

**SMUSD**  
**Citizen's Oversight Committee**  
**San Marcos Unified Prop K**

**SECOND ANNUAL  
REPORT**

**March 11, 2013**

**Rendering**



**GYM—December, 2013**



**February, 2013**



**COC Mission Statement**

**The SMUSD Citizens Oversight Committee was formed by the District Board to provide an independent monitoring and review of all Proposition K fund expenditures in accordance with contracts executed by and between the District, its Contractors & Sub-contractors and all Bond Agency requirements and to keep the public informed through normal public information channels.**

**Citizen's Oversight  
Committee (COC)  
Prop K Members:**

David Barnum  
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Anthony Martindale  
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**COC Website:**

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**COC meetings:**

Citizens' Oversight Committee meetings are open to the public. Check the website for meeting times, agendas, and minutes.

In November 2010, through Proposition K, the Citizens of this school district approved the issuance of up to \$287 million in General Obligation Bonds. These Bond proceeds shall be used to modernize old and outdated facilities, expand student capacity, and upgrade District technology at 18 school sites. A committee made up of local members of the community was appointed by the School Board to act as a Citizens' Oversight Committee (COC). The committee's charge is to review the inception and progress of all projects funded by Proposition K resources. The COC meets quarterly and submits an annual report to the school Board and community on progress of the projects undertaken.

## **INTRODUCTION**

The SMUSD Citizens Oversight Committee (COC) was appointed by the District Governing Board to be the eyes and ears for the taxpayer/citizens living within the district boundaries. By law, the committee is required to monitor Prop K bond expenditures and report to the community at least once each year. The 2012 Annual Report of the COC consists of two parts: Part One is the committee's review of the State mandated performance audit and committee recommendations. Part Two consists of the committee's comments on the management and conduct of the San Marcos High School project.

## **MODERNIZATION PROJECTS**

The primary remodel project under construction is the San Marcos High School campus. The original campus was built and completed for approximately 1500 students in 1960. Over the past 50 years many buildings were added and remodeled. It was determined that to modernize the old campus for a projected 3000 students would not be a wise investment of limited funding.

Staff and the community decided to level the old campus and build a state of the art new campus. First, a temporary campus of 110 portable buildings was created to house over 2300 current students. Next, the old campus of 200,000 square feet was demolished. As the community can see from San Marcos Blvd., the new buildings are being erected quickly. The new campus will be approximately 420,000 square feet and rise to four stories in the front of the campus. The budget for construction and equipment is \$180 million. The first phase is the Gymnasium and Industrial Arts buildings. These buildings will be completed and ready for occupation in August 2013. The balance of the projects are the classrooms, administration and performing arts buildings. These projects are being erected and will be completed for occupation in January 2014. Once the students are transferred from the temporary campus to the permanent campus, the 110 portable buildings will be removed. After removal the ball fields will be renovated and ready for use in August 2014. The project is in full swing and on schedule. Proposition K also called for modernization of the Districts' technology infrastructure. Staff has contracted with professional consulting firms to assess the current infrastructure on every campus. Staff will be working with site staff to determine the desired classroom set up as well. Once the studies have been completed, electrical engineers and architects will be hired to design standards and blue prints for each site. Various contractors will be hired to implement the improvements and the project completion will be approximately 2 years. It is important to note that this is for infrastructure and not individual student technology devices. Staff wants to inform the community that the new K-8 school, in the planning stage, is not a Prop K funded project. This project will be financed with District tax proceeds from the San Marcos RDA and Community Facilities District (Developer) Bond proceeds.

## **AUDITS OF PROPOSITION K BOND BUILDING FUND**

Proposition 39, also known as the School Facilities Local Vote Act of 2000, was approved by the voters of the State of California in November of 2000. The resulting amendments to the California Constitution, following the approval of Proposition 39, included provisions requiring school districts that issue such bonds be required to conduct annual, independent financial and performance audits until all bond funds have been spent. The primary purposes of both audits are to ensure that the bond funds have been used only for the construction, rehabilitation and equipping of school facilities, or the acquisition or lease of real property for school facilities, relevant to the projects listed in the measure, and not for any other purpose such as teacher and administrative salaries.

AB 1908, a related piece of legislation that was approved in June of 2000, required, among other things, that the Education Code be amended to include the requirement that a Citizen's Oversight Committee ("COC") be formed by the governing board for the purpose of informing the public concerning the

expenditure of bond revenues. In furtherance of its purpose, the COC's permitted activities include the review of the District's annual, independent performance and financial audits. The San Marcos Unified School District engaged the services of Christy White Associates to conduct the independent financial and performance audits, described above, of the use of Proposition K bond proceeds for the fiscal year ending June 30, 2012. The audits were completed by Christy White Associates on January 10, 2013 and were provided to the COC on January 16, 2013. The COC reviewed the audits and discussed their substance during a regularly scheduled meeting conducted January 31, 2013.

