

THE ANAHEIM UNION HIGH SCHOOL DISTRICT MEASURE Z
CAPITAL PROGRAM: THE TIP OF THE ICEBERG

SUMMARY

In March 2002, voters in the Anaheim Union High School District (AUHSD) passed Measure Z, a \$132 million bond issue to support the modernization of all the schools in the District, new construction at several school sites, and a new junior high school. The AUHSD's total budget for this entire construction program was \$301.7 million (later increased to \$306.8 million). This budget included the \$132 million of Measure Z bonds, an estimated \$132 million in matching funds from the State of California under Proposition 1A and subsequent State school construction bond issues, and other AUHSD funds from developer fees and deferred maintenance. The District had determined the size of the bond issue from the estimated cost of the construction program, which in turn was based on a needs analysis and economic plan done by consultants during 1999-2001.

Soon after the passage of Measure Z, the AUHSD appointed a Citizens Oversight Committee with responsibility for providing the Board of Trustees with an independent assessment of the financial expenditures on the program, which began in the spring of 2002. The work was divided into three "Waves" of schools, with the schools in the First Wave having the highest estimated potential eligibility for State matching funds due to site growth requirements and modernization needs. Sites in the Second Wave had been modernized within the last 5-10 years and had fewer growth needs, while those in the Third Wave were schools with the least estimated State matching funds eligibility.

During 2002-2003, the budgets for Measure Z changed repeatedly as the start of construction approached and estimates of State matching funds also changed. By early 2004 the Measure Z program was encountering a combination of construction delays and cost overruns due to bids coming in higher than budgeted, change orders, and rapidly escalating materials costs. In May 2004, District staff gave a report to the Board of Trustees and the Oversight Committee indicating that construction costs were escalating and that there were disruptions during construction. Also, during 2002-2004, the AUHSD underwent significant management changes, with two new superintendents taking the helm during that period.

In January 2005, due to the cost overruns on the First Wave, the AUHSD Board of Trustees put all work for the Second and Third Waves on hold. The District had not felt the need to establish an effective work priority classification to enable equitable District-wide program scope reductions when costs escalated. An effective priority classification would have identified, for example, all work connected with health and safety, all work connected with building integrity, all work connected with instructional support, etc. There would have been several such categories of work cutting across the entire District, each with its own construction budget, allowing lower priority work scope to be dropped District-wide when the program began to overrun its budget, rather than simply stopping work at entire groups of schools.

The problems at the First Wave schools continued to worsen, and by mid-2005, one of the key AUHSD staff responsible for day-to-day management of Measure Z left the District. By April 2005, the Board of Trustees authorized an Operational Forensic Performance Audit of the Measure Z program by a team of outside consultants. In August 2005, the resulting report identified numerous management and oversight deficiencies in the program. Further key management changes occurred in early 2006 and the new management team reorganized the Measure Z program, instituting better controls and oversight structures in an effort to put the project back on track. By late 2006 District

2006-2007 ORANGE COUNTY GRAND JURY

staff had generally established effective control of the program, although some problems still remained and there was no plan for completing work on the Second and Third Wave schools. Additionally, the AUHSD Board of Trustees needed to improve their ability to work together as an effective oversight and policy setting body for the Measure Z program, and the Citizens' Oversight Committee needed to evaluate and re-define its role and responsibility as well.

PURPOSE OF INVESTIGATION

Over the past five years, the availability of sizable matching State funds for school district capital projects has fostered a dramatic increase in bond issues for large scale construction and renovation programs in school districts throughout Orange County. A number of these programs have been reported to have experienced cost overruns and other management problems, resulting in the districts' inability to complete the full work scopes envisioned in the original bond issue elections. The existence of such problems in the AUHSD's Measure Z program was specifically brought to the Grand Jury's attention in a citizen complaint letter. The Grand Jury believes that this study of the Measure Z program will allow the development of "lessons learned;" observations regarding best practices that school districts countywide could adopt for funding and managing future major capital expenditure programs, as well as recommendations specific to the AUHSD.

METHOD OF INVESTIGATION

1. Interviews with current and former AUHSD personnel and contractors.
2. Review of AUHSD planning documents used in preparation of Measure Z.
3. Review of minutes and presentations from Board of Trustees and Oversight Committee meetings related to the Measure Z construction program.
4. Review of AUHSD operational procedures relevant to capital projects.
5. Review of applicable State laws and Web sites of relevant State agencies.
6. Review of sample source documents for Measure Z construction program change orders.
7. Review of AUHSD project and construction management reports related to the Measure Z construction program.
8. Review of AUHSD financial reports relating to the Measure Z construction program.
9. Review of independent audit reports relating to the Measure Z construction program, including the Operational Forensic Performance Audit dated 8/31/2005.
10. Visits to AUHSD school construction sites and District headquarters.
11. Interviews with the staff of the Orange County Superintendent of Schools/Orange County Department of Education.
12. Interview with member of the 2002-2006 Citizens' Oversight Committee.

BACKGROUND AND TIME LINE: NOVEMBER 1998 - NOVEMBER 2006

November 1998: State Proposition 1A is passed, providing for \$6 billion in State School Bonds for K-14 facilities and revising the State funding policies for matching local school district capital expenditures. This is the first of a series of similar State School Bond issues passed during the next seven years.

1999: Prior to Measure Z, the AUHSD floats a \$23 million "Bridge" loan to pay for capital projects and begins some facility improvement projects at certain schools. These projects ultimately qualified for \$25.3 million of matching State funds during 2001-2002.

January 1999-mid 2000: The AUHSD prepares plans for modernizing its schools and constructing some new schools, taking advantage of the matching State funds available under Proposition 1A.

2006-2007 ORANGE COUNTY GRAND JURY

The AUHSD conducts a school-by-school facility review and prepares a District-wide *School Facility Needs Assessment Analysis* assisted by a consulting firm. The district then begins work on an *Economic Master Plan* including a long-term financial plan for funding the facility plan.

