

CITIZENS’ BOND OVERSIGHT COMMISSION

BRIEFING PAPER

BACKGROUND

On November 7, 2006, California voters approved the five bond measures below. Four of the bond measures (i.e., Propositions 1B, 1C, 1D, and 1E) were placed on the ballot by Governor Schwarzenegger and the Legislature. The fifth measure (i.e., Proposition 84) qualified for the ballot through a separate voter signature gathering campaign.

Is it really the biggest public works deal in California history? According to the *Orange County Register*, “Yes. Even by adjusting previous bond packages for inflation, this one tops them all – including those from the public-works intensive era of former Gov. Pat Brown. In his eight years as governor, the state borrowed \$20 billion, adjusted for inflation, according to the non-partisan Legislative Analyst's Office.¹”

| Proposition | Summary | \$\$ Bond Issue | Election Results |
|-------------|--|-----------------|---|
| 1B | <ul style="list-style-type: none"> • Repairs/upgrades state highways, local streets and roads • Improves seismic safety of bridges • Expands public transit • Reduces air pollution • Builds car pool lanes • Improves anti-terrorism security at shipping ports | \$19.9 billion | <p>61.4% in favor (5.1 million voters)</p> <p>38.6% opposed (3.2 million voters)</p> |
| 1C | <ul style="list-style-type: none"> • Provides shelters for battered women and children • Provides low-income housing for seniors • Provides homeownership assistance for the disabled, military veterans, and working families. • Provides accessibility improvements to apartments for families and the disabled. | \$2.85 billion | <p>57.8% in favor (4.8 million voters)</p> <p>42.2% opposed (3.5 million voters)</p> |
| 1D | <ul style="list-style-type: none"> • Relieves public school overcrowding and repairs older schools. • Improves earthquake safety and funds vocational educational facilities in public schools. • Repairs/upgrades public college and university buildings | \$10.4 billion | <p>56.9% in favor (4.7 million voters)</p> <p>43.1% opposed (3.6 million voters)</p> |
| 1E | <ul style="list-style-type: none"> • Rebuilds vulnerable flood control structures. • Protects drinking water supply system by rebuilding Delta levees. | \$4.09 billion | <p>64.2% in favor (5.3 million voters)</p> <p>35.8% opposed (2.96 million voters)</p> |
| 84 | <ul style="list-style-type: none"> • Provides for safe drinking water, flood | \$5.39 billion | 53.8% in favor (4.4 million voters) |

¹ Orange County Register, “Biggest Bond Package in History, “ May 5, 2006 at http://www.ocregister.com/ocregister/news/state/legislature/article_1131941.php

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|--------------|---|-----------------------|---|
| | control, waterway and natural resource protection, state and local park improvements, and water conservation efforts. | | million voters) 46.2% opposed (3.8 million voters) |
| TOTAL | | \$42.6 billion | |

Source: CA Secretary of State's website at <http://www.voterguide.ss.ca.gov/> and http://sos.ca.gov/elections/sov/2006_general/contents.htm

WHAT ARE THE PROBLEMS THAT THIS COMMISSION SEEKS TO REMEDY?

Significant infrastructure investment throughout the 1950s and 60s led to historical improvements in water resources, transportation and state education resources. However, the infrastructure investments made by previous generations of Californians are showing their age after nearly a half century and are straining to support a population that has grown by more than 17 million² since 1970 and is projected to grow by another 9 million by 2025. While California voters approved the largest bond package in state history this past November, the resulting \$42.6 billion should only be viewed as a first installment of a continuing effort to meet the state's most pressing infrastructure concerns. How do we lay the foundation for going back to voters for the next installment?

We must fortify the system of fiduciary oversight to ensure that these bond proceeds are spent prudently so that promised deliverables --- in the forms of less traffic congestion, more affordable housing, new educational opportunities, cleaner air and water, reduced risk of flooding --- are realized on time and within budget.

Attachment A includes examples of how the public's trust has been compromised with regard to past state and local bond finance spending.

OBJECTIVES OF THE CITIZENS' BOND OVERSIGHT COMMISSION

The Commission's charges are to:

- (1) establish and maintain a one-stop, direct information conduit that allows the general public to track each and every public works project that is funded by state bond proceeds. This includes providing timely information that tracks each project with its respective expectations relating to cost and schedule.
- (2) uncover fraud, waste, and abuse. Specifically, through systematic auditing by the SCO and review of the audit findings by the Commission's members, we seek to identify the misallocation of bond funds (i.e., use of bond proceeds for expenses

² CA Department of Finance (Demographic, Economic and Financial Research Unit), "E-7 California Population Estimates, July 1, 1900-2006," December 2006 at <http://www.dof.ca.gov/Research/Research.asp>. CA population in 1970: 20 million; in 2006: 37.4 million; and in 2025: 46 million.

