TASK FORCE ON BOND ACCOUNTABILITY

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December 23, 2015

State Treasurer John Chiang
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Treasurer Chiang:

On behalf of the members of the Task Force on Bond Accountability, we present to you our final Report. This Report includes numerous observations based upon public hearings and presentations made to the Task Force. It also includes a set of Best Practice Guidelines that should serve as a model for public agencies throughout the State as well as the nation. It is the Task Force's expectation that these Guidelines should become a standalone document and perhaps incorporated into the CDIAC Debt Primer.

The Guidelines were developed recognizing that there was a lack of commonly accepted best practices that public agencies might adopt to ensure that bond funds were being used for only legal and intended purposes. The absence of guidelines represented a significant deficiency in the body of knowledge concerning the fiduciary care and use of state and local bond proceeds.

Over the course of eight months the Task Force dedicated itself to fulfilling the mission you laid out, which was to propose new safeguards against theft and misuse of bond funds in California. The Task Force believes that the final Report, along with a set of best practice guidelines will enable public agencies to provide their taxpayers the requisite assurance that the bond funds they have approved are being used for legal and intended purposes.

Representing all of the members of the Task Force, we want to express our gratitude to you for your leadership on this important issue and for the trust you placed in us to coordinate and direct this work. We are confident that with your continued interest and support the guidelines developed by the Task Force will be universally adopted by public agencies in California.

Sincerely,

Fred Keeley   Jay M. Goldstone

CALIFORNIA STATE TREASURER JOHN CHIANG

TASK FORCE ON BOND ACCOUNTABILITY

Task Force Final Report

December 14, 2015

Executive Summary

Both households and businesses employ measures to ensure they properly manage their money. Individuals may compare expenses to an account statement sent by the bank while a business may conduct a "three-way match" of the invoice, requisition, and payment to ensure that payments are both valid and accurate.

A three-way match represents what accountants and auditors refer to as a control activity. A number of control activities roll up into a control system. A control system is a set of processes and procedures designed to give managers a reasonable assurance that the agency's resources – principally its money – are being used properly. No matter how well-designed the control system, however, there is always a chance that a determined individual will fraudulently misuse resources. But without an internal control system management has no reasonable assurance that this is not regularly occurring.

While almost all public agencies use three-way matching to pay invoices from contracts, purchase orders, and others claims, they may not always use these procedures to review and approve payments from bond funds.[1] Both the federal and state governments have adopted laws that narrowly limit the use of proceeds as a way to strictly control the use of the bonding authority. These laws require, among other things, that bond proceeds be used for public purposes as well as the intended purposes stated in the bond documents or subsequent amendments, that they be spent within a specified period of time, and that they not be used to benefit from arbitrage. As a result of these and other limitations the administration and management of bond funds is a more complicated task, requiring more specialized knowledge, than the management of other governmental funds. The additional burden imposed by these rules may lead public agencies to establish different procedures to manage the use of bond funds than used to manage other funds. These alternative procedures may, on occasion, lack rigorous internal controls.

California public agencies have issued $1.4 trillion in debt in the past 25 years. During this time there have been only a few cases of fraud leading to the misuse or loss of bond funds. Nonetheless, without adequate internal controls, public managers cannot profess with a reasonable assurance that bond funds are being used for their intended purposes. California State Treasurer John Chiang recognized that California public agencies have at their disposal a number of manuals and instructional guides describing how to administer their bond funds, but they lacked a comprehensive set of practices that can help to provide these agencies an assurance that their bond funds were being spent properly. To address this he convened a group of public finance professionals and representatives of state and local agencies to consider the need to guide public agencies in creating internal controls over the use of bond funds.

The group, named the Task Force on Bond Accountability, met five times over a period of eight months. It heard from accountants, auditors, public agencies, treasurers, and other members of the public and it gathered information and identified current control practices and recommended best practices. This report is an account of the efforts of the Task Force to identify current practices, to evaluate them, to recommend improved practices, and to find ways to imbed these practices in the day-to-day operations of public agencies.

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[1] References to "bond financing" and "bond documents" are not intended to suggest that the recommendations and best practices contained herein be limited to debt incurred through the sale of bonds. Many of the recommendations and best practices may be equally valuable to improving the management of proceeds of other debt instruments as well.

Among its observations, the Task Force recognized that the responsibility for establishing an internal control systems lies with the governing body. It is the duty of the governing body to provide the direction and resources to establish and maintain an internal control system that provides reasonable assurance that bond funds are used for legal and intended purposes and in compliance with all requirements. The Task Force heard presentations affirming the fact that public agencies that issue debt come in all sizes and shapes and some smaller agencies may lack the internal resources to conduct a three-way match of payments. To address this, the Task Force recommends such agencies create compensating controls, including timely post-audit testing of payments, or they procure external professional services to fill the gaps in their administrative systems. Regardless of who implements the control system, however, the governing body continues to hold a fiduciary responsibility with regard to the management of the agency's funds.

The Task Force paid special attention to the challenges posed by conduit financings to the use of an internal control system. In a conduit financing a public or quasi-public agency, typically a financing authority representing one or more public entities, issues debt on behalf of a public or private borrower. The financing authority acts as a conduit for the borrower by providing the borrower access to debt financing, which is typically tax-exempt. Because the issuer and borrower are not necessarily related entities, some accounting, recordkeeping, and reporting functions may be handled by the conduit issuer, giving the borrower varying degrees of control over the bond funds. Even if the borrower has developed an adequate internal control system it may not always cover the operations of the conduit issuer. As a result, the Task Force recommends that borrowers assume responsibility for the bond funds and develop the appropriate legal and administrative framework to ensure that the bond funds are subject to its internal control system.

Based upon the Task Force's observation that some public agencies may not have an adequate control system to manage their bond funds, the report includes a set of 17 guidelines that, if used, will help to ensure that bond funds are appropriately managed. These guidelines do not themselves provide public agencies sufficient instructions to establish and maintain an internal control system. Instead they are intended to be layered on top of an existing system for the purposes of providing and strengthening controls over the management of bond funds.

The Task Force believes there is additional work to be done to help public agencies improve the management of their bond funds. This includes additional guidance on how to implement the guidelines, programs to educate elected officials and managers on the guidelines, and greater openness about the use of bond funds. With regard to this last point, the Task Force believes that public agencies should create channels, whether citizen's committees or websites, to explain to taxpayers what they do with the money received from selling bonds.

Introduction

On February 12, 2015, California State Treasurer John Chiang convened a special task force to develop best practice guidelines on the fiduciary care of and use of state and local bond proceeds. The Task Force on Bond Accountability (Task Force), composed of current and former securities regulators, local treasurers, and public agency fiduciaries, along with academicians and finance industry experts, was charged with developing best practice guidelines for how bond proceeds should be managed in order to reduce the risk of fraud, waste, and abuse. Additionally, the Task Force was asked to consider strategies to increase transparency and oversight of the use of bond funds.

The Treasurer's decision to form the Task Force resulted, in part, from the revelation that approximately $1.3 million was discovered missing during a routine audit of bond funds held by the Association of Bay Area Governments (ABAG), an issuer of bonds for local governments, non-profit organizations, and private entities in the San Francisco region. The funds were being held in trust by ABAG for the City and County of San Francisco. The San Francisco Chronicle reported that the bond money, which was earmarked for public parks and street improvements in downtown San Francisco, was allegedly embezzled by ABAG's director of financial services.

The Treasurer appointed former Santa Cruz County Treasurer and Assembly Speaker pro tempore, Fred Keeley, and former chair of the Municipal Securities Rulemaking Board (MSRB) and Chief Financial Officer and Chief Operating Officer for the City of San Diego and current Managing Director at MUFG Union Bank, Jay Goldstone, as co-chairs. Other members of the Task Force included Jim Bemis, principal at Montague DeRose and Associates; Robert (Bob) Campbell, auditor-controller of Contra Costa County; Carrie Corder, assistant general manager and chief financial officer of Cucamonga Valley Water District; Andrew Finlayson, chief of the State Agency Audits Bureau of the State Controller's Office; Blake Fowler, director of the Public Finance Division of the State Treasurer's Office; William Holder, dean of the University of Southern California Leventhal School of Accounting and former member of the Governmental Accounting Standards Board (GASB); Ana Matosantos, former director of California's Department of Finance; Jenny Salkeld, chief financial officer of San Diego Unified School District; Nadia Sesay, director of San Francisco Controller's Office of Public Finance; and, Bob Whalen, mayor of Laguna Beach.[2]

At its first meeting, held on April 8, 2015, the Task Force adopted the following Mission Statement and Scope of Work.

> **Mission Statement**
> To develop and recommend practices that enable public agencies to ensure that bond proceeds are used only for legal and intended purposes and that they are properly accounted for, managed, and safeguarded in a manner consistent with applicable legal requirements and with best practices and internal controls and transparent to the public.
>
> **Scope of Work**
> In an effort to protect public agencies and their constituents from the misuse of bond proceeds, the Task Force on Bond Accountability will undertake the following scope of work in an advisory role to the California Debt and Investment Advisory Commission:

[2] *See* Appendix B for Task Force member biographies.

1. Identify the range of practices employed by public agencies and other fiduciaries that receive and disburse bond proceeds.
2. Evaluate these practices to identify increased protections against mismanagement or misuse of proceeds.
3. Establish best practice guidelines for public agencies that provide administrative and accounting controls and oversight of the administration of bond proceeds.
4. Recommend administrative practices that institutionalize and operationalize the use of these guidelines. (Specifically, to consider imbedding best practice standards in controlling documents, audit programs, and definitions of roles and responsibilities of administrative and elected officials.)
5. Promote the adoption of best practice guidelines through publications, training, or other means.
6. Consider legal, administrative, and organizational strategies to increase transparency and oversight of the administration of bond proceeds by public agencies.

This report recounts the process and outcomes of the Task Force's work. Over the course of five meetings, the Task Force considered how state and local agencies administer bond proceeds and determined that there was an opportunity to develop recommended practices that could help public agencies improve the tracking of bond proceeds to ensure that the proceeds were being used for legal and intended purposes. These Best Practice Guidelines are included as Appendix A. In addition, this report includes the Task Force's recommendations on how public agencies can encourage adoption of these practices through education and training and further the adoption of these practices through policies and procedures. Finally, the report recommends further analysis that may lead to more specific accounting and administrative procedures to be used by State and local agencies to administer bond funds.

In fulfilling the Scope of Work, the Task Force believes that the adoption and application of the proposed Best Practice Guidelines will achieve the following outcomes, among others:

1. Provide a set of generally accepted practices that help to ensure the proper management of public funds by public agencies, irrespective of the type of agency, type of proceeds, or types of projects financed with bond proceeds;
2. Address the inconsistencies or gaps in best practices that apply to the related fields of financial operations, including accounting, auditing and reporting, or debt financing;
3. Provide core principles and practices that can be used to train new staff and ensure continuity of roles and responsibilities;
4. Establish a framework of review that may be used by auditors to evaluate whether public agencies apply a system of internal controls to manage the expenditure of bond proceeds;
5. Provide those who hold a fiduciary responsibility for the management of bond proceeds with a framework necessary to meet this obligation and, in so doing, help them achieve organizational goals; and

6. Enable the public to participate in the process of understanding and assessing the benefits of bond financing and the efficiency and effectiveness with which these funds are administered by public officials.

Background

The alleged embezzlement of nearly $1.3 million in bond funds from a conduit issuer in the Bay Area led to a unified response by state officials in California. Treasurer Chiang convened the Task Force on Bond Accountability to determine opportunities to develop and disseminate best practices regarding the management of bond proceeds following a bond sale. Senate pro tempore Kevin de Leòn committed to holding hearings on the conduit issuer, the Association of Bay Area Governments (ABAG), and State Controller Betty Yee launched an audit of ABAG.

On May 14, 2015, the Senate Committee on Governance and Finance, chaired by Senator Robert M. Hertzberg, issued an oversight report.[3] The report, titled *Misappropriated Bond Proceeds at the Association of Bay Area Governments*, described the bonds, the project, and the relationship between the issuer (ABAG) and the borrower, a community facilities district located in the City and County of San Francisco. The report explained the alleged embezzlement scheme and linked this to the documents used to carry it out. In the end, the report asked several questions about the management of bond proceeds and the manner in which public agencies ensure that they are used for legal and intended purposes and in a manner transparent to the administrators and the public.

On June 2, 2015, State Controller Betty Yee released a report of her office's review of ABAG.[4] The report, which assessed ABAG's controls used to "safeguard public assets and ensure proper use of public funds," did not identify any "significant deficiencies with the ABAG's administrative and internal accounting controls." It did, however, note several serious weaknesses in ABAG's internal controls over the operations of ABAG's financing authority. In assessing ABAG's administrative processes, the Controller's review applied standards for internal controls.

The work of the Senate Committee on Governance and Finance and the Controller's Office as well as the body of work associated with financial management and bond administration, helped the Task Force narrow its scope of work. Specifically, the Task Force set out to consider the internal controls employed by public agencies to manage the use of bond proceeds.

The American Institute of Certified Public Accountants (AICPA) defines internal control as:

> A process affected by those charged with governance, management, and other personnel that is designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over safeguarding of assets against unauthorized acquisition, use or disposition may include controls relating to financial reporting and operations objectives.[5]

The Government Finance Officers Association's (GFOA) *An Elected Official's Guide to Internal Controls and Fraud Prevention*, the GFOA's *Debt Management Policy*, the Government Accountability Office's (GAO) *Standards for Internal Controls in the Federal Government* (Green Book), the GAO's *Generally Accepted Government Auditing Standards* (Yellow Book), and the California Debt and Investment Advisory Commission's *California Debt Issuance Primer* each provide guidance for public agencies in carrying out the establishment and maintenance of an internal control system.

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[3] The report is available at http://sgf.senate.ca.gov/publications.
[4] The report is available at http://www.sco.ca.gov/Files-AUD/association_of_bay_area_governments.pdf.
[5] *Internal Control – Integrated Framework*, Committee of Sponsoring Organizations of the Treadway Commission (COSO), May 14, 2013.

An Elected Official's Guide: Internal Control recognizes that public agencies, as guardians of public funds, have a fiduciary responsibility to ensure a reasonable assurance of internal control over all assets (including bond funds) under their authority.[6]

The application of internal control by public agencies should achieve three basic objectives:

- To operate effectively and efficiently and to safeguard their assets (Operational);
- To provide reliable information to those who need it (Reporting); and
- To comply with all applicable constraints, as required by policies, procedures, and statutes, etc. (Compliance).[7]

According to the GFOA, internal control is nothing more (or less) than the combination of people, policies, and procedures that managers rely upon to be able to provide a positive response to each of the following questions:[8]

- How do you know that the entity is operating effectively and efficiently and is safeguarding its assets?
- How do you know that financial statements and other reports can be relied upon?
- How do you know that the entity is complying with applicable laws, regulations, and policies?

