

**REPORT BY THE
AUDITOR GENERAL
OF CALIFORNIA**

**SOME SCHOOL CONSTRUCTION FUNDS
ARE IMPROPERLY USED AND NOT MAXIMIZED**

**Some School Construction Funds
Are Improperly Used and Not Maximized**

P-013, January 1991

**Office of the Auditor General
California**



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P-013

Honorable Robert Campbell, Chairman
Members, Joint Legislative Audit Committee
State Capitol, Room 2163
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning the Office of Local Assistance's responsibilities for the daily administration of school construction programs. The report indicates a need for the Office of Local Assistance to more closely monitor its programs to maximize the limited funds available for school construction projects.

Respectfully submitted,

A handwritten signature in cursive script that reads "Kurt Sjoberg".

KURT R. SJOBERG
Auditor General (acting)

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Summary

Results in Brief The Department of General Services (department), through its Office of Local Assistance (OLA), is responsible for providing administrative support for the State Allocation Board (SAB). In this capacity, the OLA disburses funding according to policy established by the SAB to local public school districts to build or improve their school facilities. However, during our review we noted the following deficiencies:

- The OLA disbursed approximately \$18.4 million to school districts' lease-purchase projects instead of transferring this money to the State's General Fund as required;
- At least 40 school districts were improperly reimbursed for \$3.9 million in commitments made and costs incurred for lease-purchase asbestos abatement construction before the SAB approved the districts' projects;
- The OLA overpaid by at least \$25,700 the management fees for seven asbestos abatement projects, and disbursed at least \$227,000 of asbestos abatement funds to 18 projects without receiving the required documentation from the districts;
- The OLA has not recovered at least \$2 million in construction funds loaned to school districts that it should have recovered and made available to other eligible districts;

- The OLA lost at least \$169,000 in discounts offered by portable classroom manufacturers because it did not pay the manufacturers' invoices promptly;
- The OLA does not adequately monitor the school districts' contributions toward the cost of their lease-purchase construction projects;
- To participate in the OLA's programs, school districts are required to use the proceeds from their sales of surplus real estate to pay for capital outlay and maintenance. However, the OLA does not adequately review how school districts use the proceeds from the sales when the districts apply to the State School Building Lease-Purchase Program (lease-purchase program) for the first time, nor does it comply with its own procedures to ensure that school districts appropriately use the proceeds from the sales; and
- The OLA does not promptly conduct required close-out audits of school district construction projects funded with state money to determine whether any funds that may have been apportioned to the projects in excess of actual costs are to be returned to the State.

Background The OLA administers programs that provide funding to local public school districts. For example, the programs provide funding for the acquisition and development of school sites, construction and renovation of existing school buildings, asbestos abatement, and the installation of air conditioning in year-round schools. The OLA also collects non-use payments from school districts that hold unused school sites, and monitors the disposition of surplus school property. The majority of funding for these programs is derived from general obligation bonds issued by the State. Between January 1982 and December 1990, California voters have approved the issuance of \$4.95 billion in bonds to fund the programs administered by the OLA.

**Rent Income
Not Transferred
to the State's
General Fund**

The Education Code directs the SAB to collect rents from school districts participating in the lease-purchase program, and allows the rent to be as much as the interest earned in the districts' lease-purchase funds. The Education Code requires that the interest collected as rent be transferred to the State's General Fund. However, since 1982, the OLA has not transferred \$18.4 million in interest to the State's General Fund. Instead, the OLA disbursed these funds to school districts' lease-purchase projects by applying the interest earnings to the cost of the projects. The department contends that the Education Code only addresses situations where rents are collected and actually deposited in the State School Building Lease-Purchase Fund, not where rents are directly applied to the cost of projects without deposit. However, based on an opinion obtained from the Legislative Counsel, we believe the OLA has misinterpreted the code.

**Asbestos
Abatement
Costs and
Commitments
Were Incurred
Before SAB
Approval**

The Education Code authorizes the SAB to apportion funding to school districts for specified school construction projects including asbestos abatement. However, according to a Legislative Counsel opinion, the law does not allow the SAB to reimburse districts for costs incurred and commitments made for lease-purchase asbestos abatement projects before the SAB's approval. However, we found that at least 40 school districts were improperly reimbursed for \$3.9 million of asbestos abatement construction commitments and costs incurred before the SAB approved their projects. In addition, another \$2.6 million was apportioned to school districts for costs incurred and commitments made before the SAB approved the districts' projects. As a result, these funds are not available to other school districts that have already been approved for asbestos abatement project funding. The SAB contends that it believed that certain provisions of the Education Code allowed for reimbursement of such costs.

Management Fees Overpaid and Funds Disbursed Without Required Documentation

The SAB's policy for lease-purchase asbestos abatement projects limits fees for project management to 12 percent of the total project costs. However, for 7 of the 35 asbestos abatement projects we reviewed, the OLA paid management fees exceeding the amount allowed by a total of \$25,700. As a result, at least \$25,700 is not available to school districts eligible for the abatement of asbestos in their schools. Additionally, the OLA disbursed at least \$227,000 of asbestos abatement funds to 18 projects without receiving the districts' contracts. SAB policy requires that the districts submit these contracts before the districts can receive funding. Because the OLA did not receive the contracts, it cannot be certain whether this amount was spent by the districts in accordance with the SAB's policy and state law. The OLA's local assistance officer stated that the project manager fees were overpaid because funds were released based on general estimates in the school districts' applications rather than detailed cost estimates. He also stated that funds were released without contracts because the work was done through purchase orders rather than contracts. He stated that staff have been instructed in the importance and necessity of having a valid contract before funds are released to a school district.

Unrecovered Loans for Advance Planning of Construction Projects

The OLA loans funds to school districts for the costs of advance planning of school construction projects. The Education Code requires repayment of these loans if the SAB does not approve the projects for funding within 24 months after the date of the loans. From the inception of the advance planning loan program in January 1987 until June 1990, the OLA has not collected at least 36 loans totaling over \$2 million from districts that did not submit applications within 24 months, as required by the Education Code. As a result, at least \$2 million of advance planning funds are not available to other school districts. The OLA has not recovered these funds because, at the time of our review, it had not implemented procedures for identifying and collecting those loans eligible for recovery.

**Failure To Take
Advantage of
Discounts
Offered by
Portable
Classroom
Manufacturers**

Some manufacturers of portable classrooms offer discounts for prompt payment of invoices. Of the 30 invoices we initially reviewed for the period from June 1989 through March 1990, we found 15 invoices that the OLA did not pay in time to take advantage of \$152,000 in discounts. After the OLA developed new procedures for prioritizing and handling invoices that offered discounts in August 1990, we reviewed an additional 39 invoices. The OLA did not pay 7 of the 39 invoices in time to claim more than \$17,000 worth of discounts. Because the OLA did not pay its invoices promptly, it paid at least \$169,000 more for portable classrooms than necessary.

**Inadequate
Review of
School
Districts'
Reports of
Contributions
to Lease-
Purchase
Projects**

The Education Code requires school districts participating in the State's lease-purchase programs to contribute a share of their construction projects' costs. However, the OLA does not adequately monitor the districts to ensure that the districts are properly reporting their contributions. As a result, erroneous or improper deductions claimed by the districts may go undetected, and the districts may receive more state funds than they are entitled to. For example, as of July 30, 1990, the OLA had completed desk reviews of only 2 percent of districts' quarterly reports to determine the accuracy and validity of the deductions claimed. However, of the few reports that were reviewed, districts had erroneously deducted more than \$2.5 million from a total of \$5 million in deductions claimed. In addition, two of three school districts we reviewed underreported their gross contributions in fiscal year 1988-89 by a total of more than \$177,000. According to the local assistance officer, competing priorities have limited the staff available to audit districts' reports on their contributions.