April 2000: The AUHSD classifies its school facility projects into 4 classes of work priorities:

- Priority A: \$112.4 million for Health and Safety related upgrades, power and electrical system related work, all facility improvement projects already underway at that time at District schools, and other projects eligible for matching State modernization grant funding;
- Priority B: \$23.3 million for Technology improvements such as networking infrastructure, computer hardware and software and video equipment;
- Priority C: \$69.4 million for new school facilities, such as new classroom wings, to accommodate enrollment growth (most of these projects are also eligible for matching State modernization grant funding); and
- Priority D: \$28.5 million for other improvements that are not eligible for matching State modernization grant funding.

The District estimates the cost of a modernization program excluding any new construction (Priority C work) as follows:

Total including 10% project contingencies on Priorities A, B and D	\$233.6 million
Additional “Bridge Program Payoff” (prepayment of Bridge loan)	23.0 million

Total	\$256.6 million

The sources of funds for these projects are anticipated to be as follows:

Money available from existing AUHSD funds and normal operating cash flow	\$ 44.1 million
New local bond measure	108.0 million
Proposition 1A State matching funds	104.5 million

Total	\$256.6 million

It is unclear whether there are individual project contingencies for each school in addition to the overall 10% program contingencies. It is also unclear whether or not these estimates include soft costs (architect and construction management fees, etc.). The Bridge Loan ultimately was not refinanced from Measure Z proceeds due to the Measure Z program’s eventual cost overrun.

March 2001: The AUHSD retains an architectural/consulting firm to provide ten year projections of District classroom needs and a program to modify existing classroom facilities and possibly add new ones in order to reduce the number of portable classrooms. The results of this study are incorporated in the *Facilities Master Plan*, which is presented to the AUHSD Board of Trustees on November 15, 2001.

Early 2002: The schools are classified into three “Waves” for construction scheduling purposes. The First Wave schools are those with the highest estimated eligibility for State matching funds due

2006-2007 ORANGE COUNTY GRAND JURY

to lack of modernization and/or expected growth in enrollment. The Second Wave includes schools that have been modernized in the prior five to ten years and have fewer growth needs. The Third Wave includes schools that have the least estimated eligibility for State matching funds. The work priority identifications from April 2000 are not considered in the classification of schools into these “Waves.”

March 5, 2002: Measure Z is approved by the voters for a total bond issue of \$132 million, an increase from the April 2000 estimate of \$108 million. The purposes of Measure Z stated in the ballot are:

To qualify the District to receive \$125,000,000 in State matching funds, relieve existing student overcrowding, construct classrooms, build a new junior high school, replace inadequate electrical systems, provide students with access to modern technology, upgrade fire safety systems, remove asbestos, and make seismic repairs ...

The original First Wave schools by this point have a total budget of \$76.8 million plus a 5.32% construction program contingency and \$8.6 million for “Technology Networks.” In addition, each individual school site has a project level contingency of 5% of hard construction costs. The first bond sale is pegged at \$90 million.

April 2002: The First Wave schools are revised. The First Wave now includes Anaheim High School, Cypress High School, Katella High School, Kennedy High School, Lexington Junior High School, Oxford Academy, South Junior High School, Sycamore Junior High School, the new Junior High School, Loara High School and “Technology Networks” (100Mb/s Ethernet in all schools). Some new construction is included at certain campuses along with the renovation program budgeted in April 2000. The individual school estimates include soft costs (architects’ fees, construction management fees, etc.) and site contingencies. The total *revised* cost of the First Wave is budgeted at \$168.5 million plus \$8.6 million for the “Technology Networks.” The total program funding for the First Wave is budgeted at \$191.3 million with \$101.3 million of State matching funds plus \$90 million of bond funds; this total includes a \$14.2 million (8%) construction program contingency. The overall program contingency is a “plug figure” derived by subtracting the estimated construction costs of \$177.1 million from the available funds of \$191.3 million. A 10% contingency figure would have been more in line with construction industry standard practices for school renovation projects.

The First Wave schools are split among four construction management firm-architect teams, with each team designing and managing three school site projects. The overall construction program costs for the total of all three Waves and corresponding funds available are estimated as follows:

Projected Costs:

Existing Campuses	\$254.6 million
New Junior High	35.6 million
Contingency Reserve	11.3 million

Total Program	\$301.7 million

Estimated Funding:

State Matching Funds	\$131.9 million
Developer Fees	8.0 million

2006-2007 ORANGE COUNTY GRAND JURY

Deferred Maintenance	8.2 million
Other District Funding	12.0 million
Junior High Site Factors	9.6 million
Measure Z (bond)	132.0 million

Total Program	\$301.7 million

The estimated State matching funds have increased from the \$125 million stated in the Measure Z ballot wording due to the revisions in cost of the construction program.

June 2002: The first \$92 million of Measure Z bonds are sold. The additional \$2 million covers the expenses of sale.

July 2002: The AUHSD organizes a Citizens Oversight Committee for Measure Z. This Committee is required by the conditions of the Measure Z bond, is independent of the Board of Trustees (so Board members do not attend its meetings) and is authorized to do the following:

- issue a written report at least annually concerning the expenditure of Measure Z bond proceeds;
- review AUHSD expenditure plans and reports to ensure that Bond proceeds are only expended for purposes set forth in Measure Z, and specifically that none of the Bond proceeds are being expended on operating expenses;
- review the annual independent financial and performance audits of the District;
- inspect school site facilities and grounds;
- review District efforts to reduce costs and improve efficiencies in site design and construction, including joint-use and reusable facilities plans; and
- review District deferred maintenance plans.

July 30, 2002: The Citizens' Oversight Committee reviews the project implementation teams (architects and construction managers) and the projected summary project schedules for the First Wave schools.