### **FINANCIAL AUDIT**

The financial audit report of the Proposition K Building Fund indicated that the audit was conducted in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. The audit was designed to "obtain reasonable assurance about whether the financial statements are free of material misstatement." The process utilized included the verification, or "testing", of certain amounts and disclosures made in the financial statements by review of the supporting evidence relevant to each examined disclosure. In addition, the audit included the assessment or evaluation of the accounting principles used, significant estimates made by management and the overall financial statement presentation for the period subject to the audit.

The audit verified that the accounting policies of the District conform to generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB) and the American Institute of Certified Public Accountants (AICPA). Of note, the financial statements reflect that the District maintains the majority of the unspent bond proceeds (cash) in the San Diego County Treasury with a small deposit being held with a "fiscal agent" (Union Bank) for the purposes of payment of constructions costs relating to the Proposition K bond.

The COC identified an error in the Note 3 to the Financial Statement wherein the audit report referenced the 2010 Series B General Obligation Bonds of \$64,995,522 as being "current interest bonds". The subject bonds were in fact capital appreciation bonds. During the January 31, 2013 regular COC meeting, a representative of Christy White Associates advised that an appropriate revision would be made to the audit report accordingly. The COC did not identify any other issues of concern relevant to the statements set forth in the audit report or otherwise conclude that the findings were inaccurate.

The conclusions of the auditor with respect to its findings following the completion of the Financial Audit were positive. The auditor did not note any deficiencies in internal controls over financial reporting that constituted a material weakness and indicated its conclusion as follows:

*"In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Proposition K Bond Building Fund of San Marcos Unified School District as of June 30, 2012, and the results of its operations for the fiscal year ended June 30, 2012, in conformity with accounting principles generally accepted in the United States of America."*

### **PERFORMANCE AUDIT**

A performance audit of the period ending June 30, 2012 was also conducted by Christy White Associates and presented concurrently with the financial audit. The performance audit was conducted in accordance with generally accepted government auditing standards (GAGAS). The primary purposes of the performance audit were to:

- Ensure that the proceeds from the sale of the Proposition K bonds were only used for the purposes set forth in the ballot Proposition and as represented to the voters; namely the construction, rehabilitation and improvement of school facilities and infrastructure;
- Ensure that the proceeds from the sale of the Proposition K bonds were not used for any teacher or administrative salaries or other school operating expenses.

The audit set forth various procedures used to confirm compliance by the District in its use of Proposition K Bond Building Funds with the purposes set forth in the bond measure and applicable law. Some of these procedures to determine compliance, and the findings of the auditor relevant to each, included:

- 1 Evaluation of Internal Controls by making inquiries of management to determine that adequate internal controls exist to:

- a. Prevent fraud or abuse regarding Proposition K funds
- b. Ensure that adequate separation of duties exist in the accounting for Proposition K funds
- c. Prevent material misstatements in the financial statements
- d. Ensure that expenditures are allocated to the proper District funds

**FINDINGS:** *"The results of our audits tests show that internal control procedures appear to be working to meet the financial and compliance objectives required by generally accepted accounting standards and applicable laws and regulations."*

- 2 A site walk that was conducted by the auditor to *"verify that Proposition K funds expended for the fiscal year ended June 30, 2012 were for valid facilities acquisition and construction purposes."* The auditor visited both the interim high school and the San Marcos High School reconstruction project.

**FINDINGS:** *"Through observation and inquiry, auditor was able to gain an understanding of the projects taking place and ensure that funds were being properly expended in accordance with the Proposition K ballot language."*

- 3 Testing expenditures to determine if Proposition K Bond Building Fund funds were spent solely for the purposes set forth in the bond measure and applicable law. The expenditure test included a sample of 33 payments, totaling \$23.6 million, or approximately 65% of total expenditures for the fiscal year 2011-12.

**FINDINGS:** *"We found the expenditures tested to be in compliance with the terms of the Proposition K Bond Building Fund ballot language, sound internal control practices, and applicable state laws and regulations without exception."*

- 4 Testing of contracts and bid procedures to determine that formal, qualifications-based selection procedures were used and in place. The lease-leaseback contract with Lusardi Construction Company and two professional services contracts, with LPA Inc. and Ninyo & Moore, were tested to determine that formal, qualifications-based selection procedures were followed for the contracts awarded. In addition, one change order charged to the Proposition K Bond Building Fund during the 2011-12 fiscal year was tested to confirm that governing board approval, and any other necessary approvals, were obtained and that sufficient, supporting documentation existed to justify the approval of the change order.