Inadequate Review of School Districts' Sales of Surplus Property	<p>If a school district sells surplus property and uses the proceeds for purposes other than capital outlay or maintenance, SAB policy requires that the district be precluded from participating in the OLA's programs for five years. However, the OLA is not adequately reviewing how school districts use the proceeds from their sales of surplus property. For example, we found two school districts that had sold surplus real estate totaling \$308,000 during the five-year period before they applied to the lease-purchase program. Although we found that the districts used the proceeds properly, the OLA did not know that the districts had sold any property or how the sales proceeds were used because the OLA only considers those sales that occur in the previous year. As a result, some school districts could sell surplus real estate and use the proceeds for purposes other than capital outlay and maintenance and, then, improperly receive state funds.</p>
Completed School Construction Projects Not Audited	<p>According to the OLA's policy, expenditures for school districts' construction projects are to be audited by the OLA's audit group at the close-out phase of construction. As of June 27, 1990, school districts participating in the lease-purchase program completed construction on 1,112 projects. However, the OLA has not reviewed the expenditures of 779 (70 percent) completed projects to ensure that they are accurate. These projects have been ready for their close-out audits for an average of 24 months; at least 16 of the projects have been ready for review since April 1983. According to the department's director, competing priorities have limited the OLA staff available for close-out audits.</p>
Recommendations	<p>The Office of Local Assistance or the State Allocation Board, as appropriate, should take the following actions:</p> <ul style="list-style-type: none"> • Transfer to the State's General Fund all interest earnings collected from school districts as rent;

- Recover all lease-purchase asbestos abatement funds apportioned to school districts for costs incurred and commitments made before the SAB approved the districts' projects;
- Determine whether any funds disbursed to school districts for asbestos abatement management fees that exceeded the required limit can be recovered from the districts;
- Obtain and review documentation from school districts for all funds disbursed without the required documentation, determine whether the funds were used in accordance with the SAB's policies and state law, and recover any funds that were used improperly;
- Adhere to newly implemented procedures to identify advance planning loans that should be recovered, and take the appropriate action to recover the funds from the school districts;
- Ensure that available discounts are taken from the manufacturers of portable classrooms;
- Audit a representative sample of the quarterly contribution reports received from school districts to ensure that the gross contributions and deductions claimed by the districts are accurate and valid;
- Review districts' sales of surplus real estate occurring in the five-year period before the districts' applications to the lease-purchase program to ensure that the proceeds from the sales were used for capital outlay or maintenance as required by the Education Code; and
- Conduct close-out audits for all completed construction projects, and ensure that all future construction projects are audited promptly upon completion.

Agency Comments The Department of General Services (department) disagrees that the Office of Local Assistance is improperly using some of its school construction program funds. However, the department stated that it will take appropriate actions to address the recommendations.

Introduction

The State Allocation Board's (SAB) primary function is to control the apportionment of state monies to fund school construction projects. The Department of General Services' Office of Local Assistance (OLA) provides administrative support for the SAB and is responsible for the daily administration of the school construction programs according to policy established by the SAB. These programs include the State School Building Lease-Purchase, State School Deferred Maintenance, Emergency Classroom, Year-Round Incentive, Asbestos Abatement, and Child Care and Development Facilities programs.

The State School Building Lease-Purchase Program (lease-purchase program) provides funding to school districts for the acquisition and development of school sites, construction of new school buildings, and the modernization of existing school buildings over 30 years old. This program is referred to as a lease-purchase program because the State leases the facility to the district for a nominal rental payment, usually \$1 per year for 40 years. At the end of the lease period, title is transferred to the district.

The State School Deferred Maintenance Program provides funding to school districts for major repairs or replacement of the various structural and mechanical components of school buildings. The State will match, subject to certain limitations, school districts dollar for dollar for funds committed to the district's deferred maintenance. In addition, the State will provide funding for "critical hardship" deferred maintenance needs when the SAB has determined an extreme hardship exists and when the project cost exceeds the district's deferred maintenance funding for the year.

The Emergency Classroom Program leases portable classrooms to school districts that have an immediate need for additional classroom space. These portable classrooms are intended to house students while permanent facilities are being constructed or repaired. The State charges the school districts from \$1 to \$2,000 per year for each portable classroom.

The Year-Round Incentive Program provides cash payments to school districts as an incentive for the district to operate year-round. In addition, this program offers funding to provide air conditioning and insulation for schools that operate year-round.

The Asbestos Abatement Programs provide funding to school districts for the identification and containment or removal of asbestos materials in schools. The State Asbestos Abatement Program is funded with appropriations from the State's General Fund. The Lease-Purchase Asbestos Abatement Program obtains its funding from general obligation bonds issued by the State. These programs could fund up to 75 percent of an eligible school district's costs for an asbestos abatement project.

The Child Care and Development Facilities Program provides eligible child care and development programs with loans and grants for the repair and renovation of facilities used in the programs. This program also leases portable classrooms to be used by the child care and development programs.

Finally, in conjunction with its administration of programs that provide funding for school facilities, the OLA also administers a program that collects non-use payments from school districts that hold unused school sites and administers a program that monitors the sales of surplus school property.

Most of the funding for these programs is derived from general obligation bonds issued by the State. Between January 1982 and December 1990, California voters have approved the issuance of \$4.95 billion in bonds to fund the programs administered by the OLA.

However, the demand for these funds often exceeds the supply. As of October 24, 1990, approximately 838 projects were on a waiting list and were eligible to receive approximately \$520 million from the OLA's school construction programs. In addition, an unknown number of school districts may be eligible for funds for which they have not yet applied. However, according to the director of the Department of General Services, only \$168 million was available to be apportioned to these districts. Consequently, many of the districts that were on the waiting list or that had not yet applied to the programs could not have their projects funded. If the OLA had recovered funds inappropriately apportioned to other school construction projects, additional funds would have been available for the unfunded projects.

**Scope and
Methodology**

The purpose of our review was to evaluate the efficiency and effectiveness of the OLA's capital outlay activities. Because the OLA's primary function is to process school districts' applications for school construction programs, we focused on the OLA's role in apportioning and disbursing funds to school districts. We reviewed each school construction program administered by the OLA to assess the OLA's controls over the apportionment and disbursement of state funds and its compliance with applicable laws and regulations governing the various programs.

We reviewed each funding program administered by the OLA by analyzing the SAB's policies and procedures for apportioning and disbursing the funds. We also reviewed the California Education Code and other laws and regulations applicable to the various programs to determine what effect, if any, they have on the apportionment and disbursement of funds. Then, we selected a small, nonstatistical sample of projects from each program to determine whether the funds were apportioned in accordance with the SAB's policies and procedures and any applicable laws or regulations. When we noted any discrepancies, we selected larger samples to determine the scope of the problem. In addition, we visited three school districts to determine whether the districts

were accurately reporting to the OLA their matching share contributions for their school construction projects.

We did not assess the effectiveness of the funding programs in meeting the needs of school facilities in California, nor did we determine whether the school districts were using the funds as intended.

Moreover, we did not assess the OLA's timeliness in processing applications from school districts. That issue was addressed in a report released by Price Waterhouse in January 1988 under contract with the Office of the Legislative Analyst. Because the Price Waterhouse report was issued only 26 months before the start of our review and because school building projects can take five years or more, we could not fairly assess the impact of any changes the OLA has made as a result of the Price Waterhouse report. Appendix A describes the status of the OLA's implementation of the Price Waterhouse recommendations.

Finally, in Appendix B, we reviewed the status of the OLA's implementation of the Office of the Auditor General's recommendations contained in its report entitled "California Can Improve Its Program To Fund Asbestos Abatement Projects in School Districts," Report P-773, August 1988.

Chapter 1 Improper Use of Some School Construction Funds

Chapter Summary

Approximately \$18.4 million from the State School Building Lease-Purchase Fund that should have been transferred to the State's General Fund was used in the State School Building Lease-Purchase Program (lease-purchase program). In addition, the Office of Local Assistance (OLA) has not collected another \$13.4 million from school districts that should have been transferred to the State's General Fund. As a result, the State's General Fund, some of the funds of which are used to redeem school construction bonds, has paid at least \$31.8 million more to redeem bonds than is required by law. In addition, at least 40 school districts were improperly reimbursed for \$3.9 million in commitments made and costs incurred for lease-purchase asbestos abatement construction before the State Allocation Board (SAB) approved the districts' projects. As a result, these funds are not available to other school districts that were approved for asbestos abatement project funding. The OLA also overpaid by at least \$25,700 the management fees for seven asbestos abatement projects. Consequently, at least \$25,700 is not available to school districts eligible for the abatement of hazardous asbestos in their schools. Finally, the OLA disbursed at least \$227,000 of asbestos abatement funds to 18 projects without receiving from the districts the contracts as required by the SAB. Therefore, the OLA cannot be certain whether this amount was spent by the districts in accordance with the SAB's policies and state law.

**Rent Income
Not
Transferred
to the State's
General Fund**

After the SAB approves a school district's application to the lease-purchase program, the SAB apportions funds for that district's project. The apportionment is essentially a reservation of funds for the district's school construction project. When the SAB authorizes a disbursement of funds to a school district for its lease-purchase project, the district's apportionment balance is reduced by the amount of the disbursement. The funds are deposited in interest bearing accounts of the treasury of the county in which the district is located.