- not consistent with either the General Obligation Bond Law³ or the voter-approved bond initiative);
- (3) identify greater efficiencies that produce public benefits that are greater than the actual sum of the bond proceeds.

WHAT THE COMMISSION WILL NOT DO

- The Commission will neither duplicate the efforts nor usurp the authorities of the Legislature and state agencies responsible for deciding which projects to fund and what priorities should govern the allocation of bond funds.
- The establishment of this Commission will not preclude the Legislature and individual state agencies from establishing their own accountability and oversight procedures, as permitted by law.

Indicative of our intention to not encroach upon the allocation-making prerogatives of the Legislature and those individual state agencies vested with such authority, the role of the Citizens' Commission begins only after the allocations have been made. The role of the Commission will be to ensure that the individual public works projects financed by these bond funds meet the standards, criteria and expectations established by the Legislature, the responsible state agencies, and --- of course --- the voters.

COMMISSION MEMBERSHIP

The Commission will be comprised of 11 members, including the following:

- State Controller
- State Treasurer
- Director of Finance
- Two public members appointed by each of the following:
 1. Governor
 2. Senate Rules Committee
 3. Assembly Speaker

Of the two appointments, one member must have at least 10 years of experience with public infrastructure development and/or public infrastructure financing (e.g., an architect, engineer, construction manager, construction labor union, attorney, investment banker, etc.) The other shall be a member of the public not related professionally to infrastructure development and finance (e.g., taxpayer advocates, environmental conservation organizations, the education community, low-income housing advocates, local governments, agri-business and others impacted by the public works projects financed by bond proceeds).

- One public member appointed by each of the following:
 1. State Controller
 2. State Treasurer

The Commission will elect a Chair and a Vice Chair.

³ Government Code Section 16720 et seq.

TERM OF APPOINTMENT

- Each public member shall serve a five-year term.
- Each public member shall serve a maximum of two terms.

COMMISSION STAFF

- The Commission can appoint expert advisory committees as it deems necessary to assist in its work.
- The Commission will have an Executive Secretary who will be responsible for carrying out the directives of the Commission, including its day-to-day operations. The Executive Secretary will be appointed by the State Treasurer subject to the approval of the Commission, and will be an employee of the Office of State Treasurer.
- To the extent possible, staffing needs will be met utilizing the existing resources of the Controller, Treasurer, and other state agencies/departments.

DUTIES OF STATE AGENCIES AND DEPARTMENTS

Once a bond-financed project is approved for construction, the state agency responsible for administering it shall deliver the following information to the Commission:

- A description of the project, along with the location and whether the project is new construction or a renovation.
- The bond authorization that will provide the funds.
- Additional sources of funds other than state bond proceeds.
- The expected timeline for construction, including milestones and projected completion date.
- An estimate of costs and how much of the costs will be expended when each of the above milestones is met. The budget will be itemized to show detail.

After the responsible agency has provided the initial reporting above, the agency shall provide quarterly progress reports which, among other things, will identify the following:

- Cost overruns
- Delays
- Bond-proceed spending that falls outside the eligibility parameters approved by the legislation or initiative that approved the bond.
- Awarded contracts, along with relevant detail (e.g., who, how much, expected delivery date).

Upon completion, the responsible agency shall deliver a completion report that compares performance on a project with the initial expectations.

ENFORCEMENT HAMMER

- The Pooled Money Investment Board and the State Treasurer may, respectively, withhold loan approval and withhold bond proceeds if the responsible state agency is not current on all reporting requirements, as determined by the Commission.

DUTIES OF THE COMMISSION

- The Commission shall collect and disseminate the above information to the public.
- The information will be organized in a manner that is easily digestible by the public and will be available online in a searchable format.

DUTIES OF THE CONTROLLER

- In consultation with the Commission, the Controller may audit any public works project financed by the bonds approved by the voters/Legislature in November 2006 and thereafter. The audits will seek to achieve the following:
 1. validate the data received pursuant to the reporting requirements detailed under “Duties of State Agencies and Departments;”
 2. uncover fraud, waste, and abuse (e.g., use of bond proceeds for expenses not consistent with either the General Obligation Bond Law⁴, the voter-approved bond initiative, and criteria established by the Legislature and responsible state agency);
 3. identify cost overruns and delays in schedules.
- The Controller will have explicit statutory authority to access and examine all records of any individual or entity receiving bond proceeds.

DUTIES OF THE TREASURER

- Along with other information, the Treasurer will incorporate the findings of the Commission into the annual Debt Affordability Report and publish them online.