Task Force Proceedings[9]

The Task Force held five meetings over a period of eight months in Sacramento (April 8, 2015), Los Angeles (May 21, 2015), San Francisco (June 6, 2015), Sacramento (October 8, 2015), and Sacramento (December 14, 2015).

The Task Force gathered information on the internal controls and practices employed by public agencies to manage bond proceeds through different means, including:[10]

- Speaker presentations;
- Staff research and reports;
- Task Force member expertise; and
- Case studies of California issuers.

Speakers included the following individuals:

- California State Treasurer John Chiang
- Jose Matamoros, *BNY Mellon, Corporate Trust Services*
- Andrea Roess, *Managing Director, David Taussig & Associates, Facility District Administrator*
- Larry Walker, *Auditor-Controller/Treasurer/Tax Collector, San Bernardino County*
- Julia Cooper, *Director of Finance, City of San Jose*
- John Collins, *Deputy State Auditor, California State Auditor's Office*

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[6] *An Elected Official's Guide: Internal Control*, Government Finance Officers Association, 2015, pg. 7.
[7] *Id.* at 9.
[8] *Id*.
[9] Meeting minutes and staff reports are available at http://www.treasurer.ca.gov/tfba/index.asp.
[10] *Id.*

- Jim Godsey, *Partner, MGO Advisory Services, Certified Public Accountants and* Scott Johnson, *Partner, MGO Advisory Services, State and Local Government Services*
- Joan DiMarco, *Managing Director, PFM Asset Management LLC*
- Rudy Nothenberg, *San Francisco Municipal Transportation Authority*
- Rebecca Rhine, *Citizens' General Obligation Bond Oversight Committee*
- Michael Turnipseed, *President, California League of Bond Oversight Committees*
- Erika Alvord, *Director, KPMG LLP*

The Pre- and Post-Issuance Activities of Public Agencies

Speakers identified a number of activities that public agencies carry out in the process of issuing debt. These included:

Pre-Bond Authorization (Prior to Voter/Governing Body Approval)
Careful planning and thorough preparation is a critical factor in successful bond management. Preparation typically begins long before the authorization of the bonds and may include:

- Development of a multi-year capital improvement plan (CIP);
- Establishment and consideration of debt management, investment, and disbursement policies to guide the issuer's financing and management of bond funds;
- Careful review of federal, state, and local laws;
- Advance preparation and education of the governing body of the issuer and, if appropriate, the community at large; and
- A comprehensive plan to allow for the accurate and timely flow of information to current and prospective investors, members of the governing body, and the public.

Along with a CIP, a public agency should have adopted a debt management policy that, in general, reflects the scope of activities that the issuer is likely to fund by issuing bonds. The debt management policy can be used to reflect community goals and expectations concerning the use of debt financing as well as a guide for the type and structure of the debt to be issued. Debt management policies should also be formally submitted to and adopted by the governing body. A debt management policy enables the public agency to:

- Establish parameters for issuing and managing debt;
- Provide guidance to decision makers so as not to exceed the debt affordability standards;[11]
- Direct staff on objectives to be achieved both pre- and post-issuance;
- Promote objectivity in decision-making and limit the role of political influence; and
- Facilitate the process by considering and making important policy decisions in advance of an actual debt issuance.

[11] An issuer may also consider adopting debt affordability standards in order to help them evaluate when, why, and how much debt should be issued. These standards can lead to a debt affordability plan that keeps debt levels within acceptable ranges. A debt affordability plan will typically include a set of target ratios for debt, which might be based upon assessed valuation of property, revenues, population, system users, or other factors relevant to specific types of issues.

Voter Approval/Authorization of Issuance
Issuers of municipal bonds are legally authorized by state law to borrow money for different purposes and in some cases for their "general corporate purposes."[12] For the most part, these purposes are limited to those that in one respect or another benefit the public welfare—so-called public purposes.[13] The legally required procedural steps vary widely among the different types of public debt financing.[14] Depending on the type of bond authorized, the issuer may have to satisfy additional legal requirements prior to issuing the authorized bonds.

The legal authority for the issuance of public debt can be visualized as a three-legged stool, including:

- The state law that authorizes the issuance of bonds;
- The federal and state tax laws that govern the eligibility of the bonds for tax-exempt status[15]; and
- The federal and state securities laws that govern disclosure, sale, and trading of bonds.

As these legal requirements are in a constant state of change, issuers should monitor and review them on a regular basis and in consultation with bond counsel, the local agency's general counsel, and other appropriate legal professionals.

Typical Bond Issuance Process (Structuring, Sale, and Closing)
As mentioned previously, one of the first decisions to be made by an issuer is the selection of the initial members of its debt financing team, including, but not limited to, bond and tax counsel, disclosure counsel, financial advisor, underwriting firms, and trustee. Throughout the issuance process the issuer is the key figure and the focus of activities and regardless of the number or role of other team members the issuer cannot abdicate its responsibility for the decisions made during the issuance process.

Having selected a debt financing team, an issuer then works closely with the team members during the structuring and sale phase of the debt issuance process to finance its capital improvement or working capital program. Subject to legal constraints and considering the recommendations of the team members, an issuer retains ultimate control and responsibility of the overall financing plan and the details of the financing structure. The issuer's staff members are ultimately responsible for reviewing all aspects of the financing, including the management of the financing schedule, development, review and approval of bond documents (i.e., indenture, loan agreement, preliminary and final official statement, bond purchase agreement, tax certificate, continuing disclosure agreement, and other related legal documents), and review and approval of underwriting policies, issuer representations, and certifications.

The issuer's staff is in the best position to be aware of the impact of the financing on other areas of the issuer's finances and operations. Key considerations of the issuer that should be addressed prior to the sale of bonds include, amount to be issued, type of debt to be issued, structural features of the bonds, method of sale of debt, and compliance with disclosure requirements. The issuer's management and staff are also responsible for seeking approval from its governing body prior to the sale of bonds. All members of the governing body should be provided with an appropriate scope of details regarding the

[12] *California Debt Issuance Primer*, California Debt and Investment Advisory Commission, 2006, pg. 2-3.
[13] In the case of a municipality operating under an independent charter, debt may be issued for purposes that constitute "municipal affairs."
[14] *California Debt Issuance Primer*, *supra* note 11 at pg. 37.
[15] Public debt may also be issued on a taxable basis although tax-exempt issuance is more common.

proposed bond issuance so that each member has a thorough understanding of the bond issuance that they are asked to approve. This includes providing the governing body with copies of all documents relating to the bond sale, especially the preliminary official statement (POS). The members of the governing body are fiduciaries and, as enforcement actions of the Securities and Exchange Commission (SEC) demonstrate, they are also responsible for the accuracy of the POS and cannot solely rely on presentations from staff.

Post-Issuance Management of Bond Funds

Upon the closing of a bond financing transaction, the issuer assumes responsibility for the long-term management of bond proceeds, including:

- Supervising, investing, and administering the use of bond proceeds in compliance with federal and state laws;
- Collecting or monitoring the collection of pledged revenues;
- Use of revenues to pay administrative expenses and debt service;
- Compliance with all undertakings, bond covenants, and agreements;
- Management of any enterprise funded by the bonds;
- Filing of any required reports with various government regulators, bond insurer or other credit enhancement provider, if any, and credit rating agencies;
- Addressing any problem that may arise with respect to the bonds, such as a shortfall in pledged revenue, a tax audit, or a regulatory issue; and
- Preparing, reviewing, and filing annual reports and listed event notices pursuant to SEC rules.

The degree to which members of the issuer's debt financing team are capable of looking out for the issuer's long-term interests, or are motivated to do so, will vary depending on the relationship that each team member has with the issuer. Ultimately, the issuer bears responsibility for its own interests. For this reason, issuers should remain an active participant in the issuance of debt and long-term management of their bonds. Even if the issuer selects its consultants with an eye toward providing services that cannot be provided in-house, issuers need to continue to examine the consultant's work and ask the questions necessary to assure themselves that the end result meets their objectives and all legal requirements and obligations.

Custody and Control of Bond Funds

At bond closing and, depending on the type of bonds issued as well as the needs and capabilities of the issuer, the bond proceeds as well as the pledged revenues collected for the repayment of the bonds and other permitted uses may either be deposited with a trustee that is a public control agency (i.e., funds are held within the local government's or county's treasury) or with a commercial bank or corporate trust company (i.e., funds are held outside of the local government's treasury). In either scenario, bondholders are comforted by the involvement of a fiduciary acting on their behalf and holding funds and accounts relating to the bond issue. The terms under which the trustee safeguards and administers the use of the proceeds are set forth in an indenture, resolution, or other bond documents. A trustee may perform one or more of the following duties:

- As trustee—establishing and holding the funds and accounts relating to the bond issue, determining that the conditions for disbursement of bond proceeds and pledged revenue have been met, and, in some cases, collecting revenues and executing investments;

- As bond registrar—maintaining a list of the names and addresses of all registered owners of the bonds and recording transfers and exchanges of the bonds;
- As authenticating agent—authenticating bonds upon initial issuance or upon transfer or exchange;
- As paying agent—paying interest on the bonds by check or wire to the respective registered owners, and paying principal of the bonds to the registered owners upon surrender of the bonds at maturity or upon earlier redemption; and
- As trustee—protecting the interests of bondholders by monitoring compliance with covenants and acting on behalf of bondholders in the event of default.

In performance of its duties, a trustee acts in a fiduciary relationship to both the issuer and the bondholders since both are beneficiaries of the trust established by the indenture, resolution, or other bond documents.

Internal Control Practices Common to Public Agencies

The information and materials gathered or submitted by staff, presenters, and Task Force members helped to document common practices employed by public agencies in the management of bond proceeds. In addition, the State Controller's Office's (SCO) audit of ABAG and the Senate Committee on Governance and Finance review of ABAG were useful in identifying administrative or legal failings leading to the misappropriation of bond funds. Collectively, these provided the Task Force an understanding of the common internal controls employed by public agencies during the life of the bonds.

During the **Start-up Phase**, public agencies may:

- ❖ Develop regulations/guidelines/procedures/program manuals as necessary for all stages of the bond lifecycle before the bonds are issued;
- ❖ Conduct risk assessment to determine what can go wrong and ensure procedures exist to mitigate each significant risk;
- ❖ Perform workload analysis to determine staffing needs. Assess training needs. If any outsourcing is planned – be careful to retain sufficient control to ensure effective oversight;
- ❖ Establish appropriate accounting/fund structure to properly account for and track all bond funds;
- ❖ Establish an annual report to taxpayers accounting for the expenditure of bond funds; and
- ❖ Establish an oversight committee to review bond programs and to facilitate public involvement and disclosure. Provide the oversight committee with the necessary legal and organizational resources to achieve its mission.

When developing **Policies and Procedures:**

- ❖ The agency's policies and procedures should set forth the internal controls needed to ensure the appropriate use of bond proceeds;
- ❖ The debt policies and procedures should be entwined with other organizational policies and procedures so as provide a coordinated and comprehensive system of controls;
- ❖ The policies and procedures should be subject to intermittent review;
- ❖ Staff should be trained on the policies and procedures;

- The procedures should provide for the reasonable detection of the agency's non-compliance with policies;
- The agency should set forth procedures to correct non-compliance when uncovered; and
- The agency should retain records to show evidence of compliance.

When **Disbursing Bond Funds**, public agencies may:

- Require adequate documentation before making payments. Depending on the circumstances this could include:
    - Contracts, purchase orders, invoices, canceled checks (time and/or materials)
    - Deliverables, special studies/reports
    - Contractor/subcontractor agreements and payments
    - Description/volume of activities or services provided
    - Certifications e.g., review/approval of progress or completion by internal or external oversight parties
    - Progress reports (could also be a component of monitoring activities)
- Public agencies that reimburse service providers from bond funds may adopt some of the following procedures:
    - Invoices should be submitted by the responsible program or department within the agency
    - The documentation should be reviewed by an independent authority, typically accounting or treasury
    - When approved by the reviewer, the requisition should be issued by another independent authority, typically the finance department
    - Disbursements are posted to appropriate fund and account
    - Account balances are fully represented in the agency's annual financial report
- Verify compliance with contract/award agreement/bond act requirements;
- Track payments to ensure contract/award/budget amounts are not exceeded;
- Establish and track withholds from progress payments;
- Track administrative costs (administering agency/recipient) to ensure limits are not exceeded;
- Consider cost allocation requirements e.g., multiple funding sources;
- If applicable, determine whether conditions have been met for advance payments; and
- Manage multiple funding sources, including avoiding spending funds on closely-related purposes/activities that technically fall outside the allowable uses of bond proceeds. Limitations will vary among funding sources so avoid treating them as interchangeable "pots" of money.

During the **Construction Phase**, public agencies may:

- Develop/Review progress reports – (this could be part of the invoicing/payment request process to the extent other parties are involved or it may be work the administering agency needs to perform)
    - Current and to-date expenditures
    - Current and to-date activities completed
    - Status of project relative to budget and schedule

    - Key issues encountered and related mitigation strategies
- Conduct site visits and document results;
- Monitoring may need to occur beyond the date that all funds have been disbursed, particularly when the issuer needs to document compliance with continuing eligibility requirements;
- Document all recipient contacts/communications;
- Consider periodic review by internal/external auditors (may be required); and
- Address conflicts of interest by ensuring that designated employees and contractors complete and file statements of economic interests on time. Review and evaluate potential conflicts and take action as warranted.

During the **Reporting and Closeout Phase** of a bond program, public agencies may:

- Develop tools, including a review process, to accurately report on the status of bond programs (transparency);
    - Bonds authorized, issued, unissued
    - Debt service principal/interest to-date and remaining
    - Other funding sources if applicable
    - Amounts awarded/remaining and spent/to be spent in total and by project/recipient
    - Planned and actual timelines/deadlines for bond issuance, awards, expenditures, and project completion
    - Planned activities/outcomes and actual results by program and project/recipient
- Develop a user-friendly website to show what bond program has accomplished and keep information up to date;
- Develop and frequently update Frequently Asked Questions (FAQs) for various stakeholders;
- Establish and meet deadlines for periodic reporting and updating website;
- Conduct and document final inspection/closeout of project (onsite/project file);
- Establish target dates/deadlines for closing down the bond program and update as necessary;
- Determine what will be done with any remaining funds, including the possibility to increase bond debt service or redeem bonds early, or allocate funds to other approved recipients;
- Secure funding for any ongoing operations and maintenance costs; and
- Develop process to provide ongoing reports to the governing body on bond program.

While **Auditing the Internal Controls**, public agencies may:

- Assess the agency's procedures for monitoring compliance with the applicable bond documents;
- Assess the agency's processes for ensuring prompt payment of debt services;
- Review the agency's procedures for maintaining reserve balances as set forth in bond agreement; and
- Assess the suitability of book of records and accounts.

While **Testing Compliance with Bond Documents**, public agencies may:

- Confirm the legal authority for the bonds;
- Test agency's compliance with the applicable bond documents;
- Review agency's compliance with continuing disclosure obligations; and

- ❖ Review agency's compliance with post-issuance state and federal laws and regulations.

Lessons Learned from the Observed Internal Control Practices of Issuers

Difference between Public Agencies
Issuers of public debt differ in many essential ways from each other, including their organizational structure, their purpose or authority, the facilities they construct, maintain, or finance, and their staffing and organizational capacity. They also differ in terms of their financial and administrative practices, including the underlying financial management systems they use. The spectrum of public agencies in California ranges from a joint powers authority that depends upon contractual services provided by a public or private entity to the State of California. In the middle are distributed cities, counties, schools, and special districts — public corporations offering full or special services.

The Unique Challenges Posed by Conduit Financings
In the municipal market, a conduit financing is a method of borrowing that involves a conduit issuer, usually a special-purpose public entity such as a financing authority, and a borrower. The borrower, be it a public or private entity, uses the conduit issuer's standing as a public agency to issue debt in the municipal market. Under this structure, the borrower is the responsible party obligated to repay the debt and comply with the administrative and regulatory requirements of the bond sale. But, in a conduit financing the roles of issuer and borrower can become confused or mismanaged. In the extreme, the borrower may not have direct control of the bond funds and may be forced to rely on the conduit issuer, a separately organized entity, for certain accounting, reporting, and payment processes.

Importance of Policies
Policies that inform or relate to the agency's administration of bond proceeds go by a variety of names, including debt policy, fiscal management policy, administrative memos and manuals, and governance policy. Public agencies develop policies to establish objectives, improve decision making, and evaluate the outcome of operations. With respect to the administration of bond proceeds, public agencies operate under many different policies that do not always work harmoniously together. They may, in fact, impede the agency's efforts to account for and report on the use of bond proceeds.

Public agencies develop and apply debt management policies to ensure that debt is issued and managed prudently. This practice is advocated by the GFOA which published and subsequently updated best practice guidelines for debt management policies in 1995, 2003, and 2012.[16] These guidelines along with other GFOA publications recommend that a formal debt management policy, guiding debt issuance, should be a part of a public agency's debt administration practices that may include other accounting and administrative policies. The GFOA endorsed the use of a debt management policy to improve the quality of decisions, articulate policy goals, provide guidelines for the structure of debt issuance, and demonstrate a commitment to long-term capital and financial planning.

Internal Control Best Practices
Public agencies that develop and adhere to proper internal controls are more likely to run efficient and effective operations, produce reliable reports about its operations, and comply with laws and regulations. The concept of best practices would suggest, however, that policies that vary from the

[16] Best Practices, Debt Management, Government Finance Officers Association (GFOA), *available at* http://www.gfoa.org/topic-areas/debt-management.

mean or standard practice expose the agency to risk. Internal control best practices are generally applied to financial transactions and reporting. Because bond funds are often held and administered separately from general operating funds, public agencies may apply a different set of controls to bond funds than they do to other governmental funds under their direct control.

Different Organizations, Different Internal Controls

A natural outcome of differences between organizations, their size and sophistication, as well as their financial and administrative structure, is that there is no universal set of internal controls that meet the needs of every agency. So where does an agency start if it intends to establish appropriate controls? In almost every case, the agency should begin by assessing risk. Where are the procedural and informational weaknesses in the system? Addressing these is the act of designing an internal control system.

Integration of Policies, Procedures, and Information

In general, public agencies involve more than one unit or division of the organization in the review of transactions and activity reports. Doing so helps to ensure the validity and accuracy of the information produced and the appropriateness of the transactions. However, it is imperative that the policies and procedures are coordinated to maximize efficiency and effect and to provide the necessary controls to meet objectives.

Review and Oversight

Some public agencies utilize external parties to monitor transactions, test compliance, and evaluate performance of bond programs. Proposition 39 specifically requires the creation of a citizens' bond oversight committee.[17] The ability of an external party to review and monitor the agency is naturally a function of the funding, authority, and information it receives from its chartering agency. But the responsibility to properly manage the bond funds remains the fiduciary responsibility of the elected and appointed officials. Citizens' oversight groups are absent in certain market sectors, specifically bonds issued by joint powers authorities, lease financings, and Mello-Roos and assessment district bonds among others.

The Importance of the Bond Documents

In order to achieve its objectives, the agency should insert specific financial and administrative procedures into the bond documents. This includes the maintenance of security interests, the establishment of sub-accounts, the waterfall of revenues and payments, permitted investments, compliance and documentation procedures, covenant restrictions, and requirements surrounding disbursements from construction funds. Of note is the fact that the structure and content of the bond documents vary from issuer to issuer and from issuance to issuance. They may not, as a result, contain in sufficient detail the accounting and administrative procedures needed to enact the agency's control system.

Other Agreements or Documents Controlling Funds

In certain types of debt financing there are other documents than an indenture that control the administration of proceeds. In a Mello-Roos financing there may be an acquisition or funding agreement allowing the public agency to essentially purchase a built facility. When there are multiple agencies involved and the bond proceeds may be passed from the issuer to another public entity, there may be a

[17] The Smaller Classes, Safer Schools and Financial Accountability Act of 2000 amended Section XIIIA of the State Constitution.

joint community facilities agreement. In the case of a conduit issuance, a loan agreement may cover some of the uses of funds.[18] These documents do not always conform to the agency's internal control system.

General Contents of an Indenture between an Issuer and Bondholder

The National Association of Bond Lawyers (NABL) has produced a model indenture that includes certain procedures regarding payments from bond proceeds.[19] Article IV, Funds and Accounts, in particular, addresses the creation of funds, terms for the management of the project fund, the debt service, the reserve fund, the rebate fund, and the management of other funds and revenues. The indenture also provides examples of standard covenants and agreements made by the issuer regarding payments, accounts, reporting, and tax compliance.

Existing Requirements to Report on Bond Funds

There are few requirements placed on California issuers to report on the condition of outstanding bond funds. Among those identified are the requirements under the Mello-Roos[20] and Marks-Roos Act[21] to report to California Debt and Investment Advisory Commission (CDIAC) on the amount of debt outstanding as well as other financial information relevant to the financial health of the district.

Funds Management and Reporting

The benefit of reports used to track disbursements of bond proceeds is a function of the information contained in the report. A public agency that merely reviews account balances will be able to determine whether bond funds are being spent in a timely fashion or whether the disbursements appear to be made from the correct accounts. To determine whether they were legal and authorized expenditures may require additional detail and authority. Several agencies engage oversight committees or internal audit committees to help conduct financial reviews of expenditures. But the outcome of their efforts is equally dependent upon the authority provided the oversight group as it is upon the information they are provided by the convening public agency.

Existing Requirements to Establish and Apply Internal Controls

In general, public agencies should account for the presence and performance of internal controls during their annual audits. But audits differ in the depth to which they consider the suitability, scope, and application of internal controls by the agency. This leads to differing levels of oversight and control across all public agencies, ranging from strong control systems to weak or non-existent control systems. Absent any other restrictions, a public agency with a poor system of controls is not prohibited from issuing debt.

Differences between Performance and Financial Audits

The scope and purpose of a financial audit may differ from that of a performance audit when performed on bond funds. A financial audit may track, account for, and report on specific expenditures of bond

[18] The ABAG financing was a conduit issuance. Many public agencies issue conduit bonds on behalf of private business or non-profit corporations (borrowers). As long as the projects financed with the proceeds meet a public purpose, interest paid to investors is usually exempt from state and federal taxation.

[19] *Model Trust Indenture*, National Association of Bond Lawyers (NABL), *available at* https://www.nabl.org/portals/0/documents/nablformalreportsmodeldocs-nablformtrustindenture.pdf.

[20] The Mello-Roos Community Facilities Act of 1982 (Chapter 2.5 of Part 1 of Division 2 of Title 5, commencing with Government Code section 53311 et seq.).

[21] The Marks-Roos Local Bond Pooling Act of 1985 (Article 4 of Chapter 5 of Division 7 of Title 1, commencing with Government Code section 6584 et seq.).

proceeds whereas a performance audit may be used to determine the outcome of expenditures of proceeds. As a consequence, a financial audit may answer questions about when, to whom, and how much was paid out while a performance audit may only answer whether the funds were spent for the intended purposes. Regardless of whether bond funds are subject to a financial audit or a performance audit the agency must be willing to take action based upon the audit findings. The opportunity for an auditor to assess the value of bond expenditures when conducting a performance audit is a function of the specificity of the original bond act in defining the purpose or objectives of the bond program. School bond acts make general references to requirements and projects but do not often provide an easy starting point to evaluate the outcome of expenditures.

How to Make the Use of Bond Proceeds Transparent
Some local agencies post information to the internet that enables the public to track expenditures of bond proceeds back to the capital improvement plan. This transparency increases accountability and oversight. But just as importantly it solidifies the relationship between the stewards of the public's interest and the public who has committed to repay the debt through taxes or other charges.

Reasonable versus Absolute Assurance
Per the GAO's *Standards for Internal Controls in the Federal Government*, "[N]o matter how well designed and operated, internal control cannot provide absolute assurance that all agency objectives will be met." As a result, management has a responsibility to employ available resources to achieve a reasonable assurance that control processes will produce the desired outcomes. Similarly, controls must balance the need to prevent inappropriate behaviors as well as detect them when they do occur.

Good Internal Controls May be Transferable
Best practices created to assist issuers in complying with tax requirements pertaining to the use of bond proceeds can provide a model for administrative and financial controls that meet other organizational objectives regarding the use of these funds.

Project Management and Controls
The process of accounting for and reporting on the use of bond proceeds must be linked to capital project management system so that the expenditures of proceeds are valid, cost effective, and productive. This control system may be developed and monitored by the public agency or by an external service provider, but it remains the first step in accounting for what has been spent and for what purposes. Components of a project management system include budget, procurement, scheduling, disbursements, and reporting.

Observations of the Task Force on Bond Accountability

In evaluating the practices of issuers, the Task Force embraced the framework of internal controls published by the GAO.

- Control Environment—Provides the fundamental discipline and structure of internal control system;
- Risk Assessment—Identification and analysis of relevant risks;
- Control Activities—Policies, procedures, and practices that ensure management's objectives are achieved and risk is mitigated. This includes segregation of duties, review and verification procedures, etc.;

- ❖ Information and Communications—Support all other control components by communicating control responsibilities to employees and by providing information in a timely manner so that employees can carry out their assigned tasks to mitigate risk;
- ❖ Monitoring—Internal and external oversight by management or others to ensure that controls are effective and that processes and procedures are being adhered to.[22]

Based upon this framework and in combination with the lessons learned, the Task Force recorded 20 observations. These form the basis of the Task Force's Best Practice Guidelines contained in Appendix A.

Observation 1. Control Environment--Governance
The governing body of the public agency is responsible for ensuring that the bond proceeds are being used for their legal and intended purposes, that they are properly accounted for, and managed in accordance with applicable legal requirements and with best practices and internal controls. Furthermore, use and benefits of expenditures of bond funds should be made transparent to the public. With respect to conduit bond issues in which neither the issuer nor borrower has direct control of or oversight over the use of bond funds, the borrower must ensure that the use of bond funds are subject to an internal control system that ensures that the bond funds are being used for intended and legal purposes and in compliance with all legal and administrative requirements.

Observation 2. Control Environment--Administration
While it is the responsibility of the governing body to establish and maintain a system of internal controls to manage the use of bond funds, it is the role of the agency's managers to work with the governing body to administer and maintain the system. To this end, management should create a formal organizational structure that assigns responsibility to specific positions for processing, approving, and recording the expenditures of proceeds. These responsibilities should be fully described in the duty statements for each participating role. Furthermore, care should be given to the need to segregate duties such that each role can be carried out with the appropriate level of independence. In particular, reviewing and reconciling control accounts should be assigned to a person other than the person responsible for recordkeeping. The person responsible for recording cash should be separate from the person recording debt. The agency should provide training to support staff efforts to implement the system and, in those cases in which the agency outsources roles central to the system, it must retain control of those roles to ensure proper oversight.

Observation 3. Control Environment--Administration
Some public agencies, typically small organizations, lack the staff and resources to cover all administrative roles and provide the necessary controls to obtain a reasonable assurance the bond funds are being properly managed. The risk inherent in smaller agencies requires greater vigilance on the part of the governing body and different strategies, including the use of external consultants, to provide the appropriate segregation of duties. The use of external service providers does not, however, absolve the governing body of its responsibility for providing and maintaining an internal control system. In a conduit financing, the borrower must assume responsibility for applying internal controls to the use of bond funds and identify the roles and responsibilities that are essential to the application of the internal control system.

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[22] *Standards for Internal Controls in the Federal Government*, U.S. Government Accountability Office, Sept. 2014, *available at* www.gao.gov/assets/670/665712.pdf.

Observation 4. Control Environment--Oversight
Public agencies that issue bonds should consider establishing a bond oversight committee to monitor and review compliance with bond documents and the use of bond proceeds. If the agency does establish an oversight committee, it should be certain to provide it the authority and resources needed to achieve its mission. The committee may be composed of individuals internal to the agency or external to it. Each has its own merits and depends upon the role the agency assigns to the committee. An internal committee may be well-equipped to oversee project-level expenditures and change orders whereas an external committee that lacks the expertise to do so may be positioned to provide a high level review of program goals and accomplishments. A bond oversight committee, whether internal or external to the issuers, does not absolve the governing body of the responsibility to oversee the legal and intended use of bond proceeds.

Observation 5. Control Environment--Administration
The public agency should conduct a workload analysis to determine the level of staff required to properly administer the control system. In the event the agency lacks the capacity internally to administer the internal control system, it may consider filling roles and assigning duties to external service providers. The agency should develop compensating controls such as timely post-audit testing to validate compliance with the administrative and regulatory requirements of the bond issue.

Observation 6. Risk Assessment--Program Objectives
The public agency should identify the objectives of its bond program. These objectives may address the outcomes of bond financing, including those related to the projects, the costs, and public participation. They may also relate to the agency's compliance with legal and administrative requirements or to the quality and availability of financial data.

Observation 7. Risk Assessment—Program Goals and Objectives
The public agency should identify the risks that might keep it from achieving each of its program objectives. The mitigation of these risks forms the basis of the agency's control system. Once a risk is identified, the agency should establish measures in the form of process and procedures to manage that risk. In a conduit financing, the risk assessment should include the roles and responsibilities of the conduit issuer with respect to the use of bond funds and compliance with legal and administrative requirements.