The Education Code, Section 17732, directs the SAB to collect rents from school districts participating in the lease-purchase program. Section 17732 also states that the amount of rent the SAB collects from a district can be as much as the amount of interest earned in the district's lease-purchase fund. In 1980, the SAB adopted a policy that states that the rental payments required by Section 17732 may take the form of a contribution toward the cost of an ongoing project or take the form of a direct remittance. According to this SAB policy, the OLA's practice has been to notify the districts when it intends to treat the interest earnings as contributions toward the costs of the districts' ongoing projects. The effect of this transaction is to reduce the districts' remaining apportionment balance by the amount of interest earned by the districts. This transaction is finalized with administrative journals prepared by the OLA that notify all parties concerned, including the district and the State Controller's Office, that the interest earned by the district has, in effect, been collected by the OLA.

Section 17685 of the Education Code, which is part of the 1982 school construction bond act, states that all money deposited in the State School Building Lease-Purchase Fund pursuant to Section 17732 should be available only for transfer to the State's General Fund to reimburse the General Fund for funds paid to redeem school construction bonds. In addition, the subsequent school construction bond acts of 1984, 1986, and 1988 contain identical provisions.¹ Moreover, the Education Code,

¹The 1990 School Construction Bond Acts do not contain such provisions.

Section 17708.5, forbids disbursements to school districts' lease-purchase projects from any funds required by law to be transferred to the State's General Fund.

We asked the Legislative Counsel to review the issue and determine whether the OLA, acting according to SAB policy, has the authority to apply a district's interest earnings toward the cost of the district's school construction project. The Legislative Counsel stated that according to the view taken by the OLA, Section 17685 would be interpreted literally to direct that rent payments required under Section 17732 be transferred to the General Fund only when the revenues are actually deposited into the State School Building Lease-Purchase Fund. Thus, according to the OLA's position, if the OLA does not actually receive those rent payments for deposit into that fund, but chooses, instead, to directly debit the school district's apportionment in the amount of those rent payments, the requirement to reimburse the General Fund would not apply. However, the Legislative Counsel disagrees with the OLA's interpretation of the statutes.

The Legislative Counsel stated that it is an established rule of statutory construction that when the language of a statute is clear, a court interpreting it should follow its plain meaning. However, the literal meaning of a statute may be disregarded to avoid absurd results. Moreover, the OLA may not properly allocate rent payments required under Section 17732 in a manner that contravenes the conditions set forth in Section 17685. The Legislative Counsel stated that the intent of Section 17685 was not to make the transfer of the interest earnings dependent on whether the SAB chooses to directly debit the cost of a project or receive a direct remittance from the district. Instead, according to the Legislative Counsel, the intent of the law is to require those payments to be transferred to the General Fund to reimburse the General Fund for funds paid to redeem school construction bonds. The Legislative Counsel, therefore, concluded that the OLA, acting according to SAB policy, is not authorized to apply rent payments toward the cost of school construction projects.

Since the enactment of the Education Code, Section 17685, in 1982, the OLA has prepared administrative journals collecting more than \$18.4 million in interest earnings from school districts. However, none of this interest has been transferred to the State's General Fund to redeem school construction bonds as required by Section 17685. Instead, contrary to Section 17708.5, the OLA disbursed these funds to school districts' lease-purchase projects by applying the interest earnings to the cost of the projects. In addition, at least another \$13.4 million of interest earnings have been reported to the OLA for which the OLA has not prepared administrative journals to collect the earnings. Some of these interest earnings for which the OLA has not prepared administrative journals date back to 1982. As a result, the State's General Fund has paid at least \$31.8 million more to redeem school construction bonds than was required by law.

The Department of General Services (department) contends that the Education Code, Section 17685, only addresses situations where rents are collected and deposited in the State School Building Lease-Purchase Fund. However, based on the opinion obtained from the Legislative Counsel, we believe the department has misinterpreted this code section.

**Asbestos
Abatement
Costs
Incurred and
Commitments
Made Before
the Required
Approval**

The Leroy F. Greene State School Building Lease-Purchase Law of 1976 (lease-purchase law) authorizes the SAB to apportion funding to school districts for specified school construction purposes such as deferred maintenance activities including asbestos abatement. Under the lease-purchase law, school districts are required to obtain the SAB's approval for their projects before the district can incur any costs that would be reimbursable under the lease-purchase program. One exception to this rule is found in the Education Code, Section 17736. This code section allows the OLA to reimburse a school district applying to the lease-purchase program for expenditures incurred or commitments made before the SAB's approval of the project if, among other things, the expenditures or commitments do not include any cost incurred for "construction" of a project.

We asked the Legislative Counsel to review the lease-purchase law and determine whether the definition of “construction” as used in the Education Code, Section 17736, includes lease-purchase asbestos abatement projects. The Legislative Counsel stated that the Education Code, Section 17702.1, which defines “construction,” includes the performance of deferred maintenance activities. Thus, because the lease-purchase law includes asbestos abatement projects as part of deferred maintenance activities, asbestos abatement activities are construction activities, as the term “construction” is used in Section 17736. Consequently, Section 17736 does not allow the SAB, under the authority of the lease-purchase law, to reimburse school districts for costs incurred or commitments made for lease-purchase asbestos abatement projects before the SAB’s approval.

Nevertheless, we found that the OLA has reimbursed 40 school districts for \$3.9 million in costs incurred or commitments made for lease-purchase asbestos abatement construction before the SAB approved their projects. In addition, another \$2.6 million has been apportioned to school districts for costs incurred or commitments made before the SAB approved their projects. As a result, these funds are not available to other school districts that were approved for asbestos abatement project funding. For example, as of October 24, 1990, approximately 187 asbestos abatement projects eligible to receive approximately \$12.8 million were on a waiting list. However, because funds for asbestos abatement are limited, these projects will not be funded until the OLA recovers funds improperly disbursed or apportioned to other districts or additional school construction bonds are authorized.

The executive officer of the SAB provided the Legislative Counsel with a letter explaining the SAB’s position on reimbursing school districts’ asbestos abatement costs incurred before the SAB’s approval of their projects. The executive officer stated that the SAB determined that asbestos abatement projects are not “construction” projects as the term is used in the Education Code, Section 17736. The executive officer also stated that the SAB did not treat asbestos abatement as “construction” but merely as a separate capital facility outlay item and allowed reimbursement

within the guidelines authorized by Section 17736. The executive officer did concede that had asbestos abatement been considered “construction,” projects would have been disallowed if the expenditure or commitment for the work was incurred or made before the date the projects were approved by the SAB.

**Management
Fees Overpaid
and Funds
Disbursed
Without
Required
Documentation**

The SAB’S Lease-Purchase Asbestos Abatement Program Guidebook (guidebook) describes the costs for asbestos abatement work that are eligible under the program. The guidebook allows reasonable costs for project manager services that do not exceed 12 percent of the eligible asbestos abatement costs approved by the SAB. The guidebook also states that the State’s share of the project’s cost will be released to the school district after the district submits to the OLA the contract for the abatement work.

However, the OLA does not always comply with the SAB’s guidelines when disbursing funds to school districts for their asbestos abatement projects. For example, the OLA overpaid the project managers’ fees in 7 of the 35 lease-purchase asbestos abatement projects we reviewed. Based on the SAB’s 12 percent limitation on project managers’ fees, the OLA should have paid no more than \$39,300 for such fees on these 7 projects. However, the OLA paid more than \$65,000, \$25,700 more than allowed by SAB policy.

Furthermore, for another 5 projects, we could not determine how much was paid to the project managers and whether the fees exceeded the SAB’s policy because the OLA’s project files did not contain proper documentation to support the fee calculation. In addition, the OLA released a total of at least \$227,000 to 18 lease-purchase asbestos abatement projects without having a contract between the districts and the contractors for the asbestos abatement work as required by SAB policy.

Because the OLA overpaid management fees, at least \$25,700 is not available to school districts eligible for the abatement of hazardous asbestos in their schools. In addition, because the OLA

did not obtain required documentation and contracts from school districts before disbursing project funds, the OLA cannot be certain that at least \$227,000 was spent in accordance with guidelines and state law.