July 31, 2002: A certified public accounting firm is retained to audit Measure Z's General Obligation Bond Fund.

August 15, 2002: The AUHSD Board adopts the revised *Facilities Master Plan* incorporating all revisions to date.

September 2002: The Citizens Oversight Committee is presented with a revised school-by-school construction budget and funding summary. This shows \$304.1 million of "gross allocations," less \$42.2 million "credit for previous work" (principally the Bridge program work), leaving "adjusted allocations" of \$261.9 million and "total projected costs" of \$306.8 million, an increase from the previous total program budget of \$301.7 million. These cost allocations represent the amount of estimated funds to complete the program based on the construction estimates in effect at the time.

2006-2007 ORANGE COUNTY GRAND JURY

The following information is included:

	----- millions of dollars -----			
	1 st wave	2 nd wave	3 rd wave	Total
Total Project Allocation	\$193.7	\$ 36.5	\$ 67.3	\$297.5
Total State Funding	88.9	23.6	20.2	132.7
Bond Issue and AUHSD Funding	112.0	22.3	39.9	174.1
Total Funding	\$ 200.9 (1)	\$ 45.9	\$ 60.1	\$ 306.8

(1) Increased from April 2002 estimate of \$191.3 million.

This is the first time that the cost allocations to all three “Waves” of construction are identified in a presentation. There is no discussion by the oversight committee at this meeting about the apparent discrepancy among the gross allocations” of \$304.1 million, the “adjusted allocations” of \$261.9 million, and the “Total Project Allocation” of \$297.5 million that appears in this chart.

November 27, 2002: A program schedule is prepared for the First Wave schools showing the critical dates for each phase of each school project. According to this schedule, all schools are currently in the design and development phase except for Sycamore and the new Junior High School, which are shown as being in schematic design. The schedule indicates that plans for the majority of the schools have already been submitted to the Division of State Architect (DSA) for required approval prior to bidding and construction start. The schools are estimated to go into bidding between February and July 2003, with construction beginning approximately two months after the beginning of the bidding periods.

December 2, 2002: The Citizens Oversight Committee reviews the Measure Z Audit contract and the school-by-school detail construction budgets from the April 2002 presentation. It also reviews the projected summary project schedules, showing two to three months’ slippage from the July 30, 2002 presentation. The schedule format does not show the original plan, so it is difficult to see the slippage without comparing the two schedule documents.

January 15, 2003: A presentation entitled *Measure Z: World Class Facilities for World Class Students* shows the following information about individual First Wave schools for the first time:

	----- millions of dollars -----			
Project – First Wave	Bond Fund	State Fund	Total Fund	Allocation
Anaheim HS	\$13.4	\$14.3	\$27.8	\$23.7
Cypress HS	10.9	13.3	24.2	18.4
Katella HS	12.1	14.5	26.7	24.1
Kennedy HS	10.4	12.7	23.1	26.7
Loara HS	11.5	13.9	27.0(1)	22.7
Oxford Academy	4.7	5.4	10.1	10.5
Lexington JHS	2.6	3.7	10.1(2)	9.2
South JHS	3.8	5.0	10.3(3)	12.6
Sycamore JHS	3.1	3.3	6.3	10.2
New Junior HS	18.6	16.7(4)	35.3	35.6
Totals	\$ 91.1	\$102.8	\$200.9	\$193.6

2006-2007 ORANGE COUNTY GRAND JURY

- (1) Includes \$1.6 million of additional AUHSD funding.
- (2) Includes \$3.8 million of additional AUHSD funding.
- (3) Includes \$1.6 million of additional AUHSD funding.
- (4) Includes \$9.6 million for site acquisition and improvements.

The presentation also shows amounts for Second and Third Wave schools and compares the overall totals to the “original Facilities Master Plan” as follows:

	----- (millions of dollars)-----			
	Bond Fund	State Fund	Total Fund	Allocation
	-----	-----	-----	-----
Current program	\$132.0	\$146.6	\$306.8(1)	\$297.4
Original Facilities Master Plan	132.0	136.4	296.5(1)	288.7

- (1) Includes \$28.2 million of additional AUHSD funding.

Based on the difference between the total funding and the allocation, there appear to be sufficient funds available to complete all three Waves. An overall program schedule is given which shows a two to six month slip from the schedule of November 27, 2002, although the prior schedule is not shown for comparison.

Cash outlays for the Measure Z program are lower than anticipated (probably due to the schedule delays). Expenditures are shown for the entire program to date totaling \$5.6 million, representing actual payments to contractors and consultants.

In an undated presentation to the Board of Trustees from approximately this time frame, a 75% ratio of hard costs (actual labor and materials for the construction) to total costs (hard costs plus soft costs) is stated to be the “target efficiency factor” for the Measure Z program. The comparable ratio for another district’s program, the Newport-Mesa Unified School District’s Measure A, is shown as 69.42%. The ratio on the First Wave schools is shown as 83.37% as of January 15, 2003. This means that the soft costs on the First Wave schools are anticipated to be 16.63% of total costs, well below normal construction industry practice of 25-30%.

The system for tracking Measure Z program budgets and actual expenditures is maintained as a set of Microsoft Excel spreadsheets. District financial managers reconcile this Excel system quarterly in total to the AUHSD official operational accounting records maintained on the Orange County Department of Education (OCDE)/Superintendent of Schools’ Bi-Tech computer system, which does not support multi-year capital program or project tracking. A great deal of clerical effort is expended in resolving discrepancies between the two systems. Schedule update charts do not show the original project schedule for comparison, making slippages difficult to see. Each of the four construction management firms submits reports and correspondence to the District in different formats because the AUHSD has not standardized these formats, resulting in additional extra work to consolidate the information received and lack of timeliness of the consolidated information.

