Staff Report
May 21, 2015

Case Study: San Diego Unified School District

ABOUT THE ISSUER

San Diego Unified School District (District) serves more than 132,000 students in pre-school through grade 12 and is the second largest district in California. The student population is extremely diverse, representing more than 15 ethnic groups and more than 60 languages and dialects. The District's educational facilities include 107 traditional elementary schools, 11 K-8 schools, 24 traditional middle schools, 28 high schools, 41 charter schools and 13 alternative schools.

The District is a large and sophisticated issuer of municipal bonds that in general, accesses the municipal capital market each year to issue general obligation (GO) bonds[1] that have been approved by a majority of local voters[2] for the purpose of constructing new facilities and renovating and repairing existing facilities. The repayment of GO bonds issued by the District is secured by a pledge of ad valorem property taxes which are levied in amounts necessary to pay principal and interest on the bonds due each year. The District also issues Tax Revenue Anticipation Notes (TRANs) to finance its short-term cash flow needs within each fiscal year.

INTERNAL CONTROLS AND POLICY

The District has a written policy manual with procedures and policy statements that outline the Board of Education's objectives and direction regarding the School's fiscal management and governance practices.

The practices and safeguards that have been implemented by the District to apply a reasonable assurance of internal control and accountability over its programs are administered through the District's Enterprise Resource Planning (ERP) system. The ERP provides the discipline and structure of the District's control environment by enforcing business process controls required pursuant to the District's policies and procedures. Approximately 94 percent of the District's financial transactions are processed through the ERP, including disbursements of bond proceeds.

The District also accounts for its financial transactions in accordance with the policies and procedures of the California Department of Education's California School Accounting Manual. The accounting policies of the district conform to Generally Accepted Accounting Principles (GAAP) as prescribed by the Governmental Accounting Standards Board and the American Institute of Certified Public Accountants.

Additionally, the District adopts its budget on an annual basis consistent with GAAP for all government funds. In accordance with state law, the Board of Education (Board) adopts a budget no later than July 1. A public hearing is conducted by the Board to receive comments prior to the adoption of an annual budget.

Lastly, the tone at the top of the District's organizational culture is established by the Board pursuant to a Memorandum of Conduct that requires the district to uphold the highest ethical standards in all of its professional operations and relationships.

---

[1] California Education Code Section 15140 et seq. authorizes school districts to issue voter approved bonds.

[2] Article XVI, Section 18 of the State Constitution requires local government to obtain two-thirds (supermajority) of the popular vote to approve debt secured by ad valorem property tax. In 2000, Proposition 39 authorizes school district bonds for repair, construction or replacement, if approved by 55 percent of the local voters.

MANAGEMENT OF BOND PROCEEDS

Pre-Issuance. The District administers a multi-billion dollar capital improvement program funded by two General Obligation (GO) bond measures--Propositions S and Z. Proposition S is a $2.1 billion GO bond measure passed on November 4, 2008. Proposition Z is a $2.8 billion GO bond measure passed on November 6, 2012. The district does not receive all the bond funds at once. The District receives a portion of bond proceeds periodically based on when the bond sales occur. Bonds are issued pursuant to a phasing plan for bond projects, approved by the Board and implemented by the District's Facilities Planning and Construction Division to manage capital improvements.

The District also works with its financial advisor and bond counsel to develop a bond project plan and to coordinate the timing of bond sales. The bond project plan is reviewed by the Board on a semi-annual basis[3] to confirm the District's capital improvement projects are properly aligned with the Board's priorities to modernize school sites, maximize opportunities to use grant funding, and to emphasize projects that provide safer, innovative and equitable facilities throughout the District.

As a direct issuer of debt, the District selects its bond financing team including, but not limited to, bond counsel, disclosure counsel, financial advisor and senior managing underwriter. Furthermore, the San Diego County Treasurer (County Treasurer), as a fiduciary partner and a fiscal resource to the San Diego County Office of Education, is a member of the district's bond financing team and assists with bond transactions as follows:

- Assist with the development of the appropriate financing structure
- Review bond documents
- Participate on underwriter's market pricing calls
- Manage bond proceed according to the bond resolution requirements

Prior to the issuance of bonds (also referred to as a bond closing), the District requests that its Board approve the resolution (Bond Resolution) authorizing the bond issuance and applicable bond documents. The District's management team, in conjunction with bond counsel and disclosure counsel, provide one-on-one briefing meetings with the Board members on Securities Laws and Disclosure Guidelines.

The Independent Citizens Oversight Committee (ICOC) is also advised of the District's plan for bond issuances and offers advice on how each issuance is managed. While the ICOC has no direct role in the approval process, in prior bond financings, it has provided counsel to the District and was instrumental in the decision to use short-term bond series for short-term life equipment purchases.

Issuance Process. Having assembled a team, the District works with team members to work out the details of the debt structure and prepare bond documents. For the District's GO bonds, a Board approved Bond Resolution is the document that includes the provisions and covenants controlling the deposit and cash flow of bond proceeds. The District works closely with bond counsel, disclosure counsel, financial advisor, County Treasurer, and district management and staff to provide accurate information with respect to the Preliminary Official Statement and Official Statement, the Bond Resolution, and all corresponding bond documents.

[3] The School's project plan is reviewed by the Board in June, prior to the start of the fiscal year and again in December, prior to the start of the calendar year.

In a typical bond issuance transaction, bond proceeds are deposited in a capital project or building fund[4] with the County Treasurer, serving as a third-party Paying Agent.[5] The role of the County Treasurer is to oversee and control bond proceeds, including disbursements, pursuant to the terms and conditions of the Bond Resolution. An officer's certificate or requisition approved by the District's Chief Financial Officer (CFO) is utilized to instruct the County Treasurer to disburse bond proceeds. A Fiscal Agent agreement with the County Treasurer is also approved by the Board which allows for payment of services related to the issuance. The Bond Resolution also documents anticipated fees that are reviewed by the CFO when invoices are approved by the district prior to payment by the County Treasurer.