The OLA's local assistance officer stated that the OLA overpaid the project managers' fees because, before January 1, 1990, funds were released to school districts based on general estimates in the districts' applications and supporting documentation rather than detailed cost estimates. However, according to the local assistance officer, effective January 1, 1990, the guidebook was revised to require school districts to provide the OLA with cost estimates before funds are released to the districts. In addition, the local assistance officer also stated that the OLA now requires that all projects have manager contracts that include specific language as to the services the project manager will perform, the fee schedule, and the basis for determining the fee. Finally, the local assistance officer stated that, in some cases, especially for small asbestos abatement projects, there was no asbestos abatement contract in the project file because the work was done through purchase orders rather than contracts. The local assistance officer stated that the field representatives in the lease-purchase asbestos abatement program have been instructed as to the importance and necessity for a valid asbestos abatement contract before funds are released to school districts.

Conclusion Approximately \$18.4 million from the State School Building Lease-Purchase Fund that should have been transferred to the State's General Fund was used in the State School Building Lease-Purchase Program. In addition, the Office of Local Assistance has not collected another \$13.4 million from school districts. Further, at least 40 school districts were improperly reimbursed for \$3.9 million for costs incurred or commitments made before the State Allocation Board approved the districts' lease-purchase asbestos abatement projects. The SAB's executive officer stated that the SAB determined that the Education Code, Section 17736, allows for such reimbursements. However, the Legislative

Counsel concluded that this code section does not allow the SAB to reimburse school districts for costs incurred or commitments made for lease-purchase asbestos abatement projects before the SAB's approval. Finally, the OLA overpaid management fees for asbestos abatement projects at seven school districts by at least \$25,700 and disbursed an additional \$227,000 to 18 districts without the contracts required by SAB policy. The OLA's local assistance officer stated that the project managers' fees were overpaid because funds were released based on general estimates on the school districts' applications rather than detailed cost estimates. Also, the local assistance officer stated that funds were released without contracts because the work was done through purchase orders rather than contracts.

Recommendations

The State Allocation Board or the Office of Local Assistance, as appropriate, should take the following actions:

- Prepare administrative journals to collect all interest earnings reported to the OLA since 1982;
- Transfer to the State's General Fund all interest earnings collected from school districts as rent;
- Recover all lease-purchase asbestos abatement funds apportioned to school districts for costs incurred and commitments made before the SAB approved the districts' projects;
- Review all other programs administered by the OLA, determine whether any funds have been improperly disbursed to districts for costs incurred or commitments made before the SAB's approval of the districts' projects, and recover those funds wherever possible;
- Develop procedures to ensure that school districts are reimbursed for costs incurred or commitments made before the SAB's approval of any project only when specifically allowed by state law;

- Determine whether any funds disbursed to school districts for asbestos abatement management fees that exceeded the SAB's limit can be recovered from the districts;
- Obtain and review documentation from school districts for all funds disbursed without the required documentation, determine whether the funds were used in accordance with the SAB's policies and state law, and recover any funds that were used improperly; and
- Comply with the SAB's policies by disbursing asbestos abatement funds only after the cost estimates, contracts, and other required documents are received from the school districts.

Chapter 2 The Office of Local Assistance Is Not Maximizing All Its Available Funds for School Construction

Chapter Summary

The Office of Local Assistance (OLA) needs to more closely monitor its programs to maximize the limited amount of funds available for school construction projects. Specifically, we found that at least \$2 million in state school construction funds could be available to other eligible districts if the OLA recovered loans it provided school districts for advance planning. In addition, the OLA lost at least \$169,000 in discounts offered by portable classroom manufacturers because the OLA did not pay the manufacturers' invoices promptly. Furthermore, school districts participating in the State School Building Lease-Purchase Program (lease-purchase program) are required to contribute a share of their projects' costs. However, the OLA is not adequately monitoring school districts to ensure that the districts are properly reporting their contributions. As a result, erroneous or improper deductions claimed by the districts may go undetected and, consequently, the districts may receive more state funds than they are entitled to under state law. In addition, if school districts want to participate in the OLA's programs, the districts are also required to use the proceeds from their sales of surplus real estate to pay for capital outlay and maintenance. However, the OLA is not adequately reviewing how school districts use the proceeds from their sales. Consequently, school districts could sell surplus real estate and use the proceeds for purposes other than capital outlay or maintenance and, then, improperly receive state funds from the OLA's programs. Finally, because the OLA has not conducted close-out audits on 70 percent of school construction projects that have been completed, the OLA has not determined the amount of the districts' allowable expenditures and whether any funds that may have been apportioned to these projects in excess of actual costs are to be returned to the State or the district.

**Unrecovered
Loans From
School Districts
for Advance
Planning**

Under the Leroy F. Greene State School Building Lease-Purchase Law of 1976 (lease-purchase law), school districts may request loans from the State Allocation Board (SAB) for advance planning of their construction projects. These loans are intended to help school districts pay for advance planning and related administrative costs incurred before the SAB approves their applications for construction projects. The Education Code, Section 17708.3, allows the SAB to establish a revolving loan account within the State School Building Lease-Purchase Fund. The SAB may use this loan account to make advance planning loans to any school district that submits a statement of its intent to file an application for the lease-purchase program. If, within 24 months after the district receives the loan, a lease-purchase application has not been received or approved by the SAB, the funds must be repaid to the State.

Since the inception of the advance planning loan program in January 1987 until June 1990, the OLA has provided 135 school districts with advance planning loans totaling over \$21 million. However, since the inception of the advance planning loan program, the OLA has not collected at least 36 loans totaling over \$2 million from districts that did not submit applications within 24 months as required. As a result of the OLA's failure to collect these loans, at least \$2 million is not available to other school districts for needed school construction projects. According to data provided by the OLA, as of October 24, 1990, 942 projects totaling over \$520 million were eligible to receive funding but were on a waiting list. However, at the time, only \$168 million was available to apportion to these projects.

The OLA has not recovered these funds because, at the time of our review, it had not implemented procedures for identifying and collecting those loans eligible for recovery. However, the director of the Department of General Services (department) stated that procedures have since been implemented and, in August and September 1990, all school districts with outstanding loans over 24 months old were notified of the repayment requirements.

**Failure To Take
Advantage of
Discounts
Offered by
Portable
Classroom
Manufacturers**

The OLA administers the Emergency Classroom and the Child Care and Development Facilities programs. Both of these programs lease to eligible school districts and child care providers portable classroom facilities that are built in factories and delivered to the school site. The OLA contracts with manufacturers to build a certain number of the portable classrooms for a given price. Some of the manufacturers offer the OLA discounts of up to 5 percent off the contracted price for prompt payment of their invoices. The State Administrative Manual, Section 8422.1, requires that state agencies take cash discounts when available.

However, the OLA does not always pay its bills in time to receive the discounts offered by the manufacturers. For example, we reviewed 30 invoices from manufacturers of portable classrooms for the period from June 1989 through March 1990 that offered discounts for prompt payment. We found that, for 15 of the 30 invoices, the OLA did not pay in time to take advantage of discounts worth more than \$152,000.

According to a memorandum from the OLA, many of the delays in paying invoices from June 1989 through March 1990 were attributable to work schedule disruptions, questionable invoices, and purchase estimate revisions. However, we found that, at the time of our initial review, the OLA did not have written procedures for prioritizing and handling invoices offering discounts. After our initial review, the OLA issued a memorandum on August 24, 1990, to its staff detailing new procedures for prioritizing and handling invoices that offered discounts for prompt payment. For the period between August 24 and October 31, 1990, we then reviewed all the payments exceeding \$10,000 that the OLA made to portable classroom manufacturers that offered discounts. Of the 39 payments to manufacturers we reviewed for this period, the OLA claimed discounts totaling over \$149,000. However, the OLA did not pay 7 of the 39 payments in time to claim more than \$17,000 worth of discounts, more than \$16,000 of which was offered on one invoice.

Because the OLA did not pay its invoices promptly, the OLA paid at least \$169,000 more for portable classrooms than necessary. Consequently, these funds are not available to build more portable classrooms or fund other school construction projects.

**Inadequate
Review of
School
Districts'
Reports of
Contributions
for Lease-
Purchase
Projects**

The Government Code, Section 53080, authorizes the governing board of any school district to levy a “developer fee” against any commercial or residential development project within the boundaries of the school district, for the purpose of funding the construction or reconstruction of school facilities. In addition, the Education Code, Section 17705.5, requires school districts participating in the lease-purchase program to contribute toward the costs of school facility construction. The gross contribution is equal to the maximum amount of developer fees that the district could have legally collected on building permits issued within the district’s boundaries during a given period. However, Section 17705.5 allows the school districts to claim certain deductions against their gross contributions. For example, the school districts may deduct from the gross contribution some of the costs of temporary classrooms for students while a school building is under construction. School districts participating in the lease-purchase program are required to report their gross contributions less any deductions to the OLA each quarter.² Good fiscal control practices dictate that the OLA should conduct desk reviews of all the districts’ quarterly contribution reports and audit a sample of the reports to determine the accuracy and validity of the gross contribution reported and the deductions claimed. Failure to review the districts’ contributions could result in school districts receiving more state funds than they are entitled to.