Observation 8. Risk Assessment—Fraud and Misuse of Bond Funds
The public agency should specifically assess the risk of fraud or misuse as a consequence of weaknesses in its system of controls. The agency should then be prepared to make the necessary changes to abate this risk.

Observation 9. Control Activities—Policies and Procedures
The public agency should develop a set of policies and procedures that fully implement the controls needed to ensure that bond funds are used only for legal and intended purposes and are properly accounted for, managed, and safeguarded in a manner consistent with applicable legal and administrative requirements. These policies and procedures, including debt policies and administrative and accounting memos and manuals, should cover the spectrum of activities and roles responsible for accounting for, reporting on, and monitoring the use of proceeds. The policies and procedures should be reviewed on a regular basis, such as biennially, and staff should be trained on their use. With respect to a conduit financing, the policies and procedures should account for roles and responsibilities of the conduit issuer as well as the borrower.

Observation 10. Control Activities—Internal Control System
The agency should, at a minimum, employ the same, consistent internal control system to the administration of bond funds as it does to any other funds. Although the roles involved may differ, the disbursement of bond proceeds should be subject to the same level of review as are applied to payments made from any other account.

Observation 11. Control Activities—Internal Control System
The agency should implement a system of control activities that achieves its objectives and responds to known risks that may impede its ability to attain the objectives of its bond program. This system forms the intersection between the organization's structure and the assessment of risk.

Observation 12. Control Activities—Internal Control System
The public agency should require the approving officer to affirm that the agency has complied with its internal control system prior to the disbursement of bond funds. When the public agency has issued the bonds through a conduit authority, the borrower must take responsibility for ensuring that disbursements are subject to an internal control system.

Observation 13. Control Activities—Internal Control System
In order to determine the public agency's compliance with its bond program and promises made to taxpayers and ratepayers, the agency should require progress reports on expenditures and compare these to the project schedule and budget. It should conduct site visits and maintain complete records of visits, communications with contractors, external auditors, and oversight groups. A public agency should consider the establishment of a compliance team that includes staff from programs that use or manage bond funds (i.e., finance, accounting, project management, and procurement). The compliance team should be coordinated and led by a designated individual who serves as the single point of contact.

Observation 14. Control Activities—Internal Control System
The public agency should include in its audit program a test of its compliance with the indenture, payment of debt service, reserve account management, investment of bond proceeds, and suitability of its book of records and accounts. It should also test its compliance with the bond authority and the use of proceeds and its compliance with continuing disclosure and arbitrage rebate reporting and filing requirements.

Observation 15. Information and Communication—Bond Compliance Checklist
The public agency should maintain a listing of bonds issued and the reporting requirements and dates for each issue in order to meet the issuer's obligations contained in the indenture, loan agreements, tax certification, or any continuing disclosure agreements. The agency should develop an annual checklist to determine its compliance obligations. This checklist may form the basis of internal audits that review bond compliance on a periodic basis. The agency should have a process to communicate to responsible staff the need to change requirements related to reports, disclosures, and other information. Finally, staff should be trained on the agency's compliance requirements.

Observation 16. Information and Communication—Fund Structure for Bond Proceeds
The public agency should develop the proper fund structure to record and report on the use of proceeds at a level that meets its objectives and obligations.

Observation 17. Information and Communication—Annual Report
The agency should provide an annual report to its governing body and its taxpayers or ratepayers to account for bond expenditures. The report should highlight the purpose and use of the proceeds and to the extent that the agency has defined objectives produce an accounting of its success in meeting these objectives. The agency should present the annual report as an agenda item at a meeting of its governing body. The agency should provide an internet report to the public that creatively displays what the bond program accomplished and it should keep the information up to date.

Observation 18. Information and Communication--FAQs
The agency should provide the public with information on its bond program, including FAQs that help to meet the interests of various stakeholders. The information should be made available via the Internet or other electronic means.

Observation 19. Monitoring—Oversight Committees
Bond oversight is as much a component of monitoring the effectiveness and validity of an internal control system as it is a part of the control environment itself. Public agencies should consider the benefits of an internal or external oversight committee to maintain the internal control system to ensure that it is providing the expected reasonable assurance that bond proceeds are used only for legal and intended purposes and that they are properly accounted for, managed, and safeguarded in a manner consistent with applicable legal requirements and with best practices and internal controls. If the public agency does establish an oversight committee it should provide it the resources and staff needed to achieve its mission.

Observation 20. Monitoring—Fraud Hotline
The agency should consider the establishment of a fraud telephone line or webpage. Allowing for anonymous tips to be received by the agency can facilitate another layer of oversight.

Conclusions

The mission of the Task Force is to develop and recommend practices that enable public agencies to ensure that bond proceeds are used only for legal and intended purposes and that they are properly accounted for, managed, and safeguarded against misuse. Over the lifetime of the proceeds, public agencies undertake a wide variety of tasks, involving individuals inside and outside the organizations, and produce a plethora of data displayed in reports and spreadsheets. Given the expanse of these activities, the Task Force focused its analysis on the internal controls used to track, record, and report on the bond funds. Public agencies have no commonly-accepted system of controls that cover the full lifecycle of the bond proceeds. In the absence of a generally-accepted system of controls the Task Force believes that there is opportunity to recommend practices that will help to account for, manage, and safeguard bond funds, to encourage adoption of these practices through education and training, to further the adoption of these practices through policies and procedures, and to recommend further analysis that may lead to more specific procedural recommendations.

The proceedings of the Task Force, including public meetings and staff research, helped it understand the practices that public agencies use to administer bond proceeds. This produced a set of observations that the Task Force considered in its recommendations. Furthermore, the observed or reported practices revealed several accounting and administrative procedures that public agencies commonly use to administer proceeds. These, in essence, constitute a set of best practices even if they are not embraced by all bond issuers or even consistently applied by a single issuer. The Task Force early on realized that agencies may have adopted internal controls over general expense claims but they do not necessarily exercise this same level of control over the disbursement of bond funds. The conditions and processes that create this inconsistent application of internal control best practices are the substance of the Task Force's observations. These observations recognize the fact that many public agencies maintain inconsistent and poorly articulated policies and procedures, fail to assess risk, provide inconsistent or insufficient communication to understand how they are responding to risks, and do not consistently monitor, test their compliance, and oversee or empower others to oversee the uses of proceeds. That is not to say that some agencies don't get it right. These are the models for the Task Force's Best Practices Guidelines for Bond Accountability (Guidelines) contained in Appendix A.

The Task Force released the Report of the Task Force on Bond Accountability and the Best Practice Guidelines in draft form on October 27, 2015. During the period October 27, 2015 to November 30, 2015 the Task Force solicited public comments on the Guidelines. It received five comments in written or electronic form. Each was considered by the Task Force and, where deemed appropriate, resulted in changes to the final version of the Guidelines.

The Task Force acknowledges that in order for it to accomplish its mission it must do more than simply recommend best practices. It must also consider how to encourage the adoption of these practices by public agencies in California. To this end, the Task Force suggests the following:

1. CDIAC, in partnership with other trade or professional associations should train public officials, both elected and appointed, in the Best Practice Guidelines.
2. CDIAC should incorporate the Best Practice Guidelines into its California Debt Issuance Primer.
3. CDIAC should leverage the influence of other trade and professional organizations to encourage the adoption of Best Practice Guidelines by public agencies in California.

The Task Force also recognizes that in order for public agencies to benefit from a robust control system, these Best Practice Guidelines must be institutionalized into the agency's accounting and administrative procedures. To support this, the Guidelines include tools and checklists that will make it easier for public agencies to achieve the purposes behind the Guidelines. In addition, the Task Force recommends:

1. Audit programs be amended to include, if they do not already, tests of the control system, the compliance system, and the internal communication systems used to track and monitor expenditures and fund balances.
2. The agency's policies and procedures must be updated to include the control system and to create a set of interlocking policies and procedures that cover the spectrum of roles and responsibilities associated with the administration of proceeds.
3. Public agencies should establish an oversight body to provide independent review of the bond program. This may be internal or external to the agency, but it must be afforded the authority and resources needed to exercise control over the program when necessary.
4. Public agencies should embrace advancements in electronic communications to provide information to the public on its bond programs. This information should include a detailed accounting of bond proceeds and the purposes and uses of expenditures at the project

level. The information should be current and be sufficient to enable the public to understand the benefit of financing public facilities or services with debt.

Finally, the Task Force observed that public agencies in California differ substantially. In acknowledging this, the Task Force sought to balance the specific against the general. The outcome was to provide a set of Best Practice Guidelines that may be too specific for some agencies and not specific enough for others. This would suggest that the work of establishing accounting and administrative procedures that can reasonably assure that bond proceeds "are properly accounted for, managed, and safeguarded in a manner consistent with applicable legal requirements and with best practices and internal controls and transparent to the public" is unfinished. Aware of this, the Task Force recommends that additional work be performed to provide sufficient guidance to public agencies that require more specificity in developing and administering a control system. This might include the following products:

1. Guidelines for establishing performance measures in bond programs. These can be instrumental in assessing the value of the program in an audit or review conducted in the future.
2. Model language for debt policies, administrative policies, investment policies, and fiscal management policies that assist public agencies to provide a comprehensive and interrelated control system for the administration of proceeds.
3. A tool to support the efforts of public agencies to assess the risk in their control system.

Appendix A

Bond Accountability Best Practice Guidelines

Pg. Contents

Foreword

State Treasurer John Chiang commissioned the Task Force on Bond Accountability in response to the alleged misappropriation of more than $1 million in bond funds by a public official in the Bay Area. The Task Force was not asked to be in any way an investigative body regarding that theft, but rather, to review the complex processes of public agency bond issuance, management, and close-out, to assure that all necessary and appropriate protections for public funds are in place. The work of the Task Force is timely, not only in response to this event but in light of the obligation the public sector has in sustaining the public's trust. In the relationship between the public and the agencies that represent its interests this trust is what stands between a vision and its realization. The work of the Task Force helps to retain the trust-based relationship that agencies need to issue debt and finance improvements.

The analysis, conclusions, and recommendation of the Task Force reflect months of public testimony, deep thinking by a talented staff, and debate and discussion amongst Task Force members. This document represents our best effort to provide Treasurer Chiang and all Californians with a path for better protection and management of public bond funds.

Signed

Fred Keeley, Co-Chair

Jay Goldstone, Co- Chair

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Introduction
In compliance with both federal and state legislation, public agencies are expected to establish and maintain internal controls to account for and report on the expenditure of funds. There is an abundance of resources available to administrators that provide guidance on the development of internal control systems. When applied consistently and correctly these controls can provide both the agency and the public an assurance that the funds are being properly managed and accounted for. On occasion, however, these controls prove insufficient to stop the most determined efforts to use public funds for unauthorized or unapproved purposes. Such was the case when the City and County of San Francisco discovered that $1.3 million in bond proceeds had been redirected by a conduit issuer to enrich person or persons other than the City's taxpayers.

Internal control practices designed to oversee a public agency's administration of general, operational funds may not be sufficient to oversee the disbursement of bond funds.[1] The authority, record keeping, and reporting of expenditures of bond funds may require different processes than those set up to administer other governmental funds. As a result, public agencies may need to institute additional roles or procedures to ensure that the use of bond proceeds is consistent with legal and regulatory requirements and with program and policy objectives. They may on occasion need to use external service providers to fill roles and perform duties not assignable to staff.

On February 12, 2015, California State Treasurer John Chiang convened a special task force to develop best practice guidelines on the fiduciary care and use of state and local bond proceeds. At the end of several months of research the Task Force on Bond Accountability identified 17 Best Practice Guidelines that specifically address bond funds. These Guidelines offer an additional layer of security that can help to ensure that bond proceeds are used only for legal and intended purposes and that they are properly accounted for, managed, and safeguarded in a manner consistent with applicable legal requirements and with best practices and internal controls and transparent to the public.

These Guidelines are offered on the assumption that public agencies have developed and implemented a system of internal controls that provide a reasonable assurance that the agency is properly managing its financial affairs. Because public agencies have adequate resources to guide them in the development of an internal control system, these Guidelines do not commit effort to directing public agencies in this effort.[2] At a minimum, public agencies should apply the same internal controls to bond funds as they would apply to other governmental funds. However, because bond proceeds represent a more restricted source of capital, in legal, financial, and practical ways, the Guidelines presented here are complementary and in addition to the internal control practices that the agency should already have in place.

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[1] References to "bond financing" and "bond documents" are not intended to suggest that the recommendations and best practices contained herein be limited to debt incurred through the sale of bonds. Many of the recommendations and best practices may be equally valuable to improving the management of bond proceeds of other debt instruments as well.

[2] For information on establishing and implementing internal controls, *see Standards for Internal Control in the Federal Government*, U.S. Government Accountability Office (GAO), Sept. 2014, *available at* http://www.gao.gov/assets/670/665712.pdf, hereafter *GAO Standards for Internal Control*; *see also* Gauthier, Stephen J., *An Elected Official's Guide: Internal Control*, Government Finance Officers Association (GFOA), 2015, hereafter Gauthier, *An Elected Official's Guide*, *and Internal Control – Integrated Framework* (2013), Committee of Sponsoring Organizations of the Treadway Commission (COSO), May 14, 2013.

These Guidelines embrace the internal control principles recognized by the U.S. Government Accountability Office (GAO) as a measure of the adequacy of any internal control system. These include:

1. The oversight body and management should demonstrate a commitment to integrity and ethical values.

2. The oversight body should oversee the entity's internal control system.

3. Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity's objectives.

4. Management should demonstrate a commitment to recruit, develop, and retain competent individuals.

5. Management should evaluate performance and hold individuals accountable for their internal control responsibilities.

6. Management should define objectives clearly to enable the identification of risks and define risk tolerances.

7. Management should identify, analyze, and respond to risks related to achieving the defined objectives.

8. Management should consider the potential for fraud when identifying, analyzing, and responding to risks.

9. Management should identify, analyze, and respond to significant changes that could impact the internal control system.

10. Management should design control activities to achieve objectives and respond to risks.

11. Management should design the entity's information system and related control activities to achieve objectives and respond to risks.

12. Management should implement control activities through policies.

13. Management should use quality information to achieve the entity's objectives.

14. Management should internally communicate the necessary quality information to achieve the entity's objectives.

15. Management should externally communicate the necessary quality information to achieve the entity's objectives.

16. Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.

17. Management should remediate identified internal control deficiencies on a timely basis.

The Guidelines follow the organizational structure identified by the Government Accountability Office (GAO). As such, they include guidelines addressing Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring.[3] It is highly recommended that public agencies adopting these Guidelines consult the aforementioned resources to expand upon and operationalize them. In addition, the Guidelines include two checklists that public agencies may use to comply with one or more of the Guidelines. The first, the Debt Issuance and Management Review Checklist, supports Guideline 12, addressing compliance reviews. The second conforms to Guideline 16 and 17, concerning approaches agencies may use to monitor their internal control systems.

In offering these Guidelines, the Task Force recognizes that it is wholly the responsibility of the governing body of the public agency to establish and maintain internal controls that account for and report on the use of bond proceeds. Furthermore, it is their obligation to provide this information to the public they serve and the taxpayers, who in providing the explicit or implicit authority to issue bonds, deserve a reasonable assurance that the bond proceeds are being used legally and for the purposes intended by that authority.

While these Guidelines represent the work of the Task Force to suggest steps public agencies may take to ensure the proper use of bond funds, the Task Force recognizes that these Guidelines may not be universally applicable. For those public agencies that find one or more of them difficult to implement, the Task Force suggests that the agency identify other compensating controls to achieve the same level of assurance intended by the implementation of these Guidelines.

[3] *GAO Standards for Internal Controls, supra* note 1.

Part 1 - Control Environment

How do public agencies establish a control environment that provides a reasonable assurance that the agency will achieve its objectives with respect to the issuance of bonds and the use of bond proceeds?

An agency's control environment consists of the formal structures, goals, and objectives that set a positive attitude towards and willingness to employ internal controls and conscientious management. It is the responsibility of the governing body and management to institute and maintain a control environment that promotes a properly functioning internal control system and to provide management the resources and incentive to do so.

As the governing body and management are responsible for implementing internal controls, it is imperative that they establish a control environment composed of several elements. The governing body and management should exemplify the ethical values of the local agency by setting an appropriate "tone at the top."[26] They should institute and comply with requirements to attend ethics training and employ measures of ethical behavior in performance evaluations. Personnel should have a means of reporting ethics violations without fear of recrimination. Management should timely and effectively address any reported non-compliance. Management may also include compliance with ethical values as a factor in staff's performance evaluations. Additionally, the governing body may adopt a code of conduct and establish an ethics committee that meets regularly to address compliance issues. A code of conduct may also specifically address how the governing body, management, and staff interact with external service providers that assist with debt issuance as well as parties that contract to facilitate the completion of projects associated with debt financings.

Prior to the issuance of debt, a public agency should perform a workload analysis to understand the level of staff required to properly administer control activities for its bond funds. Management should assess the need for training to support staff's effort to carry out control activities and in those cases in which the agency outsources bond administration responsibilities central to its bond program, it should retain control of those responsibilities to ensure proper oversight.[27] If a public agency selects its bond financing consultants with an eye toward providing services that cannot be provided in-house, management should closely examine the consultants' work and ask the questions necessary to ensure that the end result meets their objectives.[28] The responsibility for ensuring a reasonable application of internal controls for conduit bonds ultimately rests with the borrower, however, in general, a public agency that issues conduit bonds may retain a role in ensuring an obligated party fulfills its continuing disclosure and tax compliance responsibilities.

Procedures should articulate the distinct responsibility and accountability of each individual involved in the review and approval process. For example, the functions of authorizing, recording, reconciling, and maintaining custody of bond funds should not completely reside with one person or

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[26] Gauthier, Stephen J., *An Elected Official's Guide: Internal Control*, Government Finance Officers Association (GFOA), 2015, hereafter Gauthier, *An Elected Official's Guide*; *see also Standards for Internal Control in the Federal Government*, U.S. Government Accountability Office (GAO), Sept. 2014, *available at* http://www.gao.gov/assets/670/665712.pdf, hereafter *GAO Standards for Internal Control*.

[27] Staff should be provided training in bond financing concepts and public finance techniques leading to proficiency in comprehending bond covenants and other technical provisions in bond documents.

[28] The GFOA has issued best practices for selecting and managing municipal advisors. They are available at: www.gfoa.org/selecting-and-managing-municipal-advisors.

within a single unit or office of the agency. Commonly-used best practices to facilitate the disbursement of bond proceeds illustrate the need for segregation of duties, as outlined below:

- Invoices are submitted by the responsible program or department within the agency who shall have verified that the goals and services invoiced have been delivered;
- Documentation is reviewed by an authority independent of the transaction, typically accounting or treasury;
- When approved by the reviewer the requisition is issued by a second independent authority, typically the finance department;
- Disbursements are posted or recorded to the appropriate fund and account;
- Account balances are available in an annual report produced by the agency; and/or,
- Signatures are required as each level of review is completed before disbursement.

Other components that add accountability to the disbursement process include:

- Establishing and tracking withholds from progress payments;
- Tracking administrative costs (both administering agency and recipient) to ensure limits are not exceeded; and,
- Managing multiple funding sources, including avoiding spending funds on closely-related purposes or activities that technically fall outside the allowable uses of bond proceeds. Limitations will vary among funding sources so agencies should avoid treating them as interchangeable “pots” of money.

The agency should designate a bond compliance officer or have a bond compliance team, depending on the agency’s size and resources. Bond compliance staff should assume primary responsibility for regularly monitoring and reviewing the use of bond proceeds to ensure that proceeds are used in accordance with legal requirements. Results of their review should be reported to and reviewed by management. Regardless of the role of a financing team, primary responsibility for management of the bond proceeds, especially post-issuance, remains with the public agency and its governing body. Additional control activities relating to authorization of debt issuance and mitigation of risk are discussed in more detail in Part 3.

Public agencies can establish a manual process of review or utilize an electronic business system such as an enterprise resource planning (ERP) system, to help integrate the tracking of the reviews and approvals needed while administering bond funds.

Guideline 1—Control Environment

Responsibility resides with the public agency’s governing body for establishing and maintaining an internal control system.

The governing body of the agency has ultimate responsibility for administering a system of internal controls that must provide a reasonable assurance that the bond proceeds are used only for legal and intended purposes and that they are properly accounted for, managed, and safeguarded in a manner consistent with applicable legal requirements and with best practices. The system of internal controls should be deployed with the support of management in order to maximize the efficiency and effectiveness of this control system.

Guideline 2—Control Environment
Establish the organization's structure and lines of reporting and appropriately assign authority and responsibility to staff to implement the internal control system.[29]
At the operational level, management should assume primary responsibility for administering a system of internal controls and establish control activities based on a formal organizational structure that allocates key functions to specific positions and creates clear lines of reporting and communication between the governing body, management, and staff.[30] The allocation of responsibilities, including the processing, approving, recording, and reconciling of bond proceeds, receipts, and expenditures, should be fully described in the duty statements for each participating role. Where multiple departments or persons are responsible for contributing to bond administration, they should have open lines of communication and collaborate as necessary. Management should delegate and segregate duties as necessary and practical to reduce the opportunity for fraud or waste, while retaining control over reviewing and approving bond documents as well as authorizing expenditures from the bond fund. The segregation of duties ensures that multiple levels of review and approval are achieved for bond administration.

For some small agencies, segregation of duties may be a challenge; however, review and approval by an appropriate second person may be the most important control activity for that agency. A second review may be conducted by a member of the governing body serving in an approval role. The agency may need to assign certain responsibilities to roles outside of the organization by contracting with professional service providers or other public agencies for accounting or payment services. Alternatively, small organizations can address difficulties posed by a smaller staff or fewer resources by creating compensating controls. The agency may, for example, implement timely post-audit testing procedures to validate the fact that payments complied with its administrative and regulatory requirements.

Guideline 3—Control Environment
Ensure an independent governing body oversees internal control measures.
Public agencies should provide its governing body with the information and resources needed to independently assess the efficiency and validity of the agency's internal control system. It can do this by establishing an audit committee to review and monitor the agency's internal or external audit process with a particular focus on the timing and scope of audits. The audit committee should be responsible for reviewing the implementation of the agency's internal controls and ensure management's timely response to audit findings. The committee may also review the local agency's budgets, interim financial reports, and other financial documents as needed and make recommendations regarding the documents' adequacy or the need for improvements. Further information on monitoring of internal controls by internal and external oversight is discussed under Part 5 - Monitoring.

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[29] *See, e.g.*, *Internal Control Guidelines: California Local Agencies*, State Controller's Office, 2015, *available at* http://www.sco.ca.gov/Files-AUD/2015_internal_control_guidelines.pdf, hereafter State Controller's Office, *Internal Control Guidelines*.
[30] A governing body of a public agency issuing conduit bonds must ensure roles and responsibilities established by management for its bond program are consistent with the statutory authority and mission of a conduit issuer.

Guideline 4—Control Environment

Ensure that the public agency's policies and procedures are consistent with and reflective of its internal control system.

Public agencies that develop and adhere to proper internal controls are more likely to manage resources efficiently, produce reliable reports about its operations, and comply with laws and regulations. To help it consistently apply its control system, public agencies should have written procedures that operationalize control activities for all stages of a bond's lifecycle.[31]

The governing body should adopt a debt management policy that fully reflects the relationship between the bond program and other organizational policies, procedures, and practices.[32] This may include policy provisions that integrate bond administration objectives, performance measurements, and risk tolerances into a public agency's disbursement policy, capital budget, strategic plan, and capital improvement plan and procedures for developing its financial statements.

Guideline 5—Control Environment

Commit to recruiting, enabling, and retaining competent personnel.

The agency may establish staff competency expectations. If they do, management should undertake an evaluation of the competence of its staff in accordance with any established policies and address any shortcomings by reassigning bond administration duties to appropriately trained personnel. Further, management should have succession and contingency plans in place to reassign duties as necessary upon the departure of personnel responsible for bond administration.

The local agency's management should offer periodic training of its personnel, including governing board members, management, and staff, that are responsible for bond administration. In general, employees should be provided training and tools to perform their duties and responsibilities, improve performance, enhance their capabilities, and meet the demands a changing organization needs. Agency personnel that are part of the bond approval, bond administration, or management of bond-funded projects should be given regular training on bond financing topics such as those provided by the California Debt and Investment Advisory Commission (CDIAC), the Government Finance Officers Association (GFOA), and the Municipal Securities Rulemaking Board (MSRB) among others.

Guideline 6—Control Environment

Ensure job descriptions define responsibilities for complying with the public agency's internal control system.

In order to support an agency's integrated business operations, management should ensure that job descriptions and duty statements define bond administration duties. Management should evaluate employee performance and hold individuals accountable for their internal control responsibilities using the agency's administrative practices for conducting performance reviews.

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[31] Internal Revenue Service (IRS) guidelines encourage issuers of tax-exempt debt to have effective written procedures for its outstanding bond issues.

[32] The principles of internal control indicate that management should design an entity's information system and related control activities to achieve objectives and respond to risks. Control activities for bond funds should be designed to operationalize bond administration into all levels and functions of a public agency's control environment.

> Accountability is driven by the tone at the top and supported by the commitment to integrity and ethical values, organizational structure, and expectations of competence which influence the control culture of the entity. Accountability with regard to internal control duties supports day-to-day decision making, attitudes, and behaviors.[33]

Part 2. Risk Assessment
How do public agencies identify the objectives of their bond programs and analyze the relevant risks in order to establish a reasonable assurance that their internal control systems will manage those risks?

Within a robust framework of internal control, risk assessment is the process of identifying the objectives of a bond program and assessing the likelihood risk events will occur and unfavorably affect the achievement of those objectives. The analysis performed by the agency in a risk assessment also provides the basis for developing appropriate responses to manage risk.

In a risk assessment, the agency should compare its risk tolerance to levels of risks undertaken to achieve its objectives and, when necessary, make adjustments to ensure risks are appropriately managed within the agency's risk appetite.[34] To be most effective, risk assessment and the establishment of risk tolerances for a bond program should be embedded into the decision-making and governance process of a public agency to ensure relevant information is provided to management and the governing body in a consistent and timely manner.

A public agency's risk assessment must also focus on the potential risk of fraud or misuse as a consequence of weaknesses in its system of controls.[35] These weaknesses may be the outcome of complex program structures, turnover and poor allocations of responsibilities, lack of training, or lack of clearly stated objectives.

Risks that arise from internal conditions may be due to new bond issuances, changes in operational and program processes, and factors relating to personnel, including new hires, changing roles and responsibilities, and training needs. A heavy reliance on external consultants to perform critical internal responsibilities may also expose a public agency to risk. In determining risks relevant to a public agency's bond program that may arise from external conditions, management may consider factors that include new legislation or regulations, technological advancements and developments, exogenous events relating to the economy or natural disasters, and changing needs or expectations from stakeholders.

Since issuing debt is a complex process encompassing a broad scope of activities, risk assessment for a bond program should attempt to cast as wide of a net as possible to address potential risks through all stages of a bond lifecycle, including capital or project planning, debt authorization, structuring, sale and closing activities, and responsibilities that must be fulfilled through the lifecycle

[33] *GAO Standards for Internal Control*, *supra* note 1.
[34] *Id.*
[35] A public agency's risk assessment should also include a comprehensive assessment of risks to its information system.

of the outstanding bonds, including complying with on-going disclosure and federal tax law requirements and other matters related to post-issuance compliance.[36]

As emphasized in general principles of internal control, a risk assessment should evaluate the types of fraud that can occur within a public agency's bond program including:[37]

Guideline 7—Risk Assessment
Clearly define objectives of the public agency's debt issuance and administration program.
The governing body, along with management, should define the objectives of the agency's debt issuance and debt administration program in measurable terms easily understood at all levels of the organization.[38] These objectives should address the outcomes of bond financing, including those related to the projects, the costs, and public participation.

Guideline 8—Risk Assessment
Identify and analyze relevant risks.
Risk assessment requires management to identify risks relative to a public agency's objectives, estimate the significance of each risk, and assess the likelihood of their occurrence. Risk identification and analysis may include qualitative or quantitative rankings that identify and analyze potential frequency and magnitude of risk, forecasting methods, strategic planning, and consideration of findings from audits and other reviews.

In conducting a risk assessment, local agencies should update their debt management policies, investment policies, or other controlling documents to reflect their risk management objectives. Certain debt structures, such as swap agreements and short-term interim financing, may expose the agency to heightened risk. In amending their policies and procedures, local agencies may consider disallowing certain debt structures or investments or requiring the retention of certain municipal market professionals, such as a municipal advisor, to ensure appropriate risk management.

Part 3—Control Activities
How do public agencies ensure that the objectives of their bond programs are achieved and risk is appropriately managed?

Control activities are the actions the public agency takes through policies, procedures, and the delegation of duties to achieve its objectives and mitigate risk. The system of internal controls may vary, depending on the size, nature, and organizational complexity of public agencies. It must, however, reflect the risks identified based on the significance of the specific risk event and the public agency's defined risk tolerance.[39] Appropriate risk responses may include the following:[40]

[36] The *California Debt Issuance Primer* provides a Checklist of Steps in a Debt Financing that describes in more detail the general steps public agencies follow to issue bonds and manage post-issuance requirements. *See California Debt Issuance Primer*, California Debt and Investment Advisory Commission (CDIAC), Chapter 2 (2005).
[37] *GAO Standards for Internal Control*, *supra* note 1.
[38] The identification of objectives in measurable terms should allow management to create performance measurements that relate to elements of a bond program and to evaluate those performance measurements relative to variances of performance or levels of risk for each element on a conditional basis, i.e., Is the objective achieved in a manner that is effective, efficient, reliable, or in compliance?
[39] Risk responses that are based on a public agency's risk tolerance help ensure that objectives are performed within levels of risk acceptable to the public agency.

- Acceptance – No action is taken to prevent the risk based on the insignificance of the risk.[41]
- Avoidance – Action is taken to stop the process or the part of the process causing risk.
- Reduction – Action is taken to reduce the likelihood or magnitude of the risk.
- Sharing – Action is taken to transfer or share risks across the public agency or with external parties, such as insuring against losses.

The public agency should proactively monitor performance, related risk factors, and the magnitude of risk required to achieve its objectives and be prepared to respond to any elemental changes of condition to its bond program that may cause risk to exceed acceptable risk tolerance levels. Conditional elements that may be considered by a public agency in establishing appropriate risk tolerances for a bond program may include specifications or limitations related to debt types and limits, use of proceeds, capital expenditures, credit ratings, and delegated authority.[42]

If risk responses cannot mitigate the variation of risk relative to the achievement of the objective to a level consistent with a public agency's risk tolerance, management may need to seek guidance from the public agency's governing body to re-align risk tolerances or reconsider objectives.

In determining the necessary measure of precision for a control activity the agency should evaluate the following:

- Purpose of the control activity – A control activity that functions to prevent or detect generally is more precise than a control activity that only identifies and explains differences.
- Level of aggregation – A control activity that is performed at a more granular level generally is more precise than one performed at a higher level.
- Consistency of performance – A control activity that is performed routinely and consistently generally is more precise than non-routine control activities.
- Correlation to relevant operational processes – A control activity that is directly related to an operational process generally is more likely to prevent or detect than a control activity that is only indirectly related.

In developing risk responses, management should also consider fraud risk factors that when immediately mitigated help prevent the occurrence of fraud or misuse of public funds. Fraud risk factors that management should vigilantly watch for and immediately address include:[43]

- Incentive/Pressure – Management or other personnel have an incentive or are under pressure, which provides motive to commit fraud.
- Opportunity – Circumstances exist, such as the absence of controls, ineffective controls, or the ability of management to override controls that provide opportunity to commit fraud.

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[40] *GAO Standards for Internal Control*, *supra* note 1.
[41] The risk will not substantively impair the successful accomplishment of the objective, causing minimal impact to the public agency's operation or reputation.
[42] Information based on a model debt management policy is described in: Kavanagh, Shayne, and Wright Anderson Williams, *Financial Policies: Design and Implementation*, Government Finance Officers Association (GFOA), (2004).
[43] *GAO Standards for Internal Control*, *supra* note 1.

- Attitude/Rationalization – Individuals involved are able to rationalize committing fraud. Some individuals possess an attitude, character, or ethical values that allow them to knowingly and intentionally commit a dishonest act.[44]

Guideline 9—Control Activities
***Establish control activities that provide a reasonable assurance that the agency will meet the objectives of its bond program*.**
Public agencies should apply the same level of control to all governmental funds, including bond funds. The basic structure of this control system should invoke a "three-way matching" of invoice to requisition to disbursement receipt. Standard control requirements may include provisions requiring dual signature authority for disbursements, specifications for periodic reporting, and audits and the establishment of oversight committees. During the requisition phase public agencies should require adequate documentation before payment. Depending on the circumstances, this may include:

- Contracts, purchase orders, invoices, and canceled checks (time and/or materials)
- Deliverables, special studies, and reports
- Contractor and subcontractor agreements and payments
- Description and volume of activities or services provided
- Certifications, e.g., review and approval of progress or completion by internal or external oversight parties
- Progress reports, which may also be a component of monitoring activities

Public agencies that reimburse service providers from bond funds should adopt commonly-used best practices for the disbursement of other funds.

The internal control systems should ensure that expenditures of bond funds track to the bond act requirements and to other controlling documents, including contracts, budgets, and fund limits. Internal controls that administer funds for capital projects must necessarily include procedures to manage the various steps of project delivery, including cost and financial management, procurement management, strategy and administration, and schedule management.

The internal control system must utilize an agency's administrative practices to manage human capital and delineate responsibility for the long-term management and internal control over bond funds to staff. Specific tasks include:

- Supervising, investing, and administering the expenditure of bonds proceeds;
- Collecting or monitoring the collection of pledged revenues;
- Using revenues to pay administrative expenses and debt service;
- Complying with all undertakings, laws, regulations, policies, bond covenants, and agreements;
- Managing any enterprise funded by the bonds;
- Filing of any required reports with various government regulators, bond insurer or other credit enhancement provider, if any, and credit rating agencies;

[44] As discussed in Guideline 1, commitment to ethical values is integral to a control environment.

- Addressing any problem that may arise with respect to the bonds, such as a shortfall in pledged revenue, a tax audit, or a regulatory issue;
- Preparing, reviewing, and filing annual reports and material event notices pursuant to Securities and Exchange Commission (SEC) rules; and,
- Preparing, reviewing, and if necessary, filing arbitrage rebate forms pursuant to Internal Revenue Service (IRS) codes.

In general, public agencies are often composed of more than one unit or division, performing different business processes in support of bond administration. The internal control system must provide specific direction to these organizational units to enable them to coordinate their activities to maximize efficiency and effect and to provide the necessary controls to meet the agency's objectives.

Guideline 10—Control Activities
Require that an approving officer of the public agency certify that the agency has complied with its internal control system before disbursing bond funds.
As a standard practice the public agency should include, as a step in the approval process, a positive affirmation from the approving officer that the agency has complied with its internal control system before authorizing a disbursement of bond funds. The certification may accompany or be a part of an approval of payment form requiring no less than two authorizing signatures.

Guideline 11—Control Activities
Administer an annual compliance test to ensure the agency has fulfilled its reporting obligations on issued bonds.
The agency should develop a checklist to test its compliance with continuing disclosure, federal tax law, and other requirements, including reporting obligations. The checklist may form the basis for an audit program that reviews the issuer's compliance with disclosure and reporting requirements. To be most effective, the compliance test should be written into the agency's audit program so that the annual review tests the agency's compliance with these requirements. In a conduit financing, the compliance test would necessarily include any and all components of the conduit issuer's recordkeeping and reporting that are subject to the borrower's internal control system.

Part 4 - Information and Communications
How does a public agency ensure that it has the information needed to determine whether it is achieving its objectives and managing risks that may hinder its progress towards those objectives?

As guardians of public funds, public agencies have a fiduciary responsibility to adopt a system of internal controls that provides a reasonable assurance that it is achieving its objectives, including the receipt, management, and disbursement of bond funds. The agency must rely on information to support this internal control system. Information and communication is essential for the agency to achieve its objectives and for it to identify risks, both internal and external, that might keep it from achieving its objectives. The agency must foster an open system of communication to give and receive information on its performance. This open communication can help to foster input from stakeholders and identify risks.

Guideline 12—Information and Communication

Establish a fund and account structure that records the expenditure of bond proceeds in sufficient detail to enable the agency to evaluate the use of the proceeds and to communicate the outcome of these expenditures.

At the close of a bond sale, the public agency may deposit bond proceeds into funds and accounts with a trustee. These are managed pursuant to an indenture of trust, resolution, or other bond documents. While the trustee is responsible for safeguarding funds as a fiduciary to bondholders and the public agency, as the bond issuer, management should ensure the internal control of bond proceeds is seamlessly integrated into the public agency's accounting system and control environment. The agency should establish an appropriate accounting or fund structure in its own accounting system to properly report cash proceeds and bonds payable on the financial statements and to track and confirm the appropriate use of bond proceeds.[45] In a conduit financing, the borrower should establish the appropriate legal and administrative framework to ensure that it has access to financial information needed to administer its internal control system. This may include fund and account statements that may be used to track payments, balances, and cash flows.

Guideline 13—Information and Communication

Regularly report to members of the public and other interested parties on the outcomes of expenditures of bond funds.

The agency should develop a reporting strategy to communicate the results of its bond program. Reports produced will assist the public agency in establishing accountability and establishing a level of trust with members of the public and other interested parties. Information of interest to members of the public and other interested parties includes current status of bond funds – e.g., spent and unspent, authorized and unissued – and bond-funded projects, repayment as well as compliance with the authorizing bond initiative, continuing disclosure requirements, and information required to be reported as a condition of funding (i.e., bond sale, grant award). In general, reporting of the bond program should provide the status of bond proceeds and bond-funded projects over the term of the financing. Reports may also include audits that address the agency's compliance with applicable bond documents and the financial obligations made to investors. Just as important is the information audits can provide on the agency's appropriate and timely use of bond proceeds.

An agency can publish periodic updates on the bond program through annual reports and presentations at public meetings, and they may also dedicate a website to the agency's bond program. A website provides stakeholders with ready access to information as it becomes available. Dynamic graphics such as charts, graphs, pictures, and videos can be used to convey to taxpayers the accomplishments of the bond program; these visual representations can effectively communicate the progress of bond-funded projects.[46] In addition, Frequently Asked Questions (FAQs) can be posted on a website.[47] For any format to be effective the information needs to be reliable and timely and the agency should establish and meet deadlines for periodic reporting and updating of website information. While the information on this webpage may not be part of an agency's formal continuing disclosure requirements, the agency must take into account securities laws when providing even general information on outstanding bonds.

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[45] Reconciliation should include the monitoring of bond fund cash flows with the trustee.

[46] *Comments to the Task Force on Bond Accountability*, California State Auditor, Los Angeles, CA, May 21, 2015.

[47] *Id.*

Guideline 14—Information and Communication

Establish a process to alert responsible personnel to changes in the public agency's internal control system.

Changes in the internal control system or policies and procedures implementing the internal control system can result from new or changed risks, conditions, legislative or legal actions, or events that may impact the ability of the agency to manage the risks relevant to operations.[48] For internal controls to be effective, reliable and relevant information needs to be communicated in a timely manner to those responsible for performing control functions.[49] Information is of little use if it is not communicated to those who need it.

Guideline 15—Information and Communication

Train agency personnel, including board members, management, and staff, responsible for bond administration and compliance efforts.

Providing the necessary tools, including training, for employees to perform their duties and responsibilities is essential to effective internal control. Agencies should include employee training plans in annual performance reviews and can implement annual training for highly specialized debt administration requirements as part of its debt policy. Since debt administration begins with the approval of the bonds by the governing body, the tone from the top is essential to the implementation of a meaningful training program. Agency personnel such as board members, management, and some staff, may also be required to document biennial ethics training.[50]

Part 5 - Monitoring

How does a public agency maintain a system of internal controls over time?

The effectiveness of any set of internal controls is a function of its ability to mitigate risk. Since risks and program activities change over time, the internal control system must be dynamic. It must be able to respond to changing requirements, staffing, and agency objectives. For the agency to maintain an effective internal control system it must monitor its performance and effectiveness. Public agencies may incorporate different processes to monitor and oversee internal controls to ensure their effectiveness, however, regardless of the presence of oversight measures the ultimate responsibility for overseeing the legal and intended use of bond proceeds remains that of the governing body.

Guideline 16—Monitoring

Implement a monitoring program to determine the effectiveness and efficiency of the agency's internal control system.

Management should periodically review a public agency's policies, procedures, and practices for its bond program to ensure control activities continue to be relevant and effective in achieving objectives and managing related risks. If there is a significant change to any of the agency's accounting, administrative, or bond administration processes, management should promptly evaluate the change to determine that applicable control activities remain appropriately

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[48] State Controller's Office, *Internal Control Guideline*s, *supra* note 2.

[49] Gauthier, *An Elected Official's Guide*, *supra* note 1 at 24.

[50] The ethics training required by AB1234 became effective on January 1, 2006 and its terms are codified at California Government Code § 53235.

designed and implemented. According to the GFOA, to be effective, monitoring must possess the following characteristics:[51]

- Evaluations of internal controls are performed periodically; and,
- The effectiveness of internal controls is evaluated and communicated. The agency uses those evaluations to determine whether controls are functioning, communicates weaknesses to appropriate parties, and follows through on corrective action.

To ensure the internal control processes and procedures for the agency's bond program are effective, a public agency should employ periodic audits of the program. Any effort to monitor the agency's internal control system must include control functions performed by the conduit issuer in the case of a conduit financing.

Guideline 17—Monitoring

Establish a process to annually review the agency's internal control system.

Public agencies that issue bonds should establish a form of oversight that, as a part of its responsibilities, reviews and recommends improvements to the agency's internal control system. Common forms of oversight include a citizens' bond oversight committee or an oversight committee composed of staff within the public agency. In addition to the monitoring provided by an oversight committee, public agencies may also create a fraud detection webpage or telephone line that enables the reporting of anonymous tips that may help to reveal failures or weakness in the internal control system. In a conduit financing, any test of the agency's internal control system must include the control functions of a conduit issuer if appropriate.

[51] Gauthier, *An Elected Official's Guide*, *supra* note 1 at 31.

Debt Issuance and Management Review Checklist

The Debt Issuance and Management Review Checklist is a tool that will allow public agencies to track their compliance with specific requirements associated with the issuance of bonds and the treatment of bond proceeds.

Debt Issuance and Management Review Checklist[52]		
Checklist Item	**Completed (✓= Yes)**	**Comments/Remarks**
Agency's General Debt Profile		
The agency maintains a complete inventory of its outstanding bonds. This list is updated after each bond issuance.		
Bond covenants for the agency's outstanding bonds - both financial and non-financial - have been identified and are regularly reviewed and complied with.		
The agency has identified and is currently meeting the terms of the underlying documents (i.e., indenture, loan agreement, and tax certification) to the bonds.		
Debt service payments for the outstanding bonds have been incorporated into the agency's annual budget.		

Use of Bond Proceeds (for each bond issuance)		
Identify and describe the proposed use of the bond proceeds		
Identify the source of repayment for the bonds.		
Identify additional sources of funds, e.g., grants, loans, or other funding sources.		
Confirm proposed uses of bond funds are included in agency budget.[53]		
Confirm proposed uses of bond funds were established in conformity with controlling bond document(s).		
Confirm the agency follows generally accepted accounting principles (GAAP) to account for allocation of permitted expenditures in		

[52] An agency should work with bond counsel, disclosure counsel, tax counsel, and other special consultants to meet the specific requirements of the Internal Revenue Code (IRC), federal securities laws, continuing disclosure agreements (CDAs), or other documents. This checklist should only indicate that those specific processes have been completed; this checklist by itself would not satisfy compliance with these technical processes.

[53] Line items can include land acquisition, engineering, design, planning, and construction.

accordance with Governmental Accounting Standards Board (GASB) principles.		
Maintain a detailed timeline and measure the progress against the timeline.		
Establish and maintain an expenditure schedule that includes cash flows in accordance with the timeline.		
Establish a system to track expenditures that includes a review and approval process that conforms to the controlling bond document(s).		
Establish and follow procedures for the disbursement of bond proceeds.		
Monitor expenditures in conformity with controlling bond document(s):		
• Identify project line items for which bond proceeds will not be used		
• Indicate where bond funds will be used to reimburse the agency for prior expenditures (e.g., planning and design) and identify the type and timing of the reimbursement[54]		
Track progress of projects:		
• Identify project line items in agency's proposed expenditure report or budget.		
• Identify completed projects.		
• For incomplete projects, provide estimated start and completion dates.		
• Note total amount of bond proceeds expended on each project to date as well as the cumulative amount of proceeds available for each project.		
Regularly review and validate trustee reports:		
• Acceptances and disbursements of bond proceeds.		
• Current balances of bond funds.		
• Meeting/maintaining reserve fund requirements.		
• Investment of bond proceeds.		
If the project was approved by voters, certify that the project is in conformity with voter authorization.		

[54] Reimbursement of prior expenditures is limited in certain ways and may require the adoption of a reimbursement resolution by the public agency.

Covenants[55]		
Complete and file tax certificate.[56]		
Identify information to be reported in compliance with the bond's continuing disclosure agreement (CDA):		
• Identify the date the agency's annual financial information is due. Was the filing made on time?		
• When appropriate, the agency filed material event notices in a timely manner.		
• Ensure agency's complete, accurate, and timely filing of information through periodic reviews on what is posted to EMMA.[57]		
Review agency's website and update with currently available debt information.		
If there is a safekeeping requirement in the controlling bond documents, establish procedures to assure property custody and security.		
Establish and maintain a record retention system for documents associated with the bond financing. See tax certificate for agency record retention requirement.		
Regularly monitor the investment of bond proceeds in conformity with the bond documents and state law.		
Regularly schedule audits.		
Prepare reports (such as a Bond Accountability Report) for the governing board and/or oversight committee as required, that include: • Expenditures to date and remaining balance; • Estimate of future expenditures tied to specific projects; • Project(s) descriptions tied to voter authorization and controlling bond document(s);		

[55] Compliance with a tax certificate and reporting requirements contained in a continuing disclosure agreement (CDA) may require the agency to work with special counsel (bond/disclosure/tax) or consultants (arbitrage/tax). This checklist should only indicate that those specific processes have been completed; this checklist would not satisfy compliance with those technical processes.

[56] For detailed information on tax compliance for tax-exempt bonds refer to the IRS's *Tax-Exempt Governmental Bonds: Compliance Guide* available at www.irs.gov/pub/irs-pdf/p4079.pdf.

[57] The Electronic Municipal Market Access (EMMA) system is operated by the Municipal Securities Rulemaking Board (MSRB) and is the official source for municipalities to report securities disclosures and related information.

• Status of projects with amounts spent on each project; and, • Identifications and explanations of incomplete projects.		
Report to trustee, rating agency(ies), bond insurer, and/or credit enhancer as required.		

Internal Control System Checklist

The Internal Control System Checklist is a tool to allow public agencies to assess their internal control system for the management of bond funds. For additional information on how to evaluate internal controls, refer to the U.S. Government Accountability Office (GAO) Internal Control Management and Evaluation Tool.[58]

Internal Control Checklist for Bond Requirements		
Task/Deliverable	**Completed? (☐=**	**Comments/Remarks**
Part 1. Control Environment:		
1. Do you have a designated compliance officer?[59] (Identify a compliance officer or establish a compliance team to verify internal controls and bond requirements.)		The designated compliance officer should be a staff person that, with respect to their regular duties, are not responsible for processing invoice payments, but may be a member of the governing body of the public agency.
2. Compliance officer and compliance team members have participated in training on internal control and bond administration requirements.		
3. Establish an inventory of outstanding bonds and obtain or prepare a list of bond requirements, including covenants in the following controlling bond documents:[60] a. Indenture b. Loan or Lease Agreement c. Tax Certificate and Continuing Disclosure Agreement		*(Refer to Part 3. Control Activities of this checklist for examples of bond requirements)*
4. Establish written procedures for bond administration processes and bond requirements that support the agency's internal control system.		
5. Adopt a debt policy with objectives and		Debt policy and procedures are

[58] This tool can be accessed at http://www.gao.gov/products/GAO-01-1008G.

[59] If practicable, an agency may utilize a compliance team that represents a cross-section of bond administration roles and responsibilities throughout its program operations and organizational structure. If a compliance team is utilized, a single point of contact should be identified by the agency to coordinate compliance activities.

[60] A thorough review and understanding of covenants or provisions in controlling bond documents is necessary to prepare a list of bond requirements for compliance purposes. If necessary, an agency should seek advice or assistance from bond counsel and/or a financial advisor regarding the development of its list of bond requirements. Lists of post-issuance requirements for the specific purpose of compliance with federal tax law regarding arbitrage rebate, yield restriction, and private use and legal or regulatory requirements for continuing disclosure are available from the IRS or organizations such as the National Association of Bond Lawyers (NABL) and the Government Finance Officers Association (GFOA).

specifications for bond administration and integrate into the agency's organizational policies, procedures, and long-term plans. *(Refer to Part 2. Risk Assessment of this checklist for additional information)*		maintained in the agency's policy and procedures manual.
6. Establish an audit committee to review compliance with testing of bond requirements.[61]		*(Refer to Part 4. Monitoring of this checklist for additional information on compliance tests for bond requirements)*
Part 2. Risk Assessment:		
1. Clearly define the objectives[62] of the bond administration program related to: a. Operations (related performance measures are effectiveness and efficiency) b. Reporting (related performance measures are accuracy and precision) c. Compliance		Objectives are clearly measurable and easily understood at all levels of the agency. Objectives relate to activities within all stages of the debt lifecycle.
2. Include objectives of the bond administration program in a debt policy and integrate risk assessment for all stages of the debt lifecycle into the agency's decision-making and planning process.		The agency's objectives in its strategic plan include elements of bond administration and define strategies the agency uses to manage risk.
3. Establish performance measurements[63] to monitor how successfully the agency achieves its objectives for the bond administration program.		Performance measurements for the bond administration program are defined and included in a strategic plan.
4. Establish risk tolerance relative to each of the objectives of the bond administration program. Risk tolerance is equal to the variation of performance or condition that the agency has determined to be within its risk appetite.		A debt policy defines the level of risk that is deemed reasonable for an agency to accept in the achievement of its objectives (risk appetite) and identifies the conditional elements of the bond administration program that are monitored within the agency's internal control system.
5. Identify and analyze risks (including potential fraud and misuse) related to the objectives		Risk analysis estimates the significance of each risk, assesses

[61] Such tests commonly include procedures that validate statutory authority to borrow, legal requirements of debt sales, tracing authorized debt to accounting records, and confirming compliance with bond documents, covenants, and other legal requirements.

[62]Objectives of the bond administration program may reflect issuer responsibilities specified in controlling bond documents as well as specifications required by laws, regulations, or an agency's policies and procedures.

[63] Performance measurements relate to elements of bond administration objectives and are used to evaluate variances of performance (levels of risk) for each element on a conditional basis, i.e., Is the objective achieved in a manner that is effective, efficient, accurate, precise, or in compliance?

and conditional elements of the bond administration program. *(Refer to the Task Force Guidelines in Part 3 – Control Activities for additional information on appropriate responses an agency may deploy to manage risks)*		the likelihood of occurrence, and forms the basis for the types of control activities that are used to prevent and detect risks, including remedies that management may use to immediately respond to risk events.
Part 3. Control Activities:		
1. At a minimum, the agency applies the same system of internal control activities to bond funds as it does to all other governmental funds.		Based on bond requirements and risk assessment findings, control activities provide a reasonable assurance of internal control for bond funds applicable to all stages of the debt lifecycle.
2. Review and update inventory of outstanding bonds and related bond requirements.		Review official bond transcripts.
3. Review and update bond administration procedures.		
4. Review and update debt policy for changes to legal requirements, new debt and revised objectives, strategies, and procedures.		The debt policy is reviewed on a periodic basis for approval by the governing body.
5. Confirm compliance with policies, covenants, and bond administration procedures that support the agency's internal control system (all control activities).		All control activities sufficiently evaluate risk factors of fraud and misuse of bond proceeds.
Control Activities for Legal and Financial Requirements:		
6. Confirm legal requirements of debt sales (new issues and refunding transactions) are met.		
• Receive copies of approvals, authorizations, and controlling bond documents (official bond transcripts) and maintain in a safe and secure but accessible location.		
• Monitor/track bond authorizations to debt issuances and refunding transactions.		Update inventory of outstanding bonds.
• Bond documents and amendments are appropriately approved pursuant to the agency's administrative or legal policies and procedures.		
• Confirm bond projects and related expenditures are consistent with approvals, authorizations, and controlling bond documents.		Conduct site visits to confirm work is performed as reflected in progress estimates submitted by contractors.

7. Confirm compliance with financial covenants and other restrictions.		
• Confirm funds and accounts are established in the agency's accounting system to record the receipt of proceeds and account for bonds payable.		Applies to new issues and refunding transactions at the time of closing. For tax-exempt borrowing, proceeds include investment earnings.
• Confirm funds and accounts established by the trustee and deposits of bond proceeds reconcile with controlling bond documents.		
• Monitor trustee funds and accounts and perform periodic reconciliations of trustee statements with agency records for bond expenditures, including costs of issuance for new issues or refunding transactions.		Officer certificates or requisitions match trustee records and statement activity.
• Confirm expenditures for bond proceeds are processed pursuant to appropriate segregation of duties and practicable checks and balances (three-way matching) or, alternatively, by appropriate compensating controls.		Officer certificates or requisitions have required agency authorizations supported by audit trail documents that support the reconciliation of expenditures with capital budget and agency records.
• Confirm deposit of funds with trustee for debt service and maintenance of reserve funds or other accounts, including the rebate account and monitor cash flow activity on a periodic basis.		Confirm any excess funds at the trustee are applied pursuant to the terms of the indenture or other controlling bond document.
• Confirm trustee is performing compliance activities for financial covenants required by indenture, loan or lease agreements, or other bond documents.		Trustee is correctly following procedures contained in bond documents including the maintenance of funds and accounts, insurance and credit rating filings, monitoring and adherence to debt coverage ratios and additional bonds tests, distribution of notices and corporate actions, and mandatory or optional redemption instructions.
• Confirm compliance with debt policy provisions regarding financial performance measurements for conditional elements of the bond administration program. *(For*		Conditional elements of a debt policy are consistent with the agency's objectives and strategies in the strategic plan or other long-term planning report.

examples of conditional elements refer to the GFOA model debt policy at www.gfoa.org/debt-management-policy)		
Control Activities for Non-Financial Requirements:		
8. Confirm compliance with agency oversight requirements for bond administration activities.		
9. Confirm compliance with staffing plans for the bond administration program.		
10. Confirm compliance with agency records retention policy and procedures.		Records retention for bond related material is maintained pursuant to federal treasury regulations and tax law requirements. *(Refer to Other Control Activities in this checklist below)*
Other Control Activities:		
11. Confirm compliance with tax certificate covenants, i.e., post-issuance tax compliance requirements for bonds. *(For detailed information on tax compliance for bonds refer to the IRS Compliance Guide at www.irs.gov/pub/irs-pdf/p4079.pdf)*		Pursuant to IRS guidelines, in order to comply with post-issuance federal tax rules, issuers ensure that the rules are met both at the time the bonds are issued and throughout the term of the bonds.
• Do you have a post-issuance tax compliance procedure similar to that referenced in IRS form 8038?		
• Do you have an arbitrage rebate consultant? (Consult with arbitrage rebate consultant and/or bond/tax counsel as necessary to ensure compliance with post-issuance tax requirements for tax-exempt bonds.)		Implement procedures that will enable adequate safeguards against post-issuance violations that result in loss of the tax-exempt status of bonds.
• Maintain copies of filings with the Internal Revenue Service (IRS) for each bond issuance, i.e., Information Return Form 8038-G and arbitrage rebate reports.		8038-G is included in official bond transcripts.
• Confirm due dates for arbitrage rebate and yield restriction filing requirements with the IRS.		First installment due on fifth bond year of bond issuance plus 60 days. Tax certificate provides the bond year to determining due date for tax filings.
• Monitor compliance with expenditure spend-down targets, use of proceeds, private use, and disposition of bond-financed		Maintain a separate list of compliance requirements for tax compliance and continuing disclosure, i.e., post-issuance

facilities.		requirements for tax-exempt bonds. Request a compliance checklist from consultant or tax counsel or refer to the checklist developed by the National Association of Bond Lawyers (NABL) and the GFOA at www.gfoa.org/debt-management-policy.
• Monitor compliance with records retention requirements for bond related records, pursuant to federal treasury regulations and tax laws.		
12. Confirm compliance with continuing disclosure agreement covenants, i.e., post-issuance disclosure requirements.		
• Confirm annual filing on the Municipal Securities Rulemaking Board's (MSRB) Electronic Municipal Marketplace Access (EMMA) website due dates for annual reports and other financial reports applicable to each outstanding bond issuance.		Continuing disclosure agreement for bond issue specifies filing due date.
• Update information in the agency's annual report required by the continuing disclosure agreement for the bond issue and file with EMMA no later than the required due date. If the agency utilizes a dissemination agent to file the annual report with EMMA, the compliance officer should locate the filing on EMMA and confirm the annual report has been filed prior to the due date and verify correct CUSIPs were used in the filing.		Maintain a separate list of compliance requirements for tax compliance and continuing disclosure, i.e., post-issuance requirements for tax-exempt bonds. Request a compliance checklist from consultant or bond/disclosure counsel or refer to the checklist developed by NABL and the GFOA at www.gfoa.org/debt-management-policy. Consult with bond/disclosure counsel as necessary to ensure compliance with post-issuance disclosure requirements
• Monitor outstanding debt for events that are listed in the continuing disclosure as a material or listed event and file or arrange to file a notice of material event on EMMA for an occurrence within 10 business days of the event.		
Part 4. Information and Communications:		
1. Establish process to alert personnel to changes in policies and procedures for internal controls and bond requirements.		
2. Establish an official structure of communication within the agency based on roles and responsibilities in the bond		Job descriptions define roles and responsibilities for essential bond administration functions. *(Refer to*

administration program.		*Control Activities for Non-Financial Requirements, Item 9.)*
3. Confirm that staff with internal control and/or bond administration responsibilities, including compliance, received or are scheduled to receive periodic training.		
Part 5. Monitoring:		
1. Perform period review of bond activities and report results to the governing body.		
2. Complete Internal Control Checklist and immediately report findings to management.		

