

OFFICE OF AUDITS & ADVISORY SERVICES



GRAND JURY AUDIT OF THE SAN YSIDRO SCHOOL DISTRICT BONDS

FINAL REPORT

Chief of Audits: Juan R. Perez
Audit Manager: Laura R. Flores, CIA, CFE, CGAP
Senior Auditor: Michelle Ludwick, CGAP
Auditor I: Erich Hannon



County of San Diego

TRACY M. SANDOVAL
DEPUTY CHIEF ADMINISTRATIVE OFFICER/
AUDITOR AND CONTROLLER

AUDITOR AND CONTROLLER
OFFICE OF AUDITS & ADVISORY SERVICES
5530 OVERLAND AVENUE, SUITE 330, SAN DIEGO, CA 92123-1281
Phone: (858) 495-5991

JUAN R. PEREZ
CHIEF OF AUDITS

April 6, 2016

Melinda Richards, Foreperson
County of San Diego Grand Jury
330 W. Broadway, Suite 477
San Diego, CA 92101-3830

Dear Ms. Richards:

FINAL REPORT: GRAND JURY AUDIT OF THE SAN YSIDRO SCHOOL DISTRICT BONDS

Enclosed is our report on the Grand Jury Audit of the San Ysidro School District Bonds. The report addresses the audit objective specified in the Grand Jury request letter dated January 7, 2016

Our audit was conducted in accordance with auditing standards prescribed by the Institute of Internal Auditors, Inc., as required by California Government Code, Section 1236.

Thank you for the opportunity to be of service to your office. If you have any immediate concerns about the report, please contact me at (858) 495-5661.

Sincerely,

JUAN R. PEREZ
Chief of Audits

AUD:ML:aps

Enclosure

c: Tracy M. Sandoval, Deputy Chief Administrative Officer/Auditor and Controller

INTRODUCTION

Audit Objective

At the request of the San Diego County Grand Jury (Grand Jury), the Office of Audits & Advisory Services (OAAS) completed an audit to evaluate the adequacy of expenditures related to San Ysidro School District's (SYSD or the District) General Obligation Bonds and the adequacy of the process for obtaining additional funding through Certificates of Participation.

Background

SYSD is located in the southwest corner of San Diego County and encompasses approximately 29 square miles. SYSD reported that approximately 5,000 students attend one of SYSD's eight elementary schools or preschools. Table 1 shows the number of schools within SYSD in FY 1997-98 and FY 2015-16.

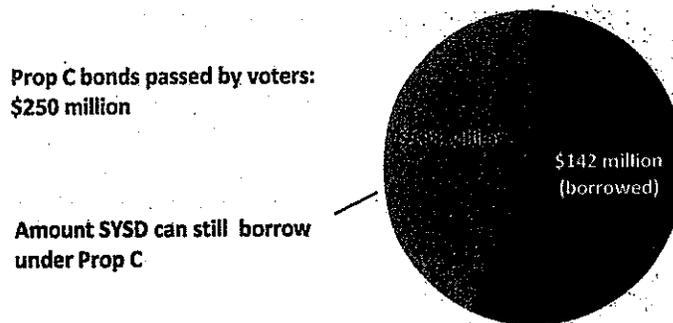
Table 1 – Number of SYSD Schools

| Number of schools | FY 1997-98 | FY 2015-16 |
|-------------------|------------|------------|
| Grades K-6 | 5 | 4 |
| Grades 1-3 | 0 | 1 |
| Grades 4-8 | 0 | 1 |
| Grades 7-8 | 0 | 0 |
| Preschools | 5 | 1 |
| Total | 10 | 8 |

SYSD is governed by a five-member Board of Trustees (Board), elected to a four-year term. The Board adopts policies to govern SYSD and approves the budget and local control accountability plan.¹ The Superintendent is directly responsible for the administration of SYSD in accordance with Board policies. The Chief Business Officer (CBO) has overall responsibility for maintaining sound fiscal control of SYSD, accounting for, and reporting all funds to the Board. The Superintendent and CBO are also responsible for implementing and enforcing appropriate internal controls throughout the SYSD.

In March 1997, voters passed Proposition C (PROP C), which authorized SYSD to sell up to \$250 million in General Obligation Bonds (GO Bonds) to finance the acquisition and improvement of real property for authorized school purposes. Figure 1 shows the amount SYSD has borrowed from the approved debt.

Figure 1: Breakdown of PROP C Funds



¹ Required per California Education Code §42127, 52062(b)(2).

From 1997 to 2015, SYSD issued nine series of GO Bonds totaling approximately \$217 million² comprised of Current Interest Bonds (CI Bonds) and Capital Appreciation Bonds (CABs). Specifically,

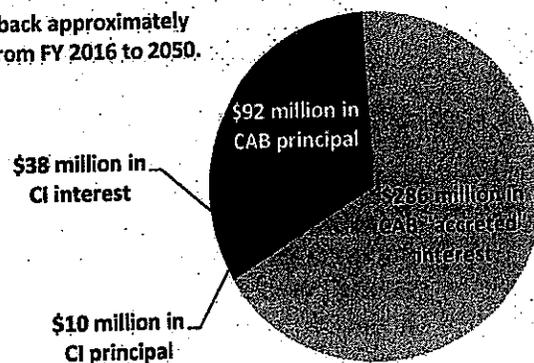
- Seven bond series were “new” issue bonds, which resulted in approximately \$141.5 million deposited in SYSD’s Building Fund.
- Two bond series were *refunded* bond series totaling more than \$75.5 million, which means the bond issuances were used to pay off outstanding bonds and accumulated (“accreted”) interest. SYSD did not receive cash from the transactions.