²School districts may use the cash method to pay their contributions or obtain a loan from the OLA. Our discussion is limited to the cash method.

To illustrate how the districts' contributions affect the amount of state funds required to complete a school construction project, we will suppose a district applies to the lease-purchase program. After the district submits the required documentation, the OLA determines that the district is eligible for a school construction project that will cost an estimated \$1 million. The OLA makes a recommendation, and the SAB agrees to apportion \$1 million of lease-purchase funds to the district. Each quarter, the district reports to the OLA the amount of its contribution. Rather than collecting the school district's contribution directly, the OLA can simply reduce the district's apportionment. For example, assume that during the first quarter, the district could have collected \$75,000 of developer fees and, therefore, reports a contribution of \$75,000. The OLA then reduces the district's apportionment by \$75,000. Therefore, the district could receive no more than \$925,000 in state funds for its construction project instead of the \$1 million originally apportioned. However, if the district underreports and shows a contribution of only \$50,000, the district could receive up to \$950,000 in state funds for its construction project, \$25,000 more than it is entitled to receive. Consequently, school districts that intentionally or mistakenly underreport their contributions could receive more state funds than they are entitled to.

Between January 1, 1987, and June 30, 1990, according to a report prepared by the OLA, the OLA received from school districts 2,262 quarterly contribution reports totaling over \$468 million in gross contributions. The same reports claimed more than \$154 million in deductions to the districts' gross contributions. As of July 30, 1990, the OLA had completed desk reviews of only 47 (2 percent) of the 2,262 quarterly reports to determine the accuracy and validity of the deductions claimed.³

³ The OLA had conducted desk reviews of another 20 quarterly reports to which the districts had not yet responded. We considered a desk review complete when the OLA and the district reached an agreement regarding the review.

Although the OLA reviewed only a small portion of the quarterly reports received, these reviews showed many inaccuracies in the reports. For example, the OLA's reviews of these 47 quarterly reports concluded that school districts had erroneously deducted more than \$2.5 million from a total of \$5 million in deductions claimed. The OLA estimates that the review of these reports took approximately 95 hours of staff time. If the OLA had not reviewed these reports and identified the erroneous deductions, these districts could have received more funds in future apportionments than they were entitled to receive.

In addition, to determine whether the gross contribution reported was accurate, the OLA has audited only one of 312 school districts required to make contributions in the lease-purchase program. At the time of our review, the final results of this audit were not available. To determine whether school districts were underreporting their gross contributions, we visited three districts and reviewed their contribution reports for fiscal year 1988-89. We found that two of the three districts had underreported their gross contributions to the OLA by more than \$177,000. As a result, these districts could receive up to \$177,000 more in state funds than they are entitled to.

According to the local assistance officer, competing priorities have limited the staff available to audit districts' contribution reports. One additional audit position was authorized in July 1990. The 1990-91 Budget Act provides the opportunity to establish five additional positions for this program. Documentation for these additional positions has been submitted to the Department of Finance. The focus of these new positions will be both desk reviews and field audits of school districts in the program.

**Inadequate
Review of
School
Districts'
Sales of
Surplus
Property**

The Education Code, Section 39363, requires all school districts to use the proceeds from the sales of surplus real estate for capital outlay or maintenance. However, if a district's governing board and the SAB have determined that the district has no anticipated need for additional sites or building construction for five years following the sale and the district has no major deferred maintenance requirements, the district may use the proceeds for other purposes. If both the district's board and the SAB have made such a determination, the district may deposit the proceeds in its general fund. According to the SAB'S policy, if the proceeds are deposited in the general fund, the district may not participate in the State Deferred Maintenance Program for five years and may not apply to any of the OLA's programs within five years without reversing the general fund transfer. In addition, for those districts participating in the OLA's lease-purchase programs, the Education Code, Section 17732, allows the SAB to collect certain sales proceeds as rent on the districts' lease-purchase projects. School districts in the purchase programs can, with the SAB's approval, retain their sale proceeds but have to use them for capital outlay or maintenance.

To ensure that the school districts applying for the lease-purchase program use the proceeds from their sales of surplus real estate in accordance with the Education Code, Section 39363, and SAB policy, good fiscal controls dictate that the OLA should require school districts not only to report any sales of surplus real estate that have occurred in the five-year period before the district's application to the OLA's programs but also to report how the proceeds were used. Failure to review district sales occurring in the five years before the districts' applications could result in school districts receiving state funds from the OLA to which they are not entitled under SAB policy.

For example, we found two school districts that had sold surplus real estate totaling \$308,000 more than one year before they applied to the lease-purchase program. The OLA did not know that the districts had sold surplus real estate or how the proceeds were used because the OLA's policy is to only review districts' sales that occur in the one year before the districts'

applications to the program. In the two cases we found, the districts provided us with documentation indicating that they had properly deposited sales proceeds or used the sales proceeds for capital outlay. Nevertheless, because the amount of state funds available for school construction are limited, it is important that the OLA review districts' sales of surplus property for the five years before their applications. Without such a review, some school districts could sell their surplus real estate, use their sales proceeds for purposes other than capital outlay or maintenance, and then improperly receive state funds from the OLA. Moreover, other school districts may not receive state funds for which they are otherwise eligible.

In addition, according to the OLA's guidelines for property disposition, when the SAB allows a district participating in the OLA's lease-purchase programs to retain the proceeds from the sale of surplus real estate, the district is required to submit annual expenditure reports to the OLA detailing how the proceeds were used. The OLA's guidelines further state that the OLA will audit these expenditure reports. However, we found that the OLA has not always required the districts to submit annual expenditure reports, has not always received reports from the districts that were required to submit them, and has not audited the reports it did receive.

For fiscal years 1986-87 and 1987-88, we reviewed the OLA's files regarding seven school districts participating in the OLA's programs that had submitted requests to the SAB to retain the proceeds from their sales of surplus property. The OLA did not require one of the seven districts to submit expenditure reports. Of the six districts that were required to submit the reports, we found only one report in the OLA's files. Furthermore, the OLA did not audit that report as the OLA's policy requires.

Because the OLA does not always require or receive expenditure reports from school districts that retain the proceeds from the sales of surplus real estate and does not audit the reports it does receive, it cannot be certain that these districts are using the proceeds from their sales for capital outlay in accordance with the

Education Code, Section 39363. As a result, the OLA may release more state funds to school districts participating in the OLA's programs than the districts are legally entitled to receive. Also, because state funding is limited, other school districts may be denied state funding for which they may be entitled.

According to the department's director, expenditure reports from districts retaining sales proceeds have not been requested in recent years because of staff shortages. Budget change proposals have been submitted for additional positions for this area of review but have been denied by the Department of Finance. The director also stated that competing priorities have limited the staff available for this activity.

**Completed
School
Construction
Projects Not
Audited**

According to the OLA's desk manual, school districts' project expenditures are to be audited by the OLA's fiscal audit group at the close-out phase of school construction projects. In addition, good fiscal control practices require that a close-out audit be promptly conducted upon completion of a construction project. If the close-out audits are not promptly conducted, funds due back to the State are not available for reallocation to other school districts eligible for the OLA's programs. When construction is completed on a project, the OLA's procedures are to review the project's expenditures for compliance with the laws and policies governing the program. The OLA's procedures are also to reconcile the apportionment and fund releases with the audited expenditures to determine whether any funds are due to the State or the school district and to adjust the apportionment accordingly.

According to data provided by the OLA, as of June 27, 1990, school districts participating in the lease-purchase program had completed construction on 1,112 projects totaling over \$1.86 billion. Of these 1,112 completed projects, the OLA has completed the close-out audits of only 333 projects totaling \$383 million. We reviewed the OLA's files for these 333 projects and found that these audits resulted in a net reduction of \$8.4 million in

apportionments. Therefore, the \$8.4 million of apportionments not used by the districts was then available for reallocation to other eligible school districts.

