

San Jose Unified School District

Final Measure F Bond Fund Performance Audit Report
For the Fiscal Year Ended June 30, 2006

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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 fourth year of implementation. Our review of the Fiscal Year June 30, 2006 Bond Program expenditures of \$84,920,362 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 considered the students' need for a safe learning environment. The District's use of Bond Program proceeds has considered classroom space requirements, technology needs, and equity. The scope of the Bond Program has been defined and communicated to District stakeholders through the Measure F Facilities Construction Implementation Plan (Implementation Plan).

The District has made changes to the Measure F Implementation Plan in the July 2006 Escalation Revision to reflect higher than anticipated construction costs. Current market conditions and increased materials costs have contributed to cost escalation on construction projects. Projected expenditures have increased by \$38,794,599. The Implementation Plan was modified, changes to the Implementation Plan were communicated in the 2006 Revision, and modifications to the Implementation Plan were approved by the Board of Education (Board).

The District plans to enter into a lease-leaseback transaction for a facilities construction project. The District is negotiating a guaranteed maximum price contract for the purpose of construction work performed under this transaction. This innovative form of contracting can provide increased procurement flexibility to help the District achieve its' construction program goals. As with almost any change in school construction procurement methods, this transaction brings inherent risks that the District will need to control. A sampling of specific control areas that will require focus and attention include: a) facility requirements coordination, b) project oversight, c) performance monitoring, d) change approvals, e) audit rights, f) lease terms and District property rights, g) Developer performance contract protections as well as h) procurement terms that comply with School District Construction regulatory and policy requirements.

In our prior year construction program performance audit report, we recommended that the District more clearly identify the funds used for each project to identify whether funds are spent as authorized. The District has improved the Bond Program fund reporting controls to reflect the source of funds for each construction project. Additionally, a new accounting system has been implemented to increase automation of the payment process and workflow management. Other good practices observed in this performance audit include:

- An open line of communication between the Program Manager, the District, and the Division of State Architects (DSA). This includes a twice-yearly meeting that is held with DSA, for forecasting purposes.
- The horizontal delivery method of constructing athletic fields on all campuses at the same time creates equity between campuses and helps to improve the bid environment.

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- Adherence to standards and procedures creates equity between schools and prevents change by managing user expectations.
- Projects are prioritized according to a standardized District-wide system.
- The District School Construction Procedures Manual (the Manual) is updated annually.
- The District continues to seek creative ways to use the funds available more effectively by exploring different contracting options.

We have identified improvements designated in the body of our report as “high priority.” Key opportunities for improvement are summarized below:

- We have reviewed a sampling of change orders in various projects and found that the change order checklist to identify the reasons for the changes, the basis for determining cost summaries and documented review and approval of each change order was implemented subsequent to Fiscal Year 2006. This control was implemented in August 2006.
- Additional safety information that directly affects the community should be available at all of the construction sites on all School campuses, such as noise and hazard advisory and clearly visible emergency contact information (name and telephone number).
- The District should expedite the close-out process by starting the process earlier, during the construction phase, such that data gathering and reconciliation is conducted on an ongoing basis.

OBJECTIVES AND SCOPE

Our performance audit evaluated Bond Program compliance with funding source requirements, effectiveness, program performance controls, and efficiency. In order to accomplish this, we reviewed key documents, conducted in-depth interviews, visited two construction sites (Hacienda Environmental Science Magnet School and Gunderson High School), and focused on the expenditures for the fiscal year to determine if funds were being used for specified Bond Program purposes.

Key documents 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
- District Facility Standards
- Relevant financial records and transaction support
- Board and Citizens' Bond Oversight Committee (CBOC) reports
- Other District reports, including those from District and County Counsel

As of June 30, 2006, the District has spent a cumulative \$180,360,493 of Measure F funds. Fiscal Year 2006 expenditures were \$84,920,362. A summary of Fiscal Year 2006 expenditures and audit sampling are as follows:

	FY2006 Expenditures	Audit Sample Tested	Percent Tested	Sample Size
Capital Outlays	\$79,780,077	\$13,769,261	17.26%	57
Materials and Supplies	2,198,222	323,696	14.73%	2
External Program Management	1,323,229	42,837	3.24%	2
Internal Program Management	1,618,834	113,651	7.02%	25
Total	\$84,920,362	\$14,249,445		

We categorized improvement opportunities as high, medium and low priority based on likelihood of occurrence and potential impact on the achievement of construction program goals. High priority items require immediate attention to prevent potential significant negative impact on achievement of program cost, scope, safety and compliance goals. Medium priority items are important but require less immediate attention than high priority items. There were no low priority items identified in this report.

BACKGROUND INFORMATION

In 2002, voters approved Bond Measure F for \$429 million to provide 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 seven to eight 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.

PREVIOUS AUDIT RECOMMENDATIONS FOLLOW-UP

We interviewed District and Bond Program personnel to determine the status of improvement opportunities identified in previous audits. Through inquiry and review of documents, we confirmed that 13 of the original 15 recommendations have been resolved, and solutions for two recommendations are being implemented.

Audit Resolution Status

Source	Issues Identified	Closed Items	Solutions Being Implemented
Moss Adams 2005	3	2	1
Moss Adams 2004	4	3	1
Moss Adams 2003	8	8	0
Total	15	13	2

Open Recommendations

The District and Bond Program staff personnel have stated that solutions are being implemented as follows:

- While CBOC agendas, minutes, reports and program information are posted on the CBOC website, this website could be enhanced by providing a summary of key information that the CBOC may communicate to help local citizens better understand Construction Bond Program activities (Moss Adams Performance Audit, June 2005).
 - The website for the CBOC is currently being studied for a significant re-organization, retrofit, and narrative update reflecting the current status of the projects and description of future scopes/phase in the coming months. Discussions are ongoing regarding possible hire of a webmaster.
- Paper flow streamlining of the 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 (Moss Adams Performance Audit, June 2004).
 - The District has begun the process of streamlining the payment application process. The process began with making the purchase orders and contracts available to all on-line from central servers. Any changes made to these documents will also be scanned and available on-line. The next step is to automate the payment process through workflow management. The district has begun a migration to a new accounting system (MUNIS). Full implementation of the accounting processes is expected.

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Past audit findings, issue status, and management responses can be found in Appendix A, the Audit Resolution Log.

KEY OBSERVATIONS

1. Compliance with Ballot, Bond, State and Other Funding Source Requirements

We evaluated Bond Program financial records and expenditure cost support to verify that funds were used for approved Bond Program purposes as set forth in the Ballot Measure and Bond documents. 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 approved Bond Program purposes.

We performed a walkthrough of the Bond expenditure cycle and sampled supporting documentation to validate internal controls. Our sample selection for testing was determined using a unit dollar sampling method, providing each dollar spent for the Bond Program an equal chance of being selected. Of the total \$84,920,362 expended in the fiscal year ending June 30, 2006, we tested \$14,135,794 of payments to vendors and \$113,651 of labor charges.

All expenditures were agreed to vendor submitted invoices, supporting documentation, Board approved contracts or properly approved field reports, types of reimbursements claimed against the allowed reimbursements under the contract, and the types of services submitted for payment for allowable services under Proposition 39. We found no Measure F compliance exceptions.

Good Practices:

- a) The District 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.
- b) The District requires expenditure approvals specific to the Bond Program and has developed financial controls to manage the expenditure of Bond funds. Controls are in place to help ensure that amounts billed represent actual work performed and are consistent with contractual requirements.
- c) The Citizens' Bond Oversight Committee represents a cross-section of the community and stakeholders. Their responsibilities include review of Bond construction status and expenditures.
- d) The Measure F Implementation Plan July 2006 Escalation Revision Program is addressing current curriculum needs and objectives as stated in the Bond materials.
- e) The Measure F Implementation Plan July 2006 Escalation Revision conforms to Measure F requirements, which are included in the Plan.

2. Regulatory Compliance

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We evaluated controls implemented to comply with selected Federal, State and local requirements as well as Measure F requirements as noted in the good practices. This included seeking evidence of regular communication with the Division of State Architects (DSA) and the periodic review of published policies, plans and procedures.