Post-Issuance. The management of bond proceeds is administered by the district through its ERP. The ERP establishes the internal control for the disbursement of bonds funds through a system of checks and balances that assigns responsibilities to different staff so that no one individual controls the transaction. An audit trail is automatically created by the ERP to accurately document the transaction and ensure prompt payment.

Furthermore, the ERP is integrated with a project management application for managing expenditures and contract change orders for capital improvement projects and business intelligence software that allows Finance staff to routinely monitor budget balances and work with their assigned cost center managers when problems are noted.

The District also uses the ERP's enhanced reporting capabilities to ensure members of the ICOC, Board, management and staff are provided with quality information necessary to monitor and assess performance and to promptly resolve issues, including findings of audits and other reviews. Examples of how the enhanced reporting in the ERP allows the District to verify sufficiency of accounting and budget controls and to provide transparency as described below.

- **Proposition S & Z Commitment Planning Report.** The commitment planning report provides the project plan (Plan) for several years and for each planned bond sale series and shows which projects will start construction at each school. The report serves as the baseline to track the actual performance against the Plan. Each project is listed and grouped based upon the type of work that will be accomplished. Each project is listed with the corresponding voter ballot book page numbers to align the work at the project to the items that the voter's approved at the ballot.

  The commitment planning report allows the District to constantly monitor the Plan and ensure that no bond series commitment exceeds its value and that a positive fund balance is maintained.

- **Budget Amendments and Status Reports.** The District reports all budget amendments that increase or decrease revenue and transfers of funds within or between major accounts to the Board on a monthly basis.

[4] Bond funds and accounts established with the County Treasurer are approved by the School's Board by resolution.

[5] The County Treasurer also serves as the District's Transfer Agent, Bond Registrar and Investment Manager of bond proceeds.

- **Expenditure Monitoring.** The District utilizes cash projection and expenditure reporting to track project expenditures on a monthly basis. Expenditures are reconciled each month by staff in Accounts Payable and the information is used by Financial Accounting to monitor the spend-down of bond proceeds.

On-going. Budgetary projections and other fiscal methodologies are employed by the District during the year to manage budgeted funds and to ensure expenditures do not exceed appropriations, including, but not limited to, utilizing controls within the District's ERP to control encumbrances and prevent overspending and control positions to prevent overstaffing.

At the end of each fiscal year, the Superintendent of Public Education (Superintendent) submits a comprehensive annual financial report (CAFR)[6] for the preceding year to the Board for approval and advises the Board on the District's financial condition through statutory reporting,[7] such as the First and Second Interim reports.

In addition, the Board's Audit and Finance Committee (Committee) reviews and monitors the District's external audit process and provides outside professional expertise to the Board and Superintendent. The Committee reviews and monitors the timing and scope of internal and external audit activities, the implementation of effective internal controls by District management and thorough management response to audit findings on a timely basis. The Committee may review the district's provisional and final budgets, interim financial reports and other financial documents as needed and as deemed appropriate by the Committee. Its recommendations regarding audit exceptions and other items are provided in writing to the Board and the Superintendent.

In compliance with Proposition 39, the District conducts an annual, independent performance audit to ensure that funds have been expended only on the specific projects listed in the measures as well as an annual, independent financial audit of the proceeds from the sale of the bonds until all of the proceeds have been expended for facilities projects. Both audits are submitted to an ICOC and the Board for acceptance and approval. The District maintains a separate web page for its Board and ICOC with significant archives available on both web pages.

The District also maintains a Fraud Hotline for employees and provides a link to a web reporting system that allows for confidential and anonymous reporting of illegal and unethical activities in the work place. The Fraud Hotline is staffed with trained, independent professionals that answer calls 24 hours, seven days a week. Callers are guaranteed confidentiality and can choose to remain anonymous. The voice mail system does not have caller ID enabled and no effort will be made to identify the caller. The caller will be given a case number and can follow-up on the status of his/her report. Information provided by the caller is summarized and forwarded to the School's Office of Internal Audit for confidential follow-up.

ROLES AND RESPONSIBILITIES IN THE ISSUANCE AND MANAGEMENT OF BOND PROCEEDS

Governing Board. The Board of Education consists of 5 members that are nominated by geographic sub-districts and elected by the entire school district for a term of four years. The Board provides the policy

[6] Financial statements are prepared using the economic resources method and modified accrual basis of accounting.

[7] California Education Code Section 42130 requires the reporting of financial and budgetary status for the period ending October 31 and the period ending January 31.

and financial oversight for the School, including the approval of resolutions authorizing the issuance of voter approved debt and controlling bond and disclosure documents. The Board also provides direction to the Superintendent through written policies that define the organizational results to be achieved for students and define operational conditions and actions to be accomplished or avoided.

The Board has established several committees to carry out its governance activities, including, but not limited to, an Audit and Finance Committee that meets every two months to provide the Board with separate and intensive oversight of the internal and external audit functions of the District.

Oversight Committee. The Board also appoints members to an ICCOC, legally required by state law,[8] to actively review the proper expenditure of Propositions S and Z funds, and inform the Board and the public concerning expenditures of bond proceeds. Proposition S and Z funds must be used for the projects listed in the bond language placed before the voters, and cannot be used for teacher or administrative salaries.

The ICOC is comprised of 13 volunteers appointed by the Board. The ICOC has established three subcommittees (Executive/Governance, Construction and Finance/Audit) to carry out its oversight activities. ICOC and subcommittee meetings are open to the public. Unless otherwise noted, ICOC meetings are held each month.

Executive Management. Pursuant to the Board's Governance Policy, the Superintendent of Public Instruction (Superintendent) is the Chief Executive Officer of the district and is the Board's sole point of direction to the operational organization. The Superintendent is responsible for all matters related to the day-to-day operation of the district, within the values expressed by the Board in policy. All staff members are considered to report directly or indirectly to the Superintendent.

In addition to assisting the Superintendent with managing the day-to-day operation of the district, other executive and senior management, including, the Chief Operations Officer (COO),[9] Executive Director of Facilities Planning and Construction, and Chief Financial Officer are responsible for the design, implementation and operating effectiveness of the School's internal control system. Each division within the School's organizational structure manage separate but interrelated responsibilities for the internal control and accountability of district funds that reduce the risk of error, misuse or fraud.

Procurement Management. The mission of Strategic Sourcing and Contracts is to manage and control contracting for construction, professional services, materials, commodities, supplies, equipment and services required to support schools and departments. Based upon these contracts, this department authorizes the acquisition of the required goods and services by release of purchase orders; thereby encumbering budgeted funds. Contracts must be approved by the Board prior to execution. By employing best practices through competition and negotiation, Strategic Sourcing and Contracts accomplishes cost containment, cost savings and cost avoidance resulting in the lowest prices and best values for the School and its taxpayers.

[8] Education Code Section 15278 requires a school district to establish a Citizens' Oversight Committee for voter approved bond measures.

[9] The COO manages the Business Operations Division, including procurement activities performed in the Strategic Sourcing and Contracts Department.

Construction Management. The mission of the Facilities Planning and Construction (FPC) Division is to design and construct clean, safe, environmentally friendly facilities that encourage successful teaching and learning. FPC manages the implementation of the district's multi-billion capital improvement program, including two types of projects: (1) Capital facilities bond projects, which are typically large and complex, and funded by general obligation bond funds approved by the San Diego voters, and (2) Physical Plant Operations facility. FPC is responsible for quality assurance through the control of construction contracts including, the approval of changes orders and invoices for the School's capital improvement projects.

Financial Management. The vision of the Finance Division is to offer "high tech/high touch" financial services to its partners to help ensure efficient use and reasonable assurance of internal control of district resources. Managed by the CFO, the Finance Division is segregated into separate departments and units that each perform internal control and accountability activities including, Financial Reporting, Financial Planning and Development, Accounts Payable, Fiscal Control,[10] Financial Accounting,[11] Payroll and Benefits.

Personnel. San Diego Unified School District has over 17,000 (full time and hourly) employees, including approximately 6,600 teachers. Under the general direction of management, personnel perform duties related to the day-to-day operations of the District pursuant to written policies and administrative procedures that are posted on the District's website.

[10] Fiscal Control performs audits, manages payroll/tax withholdings and reconciles third-party administered bank accounts.

[11] In addition to internal and external reporting, Financial Accounting also oversees the investment of public funds, issuance of debt, cash management, accounts receivables, billings, revenue and Federal Impact Aid survey cards, and all related forecasts.

Case/Policy Study: City and County of San Francisco

About the Issuer

The City and County of San Francisco (City) is a frequent issuer in the municipal market, issuing on behalf of itself and the City and County of San Francisco Finance Corporation (Finance Corporation). The city utilizes three l types of municipal debt obligations to finance long-term capital projects and the acquisition of select equipment: general obligation bonds (GOs), lease revenue bonds, and certificates of participation (COPs). In anticipation of the long-term issuance of such obligations, the City has established a commercial paper program to provide initial low costs financing for certain of its capital projects. As of April 1, 2015 the City had approximately $3.09 billion of its long-term debt obligations outstanding.[12]

To serve a population of approximately 836,620,[13] the City issues its GOs to leverage property tax receipts for voter-approved capital expenditures, including the construction and/or acquisition of improvements to real property and/or real property improvements broadly available to the residents and visitors of the City. Such facilities include, but are not limited to, libraries, hospitals, parks, and cultural and educational facilities. Lease revenue bonds and COPs are used to leverage other general fund receipts to finance capital projects and acquisitions, many of which provide a direct revenue benefit or cost savings to the City.

The City's adopted budget for fiscal years 2014-15 and 2015-16 totals $8.58 billion and $8.56 billion, respectively with the General Fund portion of each year's adopted budget is $4.27 billion in fiscal year 2014-15 and $4.33 billion in fiscal year 2015-16 - the balance is allocated to all other funds, including enterprise fund departments, such as San Francisco International Airport, the Municipal Transportation Agency, the Port of San Francisco and the Public Utilities Commission.[14]

Internal Controls and Policy

In developing and evaluating the City's accounting system, consideration is given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding: (1) the safeguarding of assets against loss from unauthorized use or disposition, and (2) the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the evaluation of costs and benefits requires estimates and judgments by management. All internal control evaluations occur within the above framework. The City's

---

[12] *Outstanding Debt & Long Term Obligations*, www.sfcontroller.org.

[13] California Department of Finance, *E-1 Cities, Counties, and the State Population Estimates with Annual Percent Change— January 1, 2013 and 2014*, May 2014, www.dof.ca.gov.

[14] *Consolidated Budget and Annual Appropriation Ordinance*, Adopted Budgets: Fiscal Years 2014-15 and 2015-16 www.sfcontroller.org.

financial auditors regularly review and test the City's financial internal accounting controls. The City's internal accounting controls are believed to adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

The City maintains budgetary controls to ensure that legal provisions of the annual budget are in compliance and expenditures do not exceed budgeted amounts. Controls are exercised by integrating the budgetary accounts in fund ledgers for all budgeted funds. An encumbrance system is also used to account for purchase orders and other contractual commitments (bond funded projects). Encumbered balances of appropriations at year-end are carried forward and are not re-appropriated in the following year's budget. The City has historically adopted annual budgets for all governmental funds and typically adopts project-length budgets for capital projects and certain debt service funds.

In November 2009, voters adopted amendments to the City's Charter to further strengthen the City's long-range financial planning. As a result of these changes, the City adopted two-year budget for all funds for the two upcoming fiscal years in July 2012. The Charter requires that the City adopt a "rolling" two-year budget each year unless the Board of Supervisors authorizes a "fixed" two-year budget appropriation for a given fund, in which case authorization occurs every two years. As further required by these amendments, the Board of Supervisors (Board) and Mayor adopt a five-year financial plan every two years. The most recent plan was adopted in April 2015. Additionally, these Charter changes provided a mechanism for the Controller to propose, and the Board to adopt, various binding financial policies, which can only be suspended by a supermajority of the Board. Financial policies have been adopted under these provisions for City budget reserve practices, the use of non-recurring revenues, and limits on the use of debt paid from the General Fund.

The City's Debt Policy establishes policies and procedures for financings under the jurisdiction of the Controller's Office of Public Finance (OPF) and pertains to all obligations payable from the City's General Fund. The purpose of the Debt Policy is to establish debt policy objectives, improve the quality of decision making processes, and provide a basis for the determining appropriate debt structures and commit to the best practices in municipal debt management planning and execution. The Debt Policy is intended to guide the OPF in the issuance and management of bonds and other obligations.[15]

MANAGEMENT OF BOND PROCEEDS

The internal controls and policy described above are integrated into the management of bond proceeds. The management of bond proceeds starts long before bonds are issued.

[15] The Policy does not apply to other departments or enterprises of the City, including the Airport Commission, the Mayor's Office of Housing, the Municipal Transportation Authority, the Port Commission, or the Public Utilities Commission.

Pre-issuance. OPF begins working with the sponsor department early in project development to identify potential issues early and work through them. Along with the other City offices[16] that will be involved in the management of bond proceeds, these meetings help determine the scope of the project and to set-up a financing timeline. For GO's that will be placed before voters, these meetings help define the project to be placed on the ballot. After the voter approval prior to bond issuances sponsor departments are given three documents:

- Project Diligence. Project information checklist. This comprehensive checklist requires the sponsor department to describe the project in detail, including an assessment of existing facilities, identify sources and uses of project funds, estimate project construction schedule, and identify potential tax issues.
- Project Diligence. Tax questionnaire. The sponsor department uses this form to help determine the nature of the project (taxable or tax-exempt) - identifying potential tax issues early helps the City in structuring the financing appropriately (to avoid any IRS tax issues post-issuance).
- Requisition Controls. Bond proceeds (disbursement) request (includes draw down schedule). The sponsor department identifies the timing of when bond proceeds will be used. This information helps determine when bonds funds are needed so that the City issues bonds when needed.[17]

The information gathered at this initial planning stage identifies the project, eligible costs, and tax constraints.[18]

As noted earlier, the City typically adopts project-length budgets for capital projects and certain debt service funds – during this initial planning phase, the Controller's Office and the sponsor department begins development of the necessary budget appropriation for a bond funded project. These budgetary accounts integrate into fund ledgers for all budgeted funds as described in the City's internal controls.

Pursuant to the City's Administrative Code all long-term financing (repayment obligation beyond one fiscal year) for proposed capital improvements shall be reviewed and approved by the City's Capital Planning Committee (CPC) prior to being presented to the Board for approval.[19]

Proposed long-term financings are subject to the following:

---

[16], Budget Analyst, Board of Supervisors, Citizen's GO Bond Oversight Committee, Clerk of the Board, Controller's Office, The Controller's Office, Office of Public Finance (OPF), Capital Planning Program, City Attorney's Office, Sponsor Department (for example Library, Hospital), and Treasurer – roles and responsibilities of these offices are defined in this staff report.

[17] At this time OPF also provides the sponsor department with the information that will be required to request a disbursement of bond funds – preparing the department for future disbursement requests.

[18] Bond counsel assists the City with the tax certificate.

[19] *Debt Policy of the City and County of San Francisco*, www.sfcontroller.org, June 2013

- *Board of Supervisors*: The Board of Supervisors shall not place on the ballot or authorize the issuance of any long-term financing until the CPC completes its review of the proposed project and project financing and submits its recommendation to the Board of Supervisors.

- *Form of Proposal*: Each proposal shall be in form and substance satisfactory to the CPC, and shall be accompanied by descriptive financial, architectural, and/or engineering data, and all other pertinent material in sufficiently complete detail to permit the CPC to review all aspects of the proposal.

- *Capital Expenditure Plan*: The CPC shall submit a written report to the Mayor and the Board analyzing the feasibility, cost, and priority of each proposal relative to the City's capital expenditure plan.

The Board of Supervisors Budget and Legislative Analyst (Budget Analyst) also prepares a report for the Board of Supervisors that analyzes the fiscal impact of the bonds.

Pursuant to the City's Administrative Code, each department requesting issuance of voter-approved GO bonds shall file a Bond Accountability Report 60 days prior to the approval by the Board of the sale of the bonds.[20] This Report shall detail original and current budget expenditure information for each project line item identified in any previous report. The Bond Accountability Report shall be filed with the Clerk of the Board, City Controller, City Treasurer, Director of OPF, Budget and Legislative Analyst of the Board with a copy to the Chair of the Citizens' General Obligation Bond Oversight Committee.[21] The obligation to file such report is the responsibility of the sponsor department.

According to the City's Debt Policy, the Director of OPF shall determine whether proposed debt transactions comply with the debt limitations prescribed by the Debt Policy. Proposed debt transactions that meet the limitations of the Debt Policy will be subject to approval by resolution or ordinance of the Board and by the Mayor as prescribed by State law, the City Charter and the City Administrative Code.

In the event the Director of OPF and the Controller determine any proposed debt transaction exceeds the limits imposed pursuant to the City's Administrative Code, the Board may approve the transaction by a two-thirds majority vote, subject to the City Charter and the City Administrative Code.

Issuance Process. All long-term financing transactions are approved by resolution or ordinance of the Board and approved by the Mayor. Bonds with prior approval for issuance by the voters will not be issued until the plan of finance has been reviewed by the CPC and approved by the Board. When the Board approves a financing, it approves the form of and authorizing the

[20] City and County of San Francisco, Administrative Code, Chapter 2 Article VIII (Section 2.70 *et seq.*)
[21] Debt Policy of the City and County of San Francisco, www.sfcontroller.org, June 2013, pg. 9.

distribution of the Preliminary Official Statement (POS), supporting bond documentations and a supplemental appropriation, the expenditure authority that details the appropriate bond structure, description and amount to be established within the City's General Ledger systems.[22] After issuance, depending on the type of obligation, bond proceeds will be deposited in the City's Treasury (GO bonds) or with a 3rd party Trustee (COPs). Even though the bond proceeds are kept with a Trustee in a COP transaction, the City sets up a bond fund account to track expenditure activity against the bond proceeds. While no proceeds are placed in the account, bond proceeds and expenditures are booked against the account as a method to reconcile the funds against statements from the Trustee. When setting up bond accounts (for any financing) due diligence is conducted on the expenditure eligibility as part of the Board appropriation process.

Post- Issuance. The Director of Public Finance, together with the Controller's Office and applicable City departments, are responsible for:[23]

- Monitoring the use of Bond proceeds and the use of Bond-financed or refinanced assets (e.g., facilities, furnishings or equipment) throughout the term of the Bonds to ensure compliance with covenants and restrictions set forth in any tax agreement relating to the Bonds;
- Maintaining records identifying the assets or portion of assets that are financed or refinanced with proceeds of each issue of Bonds, including a final allocation of Bond proceeds as described below under "Record Keeping Requirements";
- Consulting with bond counsel and other legal counsel and advisers in the review of any contracts or arrangements involving use of Bond-financed or refinanced assets to ensure compliance with all covenants and restrictions set forth in the Tax Agreement relating to the Bonds;
- Maintaining records for any contracts or arrangements involving the use of Bond-financed or refinanced assets as described below under "Record Keeping Requirements";[24]

[22] The resolution provides the amount to be issued, permitted investments, and lists the accounts to be established, i.e. Debt Fund, Cost of Issuance accounts.
[23] Debt Policy of the City and County of San Francisco, www.sfcontroller.org, June 2013, pg 23.
[24] The Director of Public Finance, through the Controller's Office or other applicable City department, shall be responsible for maintaining the following documents for the term of each issue of Bonds (including refunding Bonds, if any) plus at least three years: a copy of the Bond closing transcript(s) and other relevant documentation delivered to the City at or in connection with closing of the issue of Bonds, including any elections made by the City in connection therewith; a copy of all material documents relating to capital expenditures financed or refinanced by Bond proceeds, including (without limitation) construction contracts, purchase orders, invoices, trustee requisitions and payment records, draw requests for Bond proceeds and evidence as to the amount and date for each draw down of Bond proceeds, as well as documents relating to costs paid or reimbursed with Bond proceeds and records identifying the assets or portion of assets that are financed or refinanced with Bond proceeds, including a final allocation of Bond proceeds; a copy of all contracts and arrangements involving the use of Bond-financed or refinanced assets; and a copy of all records of investments, investment agreements, arbitrage reports and underlying documents, including trustee statements, in connection with any investment agreements, and copies of all bidding documents, if any.

- Conferring at least annually with personnel responsible for Bond-financed or refinanced assets to identify and discussing any existing or planned use of Bond-financed or refinanced assets, to ensure that those uses are consistent with all covenants and restrictions set forth in the Tax Agreement relating to the Bonds; and
- To the extent that the Borrower discovers that any applicable tax restrictions regarding use of Bond proceeds and Bond-financed or refinanced assets will or may be violated, consulting promptly with the City Attorney's Office, bond counsel and other legal counsel and financial advisors to determine a course of action to remediate all nonqualified bonds, if such counsel advises that a remedial action is necessary.

Disbursement requests are just in time (electronically) and originate with the sponsor department's accounting staff who up load request to system. OPF receive requests from sponsor departments, log them in, validate them against the bond documents, and ensure there is budget appropriation - debt service payments are annually appropriated for in the City's Budget. In addition to OPF's periodic bank statement reconciliation, the Bond Accounting Unit within the Controller's Office conducts reconciliation activities. A disbursement request includes the following:

- Description of each project line for disbursement
- Amount
- Payee information
- Support documentation including but not limited to, invoices, purchase order, line item expenditure, etc.

Bond disbursement requests must be signed by the Controller and/or, Director of Public Finance, the department head or Chief Financial Officer and Project or Program Manager of the Sponsor Department– the amount of the request and all signatures must be on the same page. There are also reporting requirements to the Citizens GO Bond Oversight Committee.

After bond issuance, the City continuously audits bond proceeds. Disbursement requests are sent to audit accountants that verify costs against contracts. Sponsor Departments must file a bond accountability report with the Clerk of the Board, City Controller, City Treasurer, Director of OPF, Budget Analyst with a copy to the Chair of the Citizens' General Obligation Bond Oversight Committee at least 60 days prior to the next bond issuance.

On-going. Aspects of the City's ongoing operations contribute to the management of bond proceeds:

The City's Debt Policy requires that City officials or employees shall attend disclosure training sessions as provided in the City's Disclosure and Procedures.[25] Staff involved in debt issuance receives annual training.

[25] Debt Policy of the City and County of San Francisco, www.sfcontroller.org, June 2013, pg. 21.

OPF maintains current and past bond sale information online. Final official statements in PDF format are posted online for recent and upcoming bond sales.[26] Past disclosure reports, Official Statements and other disclosure documents issued prior to June 30, 2007 and secondary market disclosure announcements are also archived online.[27]

The City Services Auditor in the Controller's Office maintains a whistleblower complaints hotline and website and conducting investigations regarding waste, fraud, and abuse of City resources.

Roles and Responsibilities in the Issuance and Management of Bond Proceeds

As detailed above the issuance and management of bond proceeds is a collective effort that involves the Budget Analyst, Board of Supervisors, Capital Planning Committee, Citizen's GO Bond Oversight Committee, Clerk of the Board, Controller's Office, the Controller's Office, Office of Public Finance (OPF), City Attorney's Office, Sponsor Department (for example Library, Hospital), and Treasurer, the role and responsibility of each City office in the management of bond proceeds is detailed below:

Board of Supervisors Budget and Legislative Analyst (Budget Analyst). The Budget Analyst prepares a report to the Board prior to approval of the resolution authorizing the financing details that includes the fiscal impact of the financing on the city.

Board of Supervisors (Board). The Board approves all bonds issued by the City that are managed by the Public Finance Office. The Board approves the authorizing legislation (resolution and/or ordinance) for any bond issue, and such authorizing legislation sets forth the board authorizing parameters for the bonds and also approves supporting documentation including trust indentures, leases, Preliminary Official Statement (POS), purchase contracts and other supporting agreements.

Capital Planning Committee (CPC). All long-term financing for proposed capital improvements is reviewed and approved by the City's CPC prior to being presented to the Board for approval. The CPC consists of the City Administrator as chair, the President of the Board, the Mayor's Finance Director, the Controller, the City Planning Director, the Director of Public Works, the Airport Director, the Executive Director of the Municipal Transportation Agency, the General Manager of the Public Utilities System, the General Manager of the Recreation and Parks Department, and the Executive Director of the Port of San Francisco.

Citizen's GO Bond Oversight Committee. In 2002, City voters adopted Proposition F, the Citizen Oversight of Bond Expenditures Initiative that established a committee of nine members for the

[26] Office of the Controller, Documents, Primary Market Disclosure/Final Official Statements & Upcoming Sales; www.sfcontroller.org

[27] Office of the Controller, Documents, Financial Documents – Archive; www.sfcontroller.org.

purpose of informing the public concerning the expenditure of general bond proceeds through active review and the publishing of regular reports.

On November 4, 2003, the voters added to the duties of the Committee by approving Proposition C, to add to the duties of the Committee by requiring that it serve as a Citizens Audit Review Board. In this role, the Committee provides advisory input to the Controller on matters set forth in the Ordinance, including requiring that the Committee: 1) review the Controller's service standards and benchmarks to ensure their accuracy and usefulness; 2) review all audits to assure they meet requirements set forth in the Ordinance; 3) review complaints received through the Controller's Whistleblower Hotline and their disposition; and 4) when appropriate, hold public hearings regarding the results of benchmark studies and audits.

City Attorney's Office. The City Attorney provides support to the Office of Public Finance in connection with the issuance of City debt obligation. The City Attorney's office works with bond counsel to ensure that City bonds are issued in accordance with the City's charter and state law. The City Attorney's office also works with disclosure counsel to ensure that the City complies with its disclosure obligations under the federal securities laws.
Controller. As the chief accounting officer and auditor for the City and County of San Francisco, the Controller is responsible for financial systems, procedures, internal controls and reports on the City's fiscal condition. The Controller conducts financial and performance audits of departments, agencies, concessions and contracts. In addition, the Controller provides a variety of support services that include processing the City budget and maintaining the City financial accounting information system. The Bond Accounting Unit within the Controller's Office is responsible the appropriated set up of bond fund structure in the City's General Ledger system, and facilitating the external audit review of bond funds to ensure they are being spent in accordance with bond documents/resolution/contracts.

Controller's Office, Office of Public Finance (OPF). OPF issues and manages the City's general fund backed debt portfolio.[28] Its mission is to provide and manage low-cost debt financing of large-scale, long-lived capital projects and improvements that produce intergenerational social and economic benefit to the City and its citizens while balancing market and credit risk with appropriate benefits, mitigations and controls. OPF is involved in all aspects of the issuance and management of bond proceeds. OPF works on the initial stages of the development of the financing and is responsible for determining the timing and amount needed as well as facilitating the budget appropriation necessary for a sponsor department to spend bond funds - debt service requires an annual budget appropriation. An important bond proceeds management function performed by this office is the reconciliation of Trustee reports against

[28] All references summarized in this report are for the City's Office of Public Finance and do not include the Mayor's Office of Housing, San Francisco Airport Commission, San Francisco Community College District, San Francisco Housing Authority, San Francisco Port Commission, San Francisco Public Utilities Commission, Successor Agency to the San Francisco Redevelopment Agency, San Francisco Municipal Transportation Agency, or the San Francisco Unified School District.

the City's accounting report. OPF is one of five signatures required for the disbursement of bond funds.

Office of the Treasurer and Tax Collector (Treasurer). The Treasurer serves as the banker, tax collector, collection agent, and investment officer for the City. The Treasurer is paying agent when the City issues a GO bond.

Sponsor Department. The department responsible for the project to be financed with bond funds. Examples of sponsor departments include the City's General Hospital and the City's Library. The sponsor department is responsible for reporting quarterly bond report to OFP that contain the status of the project and the amount of bond funds spent. This department is responsible for submitting a Bond Accountability Report to the OPF prior to issuing subsequent bonds.

Case Study: West Basin Municipal Water District

ABOUT THE ISSUER

West Basin Municipal Water District (District) is a special district[29] of the State of California that provides drinking and recycled water, water efficiency and water education programs to approximately one million residents within its 185-square mile service area. The District is a member agency of the Metropolitan Water District of Southern California (MWD). It purchases imported water from the MWD and sells the water to cities, water agencies, and private water companies in coastal Los Angeles County. The District purchases secondary effluent from the City of Los Angeles, to treat and produce recycled water for sale to certain retail water suppliers both within and outside the boundaries of the District for non-potable consumption, and to the Water Replacement District of Southern California for groundwater replenishment. The District also operates a groundwater desalter to produce potable water.

District revenues are derived from water sales and charges, fixed revenues, conservation income and interest income. The two primary sources are imported and recycled water sold to its customer agencies. Imported sales represent 68 percent and recycling sales represent 21 percent of all revenue sources[30]. Other revenues are from fixed revenue charges and a Standby Charge, approved by West Basin's Board of Directors.

The District is a small but frequent issuer.[31] It has issued public enterprise revenue bonds (Revenue Bonds) and certificates of participation (COP)[32] to finance water facilities and other capital improvements for water infrastructure.[33] Revenue Bonds are repaid from the revenue stream produced by the facility or enterprise financed by the bonds. Similarly, COPs are repaid from revenues in the form of installment payments from West Basin's enterprise fund. The District also uses a commercial paper program to finance projects determined to have a short useful life.

INTERNAL CONTROLS AND POLICY

The District's Board of Directors (Board) has approved a number of financial policies[34] to effectively manage the agency. Each of the financial policies supports assumptions within a Long-Range Financial Model developed by West Basin to incorporate the existing budget, incorporate future capital costs, and make certain budgetary assumptions. These assumptions include water sales, operating expense increases, water rates, capital project funding, designated funds, and debt coverage. The model provides the District with a financial outlook while addressing key business objectives. In addition, the Long-Range Financial Model ensures West Basin develops or modifies financial policies to sustain fiscal integrity into the future. Other non-financial policies are maintained by the District through its Administrative Codes and are reviewed periodically to ensure compliance with legal statutes and other

[29] West Basin Municipal Water District is the sixth largest water district in the State of California.
[30] Total budgeted revenues for Fiscal Year 2014-15 are $196,915,035.
[31] Since the early 1990's, West Basin has received more than $420 million in construction proceeds through fixed and variable debt issuances.
[32] COPs are issued by the District to provide payment flexibility related to its Commercial Paper program.
[33] The District has the statutory authority to issue debt, including Revenue Bonds and COPs, pursuant to California Water Code.
[34] Policies adopted by the Board include Budget, Capitalization, Debt Management, Investment, Designated Funds (Reserves), Procurement, Stand-by Charge, Swap, and Risk Management.

considerations. All recommendations for new or revised policies are brought to the Board for consideration and adoption.