Based on data provided by the OLA, it has not reviewed 779 (70 percent) of the 1,112 projects totaling \$1.48 billion in state funds. These projects have been ready for their close-out audits for an average of 24 months; at least 16 projects have been ready for review since April 1983, for more than seven years.

Because the OLA has not reviewed 779 projects for which construction is complete, the OLA has not determined the amount of the districts' allowable expenditures and whether any funds that may have been apportioned to these projects in excess of actual costs are to be returned to the State or the district.

According to the department's director, competing priorities have limited the OLA staff available for close-out audits. However, he stated that two additional audit positions were authorized in July 1990. In addition, the OLA has submitted a budget change proposal to the Department of Finance for 4.5 additional three year limited-term positions for midyear 1990-91. The request is being reviewed.

Conclusion

The Office of Local Assistance could maximize its limited amount of funds available and, thus, fund more school construction projects if it more closely monitored its programs. Specifically, the OLA could make an additional \$2 million available for school construction projects if it recovered loans it provided school districts for advance planning. The OLA had not collected these funds because, at the time of our review, it had not implemented procedures for identifying and collecting those loans that should be recovered. In addition, the OLA could save up to 5 percent of the contracted price for some portable classrooms if it paid the manufacturers promptly. At the time of our initial review, the OLA was not always taking advantage of discounts because it did

not have written procedures for prioritizing and handling invoices offering discounts. Another way the OLA could maximize the funding available for school construction would be to review more school districts' contribution reports to ensure that the districts are contributing their share of the construction costs. Similarly, the OLA could maximize its funding for school construction projects if it reviewed school districts' sales of surplus real estate to ensure that the districts participating in its programs are using the sale proceeds for their capital outlay and maintenance needs rather than using funds from the OLA's programs. Finally, the OLA could identify and recover any funds from school districts' apportionments that are in excess of actual costs when the OLA conducts close-out audits on all construction projects already completed.

Recommendations


To maximize its available funds for school construction projects, the Office of Local Assistance should take the following actions:

- Adhere to its newly implemented procedures to identify and collect loans that are recoverable;
- Ensure that it takes advantage of all available discounts from the manufacturers of portable classrooms;
- Audit a representative sample of the quarterly contribution reports it receives from school districts to ensure that the gross contributions and deductions claimed by the districts are accurate and valid;
- Review districts' sales of surplus real estate occurring in the five-year period before the districts' applications to the State School Building Lease-Purchase Program to ensure that the proceeds from the sales were used for capital outlay or deferred maintenance as required by the Education Code;

- Comply with its own policies by requiring all districts participating in the lease-purchase program to report how the proceeds from the sales of surplus property are used, following up when necessary to ensure that school districts provide the reports as required, and auditing the reports to ensure the districts are using the proceeds in accordance with the Education Code; and
- Promptly conduct close-out audits for all completed construction projects.

We conducted this review under the authority vested in the auditor general by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,


KURT R. SJOBERG
Auditor General (acting)

Date: January 28, 1991

Staff: Robert E. Christophel, Audit Manager
Fred Forrer, CPA
Arn Gittleman
Duane E. Butler
Bruce S. Kaneshiro

**Appendix A Status of the OLA’s Implementation of
Price Waterhouse’s Recommendations on the
School Facilities Funding Application Process**

Chapter 886, Statutes of 1986, mandated that the Office of Local Assistance (OLA) of the Department of General Services (department) contract with the Office of the Legislative Analyst for a study related to school construction financing. The contract was awarded to Price Waterhouse, which submitted the final report to the OLA on January 10, 1988.

The report presented several recommendations, eight of which focused directly on the State School Building Lease-Purchase Program (lease-purchase program) and the OLA. Of the eight recommendations, we have verified that the State Allocation Board (SAB) has implemented five, rejected one, and has not yet acted on two. A discussion of Price Waterhouse’s recommendations and the extent to which the OLA has implemented them follows:

Recommendation	Develop a program for school districts to calculate enrollment projections. The program would reduce the time school districts spend manually calculating projections as well as the time spent by the OLA’s staff verifying the data.
Status	According to the OLA’s data processing manager, a data diskette has been developed and distributed to more than 600 school districts participating in the lease-purchase program. The diskette simplifies the application process by automatically calculating the school districts’ projected enrollment based upon the enrollment data entered by the districts. School districts have the option of sending their enrollment data to OLA staff to project enrollment on the OLA’s mainframe computer.

Recommendation	Replace the traditional method used by school districts for computing the area of adequate school construction with an alternative method that uses the teaching station count versus the actual area measured.
Status	According to the department director, the SAB has not directed the OLA to pursue the recommendation to replace the traditional method of computing the area of adequate school construction because the alternative method places 30 percent of the districts at a disadvantage, many of which have been in the program the longest.
Recommendation	Management of the OLA should ensure that its newly established project to develop and distribute policy and procedures manuals for the OLA's internal operations is completed in a timely manner. Management should also ensure that the manuals are updated regularly.
Status	The OLA has distributed a 17-chapter desk manual to the field representatives in the lease-purchase program. The manual provides step-by-step procedures for the OLA's internal operations. The OLA has also established procedures that ensure changes to the manual are updated as needed.
Recommendation	Assess the feasibility of offering to the school districts participating in the lease-purchase program standardized design plans for facilities.
Status	The department director stated that the SAB has not directed the OLA to pursue a policy favoring standardized design plans for facilities.

Recommendation	Develop an annual office planning process for accomplishing the OLA's application process workload.
Status	The OLA has partially implemented this recommendation by hiring a consulting agency to develop workload standards. However, the recommendation also called for development of performance goals for all critical tasks performed in the application process for school facilities. The report submitted by the consultant does not clearly develop strategies or plans to attain the goals and standards developed for the OLA. The department director did say that the OLA executive management team meets weekly to discuss issues of planning and workload management.
Recommendation	<p>The OLA should continue to pursue much greater use of computer support for the performance of application processing functions. It should also take the following actions:</p> <ul style="list-style-type: none">• Appoint a full-time manager for the computer support function; and• Advise the Office of Information Technology, Department of Finance, of changes to the automation project.
Status	A full-time data processing manager has been hired. In addition, as required by the Department of Finance's Office of Information Technology, the OLA has prepared an Information Management Annual Plan and all other special reports.

Recommendation Redesign the OLA field representatives' job by creating two work groups within each region to improve service to school districts.

- **Phase I Group** - Field representatives within this group would be responsible for processing tasks that fall within Phase I of the application process.
- **Phase II Group** - Field representatives within this group would be responsible for processing tasks that fall within Phase II and Phase III of the application process.

Status The OLA has not implemented this recommendation. According to the OLA's manager of Field Services, changing circumstances at the school districts affect projects too frequently to effectively separate duties among field representatives. The OLA's manager of Field Services reasons that specialization would eliminate oversight and accountability for lease-purchase projects. The department director added that creating two work groups in Field Services does not make operational sense.

Recommendation The OLA should obtain administrative resources for the mail room, file room, and file control functions to adequately support the program functions of the OLA's operations.

Status An assistant was hired for the mail room in January 1988. Another was hired for the file room in January 1989. The file room has been converted to a library operation, allowing only authorized personnel to handle files and plans. The files and plans are controlled by a computer-tracking system.

Appendix B Status of the OLA’s Implementation of the Auditor General's Recommendations in a Report Issued in 1988 Regarding the State’s Funding of Asbestos Abatement Projects in School Districts

In August 1988, the Office of the Auditor General completed a report entitled “California Can Improve Its Program To Fund Asbestos Abatement Projects in School Districts” (Report P 773). The report outlines measures that the Office of Local Assistance (OLA) could use to improve the administration of the program to fund asbestos abatement projects in school districts. On September 1, 1989, the State and Consumer Services Agency provided the Office of the Auditor General with the OLA’s follow-up response. (The OLA is subordinate to the State and Consumer Services Agency.) In the following section, we discuss the OLA’s implementation of the Office of the Auditor General’s recommendations. For this discussion, we relied on information provided to us by the OLA.

- Recommendation** Ensure that school districts promptly submit all documentation necessary to qualify for asbestos abatement funds by informing these school districts of the new time limits for reserving funds.
- Status** The OLA has established a 12-month time limit for the applicant to submit the required documentation to enable the OLA to release funds. The OLA has notified school districts facing rescission of their apportionments about its new policy on time limits for reserving funds for asbestos abatement.

