

## **SUMMARY OF FCMAT AUDIT REPORT**

Jon Gundry, County Superintendent of Schools

July 13, 2017

### **Introduction**

Good evening Board members, superintendent Bauer, staff, parents, and community members. I am Jon Gundry, Superintendent of the Santa Clara County Office of Education. I am here this evening to present an overview of an audit report written by the California Fiscal Crisis and Management Assistance Team, better known as FCMAT.

In October 2016 I received a complaint that there were a number of financial and contractual irregularities that could potentially be considered, fraud, misappropriation of funds, or some other illegal practice associated with the use of bond funds intended to make repairs and new construction in the District.

Although the original allegations were fairly specific, FCMAT was not limited to investigating only those issues. I have broad authority as County Superintendent to oversee the fiscal operations of school districts in the county, and it was understood from the beginning that the scope of the audit was likely to expand as the audit progressed.

The first allegation was that the contractor, the Del Terra Group, billed the District for work not performed. The second allegation was that Del Terra double-billed the District by billing for program management and then billing again for construction management. This created a situation in which Del Terra was hired in a second contract to oversee the work they were doing under the first contract.

As County Superintendent, it is my responsibility to follow up on such complaints, and for that reason, I engaged FCMAT in December 2016 to investigate the allegations. FCMAT produced their final report on June 9<sup>th</sup> and I am here tonight to summarize the findings and recommendations in the report.

I want to be clear that I did not conduct the audit, nor did I make any of the recommendations contained in the report. My role was limited to ordering the audit, making a recommendation to the State Superintendent of Schools regarding the fiscal independence of the District, and reporting the findings of the audit at tonight's meeting. Neither the County Superintendent, nor FCMAT has the authority to enforce any of the recommendations contained in the report. Whether the District chooses to adopt the recommendations contained in this report is in the hands of the governing board of the Alum Rock School District.

## Contract Issues

One of the most significant findings of the audit is that the contract language used in the various contracts with Del Terra is not standard to the construction industry. The report states that the contract language is, ***“highly unusual in a program of this kind, and does not allow for the adequate oversight and accountability of the contractor of the District and for the use of public funds.”*** (p.27) It also states that, ***“The lack of accountability over the contractor has partly prompted the allegations of fraud and erodes public trust in the District’s ability to spend public funds prudently and legally.”*** (p.20)

FCMAT reviewed the District’s board policies and administrative regulations regarding construction contracts and found that the District’s policies and regulations met industry standards. The report states that, ***“A review of the District’s bidding policies and processes found its materials, services and supply acquisition and public works construction bidding procedures comply with the law except for work conducted by Del Terra.”*** (p. 43) FCMAT concluded that the District has appropriate policies and procedures for bidding and managing construction contracts for all contractors except Del Terra.

Because of the large amounts of money that are typically spent in a bond program, a Citizens’ Oversight Committee (COC) is required by law to add an additional layer of accountability for the expenditure of public money. In order for the District staff, the governing Board, and the COC to determine if the overall program and each individual project are within budget or are over budget, there must be regular reporting of project schedules for each project including an update of actual performance against the approved schedule. Since there is no evidence that this reporting was done, it has not been possible for the District staff, the governing Board, or the COC to evaluate Del Terra’s management of construction projects and expenditures. Del Terra is essentially managing its own performance with little transparency in how bond money is being spent. The FCMAT report also notes that Del Terra declined requests to answer questions or provide documents for the purpose of this audit. They noted that the language of the contract, ***“does not explicitly state that the district is entitled to facilities program and project files and records in real time...”*** (p. 27). Since Del Terra is the keeper of the documents, neither the staff nor the COC can properly oversee the performance of the contractor.

This is especially concerning since Del Terra has agreed to act as the District’s fiduciary agent, which means that it has made a legal commitment to look out for the best interests of the school district. Section 1.3.2 of the program management contract states, ***“Manager (Del Terra) serves as District’s agent and fiduciary in performing services under this Agreement. Manager shall, in this capacity, maintain confidences and provide professional services in a manner consistent with District’s economic, educational and governmental best interests.”*** (p. 83) It is common for the program manager to ensure that the construction manager does not take advantage of the District, but in this case the construction manager is also Del Terra. Del Terra promised that they will ensure that Del Terra does not take advantage of the District. This is not just a case of the fox guarding the henhouse. A violation of the fiduciary

responsibility to the District is very serious and could potentially expose Del Terra to legal liability if the Alum Rock board chooses to hold them accountable under the terms of the contract.