Appendix B

Members of the Task Force on Bond Accountability

FRED KEELEY, CO-CHAIR
Fred Keeley, a former Speaker pro Tempore of the State Assembly and Santa Cruz County Treasurer, is the convener of the Santa Cruz Open Space Project. At the request of the Santa Cruz County Board of Supervisors and the county administrative officer, he is leading an effort to establish an Open Space District.

Mr. Keeley, who earned a bachelor's degree in social sciences from San Jose State University in 1974, has had a long and distinguished career in public service.

From 1981 to 1985, Mr. Keeley served as principal policy analyst for Supervisor Joe Cucchiara. He served as chief of staff for Assemblymember Sam Farr from 1985 to 1996.

Mr. Keeley was elected in 1988 and re-elected in 1992 to the Santa Cruz County Board of Supervisors. Among many achievements, he co-chaired the countywide effort to establish the County Health Initiative, which converted the Medi-Cal program in Santa Cruz County from a fee-for-service model to a Medi-Cal Health Maintenance Organization.

From 1996 to 2002, Keeley represented the Monterey Bay area in the Assembly for three terms, the most allowed under California's term limit law. For four and one half years, he served as Speaker pro tempore. In that position, he authored the two largest park and environmental protection bonds in the nation's history, for a total of $4.6 billion. Mr. Keeley also authored the Marine Life Management Act and was principal co-author of the Marine Life Management Act, and authored the California Ocean Science Trust Act.

From 2003 to 2005, he was executive director of the Planning and Conservation League (PCL) and PCL Foundation. He led the successful reorganization of these two non-profit entities.

From 2005 to 2015, he served as County Treasurer. The major responsibility of this office was to manage a daily public sector investment portfolio of $650 million. Mr. Keeley was able to achieve an unbroken monthly positive distribution of earnings for the public agencies invested in the County Investment Pool for every month in which he was the Treasurer.

Mr. Keeley is currently also serving a two-year term as president of the Sempervirens Fund, is a board member and corporate officer of Working Partnerships USA, is a trustee and corporate officer of the National Marine Sanctuary Foundation, and serves on the board of the Community Foundation of Santa Cruz County.

Mr. Keeley also teaches government courses at San Jose State University and California State University, Monterey Bay.

JAY GOLDSTONE, CO-CHAIR
Jay Goldstone is the managing director of the Public Finance Group of Mitsubishi UFJ Financial Group (MUFG). He was hired by MUFG in October 2013 and is responsible for managing relations with State

and local government clients and prospects including the origination and structuring of lines of credit, direct loans and placements, standby bond purchase agreements, letter of credit, and other related banking services.

Prior to joining the bank, Mr. Goldstone had a successful 37-year career in municipal government in financial and executive capacities. He has held such positions as chief operating officer and chief financial officer for the City of San Diego; director of finance for the City of Pasadena; manager of finance for Maricopa County, Arizona; interim city manager and director of finance for the City of Richmond; and deputy director of finance for the City of Santa Clara.

Mr. Goldstone has served on the board of directors of the Municipal Securities Rulemaking Board and was chair of the board from Oct. 1, 2012 to Sept. 30, 2013. He served as a commissioner on the California Debt and Investment Advisory Commission (CDIAC) for seven years and as chair of the League of California Cities Revenue and Taxation Committee for one year.

Mr. Goldstone received a bachelor's degree from the University of Minnesota, a master's degree in public administration from Arizona State University, and a master's degree in business administration from Santa Clara University.

JAMES BEMIS

James Bemis is a principal at Montague DeRose and Associates, LLC. He joined the firm in 1999 after nearly 20 years of municipal finance experience as an issuer, investment banker, and commercial lender. He has participated in more than $100 billion in bond issues and financings for states, counties, municipalities, redevelopment agencies, water, wastewater and electric utilities, transportation agencies, educational institutions, and multi-family, senior citizen, and non-profit housing issuers.

Mr. Bemis is considered the municipal finance industry’s premier financial advisor in variable rate debt, having served as financial advisor on some of the largest variable-rate bond programs in municipal finance, including the $4.2 billion variable-rate portion of the 2002 California Department of Water Resources power supply revenue bonds, the State of California’s $4 billion in general obligation variable-rate demand bonds, and the $3 billion variable-rate portion of the State of California economic recovery bonds.

Currently, he provides ongoing advice on several of the industry’s largest variable-rate bond programs, including those for the State of California and the California Department of Water Resources. He has negotiated letters of credit and other liquidity facilities for the State of California, State of Washington, California Department of Water Resources, Sacramento County Regional Sanitation District, Port of Oakland, East Bay Municipal Utilities District, Tacoma Power, City and County of San Francisco, San Francisco Public Utilities Commission, as well as many other municipal issuers.

Additionally, Mr. Bemis is one of the industry’s foremost experts in transportation finance. Since 1999, he has been lead financial advisor on many transactions for the U.S. Department of Transportation’s Transportation Infrastructure Finance and Innovation Act program. This experience includes a number of toll road and bridge projects, and public-private partnerships (PPPs). In addition, Mr. Bemis has advised the Washington State Department of Transportation and the San Bernardino County Transportation Authority on transportation projects. Mr. Bemis has also spoken at public finance conferences on transportation finance and PPPs.

Mr. Bemis began his finance career in 1979, while employed by the City of Oxnard, completing more than a dozen financings totaling more than $500 million as a municipal employee. He worked for a dozen years as a commercial bank officer, providing credit and liquidity for two international banks, Sumitomo Trust and the Industrial Bank of Japan. During this time, he developed both banks' public finance marketing program, including providing credit enhancement, bond purchase agreements, and liquidity facilities for government and non-profit organizations. After joining the municipal investment banking firm of E. J. De La Rosa and Co. in 1993, he was responsible for business development and client relationships.

Mr. Bemis currently serves as advisor to the United States Department of Transportation, the State of California Treasurer's Office, the Washington State Treasurer's Office, the State of California Department of Water Resources, City of San Diego, Los Angeles County, City of Los Angeles, and the Sacramento County Regional Sanitation Districts.

Mr. Bemis received bachelor of arts degrees in economics and environmental studies from the University of California, Santa Barbara and a master of business administration degree from the University of California, Los Angeles.

ROBERT CAMPBELL
Robert Campbell is the Contra Costa County auditor-controller.

He has worked more than 26 years with the Office of the Auditor-Controller. In June 2010, he was elected auditor-controller and then re-elected in June 2014 to serve another four-year term.

In recognition as a leader in effective budgeting and finance, Mr. Campbell was appointed by the State Controller to the California Uniform Construction Cost Accounting Commission.

Mr. Campbell is an active member of the State Association of County Auditors, where he serves as the chair of the Legislative Committee and former member of the Executive Committee. He served as the past chair of the Bay Area County Auditors and past president of the State Association of County Auditors' Property Tax and Payroll Managers' committees.

Mr. Campbell also is a member of the Government Finance Officers' Association and the Association of Government Accountants.

Mr. Campbell received a bachelor of science degree in business administration from California State University, Hayward.

CARRIE CORDER
Carrie Corder is assistant general manager and chief financial officer for Cucamonga Valley Water District in Rancho Cucamonga.

Ms. Corder, who is a certified public accountant, has been with the district since 2001. She oversees all functions relating to accounting, treasury, debt management, purchasing, customer service and information technology.
Prior to joining the district, she worked for four years at a regional public accounting firm and for six years at the City of Claremont.

Ms. Corder has taught as an adjunct professor at two local community colleges.

She has a bachelor of science degree in business administration/accounting from California State Polytechnic University, Pomona and a master's degree in leadership and organizational studies from Azusa Pacific University.

ANDREW FINLAYSON

Andrew Finlayson joined the California State Controller's Office in 1983 and currently serves as the chief of the State Agency Audits Bureau for the Controller's Division of Audits.

With more than 30 years in the auditing field, Mr. Finlayson has led and managed a multitude of audits and projects, including financial and performance audits and management services for a wide array of public entities. Most notably, he has led and been involved with the following audits that included auditing bonds:

- Los Angeles Community College District
- City of Bell
- Delta College District

He has shared his school bond auditing knowledge with the California League of Bond Oversight Committees (CALBOC) as a speaker.

Mr. Finlayson's current responsibilities include managing and directing a group of seven managers and 40 staff and performing a variety of audits of State agencies.

He received his bachelor of science degree in accountancy and finance from California State University, Sacramento.

BLAKE FOWLER

Blake Fowler was appointed director of the Public Finance Division of the State Treasurer's Office in August 2009. He oversees the issuance of all State debt and the management of the State's general fund debt portfolio.

Prior to his current appointment, Mr. Fowler served as the assistant director of the Public Finance Division for three years.

Prior to joining the State Treasurer's Office, Mr. Fowler worked for the California Infrastructure and Economic Development Banks (IBank) for more than 10 years.

From 2000 to 2006, he served as the IBank's assistant executive director and was responsible for managing all operations and financing programs of the IBank.

He has a bachelor's degree in business administration with an emphasis in finance from California State University, Chico.

WILLIAM HOLDER

William Holder serves as dean of the University of Southern California (USC) Leventhal School of Accounting, and holds the Alan Casden Dean's Chair of Accountancy.

Prior to his current post, Holder served as a member of the Governmental Accounting Standards Board for 10 years and was the Ernst & Young Professor of Accounting and Director of the Securities and Exchange Commission (SEC) and Financial Reporting Institute in the Marshall School of Business at the University of Southern California. He is an expert on financial reporting and auditing.

Mr. Holder has published extensively and received numerous awards during his career, including being twice named as one of the Top 100 People in the accounting profession. He also received the American Institute of Certified Public Accountants Gold Medal for Distinguished Service, the highest honor awarded by that organization.

He has served on governance and other standard-setting bodies, including the Accounting Standards Executive Committee of the American Institute of CPAs (AICPA). During Congressional hearings leading to passage of the Sarbanes/Oxley Act, he provided invited testimony about financial reporting, auditing and corporate governance.

Mr. Holder holds his doctorate from the University of Oklahoma and is a certified public accountant.

ANA MATOSANTOS

Ana Matosantos is a policy and budget consultant based in Sacramento.

Ms. Matosantos served as director of California's Department of Finance for Governors Arnold Schwarzenegger and Jerry Brown between 2009 and 2013. She oversaw the annual state budget of more than $200 billion, directed budget development, negotiations and implementation, and led a department of more than 400 employees.

She was chief fiscal advisor to Brown as the State closed an annual budget gap of $20 billion and moved to annual surpluses in the billions. She joined the Department of Finance as chief deputy director for budgets in 2008, a few months before California and the nation began to confront the biggest recession since the Great Depression.

Before joining the Department of Finance, Matosantos worked on health and human services policy and fiscal matters at the Governor's Office, the California Health and Human Services Agency and the California State Senate. She served as a California Senate Fellow between 1999 and 2000.

Between 1997 and 1999, Matosantos worked as a program associate at Equal Rights Advocates, a public interest women's law center.

Ms. Matosantos graduated from Stanford University in 1997 with a degree in political science and feminist studies. She is originally from Puerto Rico

JENNY SALKELD

Jenny Salkeld is the chief financial officer of San Diego Unified School District.

She joined the district in February 2010 as controller, became the interim chief financial officer in June 2013 and was assigned to the permanent position of chief financial officer in November 2013.

Since 2010, Salkeld has been responsible for management and oversight of budget development, financial planning, monitoring and accountability, controller, payroll, and benefits. She has participated in the issuance of the district's tax and revenue anticipation notes, general obligation bonds and general obligation refunding bonds in the collective aggregate principal amount of more than $1.5 billion.

Ms. Salkeld has extensive experience managing multimillion-dollar accounting, finance, and revenue operations and is accomplished in developing financial strategies that enhance organizational growth and maximize sustainability. She was responsible for the accounting integration for a $450 million acquisition by a NASDAQ health care company. Additionally, she implemented a board-approved corporate compliance plan for a mid-size organization.

Ms. Salkeld holds a master of business administration degree and bachelor of science degree in accounting from the University of La Verne. She has completed coursework at Walden University in the doctor of philosophy in psychology program, with a specialization in organizational psychology, and is in the process of completing her dissertation. Ms. Salkeld is currently enrolled in the chief business officer program at the University of California, Riverside.

NADIA SESAY
Nadia Sesay was appointed director of the Controller's Office of Public Finance for the City and County of San Francisco by Mayor Gavin Newsom in March 2005. The Office of Public Finance manages the city's $3 billion municipal debt portfolio, oversees the issuance of all new debt secured by property taxes and general fund sources, initiates the city's debt policies and procedures and provides technical expertise for the preparation and monitoring of a 10-year capital plan. In addition, Sesay and her staff provide financial analysis to the mayor, Board of Supervisors, commissioners and department heads.

Ms. Sesay has been with the Office of Public Finance for nearly 17 years, serving as financial administrator and bond associate prior to her appointment as director. Before joining the city, she worked for Union Bank of California, N.A., in the corporate trust department as trust administrator.

Ms. Sesay also sits on the San Francisco Community Investment Board and serves as chair of the Oversight Board of the Successor Agency to the Redevelopment Agency of the City and County of San Francisco. She was awarded San Francisco's Public Managerial Excellence Award for exemplary leadership, fiscal ingenuity and vision in 2010.

BOB WHALEN
Bob Whalen, the 2015 mayor of Laguna Beach, has been a public finance specialist for more than 30 years, accumulating extensive experience acting as bond counsel, disclosure counsel, and underwriter's counsel in connection with municipal financings.

He specializes in bond work for State and local agencies, including school districts, counties, cities and water districts. He assists them in financing a wide variety of public infrastructure projects. He also represents both public agencies and investment banks in connection with disclosure issues related to public financings.

Mr. Whalen is a shareholder with Stradling Yocca Carlson and Rauth and is a member of the law firm's board of directors.

His areas of expertise include land-secured financings, lease financings, general obligation bond financings, pension bond financing, and multi-family housing financings.

Mr. Whalen is a frequent speaker on municipal finance issues at industry conferences and conferences sponsored by the CDIAC. He also speaks on the subject at the University of California, Los Angeles Extension Program and the University of California, Davis Extension Program.

He was a member of the Board of Education of the Laguna Beach Unified School District from 1997 to 2006 and has been a member of the City Council of the City of Laguna Beach since 2012.

After graduating from Harvard College, Mr. Whalen obtained his law degree from the Boalt Hall School of Law at University of California, Berkeley.