



Transmitted Via Electronic Mail

August 27, 2015

Honorable Board of Trustees
Rancho Santiago Community College District
2323 N. Broadway, 4th Floor
Santa Ana, CA 92706

Dear Board of Trustees

Please accept my report which accompanies this letter conveying my concerns over apparently material and intentional misstatement in the District's audited financial statements as well as an apparent misappropriation of public funds.

I assure you that I do not tender these allegations lightly or lightheartedly.

As a long standing public servant and public accountant, I am shocked and saddened at an apparent attempt to evade accountability over a very expensive mistake by highly placed appointed public officials under your charge.

As the Watergate Era slogan goes sometime "the cover-up is worse than the crime".

Additionally please accept this letter as a claim for fees in the amount of \$27,000.

I respectfully submit that this demand constitutes the value of fees reasonably earned by virtue of the time and effort I have in investigating this matter and in serving the public interest of promoting integrity within our systems of government.

Should the Board demure or deny my claim I am prepared to pursue a mandamus in a venue of my choice compelling a reversal of the misdeeds described in the accompanying report and the award of incidental damages; or alternatively a qui tam claim.

Accordingly, please consider this to constitute a claim pursuant to the California Government Claims Act.

Sincerely,

John P. Johns, CPA



Independent Private Accountant's Report to the Rancho Santiago Community College District Board of Trustees

Results of a self-initiated examination of District Financial Records¹

Summary of Forensic Accountant's Findings

- During fiscal year 2013-14 the Rancho Santiago Community College District Board of Trustees improperly authorized the redirection of \$16 million in District General Fund and Measure E bond funds to correct design deficiencies in the Orange Education Center which had not been discovered until September, 2012, seven years after the District declared the facility construction as being complete.
- As of June 30, 2013 and June 30, 2014 the District overstated the carrying value of its investment in plant property and equipment by \$12 million and by \$16 million respectively as a result of its failure to account for the impairment of the Orange Educational Center upon closure pending retrofitting as apparently required by the California State Architect.
- The Bond Oversight Committee annual reports for the fiscal years ended June 30, 2013 and June 30, 2014 misrepresented the status of completion of the OEC (a Measure E funded project) and failed to fairly represent the District's expectations as to future capital costs associated with the OEC.
- The District's failure to properly account for the value of its plant, property and equipment as of June 30, 2013, and resultant use of materially misstated general purpose financial statements in obtaining Measure Q bond financing constitutes a possible violation of federal securities laws which require complete and accurate financial disclosure by issuers of publicly traded municipal bonds.

I respectfully recommend that your Honorable Board of Trustees:

¹ Conducted under what I perceive to be the authority vested in me as a private citizen, pursuant to and in conformity with my understanding of the California Private Attorney General Act, and other authorities.

- Reverse the transfer of \$8.1 million in General Fund reserves to the Capital Projects Outlay Fund pending the approval of said transfer by way of a formal resolution and after a public hearing on the matter
- Assess, as is required by Governmental Accounting Standards Board Pronouncement Number 42 (GASB 42), the District's fixed assets (including the OEC) for impairment and book an appropriate accounting entry to reflect any income statement and balance sheet effect of such impairment as need be.
- Issue restated District general purpose financial statements and Bond Oversight Committee annual reports for the years ended June 30, 2013 and June 30, 2014 as necessary to fairly reflect the carrying value of and status of completion the OEC as of said balance sheet dates and to record the loss of the asset impairment recognized in the District's statement of changes in net position for the years then ended.
- Adopt policies and procedures that will ensure that the District adheres to the California Budget and Accounting manual and the Ralph M. Brown Act which require public agency resource allocation decisions be made in full view of the public.

The following are my findings in detail:

- 1. The manner by which the District Board of Trustees authorized the transfer of \$8.1 million in unrestricted General Fund reserves to the Capital Outlay Projects Fund during FY 2013-14 was inconsistent with California Administrative Code Section 58308 and the California Community College Budget and Accounting Manual.**

Whereas the California Administrative Code and the California Community College Budget and Accounting Manual require transfers and budget adjustments to be made by way of a formal resolution, the record indicates such transfers were approved by minute action² and in a way that appears to have been intentionally hidden from public view.