**FINDINGS:**

- a. *The contracts tested followed a formal, qualifications-based selection procedure, prior to being recommended to and awarded by the District's governing board;*
- b. *The change order awarded on the Lusardi contract for the San Marcos High School Reconstruction Project was accompanied by itemized supporting documentation and was reviewed and approved by the contractor, architect and Director of Facilities prior to being approved by the District's governing board;*
- c. *The contracts and change order tested appear to be in compliance with District policies and procedures and Education Code requirements;*
- d. *The District complied, in all material respects, with the compliance requirements for the Proposition K Bond Building Fund, for the fiscal year ended June 30, 2012 as described in the audit report.*

The auditor made two recommendations, in Findings 2012-1 and 2012-2, concerning procedures that would further enhance the transparency and documentation of the selection process used to award contracts in the future as well as a recommendation concerning the review process used to determine the approval of change orders. The recommendations were that *"the District document the qualifications based selection decisions employed in the "approved" contractor selection process to better enhance the controls and transparency of the selection process"* and that the District *"utilize a third party*

*construction expert to assist in analysis of change order accuracy and reasonableness.”* The District responded that in future reviews, additional documentation of communications and decision summarizations will be performed to enhance transparency. The District also engaged the services of a third party construction consulting firm, fs3 Hodges, in December of 2012 which will act to address the recommendation in this regard, noted above.

The COC was provided with numerous reports by District staff during the course of the last year, both financial and progress, concerning the expenditure of Proposition K Bond Building Funds in connection with the District’s primary project at this time, the reconstruction of San Marcos High School. Following its review and discussion of same, the COC did not identify any expenditures of bond funds for purposes prohibited under Proposition K or the Education Code and made no findings of its own that are inconsistent with the findings documented by Christy White Associates in its independent financial and performance audits which concluded that Proposition K Bond Building Fund funds were spent solely for the purposes set forth in the bond measure.

### **COC FUTURE RECOMMENDATION**

Prior to the selection of an auditor for the next fiscal year audit, COC recommends that the scope of the performance audit be expanded to include:

1. An opinion on the **effectiveness** of District internal controls
2. Identification of deficiencies in internal controls
3. **Compliance** as an objective of the audit

### **BOND FINANCING AS OF FEBRUARY 2013**

On November 4, 2010, San Marcos voters passed Proposition K, a \$287M general obligation bond that is secured by property tax revenues. The maximum annual tax promised by SMUSD to voters was \$44/\$100,000 of assessed value. However, if the assessed valuation within the school district does not increase by the projected amount taxes to support this bond could increase.

Like a home mortgage, the expected total cost to the taxpayers will considerably exceed \$287M. Prior to the election, the ballot information included an opposing statement highlighting that the projected total cost of the \$287M bond sale will cost taxpayers up to \$1.2B over the life of the bonds. The San Diego County Taxpayers Association, who endorsed the bond issue, also publicized a projected total cost of \$951M prior to the election. Both a September 3, 2010 *North County Times* article and an October 20, 2010 *San Diego Union-Tribune* article outlined the same information.

SMUSD issued two series of bonds. Series A bonds were issued in July 2011 for \$142,000,000; a combination of Current Interest Bonds and Capital Appreciation Bonds. This series of general obligation bonds will mature in 27 years. The total cost to the taxpayer is \$310,000,000.

Series B bonds were issued in May 2012 for \$65,000,000. The Series B bonds are Capital Appreciation Bonds (CABs) and will mature in 40 years. These bonds are non-callable and the total cost to the taxpayer is \$403,000,000. The district opted to issue CABs in an effort to keep the maximum annual tax to voters at \$44/\$100,000 of assessed value.

*“CABs pay a compounded interest rate and principal upon maturity instead of through regular payments over time. Some school districts turned to CABs as a way to finance construction projects despite sluggish property-tax revenues amid legal limits on the amount of debt they can take on. The bonds allow them to defer debt-service payments in the short term, avoiding near-term property-tax rate increases, but incurring much higher costs in the long run. In California, issuance of outstanding and new general obligation bond debt may not exceed 2.5% of the assessed value of taxable property within a unified school district, according to a school finance guide published by law firm Orrick, Herrington & Sutcliffe.”*

site : internet [REGIONAL NEWS](#) Calif. Capital Appreciation Bonds Have Unintended Consequences  
by: [RANDALL JENSEN](#) Thursday, September 20, 2012

## **IMPACT OF THE FINANCING**

	Prop K Bond Debt	Total Cost to tax payer	Ratio	Maturity
Series A	142,000,000	310,000,000	2.18 to 1	27 years
Series B	65,000,000	403,000,000	6.20 to 1	40 years
TOTAL	207,000,000	713,000,000	3.44 to 1	