Good Practices:

- a) The construction management firms have posted safety and emergency information in the construction trailers.
- b) An open line of communication exists between the Program Manager, the District, and the Division of State Architects (DSA). A twice-yearly meeting is held with DSA for forecasting purposes.

3. Facilities Programming and Master Plan Approach

This analysis covered approvals required before performance of Bond Program activities and expenditures. It covered the application of a Bond Program delivery model that requires scope definition, documented actions, and approvals before the design, construction, and close-out project phases. We evaluated the processes used by the District to identify facility needs, programming and coordination to completely and equitably address site requirements. Coordination with maintenance, user groups, and key stakeholders was considered in this analysis, along with the inclusion of appropriate personnel. We reviewed the definition of deliverables for each project phase and requirements for approvals. We reviewed the School Construction Procedures Manual to determine that approvals are in place and documented. This analysis included the review of tools and support processes for each project phase, comparing them to other projects and good industry practices. We evaluated Bond activities for consideration of student needs and future receipt of maintenance funds in assessing the equitable and fair use of Bond Program funds.

In Fiscal Year 2005-2006, estimated deferred maintenance plan expenditures were \$2,276,000; however, actual deferred maintenance expenditures were \$56,550. The Construction Office has drafted a Board-approved, five-year deferred maintenance plan, which distributes spending of approximately \$6.4 Million between Fiscal Years 2005 and 2009. Actual annual expenditures are flexible by individual year and are planned to equal the total amount at the end of the five-year period. To maximize the benefits of the deferred maintenance funds, the Construction Office plans to maximize State matching funds.

During the latter part of 2006, the District Construction Office, along with its Program Manager, completed a reconciliation of construction plans with available funding sources. The Measure F Implementation Plan was updated through the 2006 Revision. The new planned spending differs from the previous budget by \$38,794,599. The net increase in spending reflects anticipated construction cost escalation. The 2006 Revision, which was approved by the Board of Education on April 13, 2006, was used as the baseline for our review.

Good Practices:

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- a) The Measure F Implementation Plan July 2006 Escalation Revision represents the modification of the Measure F Program through July 18, 2006. The Measure F Implementation Plan July 2006 Escalation Revision is based on the Measure F Revision Plan 2005, which was approved by the SJUSD Board of Education on April 13, 2006. The District's Measure F Implementation Plan July 2006 Escalation Revision provides an approved basis for the Bond program scope and project time phasing.
- b) Policy and procedure performance controls from the ongoing facility improvements program are being applied to the Measure F Construction Bond Program.
- c) Projected enrollment estimates are maintained to evaluate the effect of population distribution on parking, departmental relocation, and master planning.
- d) The District has set aside the maximum amount of deferred funds in order to receive the greatest potential amount of State matched maintenance funds which are provided when fiscally available.
- e) Plans for projects cover work scopes and priorities 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 changed slightly 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 project commencement. Only projects on the schedule qualify for a bid process or purchase order approval.
- f) The horizontal delivery method of constructing athletic fields on all campuses at the same time creates equity between campuses and helps to improve the bid environment.
- g) Adherence to standards and procedures creates equity between schools and prevents change by managing user expectations.
- h) Projects are prioritized according to a standardized District-wide system.

4. Communication and Fulfillment of Site Expectations

We reviewed the various tools used by the District to communicate Bond Program plans to stakeholders including communication with students, faculty, and the surrounding community. We interviewed several School principals and Project Managers to better understand the specific types of information flow that are occurring on campuses and in the surrounding communities. This analysis included assessment of whether or not a constant and adequate level of communication is maintained regarding the projects and program.

The methods to communicate renovation plans for each site and new construction plans were reviewed and compared to good practices. This included the review of published plans and evidence of presentations to the Citizen's Bond Oversight Committee, faculty, students, the community, District Staff, Program Manager Personnel, and Construction Managers personnel. Responsibility and accountability for site communication of project performance and coordination of site activities was reviewed.