² Minute actions are those actions for which the record is reflected by way of recording of a voice vote in the minutes of the proceedings. Formal resolutions are those for which a record of the intent and action of the governing body is more

The \$8.1 million in transfers in excess of budget executed during FY 2013-14 should therefore be reversed pending the adoption of a resolution by the Board of Trustees as is I understand to be required by the authoritative references cited herein.

During FY 2013-14 the District executed inter-fund transfers from the General Fund to the Capital Projects Outlay Fund in the amount of \$8.1 million in excess of what it had budgeted at the start of the fiscal year.

While the FY 2013-14 Adopted Budget included an allowance of \$750,000 to be transferred from the General Fund to the Capital Projects Outlay Fund, at total of \$8.92 million was transferred during FY 2013-14³.

I have reviewed and included below the authoritative guidance concerning budget transfers and budget augmentations. Excerpts on point are provided below for your reference:

The California Administrative Code reads in part⁴:

"All income accruing to the district in excess of the amounts required to finance the total proposed expenditures, including transfers to other community college districts and funds, as shown in the budget of the district shall be added to the general reserve of the district, and shall not be available for appropriation by the district for the current fiscal year except by the following procedure.

The governing board of the district shall, by formal action of the board, pass a resolution setting forth the need according to major classification of district expenditures to be met from any portion of the general reserve derived from assured income in excess of the total amount anticipated in the budget."

The California Budget and Accounting Manual reads in part⁵:

thoroughly documented in the form of a written resolution accompanying the minutes.

³ See District 311 Master Report for the fiscal year ended June 30, 2014 budgetary comparison schedule (page 33)

⁴[https://govt.westlaw.com/calregs/Document/IE10B3300D48511DEBC02831C6D6C108E?viewType=FullText&originationContext=documenttoc&transitionType=CategoryPageItem&contextData=\(sc.Default\)](https://govt.westlaw.com/calregs/Document/IE10B3300D48511DEBC02831C6D6C108E?viewType=FullText&originationContext=documenttoc&transitionType=CategoryPageItem&contextData=(sc.Default))

"In addition, the governing board by formal resolution, may provide for the accumulation of moneys over a period of years for specific capital outlay purposes (including district match for SMSR as defined in EC §84660) through inter-fund transfers of general purpose moneys to the Capital Outlay Projects Fund. State moneys for SMSR projects are recorded directly into this fund. SMSR is defined in EC §84660 as "unusual, nonrecurring work to restore a facility to a safe and continually usable condition for which it was intended". These items are divided into five funding categories; roofs, utility, mechanical, exterior, and other."

I understand the purpose of the additional \$8.1 million in budget transfers from the General Fund to the Capital Projects Outlay Fund was to supplement funding to be derived from other sources (including \$5 million in redirected Measure E General Obligation Bond Funds) to retrofit the Orange Educational Center at a cost of \$16 million.

According to the Chancellor's September 23, 2013 staff report the \$16 million would be required to restore to serviceability the Orange Education Center and in conformity with State architectural standards.

The Chancellor's September 23, 2013 report did not explain why the \$16 million request for funding was *not* included in the FY 2013-14 budget which had been subject to ratification by the Board of Trustees on September 9th, just two weeks prior.

The exclusion of the \$16 million appropriation request for the Orange Education Center from the FY 2013-14 budget is in my view inexplicable when one considers that the cost to repair the OEC had just three months earlier been estimated to be \$12 million according to a June 2013 list of capital funding requirements that the Board of Trustees had approved and submitted to the State Community College Chancellor.

My review of the audio recordings combined with the observations described herein strongly suggest that the decision to allocate \$16 million in capital funds to the Orange Education Center was orchestrated in a way to minimize external scrutiny of the matter at hand.⁶

⁵http://extranet.cccco.edu/Portals/1/CFFP/Fiscal_Services/Standards/BAM/bam2012ed/CompleteBAM/Budget%20and%20Accounting%20Manual%202012%20Edition.pdf (see page 2-16)

⁶ The board meeting tapes of September 23, 2012 indicate a motion to grant approval to the \$16 million funds transfer was made *within one second* after the

As such I consider the failure of the Board of Trustees to properly authorize the reallocation of capital funds to the OEC (including those transferred from the General Fund) to be more than a technical error, and one that should be reversed by way of a public hearing and the adoption of a formal budget resolution as required by the administrative code and other authoritative guidelines.