### **Role of the Board**

The report is very clear that the responsibility for the lack of accountability for Del Terra lies with the governing Board. Typically members of a governing board do not involve themselves in the administration of construction contracts. They leave that to district staff. In this case; however, the report states that some members of the Board were personally involved with the, ***“bidding and contract management of the Del Terra contracts (in a way that) does not provide the necessary segregation of duties and responsibilities normally delegated to district staff.”*** (p. 40)

Here are some quotes from the report regarding the involvement of some members of the Board with the management of Del Terra contracts:

*\*“...staff members felt intimidated and at times threatened by the governing board regarding the use of Del Terra Group. Numerous reports indicated a climate of fear, frustration and discontent among the district’s staff and that the district is beset with a negative operating environment that includes continued, pervasive pressure to conduct business in disregard of established policies.”* (p. 2)

*\*“The Del Terra Group representatives and board members reportedly told administrative staff members not to ask questions and continue with the program.”* (p. 30)

*\*“Current and former district staff stated that board members applied pervasive pressure, including use of a threatening tone and/or manner, to persuade them to process transactions that lacked appropriate supporting documentation or were contrary to established policies and procedures.”* (p. 37)

*\*“...employees widely perceived the ethical conduct of the district’s board as questionable, which has compromised the organization’s moral tone.”* (p. 39)

*\*“District staff reported that they were subject to retribution by the board when they questioned the contract with the Del Terra Group. The board directed staff to process transactions without documentation and bypass established internal control procedures on bidding and processing invoices for the project and construction management contracts.”* (p. 39)

*\*“A majority of the board reportedly disregarded the billing and nonperformance issues and directed staff to pay the invoices.”* (p. 40)

*\*“...multiple board members received campaign donations from the Del Terra Group for their respective board elections. Of great concern is the school board’s blatant disregard for any of the nonperformance issues identified by staff and failure to follow specific board policies governing the bidding process or any formal process demonstrated by past practice in selecting*

program and construction management services. These issues raise potential questions of influence or conflicts of interest in the bidding process.” (p. 58)

## **Role of Staff**

Page 1 of the report states, **“The lack of institutional memory and operational experience in key administrative leadership positions, specifically in the areas of business and facilities management, has contributed to the inconsistent financial reporting for bond and construction related projects.”** The lack of operational experience is compounded by the culture of fear and intimidation that surrounded any business dealings with Del Terra. As I previously noted, the staff dealt with all other contractors according to board policy and the district’s administrative regulations. Del Terra was different due to the involvement of board members.

In October 2016, shortly after the Board received allegations of fraud on the part of Del Terra, **“...the board took action to authorize staff to prepare and negotiate a new program management contract with Del Terra Group without conducting a selection process for the new bond measure...The allegations are serious and should have merited discussion by the board before awarding a subsequent contract for Measure I bond funds to the Del Terra Group...the superintendent stated that this item was not recommended for approval by staff or the superintendent...However, the board directed staff to bring the item back for a vote on the November board meeting for action. Six days later at a special board meeting on October 19...the board voted that management ‘be authorized, directed, and be moved forward...and be brought back to the Board for final approval.’”** (p. 17)

Although the superintendent and district staff raised concerns about executing a new contract with Del Terra, **“...certain board members had a sense of urgency to approve Del Terra for the new contracts...and the urgency was premature without a formal selection process in accordance with the district’s board policies.”** (p. 17)

The superintendent and staff have shown an ability to perform their oversight responsibilities adequately when they are properly empowered to do so. The involvement of individual board members in operational matters related to contracts with Del Terra combined with a **“fractious school board...has created a difficult working relationship for administrative staff.”** (p. 40)

## **Recommendations**

There are more than 60 recommendations contained in the report which could be used as a plan for moving forward with proper oversight of the remaining bond projects. All of the recommendations should be seriously considered, but I would like to highlight a few from p. 31 of the report:

1. Require all project files and documents to be immediately turned over to the district in an organized fashion.
2. Renegotiate the program management contracts...

3. Enforce all aspects of the contract scope of work...
8. Empower an independent citizens' oversight committee.

I would also like to highlight the recommendation to terminate the construction management contract with Del Terra in order to end the practice of having Del Terra oversee its own work. Also, payments made to Del Terra should be scrutinized in order to determine if overpayments have been made.

### **Conclusion**

Although it is not FCMAT's role to determine whether fraud has occurred, they did find that ***"...fraud, misappropriation of funds and/or assets, or other illegal activities may have occurred in the specific areas reviewed."*** (p. 69)

As county superintendent it is also not my role to determine whether fraud has occurred. My responsibility under these circumstances is to refer this FCMAT report to the Santa Clara County District Attorney for further inquiry, which I have already done.

I would like to conclude by saying that the role of the County Office of Education is not to judge the Alum Rock school district. Our role is to assist the district in ensuring its fiscal stability and providing transparency in the expenditure of public money. We stand ready to help you accomplish both of these goals.

I urge the Board to work cooperatively with their superintendent, district staff, the Citizens' Oversight Committee, and the County Office of Education to ensure that all future bond projects are high quality and that public money is spent in a transparent manner that benefits the Alum Rock community, and most importantly, the children who attend your schools. The interests of a contractor cannot come before the interests of the children you were elected to serve. Their future depends on the decisions you make, and ensuring their success is the only reason we are all here.