CI Bonds typically allow SYSD to pay interest semi-annually until the bond matures. CABs allow SYSD to borrow for construction and pay it back with compounded interest many years later.

Figure 2 shows the total amount SYSD is expected to pay back in GO Bonds principal and interest from Fiscal Year (FY) 2016 - 2050.

Figure 2: GO Bond Repayment from FYs 2016 - 2050

SYSD will pay back approximately \$426 million from FY 2016 to 2050.



In addition to GO Bonds, SYSD also obtained funding for land acquisition and school construction and improvements using a non-voter approved debt instrument known as a Certificate of Participation (COP)³ which provides long-term financing through a lease of real property. COPs function like municipal bonds. However, if the COP involves a tax-exempt lease then both a lessor and lessee are required. Government agencies may establish a non-profit corporation to serve as the nominal lessor if no other agency or joint powers authority is available.

In 1998, the SYSD formed the San Ysidro School Public Financing Corporation (Corporation), a non-profit whose officers are the same individuals as the SYSD Board Members. Meetings for the Corporation are held during SYSD Board Meetings.

² Appendix B of this report contains a detailed listing of PROP C, GO Bonds issued by SYSD.

³ Monies obtained through a COP do not constitute a public debt; therefore California law does not require voter approval.

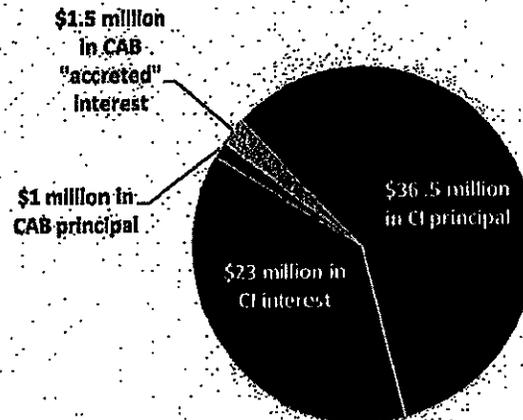
From 1998 to 2015, SYSD approved six COPs totaling more than \$66 million,⁴ also comprised of CI Bonds and CABs. Specifically,

- Five of the COPs were "new" issue COPs, which resulted in approximately \$44.9 million to SYSD.
- One COP was a *refunded* COP totaling approximately \$21.5 million, which means the proceeds were used to pay off outstanding COPs. SYSD did not receive cash from the transaction.

Figure 3 shows the total amount SYSD is expected to pay back in COPs principal and interest from FY 2016 to 2050.

Figure 3: COPs Repayment from FY 2016 to 2041

SYSD will pay back approximately \$62 million from FY 2016 to 2050:



In an effort to determine the appropriate use for debt financing and debt structures and to establish prudent debt management, the Legislature enacted Assembly Bill (AB) 2197 to clarify the reporting requirements for non-voter approved debt, effective January 1, 2009. AB 2197 also amended Education Code (Ed. Code) §42133.5 to prohibit the proceeds from COPs from being used for a school district's general operations, regardless of the school district's budget certification.

In October 2015, SYSD hired a consultant, [REDACTED], to develop and implement a Facilities Financial Management and Reporting System to be integrated with SYSD's existing fiscal system. Specifically, the consultant will track all major revenue and expenditures for SYSD's GO Bonds, COPs, and State grants.

Appendix A of this report contains a list of acronyms, abbreviations, and definitions.

⁴ Appendix C of this report contains a detailed listing of the COPs issued by SYSD since 1998.

Audit Scope & Limitations

The scope of the audit includes, but is not limited to, a review of expenditures from proceeds of general obligation bonds issued under the provisions of Prop C approved by voters in 1997, and the COPs series 1998, 2001, 2005, 2007, and 2012.

OAAS found that SYSD financial accounting system did not contain financial records prior to 2002. Further, OAAS found that records for the Building Fund prior to FY 2011 are not stored in the system of record. As such, OAAS questions the integrity of these records and was not able to evaluate Building Fund transactions prior to FY 2011.

This audit was conducted in conformance with the International Standards for the Professional Practice of Internal Auditing prescribed by the Institute of Internal Auditors as required by California Government Code, Section 1236.

Methodology

OAAS performed the audit using the following methods:

- Reviewed state laws and regulations, California School Accounting Manual (CSAM),⁵ San Diego County Office of Education Accounting Manual, guidelines and best practices related to school districts, and the administration of GO Bonds and COPs.
- Reviewed documentation of internal controls, policies and procedures related to accounting, document retention, budget controls, bond management, and COP approval processes.
- Interviewed District personnel to identify processes for managing the bond program, including paying and recording expenditures, and approval of funding through COPs.
- Inspected documentation related to the Prop C ballot measure, GO Bond and COP documents; facilities needs and planning; Board Meeting Minutes and supplemental documentation; contracts; and expenditures from the Building Fund.
- Conducted limited review of Building Fund transactions to verify whether records appear complete and accurate, including data reviews of SYSD's vendor master file.
- Conducted limited reconciliation warrants paid from the Building Fund to expenditure file provided by SYSD consultant.
- Conducted limited audit testing of SYSD of expenditures; including a review of documents related to procurement, accounts payable, escrow, and contracts.