June 2003: The AUHSD Superintendent retires and is replaced. The responsibility for management oversight of Measure Z is split between one key Director, who is responsible for the individual school projects until construction contracts are awarded, and another key Director, who is

2006-2007 ORANGE COUNTY GRAND JURY

responsible for on-going construction at the school sites. Both of these key Directors report to an Assistant Superintendent who also supervises several other Directors.

July 23, 2003: The *2002 Election General Obligation Bonds Financial and Performance Audits June 30, 2003*, prepared by the certified public accounting firm, shows actual Measure Z program expenditures of \$14.2 million against an anticipated cash outlay to date of \$30.7 million. The difference is labeled a “favorable variance,” although it is partly a consequence of the program being substantially behind schedule. It also shows \$18.7 million of “Current remaining construction commitments” for the First Wave schools, representing contracted but un-invoiced amounts.

Summer 2003: The Board of Trustees discusses retaining an overall program management consultant, but decides instead to transfer two program management staff positions to the Facilities department. Temporary portable classroom space is emplaced at most of the First Wave sites.

October 6, 2003: The Citizens Oversight Committee is informed that there is \$111 million available to fund the First Wave and that the total available funding for all Measure Z construction projects (all three Waves) from all sources is \$316 million, resulting in a \$19 million (6%) program contingency. The total is a further increase from the \$306.8 million total program size identified in September 2002, but the contingency is a smaller percentage. Some of the early bids from contractors have come back higher than the estimates shown in the January 15, 2003 presentation.

December 5, 2003: An additional \$27 million of Measure Z bonds are sold, in addition to the initial \$92 million originally sold, leaving \$13 million un-issued of the total \$132 million authorized.

Spring 2004: A major contractor working at one First Wave school defaults and work at that site stops. The District, working with the construction management firm supervising the work at that site and the contractor’s bonding company, eventually replaces the contractor, but the project is substantially delayed. There are also problems with contractors at another First Wave school, but work continues at that site.

April-May 2004: A *Measure Z Current Status* presentation shows “Escalating Construction Costs” and “Disruptions during Construction” as issues for the First Wave schools. Since January 2004, construction programs in school districts throughout the County and nationwide have been experiencing significant cost overruns due to escalations in materials costs, caused partially by large construction projects in China. Additionally, within California, a dramatic increase in demand for school construction services is caused by the great number of school districts simultaneously trying to take advantage of State matching funds; this allows contractors and architects to ramp up soft cost fees. So many school projects are being submitted statewide to DSA for approval that it is taking nearly a year for DSA to approve them. This delay exacerbates the cost escalation by creating more time for inflation between the time construction estimates are made, when the projects are designed, and the time the projects are actually put out to bid, after DSA approval is received.

Between January 2002 and December 2005, the State of California Construction Cost Index issued by the State Allocation Board Office of Public School Construction (SAB/OPSC) increases by 20%, from 1.43 to 1.72, for Class B buildings (constructed primarily of reinforced concrete, steel frames, concrete floors and roofs), which are typical of modern public school construction. This index includes “hard costs” (both labor and materials). “Soft costs” escalate more than this. Overall, construction costs increase 30% during 2002-2005. In the midst of this escalation, bids for the First Wave schools have come in substantially higher than the January 15, 2003 estimates. In some cases,

2006-2007 ORANGE COUNTY GRAND JURY

materials intended for Measure Z construction sites will be delivered to the District's operations and maintenance center rather than to the sites; the District subsequently will lose track of some of these materials and will be unable to reconcile its receiving and cost accounting records with the records of the bulk purchasing contractor. The Assistant Superintendent of Business informs the Board of Trustees in closed session that the Measure Z program is in serious financial trouble.

June 2004: The new AUHSD Superintendent retires and is replaced.

June 17, 2004: The Board of Trustees votes not to build the new Junior High School, following problems acquiring the land for the site, rapidly increasing construction costs on the First Wave projects, safety concerns connected with a high-pressure gas pipeline adjacent to the site, and an analysis showing declining enrollment trends in the feeder elementary schools. The construction budget for this project is primarily reallocated to two specific First Wave schools, instead of being spread over the entire remaining program including the Second and Third Wave schools.

June 30, 2004: According to the 4th *Interim Report on Measure Z*, the overall Measure Z Program budget including all three Waves has increased from \$306.8 million to \$330.1 million, exceeding projected available funds. The AUHSD Board of Trustees puts all work for the Second and Third Wave schools on hold.

Summer 2004: The District begins to investigate hiring an overall program management consultant. A firm is eventually selected by a committee consisting of Board of Trustees members and District staff, but members of the Citizens' Oversight Committee and some Board members express reservations about the cost, which increases from \$1.7 million to \$6 million during the negotiations with the firm. The Board of Trustees will discuss this topic until the *Operational Forensic Performance Audit* begins (see following section). Also, the OCDE/Superintendent of Schools expresses concerns about contracts at three of the construction sites where the total value of change orders exceeds 10% of the originally contracted amounts, and about certain Measure Z contracts that were issued on a "unit price" basis. ("Unit price" contracts specify fixed prices for performing certain services, such as installing electrical switches, or delivering certain materials, such as lighting fixtures or carpet.) The change order issues are eventually resolved with OCDE/Superintendent of Schools after the AUHSD Board of Trustees approves the overages.

Fall 2004: According to the *Operational Forensic Performance Audit* (see following section), during this period the AUHSD Board of Trustees became concerned with "... the number and sizes of change orders on the program and began to ask key Measure Z managers for more information on program status."

November 24, 2004: The *General Obligation Bonds Financial and Performance Audits June 30, 2004*, prepared by the independent certified public accounting firm, show actual expenditures of \$22.3 million plus \$52.2 million of additional commitments representing contracted but un-invoiced amounts, for a total of \$74.5 million of obligations against a budget to date of \$24.3 million, indicating a potential budget overrun. This audit reviews internal controls over procurement, invoice processing and change orders, and finds no exceptions to District procedures or State procurement laws and regulations.

December 2004: The owner of a strip mall on the formerly proposed site for the new Junior High School sues the AUHSD, alleging loss of income caused by interference in mall operations by

2006-2007 ORANGE COUNTY GRAND JURY

District personnel during the diligence and negotiations for purchase of the property (which was ultimately not acquired by the District). This lawsuit is eventually settled.

January 13, 2005: The Board of Trustees directs the following changes in Measure Z program scope:

- The Lexington Junior High School activities room is canceled;
- the Oxford Academy library is approved at a cost not to exceed \$2.5 million;
- the Kennedy High School additional classrooms are put on hold;
- all work at Sycamore Junior High School and South Junior High School related to the new buildings that were to take the place of the canceled new Junior High School is put on hold; and
- all other additional facility needs for long term projects (including all projects at the Second and Third Wave schools) are put on hold.

In addition, the construction management timelines are to be re-examined; Anaheim High School and Katella High School are not to receive any additional contingency money; and District staff is directed to again investigate the acquisition of land for a new Junior High School.

February-March 2005: The Board of Trustees approves engaging the services of a firm to perform an independent review of the Measure Z program. One of the two key Measure Z Directors resigns under pressure, and shortly thereafter the District Superintendent announces his retirement. The Assistant Superintendent who supervises both key Measure Z Directors is then asked to take over the duties of the Director who resigned. The Assistant Superintendent instead splits the work between himself and the other key Measure Z Director. Many applications for State matching funds will remain un-completed from this point until September 2005, severely impacting the cash flow of the entire Measure Z program. In addition, the preparation of regular management reports on the Measure Z program and its financial status begins to fall behind schedule. Eventually this reporting becomes five to six months out of date. The Assistant Superintendent asks to be allowed to replace the Director who resigned, but this request is denied, although one additional staff member is hired for the other key Measure Z Director.

March 17, 2005: The Board of Trustees discusses hiring a firm to provide overall program management services for Measure Z projects, but tables the item.

April 21, 2005: The Board of Trustees again considers the hiring of an overall program management firm for Measure Z, and again tables the item. The Board selects a consultant and a subcontractor to that consultant to conduct an Operational Forensic Performance Audit of the Measure Z Program. The Board tables all pending construction change orders under the assumption that the Forensic Auditor will review them. This impacts the pace of construction at many of the sites.

May 26, 2005: The Board of Trustees assigns the Assistant Superintendent who supervises the remaining key Measure Z Director to the new position of Assistant Superintendent of Facilities. He also continues to supervise his own replacement (who in the formal AUHSD organization chart reports to the Superintendent).

June-July 2005: The AUHSD Board of Trustees appoints another new Superintendent. He has direct experience with large construction bond programs. The newly assigned Assistant Superintendent of Facilities retires at the end of June. The District hires a replacement for him from

2006-2007 ORANGE COUNTY GRAND JURY

the private sector with the new title of Deputy Superintendent of Facilities. This manager has specific experience in turning around troubled school construction projects.

August 31, 2005: The *Operational Forensic Performance Audit* is completed (see following section). The two major findings of this report are:

- The First Wave of schools is two years behind schedule, having incurred \$110 million of expenditures to date; and
- the management of the Measure Z program and its financial matters is inadequate. Many key operational areas have significant weaknesses. Unless prudent management practices are put into place immediately the First Wave projects may exceed \$220 million, giving an overall budget shortfall for all three Waves of \$49 million, exceeding the funding capacity of the entire program and preventing any work on the Second or Third Wave schools.

September 2005: The remaining key Measure Z Director resigns and the new Deputy Superintendent of Facilities assumes his responsibilities for managing ongoing construction projects. The Board of Trustees hires the same consulting team that performed the *Operational Forensic Performance Audit* to provide staffing for a new Program Management Organization reporting to the new Deputy Superintendent of Facilities.

October 2005: The new Program Management Organization is put in place. This group and the Facilities department have a combined staff of 13 including the Deputy Superintendent of Facilities, District employees, and the consulting team. There are four Project Managers. Three of them supervise the work of the four construction management firm-architect teams; each team reports to a specific Project Manager. Each of these teams is at work on multiple job sites. Two outside law firms are retained to deal with Measure Z construction contract issues.

November-December 2005: The new Program Management Organization develops a revised tracking and reporting system in Microsoft Access and recaptures the historical cost data for all projects for input into this system. This effort corrects account coding errors and gaps which previously impacted the reliability of project cost information. New costs are captured from the payment approval work flow by the office of the Deputy Superintendent of Facilities, which adds them to the Access system. The system is reconciled with the official District accounting records in the OCDE/Superintendent of Schools' Bi-Tech system on a regular basis. It provides cash flow requirements forecasting both by project and for the overall Measure Z program.

November 30, 2005: At a regular meeting of business officials of County school districts, the OCDE/Superintendent of Schools presents the State Attorney General's opinion that school districts may not enter into "unit price" contracts for the performance of public works projects.

December 2005: Based on the new cost information in the Access system and new estimates for remaining work (pending un-awarded scope), the Program Management Organization prepares revised site-by-site construction budgets, schedules and cash flow projections for the First Wave schools with 10% site contingencies. Inflation is factored into these budgets at 30% versus the formerly assumed 17%. There is an \$18 million funding gap between the total of these revised budgets and estimated funds available of \$237 million including deferred maintenance funds.

2006-2007 ORANGE COUNTY GRAND JURY

January 2006: \$18 million of further reductions in work scope for the First Wave schools is achieved through value engineering (cost-saving re-design), bringing the total program cost for the First Wave into balance with the estimated available funds.

Winter 2006: Because the District had not made applications to the State for matching funds between March 2005 and September 2005, the Measure Z program faces a cash flow crisis. The District has retained a consultant specializing in State matching funds, but the consultant has been unable to complete the processing of the applications pending the receipt of important backup information and sign-offs from the District. The AUHSD Superintendent and Deputy Superintendent of Facilities visit Sacramento several times to work with the SAB/OPSC to release the matching funds. The financial information required by the SAB/OPSC is generated by the new Access system. \$11 million of construction commitments for Second Wave schools are cancelled. The final \$13 million of Measure Z bonds are issued.

Spring 2006: SAB/OPSC releases \$35 million in State matching funds for construction work already completed. \$8 million of additional matching funds are estimated to be available for the new construction at Anaheim High School once that project is completed. There are no plans for completing the Second or Third Wave work.

Summer 2006: The Board of Trustees delegates authority to the Superintendent and Deputy Superintendent of Facilities to authorize construction change orders up to a maximum value of \$100,000. This allows more rapid decision making. The Deputy Superintendent of Facilities will only approve a change order if one of the District's Project Managers has signed off on it.

September 2006: The members of the Citizens' Oversight Committee all end their terms and the Board of Trustees appoints a new set of committee members. The bylaws of the committee remain the same.

October 2006: A newly selected independent architectural team reviews the design drawings for Katella High School's modernization and Anaheim High School's new construction to check the completeness of plans and prepare the bid packets once State matching funds are approved for those sites. The AUHSD terminates one of the construction management firms for non-performance at four school sites. The AUHSD has not paid this firm since October 2005, except for two payments in August 2006 totaling just over \$220,000.

November 2006: The construction management firm that was terminated sues the AUHSD for several million dollars in back fees. The budget for the First Wave of the Measure Z program, including work already completed, is \$255 million and available funds, including anticipated remaining matching State grants, balance the costs at \$255 million. There are no firm plans for completing the work on the Second or Third Waves.

THE OPERATIONAL FORENSIC PERFORMANCE AUDIT

This report, dated 8/31/2005, contains numerous detail findings, a summary of which is as follows:

There are numerous poor management practices and schedule delays of up to two years due to "constant redesign and re-estimating, lengthy DSA approvals and some re-bidding," plus a lack of program management between February and August 2005 due to the resignation of the key Measure Z program manager without adequate replacement. The average project in the First Wave is delayed 16 months from its original schedule, with half the projects delayed 22 to 34 months. Hard

2006-2007 ORANGE COUNTY GRAND JURY

construction costs at all sites are over budget by 3% to 44% due to “poor communications regarding available budgets and the lack of cost controls.” Part of the increases in costs are also due to a 30% overall escalation in Southern California construction costs caused by a building boom, especially in school construction, where numerous districts are all mounting major modernization projects at the same time in order to take advantage of the availability of matching State funds. Re-programming and redesign allowed in the field due to lack of strong program management by the District further contributes to schedule delays and cost overruns. The District’s procedures are inadequate to control and monitor the Measure Z program and the procedures that are in place are not followed consistently. There is no standardized financial or budgetary reporting for Measure Z funds.

The report’s major recommendations are:

- implement a Program Management Office to oversee the entire Measure Z program;
- update the *Facilities Master Plan* by developing a go-forward program for completing the First Wave projects and the remaining schools in the Second and Third Waves;
- obtain legal counsel to address labor compliance issues, contract weaknesses and outstanding contractor fee issues;
- review the Bulk Purchase Program and develop standardized procedures for administering and coordinating it;
- strengthen vendor outreach to ensure inclusive and high quality bid participation, and follow documented procedures in awarding contracts;
- hold construction management firms accountable for their contract deliverables;
- develop a plan to complete Anaheim High School, Katella High School and the new construction at Kennedy High School without further delays or cost overruns;
- develop standardized management reporting procedures, requirements and templates for construction management firms working on Measure Z;
- create an enhanced change order management and review process for greater standardization and cost control; and
- strengthen the Bond Program’s financial management and reporting processes.

FINDINGS

In accordance with California Penal Code sections 933 and 933.05, each finding will be responded to by the government entity to which it is addressed. The responses are to be submitted to the Presiding Judge of the Superior Court. The 2006-2007 Orange County Grand Jury has arrived at the following findings:

- F-1. The AUHSD Board of Trustees lacked the training and expertise to properly oversee the entire Measure Z program. The majority of the Trustees had no experience in construction, capital program management, and related financial matters, and when the Measure Z program began to move into the construction phase, the Board became dysfunctional in dealing with the program.
- F-2. Since the end of 2005, the AUHSD management and staff have generally maintained effective control and oversight of the Measure Z program, although some problems still remain. Most of the recommendations in the *Operational Forensic Performance Audit* have been either fully or partially implemented. Reporting on program status is more accurate, transparent and timely.

2006-2007 ORANGE COUNTY GRAND JURY

- F-3. Prior to late 2005, AUHSD management and staff oversight was inadequate. There was not sufficient staff with knowledge of managing complex construction projects, or of obtaining matching State funds, and workload in certain key administrative areas at District headquarters effectively doubled with no increase in staffing.
- F-4. The frequent changes in the AUHSD's management – three new superintendents in four years, combined with other turnover in key personnel with responsibilities for the Measure Z program – impacted the continuity of top management oversight on the entire program prior to July 2005.
- F-5. Prior to late 2005, certain processes under Measure Z, such as unit price contracts and the bulk purchasing program, were not sufficiently differentiated from normal AUHSD operating procedures in terms of approvals, workflow, and data collection. As a result, there was confusion in both the handling and logistics of materials as well as cost allocations between Measure Z and the District's day-to-day operations.
- F-6. Prior to the *Operational Forensic Performance Audit*, reporting by District Staff on Measure Z was not transparent. Schedule updates were presented without the prior or original planned schedules for comparison; actual expenditures were presented in overwhelming detail with insufficient summarization; not enough focus was placed on the drop in the construction contingency as the program continued; budget numbers and estimates of available program funds repeatedly changed with little or no explanation or tie-back to prior presentations; and program status and financial reporting was frequently delayed until the information was obsolete.
- F-7. The OCDE/Superintendent of Schools has no effective computerized system available for tracking and controlling multi-year capital expenditure programs like Measure Z.
- F-8. Prior to October 2005, the AUHSD, along with other County school districts, lacked the internal expertise to develop a control and tracking system for large-scale multi-site capital programs, or to evaluate the adequacy of systems proposed by outside consultants.
- F-9. Prior to the appointment of a new set of members in late 2006, the AUHSD Measure Z Citizens' Oversight Committee was ineffective. Members of the Committee were unclear about the Committee's purpose and purview, and in general the Committee did not receive, nor did it apparently ask for, information about the Measure Z program beyond what was offered to it in prepared presentations by the AUHSD staff. The Committee also appears not to have submitted some of the annual reports to the AUHSD Board of Trustees that it was chartered to prepare.
- F-10. The AUHSD did not establish an effective priority classification of the work scope across all campuses, which led to an inequitable allocation of program resources once the program exceeded its budget, and which further contributed to the District not completing work on the Second and Third Wave schools.
- F-11. Soft cost budgets for Measure Z were not realistic until December 2005. Normal good planning practice is to assume 25-30% soft costs. In the AUHSD's Measure Z program, the soft cost budget was only 16.63%. This was taken as a sign of low overhead rather than as a warning of insufficient program management capability.

2006-2007 ORANGE COUNTY GRAND JURY

- F-12. Program contingency budgets for Measure Z were not realistic until December 2005. The industry standard for estimating renovation projects is 10%. In the AUHSD's case the contingency figures were primarily "backed into" by subtracting the estimated construction budgets from available funds. Once the estimated contingency fell below 10%, it should have been a signal that costs were beginning to escalate.
- F-13. There was no effective external independent project performance auditing through most of Measure Z's life, until the *Operational Forensic Performance Audit* in mid-2005. In order to minimize costs, the audits that were performed were limited to checking a sample of paid contractor invoices for adherence to District approval procedures and applicable law.
- F-14. In-service training of the Board of Trustees on program management practices and on the Measure Z program appears to have been ineffective; training of the Citizens' Oversight Committee appears to have been nonexistent until late 2006.
- F-15. The District did not effectively manage the process of securing State matching funds for the Measure Z program from February 2005 to September 2005. As a result, the entire program experienced a cash flow crisis.
- F-16. Circumstances beyond the AUHSD's control contributed to cost overruns in the Measure Z program. Unforeseen escalations in materials costs and construction management and architectural fees were being experienced during 2003-2006 by school districts statewide and even nationwide. Overall, construction costs increased 30% during this period.
- F-17. Some cost overruns in Measure Z resulted from lack of accurate information about the existing conditions at specific construction sites. For example, unanticipated subsurface conditions at two high schools resulted in extensive change orders to remediate. Also, as-built information at some sites appears to have been inaccurate.

Responses to Findings F-1 through F-17 are required from the Anaheim Union High School District.

Responses to Findings F-6, F-7, F-8, and F-16 are required from the Orange County Superintendent of Schools.

RECOMMENDATIONS

In accordance with the California Penal Code sections 933 and 933.05, each recommendation will be responded to by the government entity to which it is addressed. The responses are to be submitted to the Presiding Judge of the Superior Court. Based on the findings of this report, the 2006-2007 Orange County Grand Jury makes the following recommendations:

- R-1. The members of the AUHSD Board of Trustees should improve their ability to work together as an effective oversight and policy setting body for the Measure Z program. More in-service training should be performed, so that all Board members have a reasonable comfort level in dealing with this information and in making decisions based on it. (This recommendation arises from Finding F-1.)

2006-2007 ORANGE COUNTY GRAND JURY

- R-2. AUHSD management and staff should continue to effectively control the Measure Z program and should continue to provide the Board of Trustees with timely, accurate and transparent program status reporting. (This recommendation arises from Finding F-2.)
- R-3. When a County school district begins a major new capital expenditure program affecting multiple school sites, program-specific systems and processes for expenditure authorization, procurement, tracking and control should be integrated with, but distinct from, the existing combined manual and automated systems for day-to-day District operations. (This recommendation arises from Findings F-5, F-6 and F-7.)
- R-4. The County Superintendent of Schools should investigate developing an automated system for tracking multi-year construction programs for use by County schools, since the Bi-Tech system is not well-suited for this type of multi-year program management functionality. (This recommendation arises from Findings F-5, F-6, F-7 and F-8.)
- R-5. The Citizens' Oversight function should have knowledgeable members who have real-world experience in construction, planning, finance, budgeting, and related systems and controls. They should be proactive, and not merely follow the AUHSD Board of Trustees' recommendations and directives. Consideration should be given to allowing the Citizens' Oversight Committee to have a direct written and verbal reporting relationship to the Board of Trustees. (This recommendation arises from Finding F-9.)
- R-6. The AUHSD should consider developing an effective priority classification for the modernization work scope remaining in the District after the First Wave is completed, thereby allowing a more equitable allocation of resources to future construction projects. (This recommendation arises from Finding F-10.)

Responses to recommendations R-1 through R-6 are required from the Anaheim Union High School District.

Responses to recommendations R-3, R-4, and R-5 are required from the Orange County Superintendent of Schools.

LESSONS LEARNED: OBSERVATIONS REGARDING BEST PRACTICES

The complexities and challenges that faced the AUHSD in the Measure Z program are not unique to the AUHSD, but are challenges that other school districts in Orange County undertaking large-scale, multi-site capital programs also face.

The following are not findings, nor are they recommendations as required by Penal Code section 933; they are the Grand Jury's observations regarding best practices that the Grand Jury hopes to impart to both the County Superintendent of Schools and all of the school districts within Orange County. The Grand Jury strongly encourages the County Superintendent to be proactive in helping Orange County school districts benefit from these observations.

- L-1. Continuity of District management is critical to the success of major multi-site capital programs. The Superintendent of a school district engaged in a complex program of this type must delegate to qualified District staff who work with the program management resource to oversee the entire program. This effectively means assigning an Assistant Superintendent full-

2006-2007 ORANGE COUNTY GRAND JURY

time responsibility for the entire program and nominating one or more Owner's Representatives reporting to the Assistant Superintendent who are responsible for representing the District on construction sites. The Owner's Representatives should deal full-time on a day-to-day basis with the construction program and should be empowered to access whatever District resources are required to resolve issues as expeditiously as possible. School principals should not be placed in the position of fulfilling this function. (This observation arises from Findings F-3 and F-4.)

- L-2. County school districts undertaking major multi-site capital programs should retain professional program management resources – preferably a single contractor – to augment their own staff unless their staff are clearly qualified to manage the programs. It is unrealistic to expect existing staff who are not dedicated full-time to program management and oversight to effectively maintain control of complex limited-time construction programs of this magnitude, as the effort involved can amount to a doubling or even tripling of normal workloads. It is normally not cost-effective for school districts to maintain a dedicated, qualified program management staff unless construction programs are constantly ongoing for many years. (This observation arises from Findings F-3 and F-4.)
- L-3. Orange County school district staffs must maintain transparency of information about major capital programs to their Boards, their Citizens' Oversight Committees and the public at large. Reporting should be frequent and properly organized to highlight key status changes and significant deviations from original budgets and schedules, with appropriate background and explanations. Budgets and schedules, once determined, should not be revised unless extraordinary circumstances demand it, and then only with full participation and agreement by all stakeholders on the need for the revision, since it is impossible to judge progress against a moving target. (This observation arises from Finding F-6.)
- L-4. County school districts undertaking major multi-site capital programs should perform a valid study of the entire construction program before letting any projects out to bid. This study should include prioritization of individual program components and work scope across all school project sites into categories such as health and safety, building integrity, instructional support, etc., so that the program can be equitably re-configured if costs exceed estimates, cutting lower priority work categories program-wide instead of cutting all work at some schools and not others. (This observation arises from Findings F-10 and F-16.)
- L-5. Orange County school districts should not be “penny-wise and pound-foolish” when it comes to soft costs for major capital programs affecting multiple school sites. Soft costs of 25-30% of the total program budget are not unreasonable. Anything substantially below this level is a false economy – it does not represent “low overhead;” rather, it risks loss of control of the program. According to opinions of the State Attorney General, school construction bond proceeds may be used to pay for staff directly concerned with the management of a construction program. (This observation arises from Finding F-11.)
- L-6. Construction contingency budgets need to be realistic for school districts' major capital programs in Orange County. There should be independent contingency budgets at the overall program level and the individual construction project level. The industry standard for renovations is 10% at both levels. For new construction, the contingency budget can be somewhat lower than 10%, since there are fewer unknown or unforeseen conditions associated with completely new projects; however, it should start at 10% before contracts are

2006-2007 ORANGE COUNTY GRAND JURY

signed, and should only be adjusted downward to the extent that fixed prices are committed by contractors. Change orders should be charged to the contingency account, and the contingency account should be highlighted in reports and reviewed carefully and frequently. Expenditure of contingency budgets at a faster rate than schedules progress should be taken to indicate problems, and corrective action should be undertaken immediately if this is noticed. (This observation arises from Finding F-12.)

- L-7. Professional, independent project performance auditing should be performed consistently and regularly throughout major school district capital programs in Orange County. The on-going OCDE/Superintendent of Schools audits of capital expenditures, while thorough, do not address issues such as the quality of contractor performance, SAB/OPSC audits typically do not take place until after the entire program is completed, and individual district audits usually focus on annual operations rather than capital programs. (This observation arises from Finding F-13.)
- L-8. Thorough in-service training of the Board of Trustees and Citizens' Oversight Committee should be performed ahead of and throughout the duration of a major school district capital program. This training should emphasize construction practices, systems and procedures and related financial matters. (This observation arises from Finding F-14.)
- L-9. County school districts undertaking major capital programs that are eligible for State matching funds should retain consulting resources that are knowledgeable in the procedures and processes involved in applying for and securing those funds. District staffs do not typically have this expertise, which includes liaison with the SAB/OPSC. (This observation arises from Finding F-15.)
- L-10. County school districts should insure proper diligence is done prior to putting capital projects out to bid, making sure as-built plans are accurate, and resolving any necessary information about site conditions, utility routing, and similar matters. If not documented comprehensively prior to construction, change orders to deal with these conditions can eat up the entire contingency budget for a project. Contract language should stipulate that engineering consultants will bear the responsibility for incorrect or missing information. (This observation arises from Finding F-17.)

REQUIRED RESPONSES

The California Penal Code specifies the required permissible responses to the findings and recommendations contained in this report. The specific sections are quoted below:

- §933.05(a) For purposes of subdivision (b) of Section 933, as to each grand jury finding, the responding person or entity shall indicate one of the following:
- (1) The respondent agrees with the finding.
 - (2) The respondent disagrees wholly or partially with the finding, in which case the response shall specify the portion of the finding that is disputed and shall include an explanation of the reasons therefor.
- (b) For purposes of subdivision (b) of Section 933, as to each grand jury recommendation, the responding person or entity shall report one of the following actions:
- (1) The recommendation has been implemented, with a summary regarding the implemented action.

2006-2007 ORANGE COUNTY GRAND JURY

- (2) The recommendation has not yet been implemented, but will be implemented in the future, with a timeframe for implementation.
- (3) The recommendation requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a timeframe for the matter to be prepared for discussion by the officer or head of the agency or department being investigated or reviewed, including the governing body of the public agency when applicable. This timeframe shall not exceed six months from the date of publication of the grand jury report.
- (4) The recommendation will not be implemented because it is not warranted or is not reasonable, with an explanation therefor.