## **FUTURE FINANCING**

In September 2012, California State Assembly Member Ben Hueso introduced legislation that if passed, will impact Capital Appreciation Bonds. The legislation seeks to:

- Limit the maturity of a bond CABs from 40 years to 25 years
- Reduce the maximum interest rate from 12% to 8%
- Include a callable feature (ability to prepay) in all debt issuances
- Require one of three government entities to sign off on bond documents for school districts (The County Board of Supervisors, The County Superintendent of Schools or the Governing Board of a community college district)
- Establish debt service coverage ratio not to exceed 4 to 1 (if greater than 4 to 1 a waiver will be required by the County Superintendent of Schools).

site: <http://www.cashnet.org/members/CASHRegister/2012/September/HuesoLegislation.pdf>

The COC questioned SMUSD staff as to why the district's CABs are non-callable. Staff said that this option was not done for two reasons:

- First, the callable option would have cost the District and taxpayers an estimated \$40 million more in interest over the next 40 years.
- Second, the District's assessed valuation would have to grow even higher than predicted or the Bond interest rates would have to fall even lower than today's rates to allow for additional bond sales in 10-15 years to recall the CABs. It was noted by staff that callable options are usually limited to a minimum of 10 years past the date of sale.

## **RECOMMENDATION BY THE COC**

The COC recommends that for future bond sales, the SMUSD Board should avoid the use CABs.

## **DIVISION OF THE STATE ARCHITECT CHANGES AND VALUE ENGINEERING**

The COC has concerns regarding the DSA changes that total over \$12M through February 2013. These changes were triggered by the plan check reviews at DSA. The DSA enforces the building codes and does not ask for any changes that are not "code related".

The District started the project and established the GMP without approved plans. This situation is less than ideal, and the District is now paying the consequences by using contingency funds early in the project. Typically a project of this size has a 5% contingency for unforeseen issues or owner-related changes. The project is currently approximately 40% complete and District has used most of its contingency funds. The amount of remaining contingency funds may be an issue towards the end of the project if the District has to make more changes.

Several COC members attended the February 11, 2013 Board meeting where District staff presented proposed value engineering items to the Board. District staff, the project architects and the contractor did a good job of identifying plans to off-set the DSA changes, such as eliminating expensive exterior finishes, replacing concrete benches with metal ones, and eliminating some of the covered walkways. The proposed value engineering does not appear to change the intent of the project.

The COC recommended that the District hire a third party project manager to insure that the DSA required proposed changes are fairly priced. In addition, staff has contracted with a company to provide a program manager to stay on task and be cost effective.

The COC has worked with staff to review the contractual expenditures of the projects funded by Prop K. The primary project, the reconstruction of SMHS, had staff beginning the planning process in approximately 2007. As a part of the planning process, timing of construction and cost saving were a primary goal. To complete the project by the desired date of August 2014, a temporary campus needed to be constructed to hold the entire student body. This allowed for the original campus to be leveled and the new campus to be constructed in two phases vs. many phases. A standard practice is to build temporary classrooms for between 25% to 33% of the student and rebuild the new campus over a longer period of time.

The savings that the chosen method afforded was as follows:

1. Renting temporary facilities for a shorter period of time.
2. Generating a larger campus faster to prevent local students from leaving to other school districts; causing a financial loss to the District.
3. Completing the campus on a faster schedule (in years) allows for a construction saving. The longer the construction period, the higher the cost each year due to inflation increases in labor and construction supplies.
4. By shortening the planning and construction schedule, building supplies, such as steel etc., were pre-ordered several years ago to take advantage of lower market prices.

In addition, when the Department of the State Architect ordered changes to the design plans, the District hired a third party to audit and verify the change order costs to assure they are in line with market prices for supplies and labor.

The District and the COC will continue to review cost savings opportunities with Prop K projects and expenditures.

### **COC TOUR**

On March 5, 2013, the COC conducted a site-visit of the on-going construction site at the SMHS. Through observation and inquiry, COC members were able to gain an understanding of the project taking place and see how the Proposition K funds were expended. The reconstruction project appears to be on time and fund expended were in accordance with the Proposition K ballot language.

### **CHAIRMAN CLOSING**

As this is my final action before leaving the committee, I want to extend my heartfelt thanks to the entire committee for their support and to the staff for their forbearance given me as we argued our positions on the issues. I have served on many committees over the years, but have never had the pleasure of working with a more committed and professional volunteer group, or such a dedicated staff.

I would also like to thank the governing board for making such excellent choices in the selection of the oversight committee. While committee member categories are dictated by statute, each and every member of this committee has additional overlapping experiences in either general management, accounting, law, construction or construction management which helped to produce detailed discussions of all aspects of the issues presented by staff as we moved through the process over the past two years.

Thank you all for this unforgettable experience