-
- Recommendation** Develop and implement deadlines for each step in the internal processing of school district applications and ensure adherence to these deadlines.
- Status** According to the director of the Department of General Services, the State Asbestos Abatement Program ended June 30, 1990. The OLA is in the process of developing deadlines for the necessary steps of the Lease-Purchase Asbestos Abatement Program. Although the OLA has not yet established deadlines for each step in the internal processing of school district applications for asbestos abatement funds, it is developing an automated database system designed to track projects from the receipt of an application through the State Allocation Board's (SAB) approval and release of funds to the district.
- Recommendation** The OLA should propose to the SAB that the SAB rescind all apportionments to school districts that do not qualify for funding and to school districts that cannot provide the necessary documentation to qualify for funding, and apportion these funds to eligible school districts currently applying for asbestos abatement funds.
- Status** At a SAB meeting on October 26, 1988, the OLA recommended rescinding 90 district projects for which a six-month deadline was imposed. Approximately \$2.5 million in apportionments was rescinded. The OLA recommended rescinding approximately \$1.85 million to the SAB in April 1989, of which approximately \$250,000 was ultimately rescinded. Approximately 14 projects totaling \$1.6 million were granted a six-month extension by the SAB. As of May 30, 1990, approximately \$445,000 of these funds remained unapportioned.

Recommendation	Meet all federal deadlines for submitting applications for federal funds.
Status	As of January 1989, the OLA promptly processed all applications for the 1989 award cycle. As a result, California schools were allocated almost \$3.6 million from the federal asbestos program.

Memorandum

To: Kurt R. Sjoberg
Acting Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

Date: January 22, 1991

From: Office of the Secretary
(916) 323-9493
ATSS473-9493

Subject: RESPONSE TO AUDITOR GENERAL REPORT NO. P-013

Thank you for the opportunity to respond to your Report P-013 entitled "THE OFFICE OF LOCAL ASSISTANCE IS IMPROPERLY USING AND IS NOT MAXIMIZING ITS SCHOOL CONSTRUCTION PROGRAM FUNDS." The attached response from the Department of General Services addresses each of your recommendations.

If you need further information or assistance on this issue, you may wish to have your staff contact Rick Gillam, Audit Coordinator, Department of General Services, at 2-4188.

Sincerely,



PORTER L. MERONEY
Undersecretary

SRC:mb

cc: Elizabeth Yost
Department of General Services

Rick Gillam, Audit Coordinator
Department of General Services

MEMORANDUM

Date: January 22, 1991

File No: P-013

To: Porter Meroney, Undersecretary
State and Consumer Services Agency
915 Capitol Mall, Room 200
Sacramento, CA 95814

From: **Executive Office**
Department of General Services

Subject: **RESPONSE TO AUDITOR GENERAL REPORT NO. P-013 -- THE OFFICE OF LOCAL ASSISTANCE IS IMPROPERLY USING AND IS NOT MAXIMIZING ITS SCHOOL CONSTRUCTION PROGRAM FUNDS**

Thank you for the opportunity to respond to Office of the Auditor General (OAG) Report No. P-013 which addresses recommendations to the Department of General Services (DGS), Office of Local Assistance (OLA). The following response addresses each of the recommendations.

OVERVIEW OF REPORT

The DGS has reviewed the findings, conclusions, and recommendations presented in Report No. P-013. As discussed in this response, the DGS will take appropriate actions to address the recommendations.

Overall, the DGS is pleased that after an approximately nine-month evaluation of the efficiency and effectiveness of OLA's local assistance activities, the report does not identify any significant issues pertaining to OLA's responsibilities for which management was not already taking appropriate action prior to the audit. In addition, the reported findings that pertain to OLA's responsibilities are not surprising when consideration is given to the size and complexity of the school construction programs administered by OLA for the State Allocation Board (SAB).

Since the findings and conclusions were in most cases extensively discussed in written correspondence with the OAG during the audit, the DGS will not attempt to provide further information on these areas in this response. Instead, except for the comments contained in the following paragraphs, our response will primarily address the OAG's recommended actions.

The DGS believes that the title of both the report and the report's first chapter are erroneous and inconsistent with the finding's presented in the report. ①* These titles state that the OLA is improperly using some of its school construction program funds. This conclusion is primarily based on the first two findings within the report's first chapter pertaining to the transferring of interest earned to the State's General Fund, and the reimbursing of a school district's asbestos abatement costs incurred before the SAB's approval of their projects. For both of these findings, in deriving its conclusion, the OAG is primarily relying on legal opinions received from the Legislative Counsel. These opinions discuss the authority of the SAB (not the OLA) to perform actions which are now under dispute in the audit report. As noted in the audit report, for both of these findings, the OLA acted in accordance with SAB policies. Therefore, since

*The Office of the Auditor General's comments on specific points in this response begin after the Department of General Services' response.

only the SAB rather than the OLA is vested with the authority to allocate funds, it is difficult to see how a conclusion could be reached that the OLA improperly used funds. While we will take appropriate actions to address the OAG's concerns, the DGS believes these issues would have been more appropriately presented to the SAB and not to the DGS. In addition, since these issues have not been presented to the SAB, we believe it is premature for the OAG to conclude that any party was authorizing the improper use of funds. ② Further, as noted in our response to the recommendations which address these issues, based on the DGS review of available information, including SAB staff counsel's opinions, the policies were in compliance with State laws so any conclusion as to improper use is, at best, premature.

For the report's second chapter which pertains to maximizing available funds, in most cases, the DGS was aware of the issues disclosed in the report prior to the audit. Because of resource limitations, all funds for reapportionment cannot be identified and recovered in as timely a manner as would be preferred. However, through requests for additional staff and revisions to OLA's policies and procedures, the DGS is continuing to take appropriate actions to address this chapter's findings. Further, it should be noted that even if these actions are taken and additional funds are made available for apportionment, it will have a minimal impact on reducing the number of projects waiting for funding. As stated in the audit report, as of October 24, 1990, projects eligible to receive approximately \$520 million were on a waiting list while only \$168 million was available for apportionment.

I

THE OFFICE OF LOCAL ASSISTANCE IS IMPROPERLY USING SOME OF ITS SCHOOL CONSTRUCTION PROGRAM FUNDS

"To comply with state law and State Allocation Board (SAB) policies, the Office of Local Assistance (OLA) should take the following actions:"

RECOMMENDATION: "Prepare administrative journals for all interest earnings reported to the OLA since 1982."

DGS RESPONSE: Pending resolution of the issue discussed under the following recommendation, the preparation of administrative journals is premature. Upon resolution of this issue, appropriate actions to account for interest earnings will be taken.

RECOMMENDATION: "Recommend to the SAB that it transfer to the State's General Fund all interest earnings collected from school districts as rent."

DGS RESPONSE: While the OLA will present this issue to the SAB, a review of current information on this issue has led the DGS to conclude that the applying of interest earned towards the cost of school construction projects is within the SAB's authority. In fact, a legal opinion from the staff counsel of the SAB supporting this conclusion was provided to the auditors but is not discussed in the audit report. ③ The DGS would also point out that the sentence introducing this recommendation is inconsistent with the

finding in the report when it states that to comply with State law and SAB policies the OLA should take the recommended action. ④ As stated in the audit report, the OLA did act pursuant to SAB's policies. In fact, the Legislative Counsel opinion which is extensively referenced under this finding does not even mention the OLA. For example, where the audit report states: "The Legislative Counsel, therefore, concluded that the OLA is not authorized to apply rent payments toward the cost of school construction projects", the OAG has inappropriately substituted "OLA" for "SAB" when this statement is compared to the actual Legislative Counsel opinion. ⑤

The ultimate resolution of this issue is outside the scope of DGS' responsibilities. The DGS will follow the policy direction of the SAB.

RECOMMENDATION: "Recommend to the SAB that it recover all lease-purchase asbestos abatement funds that it has apportioned to school districts for costs incurred and commitments made before the SAB approved their projects."

DGS RESPONSE: As with the previous recommendation, the OLA will present this issue to the SAB. However, a review of current information on this issue has led the DGS to conclude that the reimbursement of these asbestos abatement costs was within the SAB's authority pursuant to Education Code Section 17736.

In addition, as with the previous recommendation, the sentence introducing this recommendation is inconsistent with the finding in the report. As stated in the audit report, the OLA did act pursuant to SAB's policies. ④

The ultimate resolution of this issue is outside the scope of DGS' responsibilities. The DGS will follow the policy direction of the SAB.

RECOMMENDATION: "Review all other programs administered by the OLA, determine whether any funds have been improperly disbursed to districts for costs incurred before the SAB's approval of the districts' projects, and recover those funds wherever possible."