⁵ Ed. Code §41010 states that California school districts must comply with the CSAM.

AUDIT RESULTS

Summary

Within the scope of the audit, OAAS concluded that SYSD lacks adequate oversight of the GO Bond proceeds and expenditures, and does not have an adequate process for approving COPs. During our review, OAAS found a number of errors which resulted from inadequate Board oversight and questionable management practices over SYSD.

Specifically, OAAS found that SYSD's prior administration failed to implement a strong system of internal controls and may have illegally destroyed documents to hide the extent of their mismanagement. Also, they withheld information and failed to sufficiently educate the Board on a number of issues related to Building Fund expenditures and the issuance of COPs, mismanaged SYSD's Building Fund, and other school assets and did not provide public transparency over tax payer money.

Further, it appears that the Board completely disregarded their fiduciary duty to govern SYSD and failed to hold SYSD administrators accountable for complying with laws, regulations, and Board policy. The Board also appears to have approved numerous questionable transactions and several complex long-term debt instruments without sufficient knowledge, expertise, or public transparency.

Inadequate Board oversight and management practices significantly increases the likelihood of non-compliance with laws, regulations and Board policy, fraud, and ethical violations occurring at SYSD,⁶ including but not limited to breach of fiduciary duty, bribery, kickbacks, and management overrides of existing controls.

Lack of a strong system of internal controls significantly increases the risk of unsound business practices, improper accounting for and recording of fund balances, which can result in fraud, waste, and abuse of tax payer money, misstated financial statements, and fiscal instability.

The exceptions noted and recommendations are included in the body of this report.

Facts:

SYSD's Recent Litigation

In January 2016, a trial date was set in a suit filed by SYSD against a former employee, who worked as SYSD's superintendent from 2007 until his resignation in 2013. The lawsuit filed in 2015, alleges the Superintendent violated public trust, breached his fiduciary duty, and committed fraud and government waste related to the separation agreement negotiated with SYSD when his contract was terminated.

⁶ According to the FBI, a former SYSD Superintendent pled guilty in federal court to deprivation of benefits for political contributions in August 2014. One SYSD Board member also pled guilty to a misdemeanor charge of perjury related to receiving gifts from contractors.

State law requires the reimbursement of any severance money paid out by school districts to an employee who is convicted of a crime involving an abuse of office. The lawsuit against the former Superintendent also alleges the District's lawyer at the time, was present while the deal was being worked out between the former Superintendent and three Board members.

In 2015, SYSD sued its former legal counsel for malpractice for allegedly failing to inform that school board of potential settlement offers during a case and for breach of its fiduciary duty to SYSD. SYSD also filed a State Bar complaint against the firm.

The law firm settled the case for \$2 million at the first mediation between the parties, before any depositions were taken or binding arbitration sessions started. SYSD received a net payout of over \$1.8 million after paying outside legal fees.

Recent Changes to SYSD Board and Administration

In FY 2014-15, SYSD received a Negative Certification on its First Interim Report and a Qualified Certification for its Second Interim Report. Further, the San Ysidro Education Association went on strike in October 2014.

In July 2015, the Board hired a new Superintendent and in September 2015, they hired a Chief Operating Officer to act as the Financial Custodian of the District. In addition, four new members were elected to SYSD's Board. According to current administrator, the current Board and administration settled with the San Ysidro Education Association and in FY 2015-16 the District received its first Positive Certification for any Interim Reports in nearly eight years.

Finding I:

Poor Fiscal Control and Lack of Adequate Governance and Oversight of SYSD

During the audit, OAAS found that former administrators maintained poor control over SYSD's business and fiscal services. Also, the Board granted administrators with blanket authority to manage SYSD. Further, the San Diego Office of Education (SDCOE), which has oversight responsibilities for SYSD, appears to have failed to conduct a review of SYSD deficiencies.

Former SYSD Administrators Maintained Poor Fiscal Control Over SYSD – According to the current SYSD administrators, prior to November 2015, SYSD lacked formalized accounting policies and procedures. In addition, accounting staff had not received any formalized training or job manuals, and were unaware of the CSAM before late 2015.

In January 2014, the Fiscal Crisis and Management Assistance Team⁷ (FCMAT) conducted an Organization and Staffing Review of SYSD and found that:

- After hiring the Assistant Superintendent of Business Services (also known as the CBO) three years earlier, SYSD eliminated the Director of Fiscal Services, Director of Purchasing, and Director of Maintenance, Operations, and Transportation and moved the responsibilities and duties formerly handled by those positions to the CBO.
- SYSD's Business Services Division lacked policies and procedures. FCMAT recommended that SYSD develop Business Services policies and procedures manual, and develop desk manuals for all positions in the Business Services area.

OAAS also found that over the last six years, SYSD's financial statements included findings against SYSD, such as going concern issues, improper year end closing, and insufficient internal controls over purchasing and fixed assets. Most recently, auditors found that SYSD's financial statements contained a material misstatement due to SYSD's omission of journal entries related to the issuance of a GO Bond. Auditors reported concerns related to the District's inability to meet its financial obligations, an increased risk of fraud, and material misstatement of fund balances.

Despite these issues, GO Bond and COP documents show SYSD reported conformance with generally accepted accounting principles in accordance with the policies and procedures of the CSAM.

Ed. Code §41010 states that California school districts must comply with the CSAM.

Lack of Appropriate Governance by SYSD Board -- Based on our review, OAAS observed that past Boards granted superintendents with blanket authority to make significant decisions for SYSD, including some issues that the Board is legally required to oversee.

According to current SYSD administrators, a superintendent's contract should fully express all rights, responsibilities, and obligations of the position. As such, the Board should not grant a superintendent with blanket authorization over school district operations.

SDCOE Lacked Oversight of SYSD -- Though numerous audit reports identified significant deficiencies in SYSD internal controls, the SDCOE did not appear to have conducted a review of SYSD's expenditures and internal controls.

⁷ FCMAT is designed to help California's local educational agencies fulfill their financial and management responsibilities by providing fiscal advice, management assistance, training and other related school business services.

Ed. Code §1241.5(b) states that at any time, the county superintendent may audit a school district's expenditures and internal controls if they have reason to believe that fraud, misappropriation of funds, or other illegal fiscal practices have occurred. The county superintendent shall report the findings and recommendations to the school's board within 45 days of completing their review.

Finding II:**State Laws and Regulations for Retention and Destruction of Public Records were Violated by SYSD**

OAAS found that until late 2015, SYSD lacked policies and procedures for record retention and destruction in accordance with state laws and regulations.

Specifically, the State Records Management Act (Government Code Sections 12270-12279) addresses the creation, utilization, maintenance, retention, preservation, and disposal of state records; and directs agencies to establish and maintain a records retention schedule that details the public records the agency will keep, how the records will be managed, and how the agency will legally dispose of non-permanent records.

Prior SYSD administrators ordered staff to destroy procurement records after three years and accounts payable records after five years. Staff were not aware of the State laws and regulations related to record retention.

OAAS found SYSD inconsistently destroyed documents. Specifically, during audit work, OAAS identified documents that SYSD should have destroyed based on interviews with District staff. As a result, SYSD could face potential liability related to premature destruction of records.

In addition, OAAS found that SYSD lacks an organized filing system. As a result, SYSD was unable to locate several key documents that SYSD should have retained; including supporting documentation for the 1998, 2001, and 2007 COPs and 2012 GO Bond issuances, supplemental documentation for Board Meeting Minutes 1997-2004, facility needs assessments, and project prioritization schedules.

Further, on September 8, 2011, the Board approved the destruction of 215 boxes of documents; however, Board Minutes do not contain a listing of documents destroyed.

According to Ed. Code §35250(d), the governing board of every school district shall make or maintain such other records or reports as are required by law.

Finding III:**Illegal Destruction of SYSD Documents**

OAAS determined that past District employees may have been involved with the unauthorized destruction of SYSD records. On July 11, 2013, SYSD Board Members addressed allegations that several

school district records had been burned on school property. According to the Board Minutes, SYSD would hold an internal investigation and cooperate with law enforcement to determine any misconduct by current or former employees.

According to current SYSD administrators, though witnesses observed former and current employees burning District records, an investigation was not conducted, accounting of items destroyed was not completed, and there was no contact made with local law enforcement. According to current SYSD administrators, SDCOE was notified of the incident, though it is unclear what action was taken by SDCOE.

Ed. Code §1241.5(b) states that at any time, the county superintendent may audit a school districts expenditures and internal controls if they have reason to believe that fraud, misappropriation of funds, or other illegal fiscal practices have occurred. The county superintendent shall report the findings and recommendations to the school's board within 45 days of completing their review. Furthermore, if the county superintendent determines that there is evidence that fraud or misappropriation of funds has occurred, then Ed. Code §42638(b) states that the county superintendent should notify the school district's governing board, State Controller, and local district attorney.

Finding IV:

SYSD Board Negligence and Disregard of Fiduciary Duty Resulted in Improper Approvals of Expenditures from the Building Fund

OAAS noted that past District Boards were negligent in performing their due diligence and disregarded their fiduciary duty to govern over SYSD. This resulted in approving expenditures from the Building Fund for purposes other than those listed in the PROP C ballot measure.

For example, Board Meetings Minutes for May 8, 1997, documented one Board Member's concern that insufficient information was provided to the Board on the law firm selected for general operation over bond projects, and she requested in the future administration provide backup information. Despite the lack of support, the Board approved the contract unanimously.

In another example, Board Meeting Minutes for September 13, 2012, documented the Board President's concern that the Board had insufficient information and knowledge about GO Bonds and CABs. The President stated that the Board should have received sufficient information before making key decisions.

In addition, OAAS found the Board approved expenses for administrators and staff to attend training and travel to conferences funded by the Building Fund. Specifically:

- On January 24, 2013, the Board approved SYSD's request to spend up to \$10,500 from the General and Building Fund to send a District office employee to a leadership academy.
- On March 14, 2013, the Board approved SYSD's request to spend up to \$5,000 from the Child Nutrition and Building Fund to send four District office employees to a conference.

OAAS found that the PROP C ballot language was overly broad and described general improvements that might be completed at any or all of the schools in SYSD. The ballot measure stated funds would be used to acquire or improve property for school purposes only.

Finding V:

SYSD Administrators' Circumvented Board Approvals and Illegally Entered into Contracts and Approved Change Orders on Behalf of SYSD

OAAS observed that one vendor's file contained a note stating that the prior CBO had directed staff not to forward change orders from the consultant to the Board.

Based on a review of Board Meeting Minutes and accounts payable documents, it appears that SYSD administrators withheld contract amendments and a number of change orders from Board review. Further, OAAS found that the former CBO signed contract amendments and change orders, and authorized payments. As a result, SYSD made several payments and entered into contracts that were not Board approved.

According to Ed. Code §35231, any contract or appointment obtained from the governing board of any school district by corrupt means is void.

Finding VI:

Lack of Accountability and Oversight of the SYSD Building Fund

OAAS found a number of issues related to SYSD oversight of the Building Fund:

Poor Budget Processes – Budget amendments for the Building Fund did not include information related to the nature of the transaction. For instance, OAAS identified a budget amendment with no description and justification of such transaction. Instead, the name of the employee requesting the update was recorded. Entries to the Building Fund did not always include a reference to a project, vendor, or other identifying information.

Improper Interfund Borrowing – SYSD borrowed approximately \$18 million from the Building Fund, and failed to transfer approximately \$6.1 million back into the fund. Interfund transactions did not consistently reference the corresponding fund. SYSD used restricted bond funds to cover payroll expenses and transfer cash to other funds. SYSD failed to repay the Building Fund in the same fiscal year, resulting in non-compliance with laws and regulations. As a result,

other SYSD funds may be overstated, and owe the Building Fund interest.

Ed. Code §42603 provides that moneys held in any fund or account may be temporarily transferred to another fund or account for payment obligations, with certain limitations.

Improper Accounting of Wire Transfers – SYSD is unable to determine the total amount of wire transfers made from the Building Fund. Further, SYSD did not record wire transfer amounts, dates, purpose, or payee. Based on audit work, OAAS identified wire transfers of approximately \$346,900 made from the fund.

Poor Controls Over Vendor Master File – SYSD's Vendor Master File contained numerous instances of duplicate vendor's names. Specifically, several employees' names were apparently manipulated and entered more than once. For instance, names including and excluding middle initials, and slight modifications on name spelling. Also it was noted that SYSD does not perform reconciliations of the Vendor Master File.

Inadequate Tracking of Project Costs – SYSD improperly tracked the funding source for project costs. For example, one project budget to actual reconciliation showed that SYSD improperly recorded costs paid from the Building Fund totaling \$376,914 as being paid from the Capital Facilities Fund.

According to Ed. Code §35250(b), the governing board of every school district shall keep an accurate account of the receipts and expenditures of school moneys. Further, Ed. Code §35250(d) states that the governing board of every school district shall make or maintain such other records or reports as are required by law.

Finding VII:

SYSD Improperly Recorded Expenditures

OAAS found a number of errors in recording and processing payments from the Building Fund including:

Improper Recording to Accounting Codes – SYSD charged expenditures object and school codes that were not applicable to the Building Fund. Specifically:

- SYSD recorded approximately \$2 million to improper object codes for Books and Supplies – Materials and Supplies; and Non-Capitalized Equipment, Services and Other Operating Expenses – Travel and Conferences, and Interagency Transfers Out – Other Debt Service (Principle).
- SYSD recorded approximately \$2.5 million to improper school codes typically reserved for District Office expenditures, such as Superintendent, data systems, Business Services, and all sites.

Improper Recording of Retention Payments – SYSD incorrectly recorded payments under the bank holding the escrow accounts for retention payments, rather than to vendor who received the payments. Support for 17 warrants showed that payments made to a contractor [REDACTED] were recorded to [REDACTED].

Payments for Impermissible Purposes – OAAS found that Prop C Bond proceeds were not always spent to acquire or improve District property in accordance with PROP C. For example, OAAS found that SYSD paid \$9,000 from the Building Fund for services related to administering SYSD's Community Facilities District (CFD) funds. These funds are used to repay COPs. In another example, SYSD spent approximately \$3,600 to send District staff to a conference for school business officials in Long Beach, California.

Improper Approvals – OAAS found that the former CBO approved her own travel report. The CBO then approved her own request for reimbursement, and signed her own reimbursement check for approximately \$958.

Purchase Orders Created After Invoices Received – OAAS found that SYSD created purchase orders after the District had received the invoice. For example, one purchase order was dated July 14, 2014; however, SYSD received the invoices on July 1, 2014.

Services Provide by Vendors Do Not Always Agree to Purchase Orders – OAAS found that descriptions for services on purchase orders and invoices do not always agree. For example, SYSD matched an invoice for services related to administering CFDs to a purchase order for analyzing redevelopment during FY 2014-15.

Double Payments Made to Vendors – OAAS found SYSD paid a rating agency twice for services related to issuing the 2015 Refunding GO Bond. Specifically, OAAS found a warrant for \$25,000 was paid to the agency; and records show the amount was also deducted from the bond proceeds after the bonds were issued.

Failure to Reverse Cancelled Warrants – OAAS found one warrant for approximately \$82,715 was cancelled; however, SYSD failed to reverse the expenditures from the Building Fund. The warrant includes two payments; \$81,750 for services related to the 2012 COPs, and nearly \$965 for miscellaneous finance services. Later, SYSD re-issued a warrant for approximately \$965. As a result, the Building Fund is understated by \$82,715.

Lack of Supporting Documentation – Support for several warrants were missing invoices and management approvals. Further, SYSD did not track or maintain records of escrow accounts held by SYSD. As a result, OAAS found that the prior CBO is still listed as the authorized contact for at least one bank account.

According to Ed. Code §35250(b), the governing board of every school district shall keep an accurate account of the receipts and expenditures of school moneys. Further, Ed. Code §35250(d) states that the governing board of every school district shall make or maintain such other records or reports as are required by law.

Finding VIII:

Inadequate Processes for Approving COPs

OAAS determined that SYSD lacks adequate processes for issuing and providing adequate oversight of COPs as evidenced by the following:

Lack of Policies and Procedures for Issuing COPs – OAAS found that SYSD does not have formal policies and procedures for approving COPs; including proper assessment of facility needs, appropriate long-term debt ratios, negotiating costs of issuance and other fees, or providing information to the public.

OAAS also found that, while current Board members knew of the Corporation, they were not aware of their duties and responsibilities related to the Corporation⁸. Further, the current Superintendent and COO did not know about the Corporation until OAAS requested documentation during audit fieldwork. Currently, the Corporation Officers have not been updated to include all current SYSD Board Members. The prior CBO is still listed as the Registered Agent for the Corporation.

Lack of Adequate Documentation to Demonstrate District Need – SYSD could not locate facility needs assessments prior to FY 2007 or for FYs 2008-2010. OAAS is uncertain whether the documents existed. In addition, though SYSD hired consultants to complete facility needs assessments for FYs 2011-2015, the documents failed to include a detailed valuation of existing facilities.

SYSD did not develop a district-wide prioritization of facility improvements based on facility need. As a result, it is unclear what information the Board reviewed to demonstrate SYSD's need for additional long-term funding.

Finding IX:

Possible Issues Related to Financial Advisors and Bond Underwriters Hired by SYSD to Oversee Long-Term Debt Issuances

During our review, OAAS identified a number of questionable issues related to the Financial Advisors and Bond Underwriters that SYSD used to issue GO Bonds and COPs. The following issues were noted:

Questionable Use of Consultants – OAAS found that SYSD utilized consultants for a number of services that appear to present a conflict of interest. Audit work found that since 2011, SYSD contracted with [REDACTED] to provide a number of services related to developer

⁸ The San Ysidro School Public Financing Corporation.

fees; facilities planning and demographics; financial advisory services, and special tax/assessments. [REDACTED] also provided services for GO Bonds and COPs.

Fee justification studies, capacity analysis, and facility assessment needs must be completed before a school district can decide on the amount of funding needed. Further, consultants' charges for issuing debt is often tied to total amount of debt issued. SYSD hired the same consultant to perform the aforementioned services and to oversee the issuance of GO Bonds and COPs. OAAS questions whether hiring the same consultant to perform those services was in the best interest of SYSD.

Presentations to SYSD Board on GO Bonds Issuances Contained Inaccurate Information – Board Minutes for March 12, 2015 show that the Board heard a presentation from a potential Bond Underwriter for the GO Bonds and COPs, [REDACTED]. According to the presentation, [REDACTED] informed the Board that SYSD would refund all CABs from the GO Bond Series F. Subsequently, the Board unanimously approved [REDACTED] as the Bond Underwriter after the presentation.

However, OAAS reviewed SYSD documents and found that the 2015 Refunding GO Bond Series did not include all CABs from Series F. Specifically, the CABs maturing in 2041, which will result in the \$581,000 in principle and \$13.6 million in interest at the bond's maturity. Based on supporting documentation it was unclear the Board was informed that SYSD would not refund all CABs from GO Bond Series F.

2015 Refunding GO Bond Debt Schedule Includes Questionable Interest Payments – A review of the 2015 GO Bond debt service schedule included two questionable payments for interest in FYs 2016 and 2017. Specifically, annual debt service for each year is \$520,750; however, there is no principal or coupon rate that supports those amounts. OAAS questions whether these payments are correct.

Finding X:

SYSD's Lacks Public Transparency of GO Bond and COP Management Programs

In 1997, a SYSD employee and the SYSD Parent-Teacher Association's (PTA) [REDACTED] created the non-profit organization called Yes on "C", Yes for Students to support PROP C. The organization circulated flyers to the public before the proposition passed that included specific projects. Specifically, the flyers stated that bond proceeds would go towards facilities (buildings and equipment) not for salaries and administration.

OAAS found that while SYSD's GO Bonds and COPs included the purpose of the funds, SYSD did not present the public with a list of projects, facility priorities, or estimates of project costs.

OAAS also found that the PTA [REDACTED] requested SYSD set up an oversight committee to monitor how the bond money would be spent in March 1997. However, the SYSD Board disregarded [REDACTED] request.

Finally, a review of SYSD's website showed that SYSD posted no information related to approvals of COPs on its website.

Ed. Code §15284(a) requires school governing boards to appoint citizens to a bond oversight committee. However, this law was not passed until 2000.

Recommendations:

1. To ensure proper oversight and governance, sound fiscal control, and properly accounting for and reporting of SYSD funds, the Board should:
 - a. Oversee development and implementation of a strong system of internal controls, formal policies and procedures, and sound business practices throughout SYSD.
 - b. Hire an independent, experienced firm to conduct a forensic audit of Building Fund revenue and expenses.
 - c. Implement a Bond Oversight Committee to monitor SYSD's use of remaining bond proceeds.

Office of Audits & Advisory Services

Compliance Reliability Effectiveness Accountability Transparency Efficiency

VALUE

APPENDIX A

Acronyms and Abbreviations

| | |
|-------------|--|
| AB | Assembly Bill |
| Board | San Ysidro Board of Trustees |
| CAB | Capital Appreciation Bond |
| CBO | Chief Business Officer |
| CFD | Community Facilities District |
| CI Bond | Current Interest Bond |
| COPs | Certificates of Participation |
| Corporation | San Ysidro School Public Financing Corporation |
| CSAM | California School Accounting Manual |
| FCMAT | Fiscal Crisis and Management Assistance Team |
| FPPC | California Fair Political Practices Commission |
| GO Bond | General Obligation Bond |
| PTA | Parent-Teacher Association |
| SDCOE | San Diego County Office of Education |
| SYSD | San Ysidro School District |

Definitions

Accreted Interest – Accumulated interest that is compounded over time.

Bond – A certificate containing a written promise to pay a specified sum of money, called the face value, at a fixed time in the future, called the date of maturity, and specifying interest at a fixed rate, usually payable periodically.

Bond Measure – A method of borrowing employed by school districts to pay for a large capital investment, used in much the same way as a person who takes out a mortgage to purchase a home. Since 2001, voters in a school district have been able to authorize a local general obligation bond if 55% or more of voters approve it by vote. Before 2001, a two-thirds vote was required. Districts can choose to seek bond passage with either a two-thirds vote or a 55% vote that requires greater accountability measures. The principal and interest are repaid by local property owners through an increase in property taxes.

Building Fund – A restricted fund that districts must use only for buildings. The money comes from sources such as bonds and the sale or rental of property.

Capital Appreciation Bond (CAB) – Also called Zero Coupon Bonds. CABs are typically sold at deeply discounted face value. The school district does not make interest payments until the bond reaches maturity. However, the school district does track the amount of interest that has accumulated ("accreted") each year. When the bond reaches maturity, the buyer is paid the full value of the bond and all the interest earned until the bond matures.

Certificates of Participation (COPs) – A financing technique that provides long-term financing through a lease (with an option to purchase or conditional sale agreement).

Current Interest (CI) Bond – Also called Fixed Rate Bonds. The school district pays fixed interest on the bond, typically twice a year, until the bond reaches maturity.

Developer Fees – A charge per square foot on residential and commercial construction within a school district's geographic boundaries. These fees, charged to developers of new properties and to property owners who remodel, are based on the premise that new construction will lead to more students. Individual school districts decide whether to levy the fees and at what rate, up to the maximum allowed by law. The maximum, adjusted for inflation every two years, is higher for residential construction than for commercial. Districts are required to substantiate the financial impact of new development and how that they have used the revenues to address that impact. Proceeds are used to build or renovate schools and for portable classrooms.

Fund – A fiscal and accounting entity that consists of a number of accounts that record cash and other financial resources, all related liabilities and residual equities or balances, and changes therein. A fund serves to separate the accounts in it from others to carry out specific activities or attain certain objectives in accord with special regulations, restrictions, or limitations.

Fund Balance – The difference between assets and liabilities. The fund equity of governmental and trust funds.

General Obligation Bond (GO Bond) – A form of borrowing commonly used to fund school facilities; these bonds are a general obligation of the government agency that issues them. Local GO Bonds, financed by an increase in property taxes, can be used to renovate, reconstruct, and build new facilities, and for certain new equipment. School districts can seek either two-thirds or 55% voter approval; the latter includes additional accountability requirements.

Mello-Roos Community Facility District (CFD) – A portion of a school district, often a new housing development that can be taxed if two-thirds of property owners vote to approve it. Under Mello-Roos, property owners pay special tax that is not based directly on the assessed value of the property.

Object Code – In school district budgets, object codes are used to classify revenues and expenditures. For expenditures, it identifies the type of item or services being purchased.

Refunded Bonds – A bond issuance used to pay off another outstanding bond. The new bond will often be issued at a lower rate than the older outstanding bond.

Restricted Funds – Money the use of which use is restricted by legal requirement or by the donor.

APPENDIX B**GO Bonds Issued by SYSD Since 1997 (in millions)**

| Bonds Issued | Purpose | Amount Issued as CI Bonds | Amount Issued as CABS | Amount Issued | Amount to Building Fund | Refunded Principal (1997-2015) | Remaining P&I ⁹ Due (CI Bonds) | Remaining P&I Due (CAB) |
|------------------------|---|---------------------------|-----------------------|---------------|-------------------------|--------------------------------|---|-------------------------|
| GO Bond Series 1997 | Acquisition and improvement of real property for authorized school purposes. | \$10,590 | \$0 | \$10,590 | \$10,860 | \$5,060 | \$0 | \$0 |
| GO Bond Series B, 2001 | Portion of the cost of replacing Sunset Elementary School, and acquiring the site for the K-3 school in the Ocean View Hills area and constructing the school. | \$9,885 | \$0 | \$9,885 | \$9,785 | \$8,080 | \$0 | \$0 |
| GO Bond Series C, 2004 | Acquire land for and construct a new middle school. | \$15,875 | \$0 | \$15,875 | \$15,875 | \$13,085 | \$0 | \$0 |
| GO Bond Series D, 2005 | Construct a new middle school for grades 7-8 and to acquire land for and construct a new K-6 elementary school. | \$8,235 | \$16,384 | \$24,619 | \$24,774 | \$2,815 | \$0 | \$44,620 |
| GO Bond Series E, 2007 | Acquisition, construction, and completion of a new District elementary school in the Ocean View Hills area of SYSD. | \$19,815 | \$14,138 | \$33,953 | \$34,138 | \$15,135 | \$2,594 | \$44,880 |
| GO Bond Series F, 2011 | Acquisition, construction, and completion of Vista Del Mar elementary school and renovation, modernization, and upgrades at Beyer Elementary School. | \$2,000 | \$15,599 | \$17,599 | \$17,599 | \$15,019 | \$0 | \$14,160 |
| GO Bond Series G, 2012 | Modernize Beyer School, facility enhancements at Willow, Sunset San Ysidro, Smythe, and La Mirada Schools to ensure older facilities are on parity with SYSD's new school facilities. | \$0 | \$28,991 | \$28,991 | \$28,991 | NA | \$0 | \$117,025 |
| 2012 Refunding GO Bond | Refunding all or portions of Series 1997, B, C, and D. | \$29,860 | \$0 | \$29,860 | \$0 | NA | \$28,543 | \$0 |
| 2015 Refunding GO Bond | Refunding portions of Series E and F. | \$14,010 | \$31,663 | \$45,673 | \$0 | NA | \$17,404 | \$156,565 |
| | | | | | | | | |

⁹ P&I – Principal and interest on the bond.

APPENDIX C

COPs Issued by SYSD Since 1998 (in millions)

| COPs Issued | Purpose | Amount Issued as CI Bonds | Amount Issued as CABs | Amount Issued | Amount to SYSD | Refunded Principal (1998-2015) | Remaining P&I Due (CI Bonds) | Remaining P&I Due (CAB) |
|-----------------------------|---|---------------------------|-----------------------|---------------|----------------|--------------------------------|------------------------------|-------------------------|
| 1998 COPs | Provide for the construction of additional classrooms to expand the Smythe Elementary School, the installation of air conditioning and other HVAC improvement to the San Ysidro Middle School, and the acquisition of several school buses. | \$3,050 | \$0 | \$3,050 | \$2,853 | \$3,050 | \$0 | \$0 |
| 2001 COPs | Portion of the costs associated with the replacement of the Sunset Elementary School, an existing 62-year old elementary school for students in grades K-5, and a portion of the cost of acquiring land for and constructing a new K-8 school. | \$7,075 | \$0 | \$7,075 | \$6,749 | \$7,075 | \$0 | \$0 |
| 2005 COPs | Portion of the costs associated with the construction of a middle school, and a portion of the cost of acquiring land for and constructing a new K-6 school. | \$17,000 | \$0 | \$17,000 | \$16,541 | \$17,000 | \$0 | \$0 |
| 2007 COPs | Portion of the costs associated with the acquisition, construction, and completion of a new District elementary school in the Ocean View Hills areas within SYSD, as well as renovation and modernization of and upgrades to existing facilities of SYSD. | \$7,330 | \$0 | \$7,330 | \$6,933 | N/A | \$11,483 | \$0 |
| 2012 COPs | Acquisition, construction, and completion of Vista Del Mar Elementary School, and the renovation, modernization and upgrades at other District Schools. | \$9,480 | \$ ¹⁰ | \$10,410 | \$9,875 | N/A | \$18,367 | \$2,519 |
| TOTAL COPs PROCESSED | | \$47,935 | \$ ¹⁰ | \$47,935 | \$46,935 | \$47,935 | \$29,850 | \$2,519 |
| 2015 Refunding COPs | Prepay Outstanding 1998, 2001 & 2005 COPs and Cost of Issuance. | \$21,585 | \$0 | \$21,585 | \$21,585 | N/A | \$29,673 | \$0 |
| TOTAL COPs REFUNDED | | \$21,585 | \$0 | \$21,585 | \$21,585 | N/A | \$29,673 | \$0 |

¹⁰ Amount rounded.