

Date: December 13, 2010

To: Board of Education, SMMUSD

From: Measure BB Citizens Bond Oversight Committee, a.k.a. Proposition 39 Committee

Subject: 2010 Annual Report regarding Measure BB Bond proceeds for the year ended June 30, 2009 and related matters

Introduction and Background:

This Annual Report represents the conclusions, concerns, and findings of the Measure BB Citizens Bond Oversight Committee regarding use of Measure BB bond cash for the year July 1, 2008 through June 30, 2009, as well as related concerns, along with respectful requests for Board action.

The Santa Monica-Malibu Unified School District was successful at the November 7, 2006 election (Measure BB) in obtaining authorization from the District's voters to issue up to \$268,000,000 aggregate principal amount of general obligation bonds. The election was conducted under requirements of California Proposition 39 as approved by voters state wide on November 7, 2000, being chaptered as the Strict Accountability in Local School Construction Bonds Act of 2000, according to our school district's website. This allowed approval of Measure BB by a 55% majority of the votes cast as opposed to the more difficult to achieve two-thirds of the votes cast, as long as there is a state mandated form of accountability and the voters were advised of such. Pursuant to Section 15278 of the state Education Code, the District is obligated to establish a citizens bond oversight committee in order to satisfy the accountability requirement of Proposition 39. The Board established this Committee in December 2006 in compliance with this requirement. As of June 30, 2009, \$60 million of Measure BB bonds were issued in October 2007.

The most important responsibility of the Committee is to make a determination whether the District is in compliance with the requirements of Article XIII A, Section 1(b)(3) of the California Constitution, and to provide a report of its activities leading to this determination. This is one objective of this report and by doing so the Committee informs the Board and the public concerning expenditures of the Measure BB bond proceeds of cash after reviewing reports provided by the District and conducting on-site visits of projects in process. The objective of Article XIII A, Section 1(b)(3) is to assure that bond proceeds are being expended only for the

purposes set forth in Measure BB; and that no bond proceeds were used for any teacher, administrative salaries or other operating expenses.

One objective of this citizens oversight committee is to lobby the Board for strict accountability over Measure BB bond proceeds in keeping within the law, but in addition, keeping within its spirit. In part we seek to accomplish this by determining beyond any reasonable question that the District's general obligation bonds as authorized by Measure BB have been expended and disbursed according to Measure BB authorized purposes, as identified by the Measure BB Advisory Committee, and approved by the Board. This Proposition 39 Committee is currently comprised of 7 citizen volunteers selected by the Board after a public request for volunteers and an application process. The Committee may meet as often as it wants, according to its by-laws, and relies on the work products of the District, its contractors, and its independent Certified Public Accountants. In keeping within the spirit of the law the Committee has communicated to the District its opinions regarding financial reporting, information needs and related concerns that if addressed by the District would be helpful in meeting the Committee's mission over the short and long terms in establishing beyond any reasonable question the District's compliance with Measure BB.

As the Committee rendered an opinion regarding Measure BB Bond Proceeds for the year ended June 30, 2009, we asked ourselves these additional questions: Do we have all the information needed to do so? If not what do we need? This report shares our decision making process, our conclusions, findings and concerns.

Overall Conclusion:

This citizens bond oversight committee cannot state beyond reasonable question the information presented to us by the District for the year ended June 30, 2009 is sufficient evidence that the District is in compliance with the requirements of Article XIII A, Section 1(b)(3) of the California Constitution. It may be or it may not be. We do not have confidence in an information source, the Special Audit Report, deemed to be critical in reaching a definitive conclusion, as discussed hereafter.

Committee Activities Leading to the Conclusion:

We relied on the Committee's first Annual Report (also referred to as 2009 Annual Report) to determine our concerns at that time so that we can establish the progress made since that time. That report was approved at its meeting of October 21, 2009 and is found on the District's web site at <http://www.smmusd.org/measureBB/CitizensOversight/pdf/AnnualCommRpt0708.pdf>.

Our activities is documented though Committee meeting agendas, and minutes that can be found at <http://www.smmusd.org/measureBB/CitizensOversight/OversightMeetings.html>. Minutes are posted to the District web site after being approved by the Committee at the following meeting.

The Committee has met 7 times since it approved its first Annual Report, supplemented by activities of ad hoc committees. There has been no public comments or attendance by the public at any of the meetings since October 21, 2009 or any correspondence from the public. Each of the meetings included useful oral and printed updates from the Chief Financial Officer (CFO) representing the District on Measure BB. Several highlights of each meeting are as follows:

April 19, 2010. There was a joint meeting with the Measure BB Advisory Committee to provide feedback to the District on a planned District Measure BB Board workshop presentation. A separate meeting of the Committee occurred afterwards. Topics included: Discussion of the Committee's disappointment due to its understanding that a formal report by the District would be given to the Board addressing the concerns expressed in the first Annual Report. The District indicated it had no such understanding. Opinion that issuance of the first Annual Report did not end the Committee's inquiries for that year as there were still outstanding concerns. Concern that the Committee has not received sufficient information to begin preparing the second Annual Report because the Special Audit Report has not been received, given it covers the year ended June 30, 2009. The District made a commitment the report would be delivered to the Committee in May. Discussion about state education code sections 15280 (a) and (b) regarding Internet posting requirements and responsibilities of the Board to provide "the sufficient resources to publicize the conclusions of the citizens' oversight committee." It was noted although the first Annual Report was issued in October 2009 it was not made available to the public on the District website until April 2010.

May 17. The Special Audit Report was received and the Ad Hoc Committee on Financial Reporting was directed to analyze that report and return at the next meeting with their comments. Additional information was requested of the District. There was a discussion of membership of the Committee given many of the members terms were expiring on June 30th. It was suggested a new ad hoc committee be formed to review detail expenditures for the last fiscal year.

June 7. The District reported the Board took action at their meeting of June 3, 2010 reappointing all current members of the committee whose terms were expiring on June 30, 2010 for an additional two-year term. The Ad Hoc Committee on Financial Reporting submitted an analysis of the audit reports. Certain specific concerns were discussed and additional information of the District was requested. There was a discussion regarding the content of the next Annual Report as to providing more details, more transparency and in language better understood by the public.

July 15. There were questions regarding expenditure reports with answers provided by the District. Committee plans to have a study session on the report previously submitted by the Ad Hoc Committee on Financial Reporting. The CFO offered to meet with the Ad Hoc Committee regarding its report before the study session and the offer was accepted. The Legal Ad Hoc Committee will report to the Committee at the next meeting on its interpretation of state education code sections 15280 (a) and (b). A Site Ad Hoc Committee was formed to arrange site visits to observe Measure BB projects.

October 12. The Legal Ad Hoc Committee gave an opinion on state education code sections 15280 (a) and (b). Internet posting is limited to reports of the Committee as a whole and not reports of an ad hoc committee. The posting of the Annual Report on the District web site complies with the section for the Board to provide "sufficient resources to publicize the conclusions of the citizens' oversight committee."

October 25. Study session took place on the report previously submitted by the Ad Hoc Committee on Financial Reporting. An ad hoc committee was formed to develop a draft Annual Report to be presented at the next meeting.

December 13. The draft 2010 Annual Report was discussed and approved with amendments by the Committee. It is reported that site visits by various Committee members did not reveal any evidence indicating misuse of Measure BB bond monies.

One major goal of the Committee has been communicating to the District its perception of the minimal information needed to meet its mission. It has also concluded, compared to other information sources, the Special Audit and Performance Audit Reports prepared by the District and audited by independent certified public accountants are critically important. These reports provide the financial overview, with many relevant details necessary to draw reasonable conclusions based on the CPAs' opinion it is fairly stated and that Measure BB monies were spent properly. Without these reports the Committee, being volunteers, does not have the time or the professional audit skill sets necessary to conduct an audit of the District's accounting systems to confirm the information presented to the Committee is reasonable, complete, accurate and proper. The auditors being independent from the District is important to eliminate any doubts of conflicts of interest, given the Committee's mission is to form an opinion regarding the District use of Measure BB bond monies and must rely on District reports.

The Committee asked the Ad Hoc Committee on Financial Reporting to review the Special Audit and Performance Audit Reports, and related matters. The District provided this Ad Hoc Committee an opportunity to review drafts of these reports for the year ended June 30, 2009 in January 2010 and provide constructive written feedback to the District. This was done on February 10, 2010, followed by a meeting with the CFO.

It is important to note the District did consider this feedback and included several of the Ad Hoc Committee's recommendations in the final reports. We hope the District found value in doing so and will continue this practice annually for the overall life of this Committee as it only helps us do our jobs better. The final CPA audit reports were distributed to the Committee in May 2010. Before then we understand the District was engaged with planning to mitigate the adverse educational impacts of the projected state funding reductions, and that may have accounted for delays.

In the best of times the District advises us the Committee should receive these critically important reports in January or February. Given the reports cover the fiscal year ending June 30th there is some concern receiving a report seven or eight months after the end of the year.

Yet because our role is to draw a conclusion as to compliance with Article XIII A, Section 1(b)(3) time is not critical, unless there is a shortage of District funds to replace improper expenditures if so discovered or such delays adversely impacts on the Committee achieving its mission. The adverse impact this year is the Board does not have whatever benefits this second Annual Report might have had that could have influenced the past year's Measure BB program reporting or other concerns, as that year ended June 30, 2010 and this Annual Report focuses mostly on the year ended June 30, 2009.

The Ad Hoc Committee on Financial Reporting reviewed the final reports, and reported its findings to the Committee. The Ad Hoc Committee later met twice with the CFO regarding the report. On October 12, 2010 the Committee conducted a detailed study session of the Ad Hoc Committee report with the presence and participation of the CFO and the two Board member Committee liaisons. There after an ad hoc committee was formed to prepare a draft 2010 Annual Report for the consideration of the Committee as a whole. The following provides evidence that lead to the above stated overall conclusion.

Major Findings, Concerns and Requests of the Board related to the Overall Conclusion:

The Measure BB Citizens Bond Oversight Committee has identified five (5) general areas of findings and/or concerns and respectfully makes requests of the Board. These include:

1. Our lack of confidence in the Special Audit Report.
2. The need for improved transparency and understandability of information presented by the District to this Committee.
3. Investments of cash and concern not all interest earned by Measure BB have been allocated to Measure BB.
4. Informal loans of Measure BB bond cash to a non Measure BB sub-fund that are not permissible under Measure BB and our opinion that formal loans to other funds are not allowable.
5. Transfers of cash between funds.

The following provides important details of the above concerns and requests of the Board.

1. Lack of Committee confidence in the Special Audit Report of the CPAs.

The Special Audit Report by independent certified public accountants is critically important as a source of information for this committee in accomplishing its mission. This report can be found on the District's web site at

<http://www.smmusd.org/measureBB/CitizensOversight/pdf/BBBondAudit2009.pdf>.

Our 2009 Annual Report detailed many concerns. We concluded then the Special Audit Report could not be relied upon to draw definitive conclusions as to Measure BB Bond funds being spent properly or not for the year ended June 30, 2008. Some of those concerns were addressed in the most recent Special Audit Report, yet we continue to have concerns. There are certain misstatement of facts and contradictions in the conclusions of the CPAs based on the information presented in the report itself.

A. Note 1 A, Significant Accounting Policies – Reporting Entity, on page 12, is materially in error. According to this “the Committee’s oversight goals include advising on District construction priorities, reviewing construction plans, reviewing project plans and budgets, and ensuring compliance with the conditions of Measure BB,” and that the committee reports to the Superintendent as well as the Board. This committee does not advise on construction priorities, nor review construction plans, and it reports directly only to the Board. It appears to be the description for the Measure BB Advisory Committee, not our Committee. We stated the same concern in our 2009 Annual Report and we understand the District shared that report with the CPAs. We ask ourselves why did they not review it thoroughly and correct the note, as it is a very simple task? This error contributed to weakening our confidence in the present Special Audit Report when combined with the following concern.

B. The CPAs apparently ignored or undervalued supplemental information on page 20 comparing expenditures to budgets that shows the District exceeded its Board authorized Final budget on certain line items. This contradicts the opinion of the CPAs regarding the reliability of the District’s internal controls that should prevent such overspending, as well as gives us

serious doubts about their overall conclusion that the District spent its Measure BB bond funds appropriately.

Page 25 discusses the procedures of the Business Services Department that should prevent over spending of the budget as approved by the Board. The Committee questions that if all contracts are encumbered for budgeting purposes how could the District materially overspend the budget by almost \$7.4 million in “Services and other operating expenditures”? In addition there is a variance of almost \$85k in “Books and supplies.” How could that happen if internal controls are working properly as the CPAs conclude? Page 5 of the Management’s Discussion & Analysis section explains the reasons for overspending of a budget line item being related to timing “while the overall program budget is within its limits.” However that contradicts the purpose of establishing budgets for control purposes, as budgets are time sensitive by law. This would put into question the effectiveness of internal controls and the credibility of the opinion of the CPAs on page 28.

The District contents the supplemental information given to the CPAs was in error, specifically the budget reflects the original adopted budget and not subsequent Board amended budgets that would show spending within its budget by line item. However it appears the CPAs did not raise concerns to the District about the supplemental information as it was published, and they based the size of their audit samples and tests upon their assessment internal controls were reliable despite evidence to the contrary after the fact. Either way it appears the CPAs did not follow though properly. It raises doubts about the quality of their audit in general. Thus the Committee lacks confidence as to the reliability of the Special Audit Report for Measure BB for the fiscal year ended June 30, 2009.

2. Transparency and understandability of information.

There continues to be too much need for technical analysis by this committee of citizens - volunteers to understand how Measure BB bond cash has been used. Accounting is likely to become more complicated in future years due to additional Measure BB bonds being issued, and the bond requirements of separate accounting, that the District intends to comply with by using separate sub-funds. A fund is a separate set of self-balancing accounts that comprise its assets, liabilities, fund balance, revenues, and expenditures. A fund has one or more sub-funds that summed together add to the fund amounts. Measure BB bond monies are accounted for

within sub-fund(s) of the Building Fund that also include non-Measure BB sub-funds, in this case for that fiscal year, the Boys and Girls Club sub-fund.

The Committee's opinion is the Measure BB program should be restricted to a fund of its own to reduce risk of account miscoding, misclassification of expenses and informal loans, as discussed in section 3, due to having other non Measure BB sub-funds within the same fund. Future bond issues unrelated to Measure BB can also be designated as sub-funds within the Building Fund under current District accounting policies. As a result there can be increased risk of errors and miscoding. Without a clear delineation, it is possible for monies to appear to be spent on Measure BB on authorized activities when in fact they were spent on related but non-authorized Measure BB activities. The Committee's concern is without such separation the probability of unintentional spending of these restricted monies is possible and it would not be evident to the oversight committee, although it might be to independent CPAs depending on the extent of their audit tests and examination of invoices.

The CPA's opinion is Measure BB monies were used only on Measure BB projects. According to the Performance Audit section on page 28 they examined \$4.1 million in invoices, (41 separate payments), about 20% of the \$20.9 million expended on Measure BB projects, based on their evaluation of internal controls, not finding any exceptions.

For the year ending June 30, 2009 there is an accounting sub-fund for the Boys and Girls Club. In our opinion as expressed in the 2009 Annual Report, based on our reading of Measure BB itself, only Measure BB transactions should be placed in its own accounting fund. In addition Measure BB bond transactions should be separated from Measure BB non-bond transactions as sub-funds within the fund. Examples of Measure BB non-bond monies include grants, and developer fees, both intended to finance the Measure BB program. The Committee recommends better transparency by limiting one accounting fund to only contain Measure BB related transactions. This fund should be presented as a separate fund in the District wide Audit Report. This would simplify citizen oversight of the Measure BB program by reducing the degree of technical analysis of school district governmental accounting by Committee members who are not governmental accounting specialists as well as give us more confidence to rely on the information provided by the District.

A. As of June 30, 2009 the cash of Measure BB bond proceeds of \$42.7 million is overstated due to the mixing of grant revenues (\$72k), monies owed by the General Fund (\$2 million) and monies owed to the Capital Facilities Fund (\$5.1 million). It appears total expenditures of \$20.9 million may be slightly misstated due to the mixing of grant revenues (\$72k).

As stated in the 2009 Annual Report the Committee's mandate is limited to oversight of use of Measure BB bond monies, not all Measure BB transactions. The monies owed by and to other funds as of June 30, 2009 are transactions made in response to concerns in our first Annual Report. To its credit the District is attempting to limit the contents of the sub-fund to only Measure BB bond monies. However after discussion with the District it is clear this is not permanent accounting policy. Thus it is possible in future years even more mixing can take place thus requiring advanced technical analysis and loss of financial transparency. It is recommended only Measure BB bond proceeds related transactions be included in sub-funds and a note declaring so be stated in future Special Audit Reports.

B. The Special Audit Report does not provide any detail report of all of the Measure BB approved projects. On page 11 (Statement of Revenues, Expenditures and Changes in Fund Balance) it grouped all expenditures into three broad expenditure categories; Plant services, Facility acquisition and construction and Debt service-issuance costs. It would be helpful for the District to include supplemental information with a detail listing of all Measure BB projects, the Board approved budget of each and the expenditures for the time period and to date that would agree in total to the sum of the three broad categories. Budgets are a financial oversight tool to ascertain if actual revenues and expenditures and inter-fund transfers appear to be reasonable, as authorized by the Board. Without this information we do not know if expenditures of Measure BB bond proceeds at each school has been authorized via the budget process other than by District contractor Parsons project management reports, which have not been audited by the independent CPA firm, as they audit only the District's accounting. We are of the opinion the public expects this citizens committee to make a determination Measure BB bond monies were spent properly on projects by school.

Parsons reporting can be useful for details and the Special Audit Report can be useful at a more summary level format after being certified to be fairly stated by an independent CPA. However there is no mechanism or review process to relate the two given there are different categories

and definitions, except at the level of aggregation of the totals. Thus there may be material misstatements in the Parsons report that will not be discovered by the independent auditors because it is not included in their audit test programs, or by the Committee, yet the Committee must rely on the Parsons reports. We do have the CPAs assurances the total of the three broad categories were allowable under Measure BB, however given our concerns regarding the reliability of their report we would also feel more confident in this report in the future if specific supplemental information was provided, and audited.

Thus we respectfully call for the Board to request staff to have the June 30, 2010 Special Audit Report or the Performance Audit Report include supplemental information or a note detailing all the Measure BB allowable projects and/or expenditures by school and/or project level, its title or description, a project budget, annual budget, as well as revised budgets, and expenditures for the year, as well as expenditures to date given these are multiyear projects, commitments as of year end and total expenditures to date plus commitments. In addition we request that projects manager(s) provide an estimate of the percentage of completion for each project. This estimate is not to be calculated based on expenditures as compared to project budget or projected expenditures, but provided as a construction engineer or an architect would, based on actual completion. We request that the CPAs test the financial information and render an opinion this supplemental information is or is not fairly stated, and thus can be relied upon by the Committee.

C. As the Special Audit Report mixes Measure BB Bond cash transactions with non-Measure BB cash transactions we respectfully ask the Board to request the District provide a supplemental schedule of bond cash flows in that report. It would show the beginning cash balance from bond proceeds, and summary of transactions to the ending cash balance from bond proceeds. This will help us understand better where the bond proceeds cash came from and where it went, as long as such mixing occurs.

D. The District being unable to accurately determine cash balances of Measure BB Bond proceeds will have an adverse side effect determining when to terminate the Committee. Bylaws Section 11 states, "The Committee shall automatically terminate and disband 180 days after all Measure BB bond proceeds are spent." Thus many years from now the District cannot know exactly when the entire bond proceeds has been expended and when this Committee is no longer legally required. It is possible the Committee could needlessly meet for many years,

producing many needless annual reports presented at many Board meetings wasting many people's time. People who volunteer their valuable time to serve on this committee could serve in other useful community roles, or whatever they chose to do, when the need for this committee ends. Some progress has been made by the District in restricting Measure BB sub-funds to containing only cash derived from the Measure BB Bonds and this has been reflected by transfers in and out of the sub-fund of millions of dollars. However this is not permanent accounting policy and thus can change in the future.

E. The Balance Sheet on page 10 of the Special Audit Report could be more transparent. It refers to 'Cash in county treasury,' yet it turns out it is cash and investments. It can lose value or gain in value, according to Note 2, Deposits and Investments on page 16 referring to Interest Rate Risk, and fair market value and amortized book value. Our 2009 Annual Report made reference the fair market value of 'cash' was about \$65,000 less than the amortized book value. This is a report to a committee of volunteers who do not have a background in school finances and labeling these accounts can be misunderstood relative to its substance. We recommend it be labeled "Cash and investments in county treasury." Otherwise this is not consistent with Page 11 (Statement of Revenues, Expenditures and Changes in Fund Balance) that shows a "net increase in the fair value of investments" of \$197k for the year ended June 30, 2009.

Being properly labeled informs the reader who could immediately know from review of the Balance Sheet to analyze the information as an investment and not only as cash. The note detailing the types of investments the county pursues is an improvement as compared to the previous year. It is possible labeling this investment as cash is acceptable as a generally accepted financial reporting practice, however we as citizens understand cash to mean cash and such should not lose or gain in value. This is the District's report as audited by CPAs and there should be District discretion to name the account. The California School Accounting Manual, as discussed on page 14, requires this account to be labeled as cash. Yet in our opinion this is mandated for reports to the state and is not required for special audit reports to Proposition 39 Committees at the District level.

F. We respectfully request the Board to ask District staff to provide a timely quarterly treasurer's report of bond cash and investments, including amortized book value and market value so the Committee may monitor cash and investments.

G. Given there continues to be too much need for technical analysis of the information provided to the Committee we recommend the Board when filling vacancies on this Committee seek and consider people with a skill set that includes school, state or local governmental fund accounting expertise.

H. Our 2009 Annual Report recommended several improvements to the Special Audit Report, such as a new section called "Management's Discussion and Analysis" that would focus only on Measure BB bond proceeds and related transactions. District staff included such a section this year and that was very helpful. In the future it would be great if there were detailed explanations of complicated transactions, as it will be more transparent and anticipate Committee concerns. There are also new schedules comparing this year with prior year activity for the Balance Sheet and Statements of Revenues, Expenditures and Changes in Fund Balance. Those have been very helpful and we thank District staff.

I. We strive to make our Committee meetings as transparent as is possible to the public and we thank the District for being as timely as is possible posting approved minutes to the District web site.

3. Investments of cash and concern not all interest earned by Measure BB have been allocated to Measure BB.

A. In the 2009 Annual Report we expressed concerns about potential losses on investments of the bond proceeds by the County Treasury; its value was about \$65,000 less than the amortized book value according to the Special Audit Report. It appeared Measure BB bond proceeds were not secure and an amount will be lost for use to finance Measure BB purposes. The following year the net increase in the fair market value of investments is \$197,000. Thus there can be fluctuation in value from year to year. We recommend the Board ask staff for a review of such investments, explore if it is in the best interests of the Measure BB program to have an independent fiscal agent manage the funds. The Measure BB Bond Building Fund may be able to earn more interest or be safer with its cash being separated from the District wide cash pool and managed by another entity as a fiscal agent.

B. Cash balance of the Measure BB Bond is entitled to more interest earnings due to an informal loan to another sub-fund within the Building Fund.

We have reviewed the District wide Audit Report Balance Sheet that can be found on the District's web site at:

<http://www.smmusd.org/fiscal/pdf/Aud2008-09.pdf>

We note the Building Fund (page 17) cash is \$680,806 less than the Measure BB Bond Building Sub-Fund cash reported in the Special Audit Report on page 10 (\$42,038,167 as compared to \$42,718,973). One would think the Building Fund cash would be more, as it is the total of all the cash of its sub-funds. Accounting for the difference is that the Boys and Girls Club sub-fund within the Building Fund had a negative cash balance of \$680,806 as of June 30, 2009. It also appears that the Boys and Girls Club sub-fund had negative cash balances at end of the second and third first quarters as well. As a result an informal loan occurred using Measure BB bond cash to the Boys and Girls Club sub-fund and after being advised as such by the Ad Hoc Committee on Financial Reporting, the District agreed. According to District calculations additional interest is due to Measure BB Bond sub-fund of \$13,970.66.

It is noted the independent audit did not discover this understatement of interest revenue. Had a restricted Measure BB fund existed the informal loan to the Boys and Girls Club could not have occurred. Had segregation of this fund's cash occurred, separate from the District's pooled cash with the County, all interest earned would be recorded and be available to be expended on Measure BB projects.

4. Formal and informal loans of Measure BB bond cash are not allowable.

Our opinion is cash from Measure BB bond proceeds may not be loaned to another non-Measure BB District fund or sub-fund under any situation because Measure BB itself at the November 7, 2006 election did not contain an explicit statement stating its intention to allow such loans. Pooling of Measure BB bond cash with other District cash, such as with the Los Angeles County Treasurer is not be allowable for the same reasons, as for the possibility of 'informal' loans, those not explicitly approved by the Board. Thus it appears to us Measure BB bond proceeds is restricted for use only for Measure BB authorized uses and its cash and

investments should be segregated from other District cash and investments in a separate account of the County Treasurer or fiscal agent.

A. Formal loans. The Board annually gives authorization to District staff to temporarily borrow cash from any fund for use for District operations and as discussed in our 2009 Annual Report this is not allowable under Measure BB.

For example the Board adopted Resolution 09-10 – ‘Temporary Interfund Cash Borrowing’ at its September 3, 2009 meeting. (<http://www.smmusd.org/brd0910/min090309.pdf> page 30) This allows the school to borrow up to “75% of available resources in any Fund” if there is “not enough cash to meet fiscal obligations in the General or other operating Funds due to the shortage of funds created by the deferral of the July apportionment payment or lack of” a state budget delaying any state funds normally received by September 30th.

This can impact on the use of Measure BB bond proceeds as its cash can be used for non-Measure BB purposes and in our opinion this is not allowable under Measure BB. In addition there is a small risk such funds as a loan may not be repaid in a timely manner and that could adversely impact on the implementation of Measure BB projects.

According to Note 5 on page 18 \$1 million was borrowed by the General Fund during the 2008-2009 fiscal year, and was reversed, thus included in the Due from other funds amount of \$2 million on the Balance Sheet on page 10. These transactions are related to the discussion in section 5 (Transfers of cash between funds) that follows.

B. Informal loans. As discussed in our 2009 Annual Report the pooling of Measure BB Bond cash with other District cash is not allowable under Measure BB even though cash pooling may be a widely accepted school district practice. The District appears to be using Measure BB bond cash for non-Measure BB purposes, at times without knowing so until after the fact. This appears to be the case having the Boys and Girls Club sub-fund within the Building Fund. As of June 30, 2009 Measure BB Bond sub-fund, as discussed previously being in the same Building Fund, had an informal loan outstanding of \$680,806 that would have been interest free had it not been brought to the attention of the District.

5. Transfers of cash between funds.

The 2009 Annual Report stated that the Committee had orally and in writing requested additional information regarding the \$1 million transferred to the General Fund from the Measure BB Bond Building Fund, as described at the time. As of the date of issuance of that report we had not received an answer. According to the Special Audit Report the monies were intended for maintenance expenditures. We wanted to examine the expenditure details to confirm they were allowable under Measure BB and had actually been spent by the General Fund. It appeared to us the inter-fund transfer acted as a source of financing for the General Fund and not as a reimbursement of expenditures, and that may be in violation of Article XIII A, Section 1(b)(3) of the California Constitution.

The most recent Special Audit Report addresses this concern, however the explanations appear to be contradictory. According to page 3 "It has been determined that Measure BB funds can't be used for Routine Restricted Maintenance expenditures in the General Fund." Note 5, page 18, refer to a \$1 million inter-fund transfer to reimburse the sub-fund for amounts transferred in the 2007-08 fiscal year. Note 8, page 19, refer to an adjustment for restatement of the beginning fund balance as a reimbursement to the sub-fund for amounts transferred out of the fund in 2007-08 for deferred maintenance. Routine restricted maintenance does not appear to be the same as deferred maintenance. Yet either way it appears the District has deemed the \$1 million transfer is not appropriate. As a result another \$1 million transferred in the 2008-09 fiscal year was reversed, and the total of \$2 million should have been paid in the 2009-10 fiscal year back into the Measure BB Bond Sub-fund.

According to discussion with the District the Measure BB Bond Attorney indicated it was a 'grey' area. Yet taking at face value the language on page 3 it appears for the year ended June 30, 2008 the District was not in compliance with the requirements of Article XIII A, Section 1(b)(3) of the California Constitution. Given the timing of the event and the follow up by the District correcting the \$1 million transfer in the 2009-10 fiscal year by calling it a loan we deem it within compliance with the requirements of Article XIII A, Section 1(b)(3) of the California Constitution, although not allowable under Measure BB, having a more restrictive requirement in our opinion, prohibiting formal loans.

Given the financial difficulties the school district may face and what the future may bring, it might be prudent to obtain additional legal opinions to ascertain if such transfers are in fact not legal

under Measure BB. Although our opinion is it is not, for budgetary reasons it might be to the District's benefit to investigate further.

Summary related to the Overall Conclusion:

We cannot conclude one way or the other, without reasonable question, that the District is in compliance with the requirements of Article XIII A, Section 1(b)(3) of the California Constitution for the year ending June 30, 2009 for the reasons stated above. However, we do point out that from what we did receive we did not find any misuse of Measure BB funds, only that we feel because of the findings and concerns raised above, we also cannot say the District is in compliance.

In the Committee's opinion we have identified material errors in the Special Audit Report that weakened our confidence relying on its information. We seek improved transparency and understandability of information presented by the District to this Committee. We are also concerned about Measure BB bond cash, its investments, the actual understatement of its interest earnings, borrowing of such cash by the District for non-measure BB uses both informally and formally and future mixing of cash. We therefore recommend that the District consult with legal counsel relative to cash, investments of cash, and segregation of cash from other District cash, and use of such cash for deferred maintenance. We seek additional quarterly information, additional supplemental information in the Special Audit Report and the establishment of a restricted Measure BB fund that would be presented in the annual District wide Audited Report. Had a restricted Measure BB fund existed the informal loan to the Boys and Girls Club using Measure BB cash could not have occurred.

We respectfully encourage the Board to discuss what should be "the sufficient resources to publicize the conclusions of the citizens' oversight committee" as required by state education code section 15280. In addition we respectfully urge the Board request a written report from District staff presenting its opinion of the findings and concerns discussed in our Committee's 2010 Annual Report.

We appreciate the efforts of the District management thus far and given this is the first Proposition 39 implementation by the District we recognize, as we hope District management does, that this is a learning experience for all of us. Our expectations as citizens may be

different than what is typical for school accounting and reporting practices. We hope we serve the District and community well over the short and long term by giving our honest objective assessment to the best of our abilities.