The District has adopted a Strategic Business Plan (Plan) that outlines the strategies, programs and activities necessary to effectively implement the Board's directions. The Plan was updated in August 2011 to reflect the mission, goals and objectives that were reassessed through a series of interviews with the Board, management and key stakeholders. The Plan provides continuous direction for each year's planning, budgeting, implementation, evaluation and reporting and sets the overall policy direction and strategic priorities established by the Board.

In addition, the District's annual budget is developed in accordance with the priorities, goals and objectives established by the Board through its Strategic Plan. Interested parties, such as bond holders, credit rating agencies, and customers can review the budget to obtain a wide variety of information on the District's short- and long-term strategic planning, financial policies, and the current and future fiscal stability. The budget reflects how the District invests its revenues derived from user fees and fixed revenue sources to support its mission, goals and programs.

In Fiscal Year 2009-10, the District formalized a Debt Management Policy that provides guidance on the issuance, management, evaluation and reporting of debt obligations. This policy also incorporates the capital assumptions to fund a variety of projects identified in other District planning documents. While the District does not have a legal debt limit due to its ability to raise its water rates and charges, it does have debt coverage requirements required in controlling bond documents applicable to each debt issuance[35].

To integrate financial management policies, project priorities and administer a reasonable assurance of internal control for project and resource management, the District uses an Enterprise Resource Planning (ERP) system. The ERP system facilitates the structure and discipline of the control environment by enforcing business process controls required by the District's Procurement Policy and procedures.

The tone at the top of the District's organizational culture is established by the Board pursuant to a Code of Conduct that requires the District to uphold the highest ethical standards in all of its professional operations and relationships.

MANAGEMENT OF BOND PROCEEDS

Pre-Issuance. A capital improvement program is administered by the District to plan for the construction of water facilities or the replacement and refurbishing of water infrastructure that will allow it to effectively respond to current and potentially long drought conditions, imported water uncertainty, and regulatory restrictions. Capital projects begin with feasibility studies and design estimates followed by construction contracts.

During its budget development process, the District reviews its upcoming capital improvement projects and determines how each project will be funded. The District recognizes that funding for a capital improvement project can be significant and may need to come from multiple sources. When determining the source of funding, several factors are considered such as the useful life of the future asset, the anticipated cost of the project, if there are potential grant opportunities, and whether the

[35] The District retains a financial advisor, bond counsel and other professional services on an on-going basis to assist with post-bond issuance compliance requirements.

customer will be contributing and the timing of the customer's contribution[36]. The District works with a team of financial advisors to identify and evaluate potential new construction proceeds or refunding opportunities. In addition, the District reviews its debt structure to ensure an overall level debt structure is maintained and aligns with the expected service life of the capital assets. Projects that are funded by the issuance of debt include:

- Capital assets with a short useful life funded through a Commercial Paper program.
- Capital assets with a long useful life funded by a state loan, COPs or Revenue Bonds.

The District's Board has adopted a Capitalization Policy to provide guidance for the capitalization and depreciation of capital assets. The intent of the policy is to ensure the District remains in compliance with Governmental Accounting Standard Board requirements and includes methods and procedures to be used in effectively identifying, recording and reporting the District's capital assets on its financial statements.

Through the ERP system the District managers have access to "real-time" data status. Managers use this information as well as any other pertinent information on the status of their specific project to write and present periodic updates to the Board. On a monthly basis, an overall capital improvement program update is given to the Board that summarizes multiple ongoing projects that are either under construction, in design or in early planning stages. The update includes the amount and percentage of approved change orders, the total contract amount, the amount invoiced to date and the expected completion date.

To meet the Board's strategic objectives, the District has created the Water Reliability 2020 (WR 2020) Program that will double conservation efforts, double recycled water deliveries, and incorporates ocean-water desalination in the District's water portfolio by the year 2020. As the District moves forward with supporting its WR 2020 program, the need to issue debt to fund investments in its infrastructure increases.

As a direct issuer of debt, the District selects its bond financing team including, but not limited to, bond counsel, disclosure counsel, financial advisor and senior managing underwriter. All team members are selected through a competitive process and approved by the Board at least every three to five years. Having selected a team, the District works with team members to work out the details of the debt structure and craft bond documents that are necessary for the type of bond they intend to issue. For Revenue Bonds and COPs, the Indenture of Trust (Indenture) is the document that includes the provisions and covenants that control the deposit and cash flow of bond funds.

Prior to the issuance of bonds (also referred to as a bond closing), the District's bond counsel and if necessary, the financial advisor attends a Board Finance Committee meeting to educate Board members on each of the legal documents presented, the role each party is responsible for and the potential risks and benefits of the debt structure being proposed by staff. These parties are also present at the monthly Board meeting if any questions arise prior to the Board approving a resolution, authorizing the bond issuance and approving applicable bond documents.

[36] Depending on anticipated customer contributions, the District may elect to pay construction costs upfront from designated (reserve) funds and immediately invoice the customer each month for reimbursement.

Issuance Process. The proceeds from a typical District bond issuance are deposited in a project or construction fund with a commercial bank that serves as a third-party bond trustee (Trustee). The role of the Trustee is to oversee and control bond proceeds, including disbursements, pursuant to the terms and conditions of the Indenture. An officer's certificate or requisition approved by the District's Chief Financial Officer (CFO) is used to instruct the Trustee to disburse bond proceeds.

The Costs of Issuance (COI) for a bond sale are approved by the Board when the resolution authorizing the issuance and other related legal documents are approved. As invoices for COI are received from financial team members, the costs are matched to the COI approved by the Board. The invoice(s) are then approved by the CFO and forwarded to the Trustee for payment out of the COI Fund established by the Trustee. After all invoices are received and paid, the Trustee closes the COI Fund.

Post – Issuance. District management is responsible for the establishment and maintenance of internal accounting controls that ensure assets are safeguarded and financial transactions are properly recorded and adequately documented. To ensure that the costs of controls do not exceed the benefits obtained, management uses cost estimates and judgments to attain reasonable assurance as to the adequacy of such controls. Finance Department personnel are responsible for the overall accounting, finance and administrative functions, which include cash management, treasury and debt management, accumulation and processing of accounting information, financial reporting[37], information technology and contracts administration.

The management of bond proceeds is the responsibility of the Finance Division, however, pursuant to its Procurement Policy, the District's ERP utilizes separation of duty to control the disbursement of bond proceeds. Procurement staff work with the Engineering and Operations (E&O) Department to issue Purchase Orders (PO), Request for Proposals (RFP), Request for Bids (RFB) or Invitation for Quotes (IFQ), whichever form of solicitation is appropriate, with the intent of procuring goods and services of a satisfactory level of quality, delivered in a timely manner, and at a price that represents the best value to West Basin and its ratepayers. At the completion of the procurement solicitation process staff presents a recommendation to the Board for their approval to award the selected vendor, contractor or consultant with a contract.

Requisitions are prepared after the solicitation process has concluded and vendor selection is complete. The Project Manager compiles the plans and specifications with the requisition form and submits it for their Department Manager's approval. Department Managers are the first level of approval and, therefore, review and sign every requisition. Above $10,000, the requisitions also require the approval of the General Manager. Requisitions over $35,000 require the approval of the Board. Once the appropriate approvals have been obtained, the requisition is forwarded to E&O Procurement for processing and agreement administration.

On-going. Pursuant to the Debt Management Policy, the CFO keeps the Board advised on the District's debt portfolio by submitting a quarterly debt report that includes the following information:

[37] As required by Generally Accepted Accounting Principles for enterprise funds, accounts are maintained and financial statements are prepared using the economic resources measurement focus and accrual basis of accounting.

- A summary of outstanding debt obligations to include the series name, original amount of issuance, outstanding principal amount, issue date, maturity dates, interest rates, and annual debt service;
- The amount of the net variable rate obligation and percentage as compared to outstanding debt;
- Comparison of variable rates to SIFMA or by remarketing agent, if West Basin has more than one agent, to other remarketing agents, with similar programs and market indices; and
- Other Considerations, such as refunding opportunities, credit enhancement, reportable conditions, or new debt issuances, if applicable.

Finance staff also performs monthly reconciliations of funds and accounts, including bond funds, to prevent fraudulent reporting and misuse.

To manage the control of funds, the District categorizes and records its funds as either unrestricted or restricted funds. Unrestricted funds consist of designated funds that can be used for any lawful purpose at the discretion of the Board. The monies held within designated funds can be shifted or re-allocated at any time at the Board's direction. Restricted funds consist of funds with external restrictions imposed by creditors, grantors, contributors, or by laws or regulations of government and can only be used for a designated purpose. Currently, the District's restricted funds are the Bond Reserve Funds and custodial cash accounts.

The District uses its Annual Budget Report as a communication and performance measurement tool. The budget document shows how the agency invests its revenues derived from user fees and fixed revenue sources to support its mission, goals and programs. The District is not required to adopt a budget and therefore does not appropriate its fund. However, as a good business practice, the District prepares, adopts, monitors, and reports budgeted information and posts the information on its website.

The District's Board also conducts Special Board Policy workshops. Each workshop is focused on one subject matter to allow the Board and staff to thoroughly analyze the subject, receive direction, and assess next steps. At the Board's direction, staff will incorporate any financial commitment resulting from the workshops into the development of the next operating budget.

Through support and guidance from the Board, staff develop and implement a wide array of leader-focused programs to insure that the District is positioned as a valuable utility among key stakeholders. Audiences include state, county and federal elected officials, cities, partners and customer agencies, community, environmental, educational and business leaders. A number of outreach programs have been developed that reflect the value provided by West Basin, including special events, tours, and presentations. Annual water-themed events, construction outreach meetings, media tours and special delegation tours of operational water facilities continue to enhance West Basin's reputation as a world-class agency dedicated to sustainable water resource management.

Lastly, water education programs engage students about the importance of water conservation and environmental responsibility and help to inform future generations on the District's role in the community. Currently, several programs are offered to elementary school children attending both public and private schools and have expanded its programs to serve middle and high school students. The District's long-term education efforts will be focused on public tours of its operational water facilities.

ROLES AND RESPONSIBILITIES IN THE ISSUANCE AND MANAGEMENT OF BOND PROCEEDS

Governing Board. Five publicly-elected officials serve as West Basin's Board of Directors. Voters in each of the five divisions from Malibu to Palos Verdes and El Segundo to Carson, elect one director to serve a four-year term. The Board then appoints two Directors to serve on the 37-member MWD Board of Directors to represent West Basin's diverse constituent interest. The Board is responsible for overseeing the strategic direction of West Basin and obligations related to its accountability.

The Board is also responsible for setting the tone of the organization by upholding the highest ethical standards in all of the District's business and professional operations and relationships. Pursuant to a written Code of Conduct, the District carries out its mission with unquestionable ethics and integrity, the cornerstone of achieving and maintaining credibility and ensuring public trust.

Executive Management. The Board has delegated the day-to-day management of the District to the General Manager. The General Manager is responsible for ensuring the District carries out its mission pursuant to the Board approved Strategic Plan, policies and codes. To achieve this, the General Manager communicates the goals and objectives with senior staff to ensure the District's budget includes the monetary requirements necessary to achieve the goals and objectives set within the Strategic Plan.

Personnel. The District currently employs 41 full-time persons, of whom 24 work in the operations, planning, communications and engineering departments and 17 work in accounting or administration.

Duties related to the accountability of funds including, bond proceeds that are expended for capital improvements are segregated into separately controlled functions performed by personnel with expertise in procurement of goods and services, project management, and finance.