Good Practices:

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- a) The District, Program Manager (PM) and individual project Construction Managers (CM) hold weekly Executive Committee meetings to address cost, schedule and quality issues for each project.
- b) The detailed program reports and other relevant information are presented in the monthly reports to the CBOC. The program status report emphasizes the status of issues needing resolution.
- c) Public meetings of the Citizens' Bond Oversight Committee are held to update the community on the status of projects. The meeting minutes are posted on the website.

Improvement Opportunities:

High Priority –

- a) Additional safety information that directly affects the community needs to be available at all of the construction sites on all School campuses, such as noise and hazard advisory, and clearly visible emergency contact information (name and telephone number).
 - ⇒ Management Response: Staff takes no exception to this recommended communication improvement and will work to develop standardized content for site signage.

Medium Priority –

- a) Individual campus websites should include construction status and impact information or provide a link to the Bond program section of the District/CBOC website in order to communicate better with Program stakeholders.
 - ⇒ Management Response: Management concurs with this recommendation. Links from the school site's webpage to the main Measure F CBOC's webpage is an improvement that will be made District-wide.

5. Cost, Schedule and Budgetary Management and Reporting

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. We reviewed Bond Program reporting as needed to provide current, accurate, and complete cost, schedule, and budgetary information to Program stakeholders. Based on interviews and information gathered during the course of the project audit, analysis was conducted to determine whether 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:

- a) The Measure F Implementation Plan July 2006 Escalation Revision factors current market conditions and material costs and highlights the changes to the project budgets and increased market-driven escalation on projects from 2006 to 2009. This Program escalation change was applied after evaluation and analysis of the bidding climate

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utilizing data from industry professionals and was prepared to match available funding with work cost and to better achieve integrity in implementation plans.

- b) The District has defined program performance reporting requirements that include a summary of the approved budget, any changes, expenditures, commitments, forecast, trends and variances.
- c) The District uses cash flow planning to identify the expected spending requirements and to match the issuance and use of Bond proceeds with spending requirements.
- d) The CMs provide project level reporting to the Project Manager and the District for use in overall program accounting.
- e) Cost, schedule and budget reporting that is done by the PM is prepared monthly and regularly compared to District fiscal accounting's Measure F Bond reports to reconcile any differences or discrepancies that could impact the reliability of program reporting.
- f) The PM prepares a detailed project-by-project analysis of cost, schedule, and budget, which highlights specific issues on each project. This report is provided to the CBOC each month. A website is dedicated to Bond performance and contains the newsletter reporting the status of projects.
- g) Use of construction management software enables the District to track program progress and status.

6. Change 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. We reviewed 63 change orders totaling \$3,457,509.

Good Practices:

- a) The District has defined control processes to identify change order causes and to evaluate change order costs.
- b) The Manual prescribes the required review and approvals required including when changes must be approved by the Board of Education (BOE).
- c) All changes tested in 2006 were properly reviewed and approved.
- d) Change orders are documented in each contract file. Project cost accounting includes the original contract amount, change order amount, necessary signatures, Board approvals, and the applicable cost codes.
- e) The Manual requires that changes be reviewed against nine specific criteria prior to approval. The Construction Office has implemented a checklist to ensure that all criteria have been met prior to approval of the change.
- f) The requirement that changes to the Implementation Plan must be documented and communicated at all levels of the organization was implemented.

Improvement Opportunities:

High Priority –

- a) We have reviewed a sampling of change orders in various projects and found that the change order checklist to identify the reasons for the changes, the basis for determining cost summaries, or the thorough review and approval of each change order, was not prepared during for Fiscal Year 2006 change orders.
 - ⇒ Management Response: The change order checklist was implemented as of August 2006 after the end of the period covered by this audit. Compliance with this new policy should be tested during the 2006-2007 audit.

7. Program Staffing

Through interviews of key operational personnel, review of program workflows, analysis of relevant expenditures, and observation of position and work requirements, we have assessed the assumptions and the basis for Bond Program staffing plans. Bond Program Management needs were compared to the adequacy of staffing requirements. Our experience with staffing at other academic capital programs as well as our assessment of factors unique to the District formed the basis of this analysis.

Good Practice:

- a) The District has a current and future staffing plan, which matches Bond Program construction activity levels.

8. Procurement Controls and Contract Administration

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 the District from exposures related to project cost, schedule, and scope. We reviewed 60 purchase orders and contracts totaling \$33,478,672 out of \$46,062,677 issued.

The Manual was completed and fully implemented in September 2004. The first revision to the Manual was implemented in April 2005, with a subsequent revision in October 2005. The Manual provides a significant advancement in the District's policies and procedures documentation and creates a baseline for future performance measurement. We have reviewed the Manual and found that it contains good construction practice guidelines, and will provide the control needed to help the District achieve stated Bond Program scope, schedule and cost goals. The Manual documents project delivery procedures for all phases (pre-design, design, bid, construction, and post-construction phases), inclusive of reference documents, flowcharts, and general contract policies.

The District plans to enter into a lease-leaseback transaction for a facilities project. The District is negotiating a Guaranteed Maximum Price Contract for the purpose of construction work

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performed under this transaction. This innovative form of contracting can provide increased procurement flexibility to help the District achieve its' construction program goals. As with almost any change in school construction procurement methods, this transaction brings inherent risks that the District will need to control. A sampling of high priority control areas that the District should focus on to help mitigate risk in this arrangement include:

- a) District responsibility for determining and means for coordinating property specifications and construction requirements.
- b) Proper level of District project oversight through controls built into agreement terms.
- c) Developer agreements that require periodic (at least monthly) reporting on all aspects of construction progress.
- d) Appropriate District approvals for project changes.
- e) Inclusion and use of a right to audit clause for District monitoring of Guaranteed Maximum Price Contract compliance.
- f) Arrangement terms that provide appropriate District property rights.
- g) Use of incentives and penalties for all major deliverables on the project.
- h) Performance bond requirements for the Developer and all major subcontractors.
- i) Compliance with and lease-leaseback agreement application of School District Construction requirements such as:
 1. Project procurement.
 2. Prevailing wage requirements.
 3. Substitution of subcontractor restrictions.
 4. Performance bonds insurance.
 5. District indemnification requirements.

Good Practices:

- a) 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 responsiveness, and comparison of bidder qualifications and pricing.
- b) 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.
- c) The District has implemented financial controls to manage the expenditure of Bond funds. The District compares budget to actual expenditures, changes, commitments and forecasts.
- d) 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.
- e) 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.

- f) The District has and applies standard terms and conditions. These terms and conditions provide 1) 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.
- g) The District "School Construction Procedures Manual" is updated annually.

9. Contractor Liens, Claims, and Other Close-out Issues

We evaluated the District's policies, procedures and practices to obtain lien releases, prevent claims and address project close-out issues. This review included analysis of checklists, procedures, retention policies, and contract terms and conditions. The performance audit team looked for implementation of procedures to identify the parameters for contractor performance and compared the District's close-out procedures to good practices. This included review of the criteria for all relevant parties to determine whether a project is complete. The team also evaluated the processes to verify there are controls to provide for release of contractor liens and other claims prior to final payment.

District control processes to review and approve contractor cost charges were analyzed. Interviews were conducted to help 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:

- a) The Construction Office uses standard terms and conditions that require relevant cost control and reporting.
- b) The District uses standardized language in each of its three primary contract types (Architect/Engineering, Project Management, and Construction Management).
- c) The District requires specific Project Performance Bonds on all projects.
- d) The Manual prescribes well-defined responsibilities and accountabilities.
- e) The contracts specify project-reporting requirements and require certain backup documentation with payment applications.
- f) The contracts provide for specific inspection and close-out requirements.
- g) The District and its Construction Management firms review and approve contractor costs for signed contracts.
- h) Applications for payment and schedule of values are reviewed and checked to ensure that fees and rates charged match actual contract amounts.
- i) 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

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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.

Improvement Opportunities:

High Priority –

- a) The District should expedite the close-out process by starting the process earlier, during the construction phase, such that data gathering and reconciliation is conducted on an ongoing basis.
 - ⇒ Management Response: Management concurs with this recommendation. The Construction Office has established a committee headed by Steve Adamo to address close-out and track progress in the close-out process. Improvements in this area should be tested during the 2006-2007 audit.