

CCIA Conference – Spring 2015

# Financial and Performance Audit Requirements Under Proposition 39

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## OVERVIEW

Proposition 39 passed in November 2000

Changed required voter approval to 55%

Proceeds used only for the purposes listed

A list of the specific school facilities projects to be funded

Annual independent performance audit required

Annual independent financial audit required

## OVERVIEW

Proposition No. 39 amended the California Constitution and the Education Code

Sections 15264 to 15288 added to the Education Code.

AB 1908 and Ed Code Section 15278(c) provide specific activities that the COC may engage in.

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## OVERVIEW

Article 13A, Section 1(b)(3)(c); California Constitution includes:

- “A requirement that the...School District Board...conduct an annual, independent performance audit to ensure that the funds have been expended only on the specific projects listed.”

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## TIMELINE

<u>Year</u>	<u>Event</u>
2000	Proposition No. 39 passed
2002	Many CCDs passed bond measures
2009	CaLBOC files complaints with CBA
2010	Senate Bill 1473 revises ECS 15286 (audits in accordance with GAGAS)
2011	Senate Bill 423 revises ECS 15286 (audits submitted to COC by March 31st)
2012	Senate Bill 1204 to allow the COC to select the audit firm (the Bill failed )

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## TIMELINE

<u>Year</u>	<u>Event</u>
2013	CaLBOC writes letters to Districts that their performance audit doesn't comply with ECS 15286
2013	Senate Bill 581 revises ECS 15286 (submit audits to COC at the same time as BOT)
2013	Senate Bill 584 revises ECS 14502.1 (for 2015-16, K-12 audit guide will include compliance steps for financial and performance audits)

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## FINANCIAL AUDIT

**Ed Code Section 15278(c) (2) (Among the duties of the COC):**

- “Receive and review copies of the annual independent financial audit required by [Prop 39].”

**What does “annual” mean?**

- No specific year – should simply be regular.
- Fiscal year?
- 12 months from date of bond measure passage?
- 12 months from date of first bond issuance?
- Is a longer year (i.e. 14 months) acceptable for the first audit?

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## FINANCIAL AUDIT

**Must be conducted under Government Auditing Standards (SB 1473)**

**Fund accounting and modified accrual basis of accounting is used**

**Disclose information on the GO Bonded debt**

**A cumulative report on total expended from inception of bond projects is helpful to the COC**

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## FINANCIAL AUDIT

### **Lack of specific guidance results in the following industry inconsistencies:**

- Using the annual district audit to comply with this requirement
- What if the Bond Building Fund is not separately presented?

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## PERFORMANCE AUDIT

### **Section 15278 provides little guidance to Districts:**

- COC is to receive and review the annual independent performance audit
- SB 1473 clarified that the performance audit is to be conducted under Government Auditing Standards
- There are different types of performance audits

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## WHAT IS A PERFORMANCE AUDIT?

**Performed annually in which there are bond proceeds available to be spent**

**The purpose of a performance audit is to:**

- Provide management with an independent and objective evaluation of government operations
- Assist management to meet the increased public demand for information disclosure
- Evaluate evidence against stated criteria
- Consider applicable standards

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## WHAT IS A PERFORMANCE AUDIT?

**Objectives can vary widely**

- Option 1: economy and efficiency
- Option 2: compliance with laws, regulations, contracts, etc.
- Option 3: internal controls
- Option 4: prospective analyses

**Most districts will typically choose between Options 1 and 2**

**Objectives are NOT mutually exclusive**

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## WHAT IS A PERFORMANCE AUDIT?

- **Economy and efficiency audits focus on:**
  - Costs and resources used to achieve program results.
  - Timeliness and quality
  - Appropriate value based on cost
  - Sound procurement practices
  - Extent to which program is achieving its goals and objectives

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## WHAT IS A PERFORMANCE AUDIT?

- **Compliance audits determine whether laws, regulations, etc. are met related to:**
  - Purpose of the program
  - Manner in which it's conducted
  - Outcomes
  - Costs incurred and revenues received

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## IMPORTANCE OF YOUR CITIZENS' OVERSIGHT COMMITTEE

A December 2009 Little Hoover Report stated the following:

- In the worst instances, local school or community college districts sometimes thwart efforts of oversight commissions by not properly educating members on their role and by limiting their ability to engage the public and report findings and recommendations by failing to provide the mandatory technical and administrative support or by not including meeting schedules or committee reports in district newsletters or on district web sites.
- Because bond oversight committees often receive little training, they sometimes cursorily approve less-than-adequate financial audits, not realizing they have the authority, as well as the responsibility, to probe, intervene and ask for more information.

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## IMPORTANCE OF YOUR CITIZENS' OVERSIGHT COMMITTEE

The COC may engage in any of the following (ECS 15278)

- Inspect school facilities to ensure bond expenditures are in compliance with the California Constitution
- Receive and review copies of any deferred maintenance proposals or plans
- Review efforts to implement cost savings measures in order to maximize bond revenues

The purpose of the COC is to:

- Inform the public concerning expenditures of bond revenues
- Ensure bond revenues are only expended for the purposes described in the California Constitution
- Ensure no funds are used for teacher or administrator salaries or the school operating expenses

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## IN THE NEWS

Generally, the industry has **earned the trust** of the public and investors, **with some exceptions:**

- 2015 Spent money on unauthorized bond projects; failed to build a promised high school
- 2013 Moving too slowly to make good on bond election promises. COC met March 2005 and not again until March 2011 (Grand Jury)
- 2012 \$89,000 of bond proceeds spent on public relations
- 2012 Bond proceeds spent on lush meals, wine and entertainment
- 2011 \$24,000 of bond proceeds spent on lobbying in D.C
- 2011 Borrowing of \$40M of construction bond funds

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## IN THE NEWS

### 2011 State Controller's Audit

- Use of funds from one bond measure to pay for projects of another bond measure; the expenditures were not on the list approved by the voters
- The COC was passive, perfunctory and ineffective
- An Annual Report was not issued as required by Ed Code Section 15280
- Vague language in the ballot measure was intentionally crafted so that virtually any expenditure could be construed to be on the list; appeared to be a way to circumvent control and avoid accountability

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## IN THE NEWS

### 2008 State Controller's Audit:

1. Substantial amounts were expended on projects not included on the approved project list
2. Proceeds were expended on operational expenses not qualified as capital in nature (including travel)
3. Audits performed did not “result in meaningful enhancement of accountability and transparency” of Prop 39 Bond proceeds

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## COMMON ISSUES FOUND IN PROP 39 AUDITS

### Financial Audit

- Prepaid insurance not properly recorded as an asset
- Retention not properly recorded as a liability
- Auditable records for salaries and benefits charged to the Bond Building Fund
- Clear audit trail for inter-fund transfers; the transfer is related to a proper voter approved project

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## COMMON ISSUES FOUND IN PROP 39 AUDITS

### Performance Audit

- COC does not include all constituents required by ECS 15282
- COC cannot obtain a quorum and unable to conduct regular meetings
- Website is not updated and does not contain minutes, agendas, reports, etc.
- An Annual Report is not issued

### Both Financial and Performance Audits

- Expenditures not spent on proper voter approved projects
- Difficulty verifying that expenses are for valid voter approved projects
- Expenditures for normal maintenance of ITC systems purchased with bond funds

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## WHAT DO I DO WITH THE AUDIT REPORT?

- Take it to your COC meeting for their review and acceptance (ECS 15286)
- Take it to your Board of Trustees for their review and acceptance
- Post it on the district's website, along with other COC materials (ECS 15280).
- Submit the pertinent parts to NRMSIR (EMMA) as part of your Continuing Disclosure

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## “IS MY AUDIT IN COMPLIANCE?”

**Ultimately, both economy and efficiency and compliance audits are performance audits under Governmental Accounting Standards**

**Districts have the option to determine the scope and type**

**Most bond counsel agree that the audits may be paid from bond proceeds**

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## “IS MY AUDIT IN COMPLIANCE?”

**Audit reports should contain:**

- Objectives, scope, and methodology of the audit
- Audit results, including findings, conclusions and recommendations, as appropriate
- Statement about the auditors' compliance with GAGAS
- Summary of the views of responsible officials

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## “IS MY AUDIT IN COMPLIANCE?”

### **Audit reports should include:**

- The scope of work on internal control
- Any deficiencies in internal control that are significant within the context of the audit objectives and based upon the audit work performed.

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## “IS MY BOND PROGRAM IN COMPLIANCE?”

### **What happens if the audit determines that proceeds were spent on an unauthorized project?**

- ECS 15284 permits the filing of a taxpayer lawsuit to prevent further expenditures.
- ECS 15288 states the intention of the legislature to pursue criminal prosecution in the event of “waste or misuse” of bond proceeds

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## QUESTIONS AND ITEMS TO CONSIDER

**When and under what circumstances should the performance audit firm interface with bond counsel on Prop 39 questions?**

**What is the appropriate interface between the performance auditor and the Citizens' Oversight Committee?**

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## HELPFUL REFERENCES/RESOURCES

**California Constitution, Article 13A, Section 1 (b)(3)**

**Education Code Sections 15264 to 15288**

**Orange County Department of Education, Schools Legal Service OPAD 06-43 issued September 21, 2006 regarding spending bond proceeds for projects not on the ballot list**

**California Attorney General Opinion No. 04-110 issued November 9, 2004 regarding allowable expenditures from bond proceeds**

**California Community Colleges Chancellor's Office Legal Advisory 04-06 issued November 18, 2004 regarding allowable expenditures from bond proceeds**

**California Attorney General Opinion No. 06-1102 issued January 9, 2009 regarding refunding of general obligation bonds**

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## HELPFUL REFERENCES/RESOURCES

### CASBO News articles:

- *Audit Reports Due to Citizens' Oversight Committee by March 31 for Proposition 39 bonds* - February 21, 2012
- *Prop. 39 Bonds Continuing Disclosure Compliance for Bonds: Are you jeopardizing your district's ability to sell bonds or other debt?* - October 11, 2011
- *Overpaying the Auditor? New Senate Bills Clarify Prop. 39 Audit Requirements* - August 5, 2011