QUESTIONS AND ANSWERS

(1) *Does the State Controller already have the authority to audit public works projects funded by state bond funds?*

Yes. Article 16 section 7 of the California Constitution provides that "[m]oney may be drawn from the Treasury only...upon a Controller's duly drawn warrant." The term "duly" has been interpreted by the courts to signify correctness, propriety, validity, and that which is legally required. The State Controller, therefore has constitutional authority to concur in all expenditures from the Treasury. In order to perform his constitutional duties, he necessarily is required to examine each claim, investigate it, and make the

⁴ Government Code Section 16720 et seq.

determination that it is lawful. In short, the State Controller has the constitutional authority to audit all claims filed against the Treasury.

Government Code section 12410 states, in pertinent part, “The Controller shall audit all claims against the state, and may audit the disbursement of any state money [including bond proceeds], for correctness, legality, and for sufficient provisions of law for payment.”

(2) If the State Controller is already authorized to audit the spending of state bond funds, why do you need this legislation?

The legislation is necessary to accomplish the following:

- (a) establish a one-stop source for the public to obtain timely information about what public works projects have been authorized in their respective communities and whether those projects are meeting both budgetary and scheduling expectations.
- (b) allow citizen participation in the fiduciary stewardship of what is the single largest bond package in the history of this state. By allowing citizens who are stakeholders in this watershed public works deal⁵ and others who are experts in public infrastructure financing and construction⁶ to play an oversight role, we are creating a system of fiduciary oversight that instills trust in voters that they made the right decision in November. If we succeed in getting the anticipated deliverables --- in the forms of less traffic congestion, more affordable housing, new educational opportunities, cleaner air and water, reduced risk of flooding --- to the public on time and within budget, we will significantly improve our chances of getting voter approval for subsequent infrastructure bond initiatives.
- (c) establish audit oversight of public works projects financed by state bond moneys as a statutorily-required mission of the State Controller, rather than as a permissive option.

(3) What value is there in requiring that the Controller audit public works projects financed by state bond moneys?

In a quick historical search of my department’s records to ascertain the number of state bond-financed projects that were audited by the SCO since 2000, I was disappointed to only find one⁷. This demonstrates how oversight of bond moneys can become lost and

⁵ For example: taxpayer advocates, environmental conservation organizations, the education community, low-income housing advocates, local governments, agri-business and others impacted by the public works projects financed by bond proceeds.

⁶ For example: architects, engineers, construction managers, construction labor unions, attorneys, and investment bankers.

⁷ In August 2005, then-State Controller Westly issued an audit report of the California dairy farm disposal pollution control projects funded by the CA Pollution Control Financing Authority for the period of October 4, 2001, through June 15, 2004. The audit found, among other problems, that one of the six dairies selected for review had failed to provide sufficient documentation demonstrating that \$1.4 million in bond proceeds were used for authorized purposes.

neglected amidst the competing priorities faced by my office. Considering the historical size of this last bond issuance and how its success is absolutely critical for voter support of subsequent infrastructure bonds, I strongly believe that it is time for audits of bond spending to become a fixture of my office's overall mission.

(4) Should the auditing of bond spending fall within the aegis of the State Controller or the Department of Finance?

The Director of Finance is the Governor's chief fiscal officer. Under professional government auditing standards⁸, the DOF is not organizationally independent from the state agencies that are responsible for the allocation of the bond moneys. This raises questions, at least in appearance, as to the DOF's ability to objectively audit the work of other state agencies also under the aegis of the Governor.

The State Controller's Office (SCO) conducts audits of disbursements from the State Treasury to ensure that State expenditures are proper, legal, and in compliance with funding requirements. Toward this objective, the SCO has accumulated vast experience in conducting post-payment field audits. In the past four fiscal years, the SCO's ratio of audit findings / audit costs has ranged from 10/1 to 17/1.

The State Controller is the voter-elected chief fiscal officer for California. Under professional government auditing standards, the SCO is organizationally independent from all state agencies.

(5) With over 200 existing auditors, why can't you absorb the auditing workload associated with your proposal?

The SCO currently has 230 allocated auditor positions. Of those 230, all but 8 are earmarked for (a) statutorily-required audits and (b) audits that are funded by special fund or reimbursement moneys. It may come as a surprise to you --- as it has for me --- that the SCO only has 8 auditors to perform permissive audits. This is a woefully inadequate number considering the ad hoc auditing needs that frequently arise⁸.

(6) Is any provision of your proposal legally precluded by the language found in the voter-approved bond initiatives?