2. In producing the FY 2013-14 annual financial statement the District failed to adhere to the requirements or Governmental Accounting Standards Board Pronouncement Number 42 (GASB 42) concerning the accounting for capital assets that have been impaired.

According to GASB 42 a write down on the carrying value of fixed assets upon the public agency's balance and a corresponding charge to earnings is required when an asset's utility or useful life has been reduced.

In preparing the financial statements for FY 2013-14, the District made no entry to account for the impairment of the Orange Educational Center (a facility built at a cost of approximately \$16 million in 2005) despite having acknowledged in correspondence to the Board of Trustees in September of 2013 that \$16 million in capital funds would be required to return the Orange Education Center to correct design deficiencies that were discovered in Calendar Year 2012.

The failure to report the financial statement effect of the OEC having been rendered inoperable until \$16 million in unscheduled renovations were to be completed is, in my professional judgment, a material misstatement of the FY 2013-14 District's assets, liabilities and net position as of March 31, 2014.

Governmental Accounting Standards Board Pronouncement Number 42 (GASB 42) provides the authoritative guidance in regards to accounting for asset impairments. The following is excerpt⁷ is on point:

item was introduced. Moreover the motion to grant approval to the Chancellor's request was seconded *within two seconds* of the having been introduced and was voted upon immediately after a third Trustee member inquired as to whether the project for which financing was to be sought could be expedited. There was no public hearing on the item, no record of any public commend, nor was a resolution introduced as I understand was required under the circumstances.

⁷ <http://www.gasb.org/st/summary/gstsm42.html>

"Governments are required to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. Such events or changes in circumstances that may be indicative of impairment include evidence of physical damage, enactment or approval of laws or regulations or other changes in environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage. A capital asset generally should be considered impaired if both (a) the decline in service utility of the capital asset is large in magnitude and (b) the event or change in circumstance is outside the normal life cycle of the capital asset.

Impaired capital assets that will no longer be used by the government should be reported at the lower of carrying value or fair value. Impairment losses on capital assets that will continue to be used by the government should be measured using the method that best reflects the diminished service utility of the capital asset. Impairment of capital assets with physical damage generally should be measured using a restoration cost approach, an approach that uses the estimated cost to restore the capital asset to identify the portion of the historical cost of the capital asset that should be written off. Impairment of capital assets that are affected by enactment or approval of laws or regulations or other changes in environmental factors or are subject to technological changes or obsolescence generally should be measured using a service units approach, an approach that compares the service units provided by the capital asset before and after the impairment event or change in circumstance. Impairment of capital assets that are subject to a change in manner or duration of use generally should be measured using a service units approach, as described above, or using deflated depreciated replacement cost, an approach that quantifies the cost of the service currently being provided by the capital asset and converts that cost to historical cost."

- 3. The FY 2013-14 audited financial statements were included in the District's 2014 offering of general obligation bonds used to finance future construction of District facilities⁸. As such the apparent failure of the District to fairly represent the carrying value of its plant property and equipment as of the year ended March 31, 2014 constitutes a potential violation of initial and continuing disclosure requirements mandated by the Municipal Securities Rulemaking Board.**

SEC Rule 15c2-12 governs municipal financial disclosures associated with the sale of municipal securities and the Municipal Securities Rulemaking Board is tasked with administering such financial disclosure requirements.

In general these rules impart upon issuers of municipal bonds to provide timely and reliable financial data, including the submission of financial statements that have been subject to independent audit for conformity with generally accepted governmental accounting standards.

⁸ <http://emma.msrb.org/ER800704-ER623130-ER1024761.pdf>

I consider the inclusion of financial statements which were apparently based in part upon material misrepresentations of management (and what could reasonably be construed as of an intentional nature) to constitute a potentially serious violation of continuing disclosure requirements of the Municipal Securities Rulemaking board as well the Dodd Frank Wall Street Reform and Consumer Protection Act.

In summary I have observed what I consider to be very serious irregularities in the District's budgeting and financial reporting practices and would strongly urge those affiliated with the District in any way to press for an thorough and independent inquiry at the earliest possible opportunity.

John P. Johns, CPA
California License Number 67309