the required annual performance audit.

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As of June 30, 2004, the District has spent a cumulative \$30,542,025 of Measure F funds. Fiscal year 2004 expenditures were \$25,651,025. A summary of fiscal year 2004 expenditures is as follows:

Materials and Supplies	\$ 1,871,983
Professional Service Expenditures	1,152,084
Capital Outlay	<u>22,626,958</u>
Total Expenditures	<u>\$ 25,651,025</u>

## **Key Observations**

### **Project Plans and Use of Funds in Compliance with Bond Program Objectives**

We evaluated Bond Program financial records and expenditure cost support to verify that funds were used for approved Bond Program purposes. In accomplishing this work, we reviewed Bond Program accounting records, contracts, purchase orders, invoices, payment records and other documentation of current expenditures as needed to determine if funds were being used for Bond Program purposes.

We performed a walkthrough of the bond expenditure cycle and sampled supporting documentation for 112 expenditures totaling \$16,974,996 to validate internal controls for the total \$25,651,025 Bond Program funds expended in 2004.

#### **Good Practices:**

- The District spent \$25,651,025 of Measure F funds in the fiscal year ending June 30, 2004, and has implemented expenditure management processes to comply with Bond Program requirements. Bond fund expenditures had proper supporting documentation and were properly approved. We found no discrepancies in the use of Measure F funds for approved Bond Program purposes.
- The Measure F Construction Bond Program is addressing current curriculum needs and objectives as stated in the Bond materials.
- The Bond Program Implementation Plan conforms to Measure F requirements.
- Plans for projects cover work scopes and priorities that were established by the Board of Education and include priorities as intended in Proposition 39. The plans for projects, as stated in the Implementation Plan, have not changed from the prior year. There are no spending activities outside the Implementation Plan. The District controls this by using the Implementation Plan as the master schedule for projects to commence. Only projects on the schedule qualify for either a bid process or purchase order approval before spending.

### **Schedule, Quality, Scope Management and Performance Controls**

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We evaluated the actions taken by the District to apply policies and procedures that accomplish Bond Program schedule, quality, scope management and performance efficiency goals. This analysis covered approvals required before performance of Bond Program activities and expenditures and the application of a Bond Program delivery model that requires appropriate scope, documented actions and approvals before the design, construction and closeout project phases. We reviewed the definition of deliverables for each project phase and requirements for approvals. This analysis included the review of tools and support processes for each project phase, comparing them to other projects and good industry practices.

**Good Practices:**

- The District's Implementation Plan provides an approved basis for the Bond program scope and project time phasing.
- Policy and procedure performance controls from the ongoing facility improvements program are being applied to the Measure F Construction Bond Program.
- The District, PM and individual project Construction Managers (CM) have weekly Executive Committee meetings. Project reports and other relevant information are presented in the monthly reports to the CBOC. These activities provide for proper communication of program activities and expenditures.

**Cost, Schedule and Budgetary Management and Reporting**

We reviewed Bond Program reporting as needed to provide current, accurate and complete cost, schedule and budgetary information to Program stakeholders. Based on the interviews and information gathered during the course of the project audit, analysis was conducted to determine whether or not there is adequate executive oversight and involvement in each of the audited projects. This analysis also reviewed the cost, schedule and budgetary reporting methodologies.

**Good Practices:**

- The District has defined program performance reporting requirements that include a running total of the budget, changes, spending, commitments, forecast, and variance to budget.
- The District applies a process to identify the expected spending requirements and to match the issuance and use of Bond proceeds with these spending requirements.
- The CM provides project level reporting which is sent to the Project Manager (PM) for District use in overall program accounting. These program accounting reports are sent monthly to the District.
- The management of the cost, schedule and budget reporting that is done by the PM is regularly compared with Fiscal accounting's Measure F bond reporting to reconcile any differences or discrepancies that could impact the reliability of program reporting.

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**Procurement and Contracting Controls**

We reviewed the implementation of District procurement controls for consistency, adherence to District purchasing policies and application of competitive and fair subcontracting practices. Procurement controls were evaluated for implementation of measures to prevent excessive expenditures. This performance audit area included coverage of contract approvals and application of terms and conditions that help protect District from exposures related to project cost, schedule and scope.

**Good Practices:**

- The District has competitive bidding procedures that address construction project bidder prerequisites, pre-qualification requirements and selection criteria. The District procedures require competitive bids, rates and fees.
- District competitive bidding practices provide for objective verification of bidder compliance and comparison of bidder qualifications and pricing.
- The work to be performed is confirmed by the project manager, cost estimates are reviewed, and there is an appropriate approval process implemented for contractor selection.
- The District has implemented financial controls to manage the expenditure of Bond funds. The District compares budget to actual expenditures, changes, commitments and forecasts.
- Controls are in place for approval and comparison of amounts billed to work performed and contractual requirements, and all supporting documents are attached and complete before payment is made to the contractors.
- Controls have been implemented to prevent the work performance before contract execution and Board approval. On some occasions, to prevent work performance before Board approval, the District has been able to obtain “Delegation of Authority to Approve Bids” from the Board of Education. This delegation enables the Board to delegate authority to the Superintendent or a designee to award bids without having to wait for Board approval. The Board reviews approvals for ratification.
- The San Jose Unified School District School Construction Procedures Manual (the manual) was completed in September 2004 and is expected to be fully implemented in November 2004. The manual provides a significant advancement in the District’s policies and procedures documentation and shall act as a baseline for future performance measurement. We have reviewed the manual and found that it contains good practices and will provide control needed to help the District achieve its’ Bond Program scope, schedule and cost controls. This manual documents project delivery procedures by project delivery phasing (pre-design, design, bid, construction, post-construction phases) inclusive of reference documents, flowcharts, and general contract policies.
- The District has and applies standard terms and conditions. These terms and conditions provide: 1) well defined responsibilities and accountabilities, 2) proper work activity approval requirements, 3) pricing and billing requirements, 4) insurance provisions, 5) schedule requirements and 6) other appropriate provisions covering project scope and quality.

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**Improvement Opportunities:**

- We found architectural and civil engineering projects that were started before Board approval. These projects were disclosed to the Board. The District's procedures manual requires Board approval before the commencement of each project. These jobs were started in the month prior to Board approval. The District is now able to get delegation of authority so that work can start without having to wait for the Board to approve the projects. Without a contract, the contractor was performing the work at risk of not being paid.
- Right to audit provisions could be strengthened in District contracts. This would help the District improve change order cost validation capabilities.

**Change Order Management and Control**

We evaluated District policies, procedures and practices to manage change orders and related costs. Procurement and project controls were evaluated for evidence of change management that help prevent excessive expenditures.

**Good Practices:**

- The District has defined control processes to identify change order causes and to evaluate change order costs.
- We have reviewed a sampling of change orders in various projects and found that there was appropriate change order documentation, identification of the reasons for the changes, cost summaries, documentation of review and appropriate approvals.
- Change orders are properly accounted for, and documented in, each contract file. The project cost accounting includes the original contract amount, change order amount, necessary signatures and Board approvals and the applicable cost codes.

**Contractor Cost Controls**

District control processes to review and approve contractor cost charges were analyzed. Interviews were conducted to ensure accurate understanding of events and circumstances surrounding contract compliance practices. Transaction flow and cost control processes were covered during these interviews. District practices were documented, testing was conducted in conjunction with interviews to evaluate the events and circumstances surrounding the validation of contract billings compliance practices.

**Good Practices:**

- The District and its Construction Management firms review and approve contractor costs for signed contracts.
- Applications for payment and schedule of values are reviewed and checked to ensure that fees and rates charged match actual contract amounts.

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- Percentage of completion is reviewed and approved to prevent early payments for work not performed (front-end loading). This control helps the District to pay only on actual work performed and to manage Bond fund cash flow.
- The Construction Management, Architects, Inspectors of Record, District Facilities Management Staff and District Fiscal Services Staff all review payment applications.
- The previous year's improvement opportunity of defining procedures for the approval and review of contractor payment applications to prevent excess payments, or unallowable charges is defined in the procedures manual and has been implemented by District Staff and their professional service providers.

**Improvement Opportunities:**

- Paper flow streamlining payment application processes to ensure efficient processing and timely contractor payments. The District should provide training to help contractors submit payment applications with supporting documentation needed for approval and timely payments. Expanded District use of technology should be explored to more efficiently document, track and process contractor payment applications.

**Deferred Maintenance**

We reviewed the District's three year cost trend summary that compares deferred maintenance expenditures to booked value of facility assets, school construction expenditures and overall maintenance expenditures (construction bond funds excluded). We validated that this summary was prepared from the District's books and records and reconciled to the District's financial statements. Amounts set aside by the District were consistent with our experience with other school districts. The summary of this information is provided below.

	<b>2002</b>	<b>2003</b>	<b>2004</b>
<b>Deferred Maintenance (1)</b>	\$831,549	\$1,643,998	\$718,525
<b>Booked Value of Facility Assets</b>	\$269,466,542	\$316,868,856	\$344,763,130
<b>School Construction Expenditures</b>	\$25,413,928	\$26,694,270	\$26,546,346
<b>Maintenance Expenditures</b>	\$11,306,890	\$10,116,294	\$8,174,400
<b>General Fund Expenditures</b>	\$259,852,036	\$267,281,919	\$251,182,344

- (1) Deferred maintenance expenditures represent the use of funds set aside under the Deferred Maintenance program. The stated purpose of the Deferred Maintenance Program is to provide State matching funds, on a dollar-for-dollar basis, to assist school districts with expenditures for major repair or replacement of existing school building components so the educational process may safely continue. Funds are also provided for critical hardship projects if the work must be completed within one year. The Deferred Maintenance Program is commonly referred to as an "end of life program" as it sets aside funds for major repair and replacement of assets.

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The Deferred Maintenance Five Year Plan provides a listing of eligible items of major repair or replacement to be considered by the District over a five year period. The State Allocation Board does not fund the projects from the Five Year Plan but rather approves the Five Year Plan as being eligible for the District to expend funds from its “Deferred Maintenance Fund”.

In order to receive State Deferred Maintenance funds, the District is required to establish a restricted fund designated for the deposit of District and State matching funds. This fund is referred to as the “Deferred Maintenance Fund”. As of June 30, 2004, the District books and records indicated that this fund represents approximately \$6.1 million. This amount, as well as deferred maintenance expenditures, appears to be a small portion of the District’s school construction expenditures and booked value of facility assets.

As the District has faced budgetary constraints, we found that District maintenance staffing levels have also declined over the past three years as follows:

<b>Fiscal Year</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
<b>Total Headcount</b>	55	47	40

**Good Practices:**

- The District applies standard and objective methods to identify deferred maintenance needs and to determine maintenance priorities and work activities.
- Construction projects are completed by assigned resources rather than as a part of maintenance activities.
- The District has considered future maintenance requirements in the development of the Implementation Plan and in defining project work scopes.

**Improvement Opportunities:**

- The District is preparing a plan that addresses deferred maintenance needs to protect the Measure F facilities investment. This plan should identify both facilities maintenance needs as well as funding available to meet those needs. The District should continue to increase public awareness of school facility needs and actions taken and needed to obtain resources necessary to maintain the public investment in school facilities.

**Actions Taken to Address Prior Year Improvement Opportunities**

- **Implementation Plan Modifications Control** – The District implemented the Board Policy to require Board approval of modification to plans established in the Implementation Plan.
- **Construction Bond Program Reporting** – The District improved the Bond Program reporting controls. The District now provides monthly Board level and CBOC reports that summarize Bond Program performance against costs, schedule, scope and safety goals.

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- **Accounting and Finance Systems** – The District’s general ledger program remains unchanged from the prior year, but the District is now able to extract information from the general ledger into a database program report generating purposes. Manual data extraction has been reduced to avoid redundant data input and excessive effort as noted in the prior year.
- **Professional Service Contracting Procedures** – The District has documented procedures covering the evaluation of professional service contracts to provide good practice guidance on the assessment of required services, standard professional service contracts, scope definition, supplier qualification, contract pricing and terms. We have reviewed selected contract awards and found that the District is in compliance with its procedures.
- **Change Order Processing Policies and Procedures** - Change order processing policies and procedures have been completed to apply good practices in providing appropriate approvals and in preventing unnecessary changes and excessive change order cost. These procedures are documented in the Manual under the Change Order section.
- **Contract Payment Control Procedures** - Procedures to properly define and specify appropriate review and approval of contractor payment applications to prevent payments that exceed contractual maximums or payments for otherwise unallowable charges have been documented in the Manual under the Pay Application section.
- **Construction Program Staffing** – In the prior year, we reported that current Facilities Construction staffing levels are inadequate to properly control construction program cost, schedule and scope. The return on investment in appropriate Facilities Construction staffing should far exceed the cost providing proper construction program management and oversight.

Needed staffing improvements should start with properly staffing project management and project oversight activities. An appropriate complement of support staff will also be needed to provide clerical, financial and technical support for project management personnel. Increases to permanent staffing levels should approximate minimum workload requirements to efficiently staff vacant positions. Professional service contracting should be considered to address peak staffing level requirements. The District should establish a plan for both increasing program staffing as well as for any needed staff reductions. Training and accountability for use of Facilities Construction policies and procedures, as well as staffing level milestones, should be integral to this plan.

The District’s staffing levels remain inadequate to properly manage the work load. Per discussion with District personnel, the main reason for the District not hiring additional staff is budget constraints and questions regarding the allowable use of bond fund proceeds to pay for District personnel who are assigned to the Bond Program. The District asked the office of the Attorney General for its’ opinion as to whether a school district can use Proposition 39 school bond proceeds to pay the salaries of district employees who perform administrative oversight work on construction projects. On November 9, 2004, the Attorney General responded to the District stating that a school district can use Proposition 39 school bond proceeds to pay the salaries of district

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employees who perform administrative oversight work on construction projects. It is the intent of the District to use this opinion as basis for use of Bond Program monies to hire staff specifically for school construction.

The District has hired a secretary for the Director of School Construction, a Senior Contract Specialist, and a Facilities Administrator. The open positions that were recommended last year include a Supervisor for School Construction and an Office Technician. Current Bond Program needs should be assessed to ensure the District applies a leveraged model that allows senior project managers to be properly supported by field personnel and to provide appropriate Bond Program oversight.