⁸ The following are two examples demonstrating the value of the SCO's ad hoc auditing authority:

- Department of Parks and Recreation's Legislative Grant Program. The SCO found grant funds were funneled by a non-profit in San Francisco to Kevin Shelly's campaign.
- LA Mission College. The SCO found the community college improperly received \$5.73 million in state funds over three years by reporting inflated enrollment figures for two non-accredited computer courses. Thousands of unwitting students who simply used computers in a computer lab were automatically enrolled in the two courses. The hours reported were four times the level the lab could possibly accommodate given the number of computers available.

According to the SCO's Chief Counsel, the only provision of the proposal that raised a legal concern was the vesting of authority in the Commission to withhold proceeds of the bond sales pending the Commission's receipt of reports. That provision has now been amended to give the authority to the PMIB to withhold future loans pending the filing of reports to the Commission.

Otherwise, the proposal contains no provisions which conflict with the voter-approved bond initiatives.

| BOND MEASURE/ INITIATIVE | ISSUING PARTY | BOND ISSUE (\$\$) | PROBLEMS FOUND |
|---|--|----------------------|---|
| <p>Proposition 50: Water Quality, Supply and Safe Drinking Water Projects. Coastal Wetlands Purchase and Protection.: State Bond Total Amount: \$3.44 Billion Passed: 2002</p> | <p>Santa Monica Mountain Conservancy</p> | <p>\$20 Million</p> | <ul style="list-style-type: none"> - Used bond money to pay its Executive Director to have an exclusive membership at an airport “Red Carpet Club”, his wife’s travel and \$577 for room service. - Expenditures were found to be unrelated to the protection of coastal watersheds in Santa Monica Bay and Ventura County. - Specifically, SMMC gave a grant of \$200,000 to Mountains Recreation and Conservation Authority (MRCA) to develop the Malibu Public Works Plan and spent \$150,000 to pay lawyers to defend a lawsuit filed by local residents. - This was a violation of Public Resources Code, which limits the entities to which the SMMC can give grant money. This puts its tax-exempt bond status at risk. - DOF audit found additional improprieties of grant monies totaling in excess of \$5 million given to MRCA by SMMC. |
| <p>Proposition 12-The Parks Bond: provides \$2.1 billion primarily for the development and improvement of state and local parks. Passed: 2000 Total Amount: \$2.1 Billion</p> <p>Proposition 13-The Water Bond: provides \$2 Billion in bond funds for various water-related purposes. Passed: 2000 Total Amount \$2 Billion</p> <p>Proposition 40: The California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002: provided \$2.6 Billion for parks and the environment. Passed: 2002 Total Amount: \$2.6 Billion</p> | <p>Coastal Conservancy</p> | <p>\$431 Million</p> | <ul style="list-style-type: none"> - Bond funds were spent for lobbying and employee perks such as transit subsidies, yoga and weight loss programs. - \$38,000 questionable purposes; \$29,000 lobbying; \$5,000 employee transit subsidies; \$3,500 yoga and weight loss programs. Audit was performed by DOF |

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|---|-------------------------------------|----------------|---|
| <p>Proposition 50: Water Quality, Supply and Safe Drinking Water Projects. Coastal Wetlands Purchase and Protection. Bonds. Initiative: provided \$3.44 billion in bonds for parks and water. Passed: 2002 Total Amount \$3.44 Billion</p> | | | |
| <p>Proposition K: Local Bond New Police Stations Passed: 1989</p> | City of Los Angeles | \$176 Million/ | <ul style="list-style-type: none"> - The money was not used to build new police stations and funding ran out because it was spent on “other projects”, forcing the City to seek additional bond funding. |
| <p>Proposition BB: Local Bond Class Size Reduction and School Construction Passed: April 1997</p> | Los Angeles Unified School District | \$2.4 billion | <ul style="list-style-type: none"> - The construction program lacks funding to complete projects. - Bond goals and limits were unclear. - Payments for airfare varied, depending on how many days in advance the reservation was made. An invoice for a round-trip ticket purchased three days in advance was \$1,824.00, while a ticket bought 12 days in advance was \$468.00. - The consultant did not live in the Los Angeles area, so the district paid for travel and living expenses. These expenses included airfare, rental of living quarters for \$2,200.00 per month, newspaper subscriptions, laundry, and meals. One invoice reviewed showed the district reimbursing the consultant for airfare for his spouse, citing that it would have cost the district more money if he were to fly home twice per week. - The district used bond proceeds to pay for consultants who acted as administrators. - Salaries and benefits totaling \$1.1 million. The bond measure specifically states bond proceeds were not to be used for administrator’s salaries. - Excessive management fees were charged to the BB Bond Program. The SCO determined that the management fee is 24.70% for the BB Bonds compared to districts of comparable size (including Chicago and New York City school system) ranged from 4% to 11%. - The data management system and the cost reporting system were inadequate. - The Blue Ribbon Citizens’ Oversight Committee did not effectively perform its responsibilities. |