DGS RESPONSE: OLA has control systems in place for its programs to ensure that funds are disbursed in accordance with SAB policies. As applicable, these systems include an internal review process to ensure the nonreimbursement of costs incurred before the SAB's approval of a district's projects, and, if necessary, the recovery of funds. This internal review process will continue. ⑥

RECOMMENDATION: "Develop procedures to ensure that school districts are reimbursed for costs incurred before the SAB's approval of any project only when specifically allowed by state law."

DGS RESPONSE: As with the previous recommendation, this recommendation was developed based on the results of the auditor's review of the funding of some asbestos abatement project costs. The OLA followed SAB policies in funding these projects. OLA has control systems in place for its programs to ensure that funds are disbursed in accordance with SAB policies. ⑥

RECOMMENDATION: "Determine whether any funds disbursed to school districts for asbestos abatement management fees that exceeded the SAB's limit can be recovered from the districts."

DGS RESPONSE: For the school districts for which the OAG has determined that project manager's fees were overpaid, currently, the OLA is taking action to recover these funds. In addition, procedures now require that funds not be released until an acceptable project manager's contract is received and it is determined that the amount of the release does not exceed the fee schedule in the contract or the 12% limitation, whichever is less. A final audit of the project will be made to adjust the approved project cost to actual eligible expenditures. This audit includes an analysis of the project manager fee payment. If an overpayment was made, the district will be required to return the excess funds to the State.

RECOMMENDATION: Obtain and review documentation from school districts for all funds disbursed without the required documentation, determine whether the funds were used in accordance with the SAB's policies and state law, and recover any funds that were used improperly; and, comply with the SAB's policies by disbursing asbestos abatement funds only after the cost estimates, contracts, and other required documents are received from the school districts."

DGS RESPONSE: The OLA is aware of those projects where release of funds was made without proper documentation and is in the process of obtaining the proper documentation. If the documentation is not made available, the OLA will require the return of all unsubstantiated funding.

II

THE OFFICE OF LOCAL ASSISTANCE IS NOT MAXIMIZING ALL ITS AVAILABLE FUNDS FOR ITS SCHOOL CONSTRUCTION PROGRAMS

"To maximize its available funds for school construction projects, the Office of Local Assistance should take the following actions:"

RECOMMENDATION: "Adhere to its newly implemented procedures to identify and collect loans that are recoverable and take the appropriate action to recover the funds from the school districts."

DGS RESPONSE: The OLA is adhering to the procedures that were implemented in August and September 1990 and is taking appropriate actions to recover funds from the school districts. To date, a total of \$225,000 has been recovered.

RECOMMENDATION: "Ensure that it takes advantage of all available discounts from the manufacturers of portable classrooms."

DGS RESPONSE: As noted in the audit report, on August 24, 1990, OLA implemented new procedures, including the notification of management of any lost discounts, to ensure the taking of discounts. These procedures have been very effective as shown by the OLA since November 15, 1990, taking more than \$300,000 in discounts while losing the opportunity to take only less than \$600 in discounts.

RECOMMENDATION: "Audit a representative sample of the quarterly contribution reports it receives from school districts to ensure that the gross contributions and deductions claimed by the districts are accurate and valid."

DGS RESPONSE: The DGS is hopeful that the request will be granted for the additional positions authorized in the 1990/91 Budget Act. Currently, OLA is preparing additional information to support these positions. It should be noted that the approximately 50% recovery rate referenced in the audit report for the 47 quarterly reports reviewed by OLA is not expected to be representative of future recovery rates. The first reports reviewed were for high risk projects.

RECOMMENDATION: "Review districts' sales of surplus real estate occurring in the five-year period before the districts' applications to the State School Building Lease-Purchase Program to ensure that the proceeds from the sales were used for capital outlay or deferred maintenance as required by the Education Code."

DGS RESPONSE: It is important to note that the OAG review did not identify any abuses or inappropriate action with respect to the proceeds from the sale of surplus property. The current procedures together with the annual audit of school districts required by Section 41020 of the Education Code appear to be adequate. ⑦

RECOMMENDATION: "Comply with its own policies by requiring all districts participating in the lease-purchase program to report how the proceeds from the sales of surplus property are used, following up when necessary to ensure that school districts provide the reports as required, and auditing the reports to ensure the districts are using the proceeds in accordance with the Education Code."

DGS RESPONSE: As resources and priorities allow, the OLA will perform the duties referenced in this recommendation. Further, the OLA will review available data to determine if additional resources should be provided for this function.

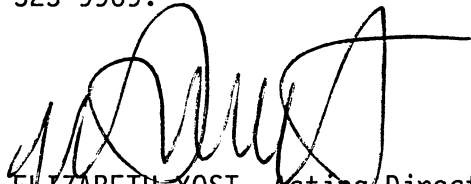
RECOMMENDATION: "Conduct close-out audits for all completed construction projects and ensure that all future construction projects are audited promptly upon completion of the construction."

DGS RESPONSE: As noted in the audit report, the OLA received two closeout audit positions in July 1990. For the additional 4.5 positions noted in the report, additional information is necessary to support these positions. This information will be developed through analyzing the effectiveness of the two new positions.

CONCLUSION

As part of its continuing efforts to improve policies and procedures, the DGS will take appropriate actions to address the issues presented in the report. It should be noted that on-going actions of OLA's management have demonstrated a strong commitment to improving operations in a timely manner.

If you need further information or assistance on this issue, please call me at 323-9969.

A handwritten signature in black ink, appearing to read 'Elizabeth Yost', written in a cursive style.

ELIZABETH YOST, Acting Director
Department of General Services

**Comments The Office of the Auditor General's Comments on
the Response from the Department of General
Services**

- ① The title of the report and the first chapter were revised after we provided a draft of the report to the Department of General Services (department). The department did not think we should conclude that the Office of Local Assistance (OLA) was improperly using funds because, according to the department, the OLA was following State Allocation Board (SAB) policy. However, we could find no evidence that the SAB made an explicit policy decision to use the funds in such a manner. For example, the SAB's policy allowing rent payments to be applied toward the cost of an ongoing project was adopted in 1980. The state law requiring the rent payments to be transferred to the State's General Fund was not enacted until 1982. Therefore, the OLA may have been applying a SAB policy that the SAB did not know conflicted with state law. As the administrative arm of the SAB, the OLA has a duty to review SAB policy and provide legal advice. We could find no evidence that the OLA reviewed this policy to determine whether it conflicted with state law and informed the SAB of any possible conflicts. In fact, the OLA did not provide a written legal opinion on the issue until after we raised some questions. Nevertheless, because we could not determine whether the improper use of funds was the result of an explicit policy decision of the SAB or the result of unilateral action taken by the OLA, we revised the titles.
- ② The department stated that because these issues have not been presented to the SAB, it is premature for our office to conclude that any party was authorizing the improper use of funds. In fact, we did provide the executive officer of the SAB with a draft copy of our report on January 14, 1991.

- ③ The OLA did not obtain a written legal opinion on this issue until our office raised some questions about it. The legal opinion prepared by the department's attorney simply restated the OLA's position, which we discuss on page 7 and page 8 of the report. Furthermore, the Legislative Counsel thoroughly reviewed the OLA's position when giving its opinion on the issue. Therefore, we decided we did not need to elaborate on the OLA's position or legal opinion.
- ④ We revised this sentence to state "the State Allocation Board or the Office of Local Assistance, as appropriate, should take the following actions."
- ⑤ We revised this sentence to state "...the OLA, acting according to SAB policy, is not authorized to apply rent payments toward the cost of school construction projects" (emphasis added). However, as noted earlier, we could not determine whether the improper use of funds was the result of an explicit policy decision made by the SAB.
- ⑥ The department states that the OLA has control systems in place to ensure that funds are disbursed according to SAB policies. However, our point is that these policies conflict with state law and should be changed.
- ⑦ While it is true that we did not identify any actual cases of abuse in our limited review, we clearly demonstrate that the OLA does not have adequate controls to prevent such abuses. Our audit procedures were designed to identify not only actual cases of abuse, but also weaknesses in controls that could lead to such abuses. Furthermore, we could not find any provisions in the OLA's procedures manual that requires OLA staff to review the audit reports issued pursuant to the Education Code, Section 41020. Therefore, we conclude that the OLA does not have adequate controls to prevent school districts from using their proceeds from surplus property sales for purposes other than capital outlay or maintenance and then, contrary to SAB policy, receiving funds from the OLA.

**cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps**