

CHAPTER 3 – Accounting Guidelines

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INTERNAL CONTROL STRUCTURE

Introduction

This chapter provides school boards, superintendents, business managers, and other school district personnel with a background and approach to establishing and maintaining an effective system of internal controls.

These internal control policies are based on the 1994 report issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and standards adopted by the American Institute of Certified Public Accountants and the federal Office of Management and Budget.

The COSO report defines internal control as “a process, effected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations

Internal control is a management process to assist a school district in achieving the educational objectives adopted by the school board. This management control system should include procedures and policies to help ensure resources are guarded against waste, loss, and misuse; that reliable data is obtained, maintained, and fairly disclosed in financial statement and other reports; and resource use is consistent with laws, regulations, and policies.

Basic Internal Control Requirements

Each school board is responsible for establishing and maintaining an effective system of internal control throughout the school district.

An internal control system should provide *reasonable assurance* that a school district will accomplish its educational objectives. The concept of reasonable assurance recognizes that the cost of an internal control activity should not exceed the benefit derived from it. Reasonable assurance equates to a satisfactory level of confidence given considerations of costs, benefits, and risks.

School district management should identify and analyze the risks in achieving educational objectives and determine how to most effectively and efficiently manage those risks. Management defines the level of risk that the school district is willing to accept and strives to maintain risks within those levels.

Each school district should adopt methods to assess risk and review control activities. The methods developed should address each school district's specific needs.

Components of Internal Controls

The five components of good internal controls within a management control system are:

1. **Control Environment**—The control environment sets the tone of a school district. Providing discipline and structure, it is the foundation for all other components of internal control. Control environment factors include the integrity, ethical values, and competence of the school district's staff; management's philosophy and operating style; the way management assigns authority and responsibility; the way management organizes and develops its staff; and the attention and direction provided by the board.
2. **Risk Assessment**—Every school district faces a variety of risks from external and internal sources, all of which must be assessed. A precondition to risk assessment is establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of obstacles to achieving the objectives, and it forms a basis for determining how risks should be managed.
3. **Control Activities**—Control activities are the internal policies and procedures that help ensure management directives are carried out. They help ensure necessary actions are taken to address risks to achieving the school district's objectives. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, review of operating performance, security of assets, and segregation of duties.
4. **Information and Communication**—Pertinent information must be identified, captured, and communicated in a form and time frame that enables people to carry out their responsibilities. Information systems produce reports containing operational, financial, and compliance related information, making it possible to efficiently manage the school district.

5. **Monitoring**—Management systems and internal activities require monitoring to assess the quality of their performance over time. Assessment is accomplished through ongoing monitoring activities, separate evaluations, or a combination of the two. Deficiencies should be reported upstream, with serious matters reported to top management.

Common Questions About Internal Control

What is a risk assessment?

A risk assessment is a process to identify, analyze, and manage risk. A school district needs a plan to identify both external and internal risks. The plan will help management understand how those risks affect their activities, assess their significance, manage their effect, and provide for continuous monitoring. Risk identification can often be integrated with a school district's planning activities.

Risk analysis involves a careful, rational process of estimating the significance of a risk, assessing the likelihood of its occurrence, and considering what actions and controls need to be taken to manage it. Risk analysis also involves estimating the cost to the school district if something does go wrong.

How does a school district identify risk?

Identification of risk can start from existing systems. The budget process, audits, strategic planning, and other chapters included in this manual all provide opportunities for managers to conduct quantitative and qualitative reviews and to identify and prioritize.

How does a school district control or minimize risk?

Control of risk starts with management deciding on the actions necessary to reduce the potential occurrence and significance and monitoring conditions to remain aware of changing circumstances.

Control Activities

The control activities presented in this section are intended to provide school boards, superintendents, business managers, and other school district personnel with an overview, use, and potential limitations of control activities to manage the risk of achieving school district objectives.

Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address and minimize the risk of achieving school district objectives.

Control activities, no matter how well designed and executed, can provide only reasonable assurance regarding achievement of objectives. The likelihood of achievement is affected by limitations inherent in all control systems.

Loss of Public Funds

Known or suspected loss of public funds or other illegal activity must be immediately reported to the State Auditor's Office (RCW 43.09.185). Districts should contact their local audit manager.

Audit Resolution Standard

School district management is to follow WAC 392-115 for state and federal audit findings.

PAYROLL PROCESS

The payroll process implements management policies and procedures to properly compensate employees for services rendered. State and federal government laws and regulations impact the process and dictate some procedural practices.

Personnel Decisions

The personnel department of each school district should be responsible for the determination of the individuals to be included on the payroll of the district. The personnel department should inform employees of mandatory benefits, available optional benefits, and other paid or nonpaid benefits. The personnel department then communicates the employee's choices regarding these compensation issues to the payroll department. The personnel department should also communicate any changes in employee benefit programs to the employees and to the payroll department. Management procedures need to ensure that the responsibility for personnel assignments is clearly delineated to ensure appropriate duty and financial accountability.

Payroll Database

The payroll process requires many periodic updates to the information database that ensures an accurate and reliable production of pay instruments. These periodic changes may occur randomly or on a regularly scheduled basis, such as a day, week, month, or year. In many instances, governmental regulation or contract terms determine when changes in the database will occur. Employee options also effect changes. The following database items need to be considered:

- **Demographic Data:** Information to identify the employee as a unique individual, including name, address, social security number, withholding exemptions, marital status, etc.
- **Hours of Work:** The normal work schedule that is related to the payroll department on a timesheet declaration from the employee or is understood by a professional contract.
- **Overtime Work:** Hours worked beyond the normal work schedule.
- **Payroll Period:** The frequency at which employees provide services and are paid. (In school districts, usually monthly.)
- **Pay Date:** The regularly identified date on which employees are paid.
- **Salary Schedule(s):** The documents that determine the periodic pay rates for individuals.
- **Paid and Unpaid Leaves:** The policy or procedures that determine which leaves of absence are paid or unpaid.
- **Unemployment Compensation:** The unemployment benefit program administered by the Employment Security Department. The district may participate in a tax rate basis or reimbursement rate basis of replenishing the fund. The reimbursement rate basis may be self-administered or administered through a cooperative arrangement with other school districts or the local ESD.
- **Optional Benefits and Deductions:** The district-sponsored benefits to which the district may or may not contribute, including health insurance, life insurance, disability insurance, annuity, United Way, credit union, deferred compensation, etc.
- **Social Security:** The federal government-sponsored program of pensions and disability income to qualified individuals supported by payroll taxes.
- **Retirement Systems:** The state government-sponsored retirement systems supported by payroll deductions and contributions by the district.
- **Workers' Compensation Insurance:** The state government-sponsored program of pensions, disability income, and medical expenses for qualified individuals who have sustained injuries on the work site as a result of performing duties for the

district. The program is administered by the Department of Labor and Industries and the district may be self-administered or a member of a cooperative arrangement to administer claims.

Time and Effort Records

Time and effort records are employee-generated time records reporting the employees' effort in support of federal grant(s) and other assignments. The federal government's Office of Management and Budget requires these records. For additional information regarding time and effort reporting, see Office of Management and Budget (OMB) Circular A-87, now superseded by Uniform Grant Guidance under 2CFR § 200.430. Time and effort records are to be completed monthly, unless a substitute system has been approved by OSPI. Additionally, semi-annual certifications may be completed in lieu of monthly time records if the employee works on a single cost-objective, as defined in Circular A-87.

The new Uniform Grant Guidance (UGG) has some significant changes in time and effort documentation language at 2CFR § 200.430, but there is not the flexibility that was expected. The reference to "semi-annual certifications" and "personnel activity reports" has been replaced with the requirement to have "records that accurately reflect the work performed." It also requires salaries to "be supported by a system of internal control which provides *reasonable assurance* that the charges are accurate, allowable, and properly allocated." It further states the records must "Reasonably reflect the total activity for which the employee is compensated."

Until we have additional guidance from OMB and the Department of Education (ED), OSPI will continue to use the current system for documenting time and effort. OSPI will provide more information as it becomes available.

RESOURCES AND RESOURCE FLOWS

The intent of financial statements is to provide information on the resources that are available to a governmental entity, as well as the flows of those resources into and out of the government over a given period of time (the reporting period). The term "resource," in a governmental context, means an item that can be drawn upon to provide services to the citizenry. Generally, the term "resource" refers to financial resources such as cash that the government may use to purchase goods or services.

The measurement focus of the financial statements is on the net change in total resources over a defined reporting period. The term "net position" is used to describe the sum total of all resources available to a government over the sum total of all liabilities and claims to those resources. The financial statements, then, report on a government's net position as of a given date and the change in net position over a defined period. Another term for "net position" is "net assets," which has been defined as the amount by which total assets exceed total liabilities.

Flows of Resources

The movement of resources into or out of a government is defined by GASB as a "flow of resources." This is further defined in two categories: inflows of resources and outflows of resources.

An inflow of resources is defined as the acquisition of net assets of a governmental entity. This is either from a government's assets increasing at a rate greater than its liabilities, or by liabilities being reduced at a rate greater than assets. The recording of revenues (increasing cash with no increase in liabilities) would be an example of an inflow of resources.

An outflow of resources is defined as the consumption of net assets of a governmental entity. This occurs either when a government's liabilities increase at a rate greater than its assets, or when a government's assets decrease at a rate faster than its liabilities. The recording of expenditures (either decreasing cash or increasing liabilities in the form of accounts payable) is an example of an outflow of resources.

Basis of Accounting and Measurement Focus

Financial statements are presented in accordance with a defined basis of accounting. The basis of accounting used determines the presentation for items such as the flow of resources into and out of a government over a defined period.

Most districts prepare their financial statements using the modified accrual basis of accounting, which focuses on the current financial resources available to the district. This focus is on the financial resources that the district has received in a given period, or will receive soon enough after the end of the reporting period, to be available to pay for the current liabilities of the government that are outstanding as of the end of the period.

Districts under 1,000 FTE students may elect to prepare their financial statements on the cash basis of accounting. Under the cash basis, changes in financial resources are recorded only when there is an actual receipt for cash received, or when a payment is made to a vendor.

The economic resources measurement focus and accrual basis of accounting is used for the districtwide financial statements. Revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions should be recognized when the exchange takes place. Transactions are external events where something of value or benefit passes between two or more parties. In exchange-like transactions, the values exchanged may not be quite equal or directly benefit the parties to the transaction but are sufficiently to justify treating the transaction as an exchange for accounting recognition. (GASB Statements 33 and 34.)

Applicability to the Reporting Period

The measurement focus of the financial statements helps to determine the nature and period to which a flow of resources is applicable. For financial statements prepared on the modified accrual basis of accounting (and the current financial resources measurement focus), the period for which most transactions are applicable is the period in which the flow of resources takes place. For districts electing to use the cash basis of accounting, the period for which outflows and inflows of resources is recorded is the period in which cash is disbursed or received.

For resources flows statements prepared using the economic resources focus, the period to which an outflow (or inflow) of resources is applicable is determined using the concept of *interperiod equity*. Interperiod equity is the state in which current period inflows of resources equal current period costs of services. Interperiod equity is a relevant metric to assess accountability, rather than a goal that is expected to be met for any particular period of time.

Deferred Outflow and Deferred Inflow of Resources

State and local governments enter into transactions that result in the consumption or acquisition of net assets in one period that are applicable to future periods. GASB identifies those consumptions or acquisitions as deferred outflows of resources and deferred inflows of resources, respectively, and distinguishes them from assets and liabilities. These deferred flows of resources are recognized when a school district

records a transaction that results in the acquisition or consumption of resources, but the underlying transaction does not occur until a future period.

A familiar example for school districts is the recognition of Property Taxes Receivable at the end of the year for the full amount of the levy, resulting in a "deferred inflow of resources." These resources are measurable but considered unavailable for revenue accrual under state law, RCW 28A.505.010, WAC 392-123-047, RCW 28A.150.400. This is a departure from GAAP as defined by GASBS 33 and Interpretation 5 and should be disclosed in the notes to the financial statements.

In a Statement of Net Position and or the F-196 Balance Sheet, amounts required to be reported as deferred outflows of resources are listed in a separate section following assets. Similarly, amounts that are required to be reported as deferred inflows of resources are listed in a separate section following liabilities.

The Balance Sheet will continue to follow the traditional "debits equals credits" format. Assets plus Deferred Outflows of Resources will equal Liabilities, Deferred Inflows of Resources and Net Position.

REVENUES AND RECEIPTS

Revenues are an inflow of resources into a school district. They are an increase in the current financial resources of the district, regardless of form. Under the modified accrual basis of accounting, revenues are recognized when they are susceptible to accrual, which means they are both measureable and available. "Measurable" means that the amount of the revenue is either known or is subject to reasonable estimation. "Available" means that the revenues must be subject to collection within the current period, or soon enough after the end of the current period to be able to pay for liabilities that are outstanding at the end of the current period.

Timely Deposits

Article XI, Section 15, of the Constitution of the State of Washington requires that all moneys, assessments, and taxes belonging to or collected for the use of any public or municipal corporation shall immediately be deposited with the treasurer, or other legal depository. Chapter 28A.400.030(3) RCW requires the superintendent of a public school district to keep accurate and detailed accounts of all receipts and expenditures of school money.

According to RCW 43.09.240: Every public officer and employee, whose duty it is to collect or receive payments due or for the use of the public shall deposit such moneys collected or received by him or her with the treasurer of the local government once every twenty-four consecutive hours. The treasurer may in his or her discretion grant an exception where such daily transfers would not be administratively practical or feasible as long as the treasurer has received a written request from the department, district, or agency, and where the department, district, or agency certifies that the money is held with proper safekeeping and that the entity carries out proper theft protection to reduce risk of loss of funds. Exceptions granted by the treasurer shall state the frequency with which deposits are required as long as no exception exceeds a time period greater than one deposit per week.

Cash Receipts

Each public school district is responsible for the establishment of procedures for the daily collection of cash, other forms of money, and for the issuance of payee receipts consistent with reliable internal control processes.

Revenue Accruals

Governmental fund types: The modified accrual criterion of measurable and available is used. It is applicable to each major source of revenue classification within the source. Accruals are not applicable to those public school districts electing under RCW 28A.505.020 to use cash basis accounting.

- *Local taxes:* Local property taxes are recorded at the net amount collected (cash basis) during the current fiscal year. This is a departure from GAAP as defined by GASB 33 and Interpretation 5 and should be disclosed in the notes to the financial statements. (See discussion of Nonexchange Transactions later in this section.)
- *Local nontaxes:* Accounts in this major source may be recorded at the amount collected (cash basis) during the current fiscal year. Some revenue accounts in this source may be susceptible to accrual including, but not limited to, rental income, investment earnings, and tuition.
- *General-purpose state revenues:* Accounts in this major source meet the measurable criteria but not the available criteria; therefore, accruals are not required. As a practical matter, all material amounts are received during the current fiscal period. However, known and probable reductions must be recognized when material.

- *Special purpose state revenues:* Many accounts meet the measurable criteria but not the available criteria; therefore, accruals are not required. However, grants paid on a reimbursable basis meet the measurable and available criteria and are, thus, subject to accrual.
- *General-purpose federal revenues:* Most accounts in this source are not measurable or available; therefore, these amounts are recorded as collected (cash basis) during the current fiscal period. For those sources that meet the measurable and available criteria, the amounts are accrued.
- *Special purpose federal revenues:* Most accounts in this source are from grants paid on a reimbursable basis that meet the measurable and available criteria; therefore, these amounts are subject to accrual. For those sources that do not meet the measurable and available criteria, the amounts are recorded as collected (cash basis) during the current fiscal period.
- *Revenues from other school districts:* Many accounts in this major source meet the measurable and available criteria making them susceptible to accrual. Some accounts are measurable but not available (e.g., payments from nonhigh districts); therefore, these amounts are recorded as collected (cash basis) during the current fiscal period.
- *Other agencies and associations:* Many accounts in this major source meet the measurable and available criteria making them susceptible to accrual. Some accounts are measurable but not available; therefore, these amounts are recorded as collected (cash basis) during the current fiscal period.
- *Other financing sources:* All accounts in this major source are recorded as collected (cash basis) during the current fiscal period. These amounts are not recorded as revenues on the income statement but as the source title says, as other financing sources.

Revenue Carry Over

Revenues that are received for a legally restricted purpose but have not yet been expended in the current fiscal period are susceptible to the restriction of fund balance. Any unexpended amounts shall be recorded in General Ledger Account 821 – Restricted for Carryover of Restricted Revenues, at the fiscal year end. An example of these special purpose revenues are special education funding and LAP. See Chapter 4, Fund Balance, "Restricted" Accounts, for more information.

Unearned Revenues

Under both the accrual and the modified accrual basis of accounting, revenue may be recognized only when it is earned. If assets are recognized in connection with a transaction before the earnings process is complete, those assets must be offset by a corresponding liability for unearned revenue. The revenue has been received and is available to pay for current liabilities of the district, but unless the district performs some service the money will have to be returned. An example would be a parent who prepays for the ASB Yearbook or school lunches in advance of the start of the school year.

Deferred Inflows of Resources

(Not for cash basis districts.)

Districts may periodically receive financial resources that are not appropriately recorded as revenues in the period received. This is because the revenue has been recorded, but it is not available to pay for current liabilities of the district.

Unavailable Revenue

Under the modified accrual basis of accounting, it is not enough that a resource has been earned if it is to be recognized as revenue of the current period. The revenue must also be susceptible to accrual (it must be both measurable and available to finance expenditures of the current fiscal period). If assets are recognized in connection with a transaction, but those assets are not yet available to finance expenditures of the current fiscal period, then the assets must be offset by a corresponding deferred inflow of resources for unavailable revenue. This type of unavailable resource is unique to governmental funds and is tied to the modified accrual basis of accounting.

Nonexchange Transactions

In a nonexchange transaction, a government gives (or receives) value without directly receiving (or giving) equal value in return. These transactions are common in governments and described below. GASB Statement 33—*Accounting and Financial Reporting for Nonexchange Transactions* prescribes the accounting for such transactions. In governmental funds where the modified accrual basis of accounting is used, revenue recognition of nonexchange transactions takes place only when the transaction has occurred *and* the revenues are available. GASB Statement 65—*Items Previously Recorded*

as *Assets and Liabilities* prescribes the accounting for such transactions. The timing of recognition is as follows:

- *Imposed nonexchange revenues* result from assessments by governments on nongovernmental entities such as individuals. Examples are property taxes and most fines and forfeits. Revenues are recognized when the use of the resources is required or first permitted by time requirements (such as the period for which property taxes are levied). Resources received or recognized as receivable before the time requirements are met should be reported as deferred inflows of resources.
- *Government-mandated and voluntary nonexchange transactions* include grants to districts for state or federally mandated programs, entitlements, and most donations. Under modified accrual, revenue is recognized when all applicable eligibility requirements are met *and* the resources are available. If the provider requires the recipient to use (sell, disburse, consume) the resources in, or beginning in, the following fiscal period, resources provided before that period should be recognized as advances to the providers and deferred inflows of resources to the recipients.

Receivables

Revenues or other positive increments in financial resources should be treated as accounts receivable at the time the revenues are earned, an invoice is issued, or a grant claim is filed.

In addition, material revenues received prior to the normal time of receipt, or in advance of the period to which they apply, should be recorded as unearned revenues in the period received and recognized as revenue of the period to which they apply. (GASB Cod. Sec. 1600.114 and 115.)

Interfund receivables and payables may result from services rendered or goods provided by a department financed from one fund to a department financed from another fund or from interfund loans. Each fund, being a separate entity, should reflect the amounts due from other funds, as well as the amounts owed to other funds. The receivables and payables should not be offset (netted) in the accounts, but they may be reported at the net amounts in the respective fund balance sheets. (GASB Cod. Sec. 1300.120.)

Electronic Funds Transfer

The deposit to, or disbursement from, a bank account by means of wire or other electronic communication is permitted by RCW 39.58.750.

Revenue Versus Contra-Expenditure Recognition

For financial reporting purposes, revenues and expenditures should be presented on the gross versus net basis because the measurement focus is on the flow of current financial resources.

Examples of expenditure reimbursements that should be reflected as revenue and not a refund of expenditure include: substitute teacher reimbursement from other districts, student fees for fieldtrips, teacher training reimbursement from OSPI, and reciprocal interfund services provided and used; such as Trip Billings to ASB.

Nonreciprocal interfund reimbursements between funds are an exception. An interfund reimbursement is treated as a refund of expenditures. Refer to the section titled Interfund Activities, later in this chapter, for additional guidance on reciprocal and nonreciprocal interfund activities.

GENERAL FUND FUNDRAISING

Based on Attorney General Opinion Cite AGO 2003 No.1, dated February 19, 2003, districts have broad discretion to engage in fundraising activities. If a school district engages in General Fund fundraising, it is required to establish a board policy. See the full Attorney General Opinion at www.atg.wa.gov for additional information.

EXPENDITURES AND DISBURSEMENTS

This section contains guidance on the treatment of expenditure and disbursement documents.

Employee Travel

Travel expenses include amounts paid for the use of personal automobiles, other transportation, and actual expenses or reimbursement in lieu of actual expenses for meals, lodging, and related items.

Travel reimbursements include amounts paid for the use of private or commercial transportation, actual or per diem charges for meals, lodging, and other related items per school board policy or procedures adopted under the guidance of RCW 42.24.115 through 42.24.160.

The school district board must pass an ordinance or resolution to establish rules and regulations for the reimbursement of travel expenses. There should be rules to cover all district officials and employees. The ordinance or resolution should discuss the board policy on tipping and charging expenses to the district, and should prohibit reimbursement for personal expenses and entertainment.

If a district wishes to issue credit cards for travel-related expenditures, the board must pass an ordinance or resolution to establish rules and regulations that satisfy the provisions of chapter 42.24 RCW, including:

- Submission of a fully itemized travel expense voucher by the employee or officer
- Settlement by the officer or employee within 30 days of the billing date
- Establishment of a lien against salary for any disallowed charges

Claims for reimbursement of travel expenses must contain a signed certification that includes the following language: "I hereby certify under penalty of perjury that this is a true and correct claim for necessary expenses incurred by me and that no payment has been received by me on account thereof."

In addition, if an officer or employee is filing a claim on behalf of others, he or she must prepare a detailed account that includes:

- Names of the others who traveled, partook of meals, or otherwise incurred expenses.
- Whether they were district employees and, if not, who they were and what connections they had with district business. This should not be construed to permit promotional hosting.
- Who provided the lodging, meals, or other services in question, with dates and times.
- A detailed breakdown of amounts.
- Some statement sufficiently explicit to show what municipal business was being carried out when the expenses were incurred.

If a district chooses the option of using monthly reimbursements for the use of personal automobiles for official business, the following procedures apply:

- The monthly rate schedule established should be limited to officers or employees who actually use their personal automobiles for travel on a regular basis. It is the responsibility of the district to ensure that each traveler is on official business.
- The rate must be based on actual costs.
- A periodic review must be performed to determine whether or not the rate continues to reflect actual costs.
- A record is needed of the board's determination.

If the above procedures are not followed, the "monthly reimbursement for use of personal automobiles" may be treated as additional compensation. According to the Internal Revenue Service, districts could be assessed the withholding tax of the employees if the amounts advanced or reimbursed for travel were not for expenses incurred or reasonably expected to be incurred, unless these amounts are reported as taxable wages on the employee's W-2. (See IRS questions and answers on OSPI's website <http://www.k12.wa.us/safs/INS/ACC/faq.asp>.)

Advance Travel Expense Account

If a district chooses to establish an advance travel expense account (imprest account), per RCW 42.24.120, the following procedures apply:

- The imprest amount must be established and maintained in accordance with the procedures prescribed for petty cash (e.g., ordinance or resolution must establish amount).

- Upon receipt of the moneys, the custodian will open a checking account in a local bank in the name of the school district entitled "Advance travel expense account—Jane Doe, custodian." Moneys received from the following sources will be deposited to the account:
- From the district disbursing officer, the total amount originally establishing the account or subsequently added.
- From officers and employees, refunds of any unexpended advances.
- From the warrant issuing official, amounts that reimburse the custodian for travel expenses allowed in the settlement of employee advances.
- The advance travel expense account must be used solely for travel advances, **not direct payments to vendors**. Moneys may be advanced to an individual who is going on travel status for travel-related expenses that will be paid for out of pocket. It must not be used for personal loans, preregistration fees, reimbursements to employees or officers for travel already incurred, etc.
- A check register will be maintained in which all transactions of the account will be recorded, including deposits, disbursements, and bank service charges. Reconciliation shall be made with the bank statement at the end of each month.
- Employee advances for travel expenses will be made by the issuance of checks drawn on the imprest bank account, payable to the applicant. Approved requests will be retained in the files of the custodian to support such advances until final settlement is made and claim for reimbursement has been submitted. Requests for such advances shall be reasonable estimates of the applicant's travel expense requirements and shall contain as a minimum the following information:
 - Date of request
 - Name of applicant
 - Destination and purpose of travel
 - Anticipated departure and return dates
 - Amount requested
 - Signature of applicant
 - Official approval of trip
 - Check number, amount, and date (to be provided by the custodian when the advance is made)
- Settlement of advances will be made on or before the 15th day following the close of the travel period by filing with the custodian an expense voucher as required by RCW 42.24.090. The custodian will verify the amount shown on such form as having been advanced to the employee. In the event the traveler's actual expense is less than the amount of the advance received, the unexpended portion of the advance will accompany the employee's expense

voucher. The expense voucher and original request for the advance will then be used to support the custodian's claim for a warrant replenishing the account. The other copy of the expense claim will be submitted to the warrant issuing officer for reimbursement of the excess to the traveler. Claims for reimbursement to the account should be submitted by the custodian periodically as needed and at the end of the fiscal year in order that all expenses incurred will be charged against the appropriations for the period then ending.

- Any default in accounting for or repaying an advance shall render the full amount which is unpaid immediately due and payable with interest at the rate of 10 percent per annum from the date of default until repaid. To protect against any losses on advances, the governing body shall have a prior lien against and a right to withhold any and all funds payable or to become payable to such officer or employee to whom such advance has been given up to the amount of the advance and an annual interest rate of 10 percent until repayment or justification is made (RCW 42.24.140). No advance of any kind may be made to any officer or employee at any time when they are delinquent in accounting for or repaying a prior advance.

Imprest Bank Accounts, Petty Cash, Stamp, and Change Funds (Accounts)

These accounts are any sum of money or tangible asset set aside for a specific purpose, usually for minor disbursements, making change or similar uses requiring immediate action outside the normal formal vendor invoice and payment voucher system (accounts payable). Incorporation into the accounts payable system will occur on a summary basis on a routine time schedule for replenishment of the appropriate imprest account or petty cash, stamp, or change funds (accounts). These accounts are defined as:

- *Imprest bank accounts:* Accounts established at commercial banks for the purpose of making minor disbursements by issuing checks as instruments of payment.
- *Petty cash funds (accounts):* Cash amounts kept in secure areas used to make minor disbursements.
- *Stamp funds (accounts):* Consists of U.S. postage stamps and postage meters.
- *Change funds (accounts):* Cash amounts kept in secure places for the purpose of making change by converting paper bills or coins into smaller denominations.

The accounts are administered by use of the following requirements:

- The board of directors of the school district must authorize the initial amount, any changes in the account, and the maximum amount allowable by resolution. Such resolution may specify controls such as surprise cash counts by district staff.
- A custodian shall be appointed over each account. The custodian is the individual responsible for maintaining the security of the tangible asset and determining access.
- The account shall be established, increased, and replenished by issuance of a warrant drawn on the appropriate fund.
- Disbursements from imprest bank accounts and petty cash funds (accounts) shall be restricted to payments evidenced by appropriate documentation including, but not limited to, invoices from vendors, receipts for goods, etc.
- Replenishment expenditures shall be itemized for inclusion into the accounts payable vouchers on a periodic basis, usually monthly, unless the nature of the account dictates some other periodic cycle. The replenishment request should include such information as board policy or procedure prescribes including, but not limited to, identification of vendor invoice, vendor receipt, account code, or other data deemed pertinent.
- Imprest bank accounts and petty cash, stamp, and change funds (accounts) should be reconciled, when replenished, to the authorized maximum amount.
- In the event the imprest bank account or petty cash fund (account) was established at an amount, which the fund does not have sufficient moneys to replenish, a journal voucher shall be prepared and recorded debiting General Ledger Account 530 Expenditures, and crediting General Ledger Account 200 Imprest Cash for the amounts previously disbursed.

Voucher Certification and Approval

All claims for the provision of goods and services, other than payroll, to the school district must be pre-audited and certified by the district's auditing officer or an appointed delegate. The certification may be made on each individual claim voucher or subject to the acceptance and approval of the board of directors. A blanket voucher certification may be used so long as it indicates the particular vouchers so certified. The use of a blanket certification does not relieve the auditing officer of the responsibility and liability for each individual voucher so certified. The certification must be signed and dated by the auditing officer or delegate. For all claims, except travel

reimbursements certified by employees or school officials, the certification must include the following language:

"I, the undersigned, do hereby certify under penalty of perjury that the materials have been furnished, the services rendered, or the labor performed as described herein and that the claim is a just, due, and unpaid obligation against _____ School District No. _____ and that I am authorized to authenticate and certify to said claim."

The auditing officer's certification for employee or school official travel reimbursement claims must include the following language:

"I, the undersigned, do hereby certify under penalty of perjury that the claim is a just, due, and unpaid obligation against _____ School District No. _____ and that I am authorized to certify to said claim."

The certification by the district auditing officer does not relieve members of the board of directors from the responsibility and liability for each voucher approved. It is the board's responsibility to ensure that the system of auditing and certifying vouchers is operating in a manner to provide the greatest possible protection for the board members and the school district.

Indication of board of director approval for payment of claim vouchers and payroll should be recorded in the minutes of the board meeting by use of the following statement:

"The following vouchers as audited and certified by the auditing officer, as required by RCW 42.24.080, and those expense reimbursement claims certified, as required by RCW 42.24.090, are approved for payment. In addition, payroll warrants in the amount of \$_____ are also approved.

(Fund Name)

Voucher numbers _____ through _____
totaling \$_____.

Payroll warrant numbers _____ through _____
totaling \$_____."

Per RCW 42.24.180, in order to expedite the payment of claims, the Board of Directors of any school district, may authorize the issuance of warrants or checks in payment of claims after the provisions of this chapter have been met and after the officer designated by resolution of the school district, has signed the checks or warrants, but before the Board of Directors has acted to approve the claims. The Board of Directors may stipulate that certain kinds or amounts of claims shall not be paid before the board has reviewed the supporting documentation and approved the issue of checks or warrants in payment of those claims.

However, all of the following conditions shall be met before the payment:

- The auditing officer and the officer designated to sign the checks or warrants shall each be required to furnish an official bond for the faithful discharge of his or her duties in an amount determined by the Board of Directors but not less than fifty thousand dollars;
- The Board of Directors shall adopt contracting, hiring, purchasing, and disbursing policies that implement effective internal control;
- The Board of Directors shall provide for its review of the documentation supporting claims paid and for its approval of all checks or warrants issued in payment of claims at its next regularly scheduled public meeting; and
- The Board of Directors shall require that if, upon review, it disapproves some claims, the auditing officer and the officer designated to sign the checks or warrants shall jointly cause the disapproved claims to be recognized as receivables of the school district and to pursue collection diligently until the amounts disapproved are collected or until the Board of Directors is satisfied and approves the claims.

The board of directors may stipulate that certain kinds or amounts of claims shall not be paid before the board has reviewed the supporting documentation and approved the issuance of checks or warrants in payment of those claims.

The original copy of all vouchers shall be filed in the office of the district's auditing officer. The detailed accounts to which the expenditures are to be posted must be clearly designated on the voucher. Supporting documentation must be retained and either attached to the vouchers or canceled by the auditing officer to prevent reuse.

Original supporting documentation for vouchers for the claims against the associated student body program fund may be retained in the school building with ready availability to the auditing officer. Summary data required for auditing and certification

of the vouchers in the Associated Student Body program fund may be forwarded to the auditing officer as required by board policy or procedure.

School districts that do not issue their own warrants shall send original vouchers and supporting documentation to the office of the appropriate county auditor.

Facsimile Signatures

The "Uniform Facsimile Signature of Public Officials Act of 1969," chapter 39.62 RCW allows the use of facsimile signatures on public securities and instruments of payments provided that certification and filing of manual signatures with the Secretary of State have been accomplished (RCW 39.62.020).

Warrants

Warrants are issued when the president or majority of the board signs an order for such and it is countersigned by the secretary (RCW 28A.330.230). The superintendent signs all orders for warrants (RCW 28A.400.030). Districts of the first class derive their authority to issue warrants from RCW 42.24.180. Second class districts are required to obtain the approval of the Superintendent of Public Instruction, on a one-time basis, to draw and issue warrants for the payment of money (RCW 28A.330.230).

Based on board policy or a board resolution, warrants may be issued before approval of the legislative body if the following four conditions have been or are met:

- The auditing officer and the officer signing the instrument of payment have been bonded for at least \$50,000.
- Internal control procedures are in place and are adequate.
- The documents supporting the issuance are made available for review at the next scheduled meeting of the legislative body.
- If upon review the legislative body disapproves any of the items paid, the issuing officer shall pursue collection of the amounts not approved (RCW 42.24.180).

In addition to other duties, the county treasurer:

- Affixes the date of redemption on the face of warrants.
- Endorses "interest-bearing warrant" on the face of such warrants, pays out the interest on interest-bearing warrants, enters the interest paid out in the warrant

register, and makes warrant calls when there are funds to redeem such warrants (RCW 36.29.010 through 36.29.060).

- Issues a statement of canceled (redeemed) warrants (RCW 28A.510.270(3)).

Warrants bear interest at the rate authorized by the issuing authority (RCW 39.56.020). The issuing officer fixes the rate of interest to be paid (RCW 39.56.030). When there are insufficient funds, the issuing authority may establish a line of credit for payment of warrants and interest (RCW 43.09.2853).

ASB warrants cannot be issued without funds on deposit (RCW 28A.325.030).

A facsimile signature for any officer may be obtained by filing with the Office of the Secretary of State authorizing them to sign:

- Public securities such as bonds, notes, certificate of indebtedness, or other evidences of obligation.
- Instruments of payment such as checks, drafts, or warrants or orders for payment, delivery, or transfer of funds.

Warrant Cancellation and Unclaimed Property

Warrants outstanding after one year should be canceled by passage of a resolution of the school board, and the records shall be as if the warrants were never issued (RCW 39.56.040). Even though the records shall be as if the warrants were never issued, school districts remain liable to pay the person or entity subsequently establishing its ownership of this property (RCW 63.29.135).

Unclaimed Property is money or intangible property owed to an individual or business. Many types of transactions may result in unclaimed property. Examples include: uncashed warrants for vendors, parent refunds, employee travel and expense reimbursements, and lunch deposits on account.

Property is considered unclaimed after it is held for a period of time with no owner contact, and a good faith effort has been made to locate the owner. School districts are required to report unclaimed property to the Department of Revenue before November 1st each year. Although reporting is mandatory, school districts have the option of remitting unclaimed warrants to the Department of Revenue or retaining it at the school district (RCW 63.29.190). Abandoned deposits on account must be paid or delivered to the Department of Revenue in accordance with their guidelines.

For items over \$75, written notices must be sent to payees with valid addresses between May 1 and August 1 informing them that there is unclaimed money being held for them. Because school districts must complete an Affidavit of Lost or Destroyed Warrant before reissuing a lost warrant, the district may wish to include the partially completed affidavit with the due diligence letter. The district should keep records of all due diligence letters sent and any responses received. If the district does not get a response, the warrant should be canceled and the amount considered unclaimed property. There are two acceptable methods for handling unclaimed property. The first method when canceling the warrant is to record the cancellation of the warrant as a reduction of the original expenditure and maintain a separate schedule for unclaimed property indefinitely (RCW 63.29.135). An alternative practice when canceling the warrant is to record a liability; subsequently clearing the liability when the amount is remitted to a claimant. Journal entry examples are found in Chapter 7.

Duplicate Instruments

From time to time, payment instruments (warrants or checks) are lost by the recipient and it is necessary to issue a duplicate payment.

Before a duplicate instrument is issued, the issuing officer shall require the recipient or the person representing the recipient to make application for the issuance of the duplicate by filing a written affidavit specifically alleging on oath that he or she is the proper owner, payee, or legal representative of such owner or payee of the original instrument. Additional information required in the affidavit is the date of issue, the number, the amount, and for what services, claim, or purposes the original instrument or series of instruments of which it is a part of was issued, and that the original has been lost or destroyed and has not been paid.

The following is a sample affidavit for use by all school districts:

AFFIDAVIT

STATE OF WASHINGTON)

ss,

COUNTY OF _____)

I, _____, being first duly sworn upon oath, depose and say that I am the proper owner, payee, or legal representative of such owner or payee of _____ School District No. _____, original (warrant or check) No. _____,

dated _____, in the amount of _____
 dollars (\$_____) which said instrument was issued in payment for _____
 _____ and that the same has been lost or destroyed and has not
 been paid.

 (Signature)

Subscribed and sworn to before me this _____ day of _____, 20____.

 (Notary Public in and for the state of Washington)

Residing at _____

INVENTORY

Inventory systems should be designed and established to meet the needs of the school district to provide and maintain adequate control of supplies, materials, and associated transactions. Inventories may be accounted for using one of two methods: the purchases method where inventories are treated as expenditures when acquired, or the consumption method which recognizes expenditures as the goods are used. Districts with central warehouses will generally use the consumption method.

When the purchases method is used, significant amounts of inventories and prepaids are still reported as assets in the districtwide statement of net position.

Inventory Accounting

The two approved inventory accounting methods are "perpetual" and "periodic."

- The **perpetual method** is common in districts employing central warehouses for the receiving, storage, and distribution of available inventory items. A continuous record of the additions and reductions to the inventory items is kept. Expenditures are recorded at the time materials are withdrawn from the warehouse for consumption by end users. An annual physical count of materials in the warehouse is required to verify and adjust the dollar value and quantities reflected in the stock on hand. The perpetual method generally is applied when there is a significant volume of items being purchased over which district management has determined that central control will ensure effective and

efficient use of materials and associated acquisition expenditures. Perpetual methods are labor-sensitive due to the central record-keeping requirement.

- The **periodic method** is applied to establish the value and report inventory on hand at the end of the annual fiscal period. All additions to tangible materials are initially charged to expenditures at the time they are received. At the close of the fiscal period, a physical count is taken of tangible material not consumed by end users and valued at the most current purchase price. The dollar values obtained by this process are placed in the appropriate inventory account and credited to expenditures as part of the closing entries. The beginning entries of the subsequent fiscal period would reverse the inventory amounts and debit them to expenditures. Then the cycle repeats itself by charging all fiscal year acquisitions to expenditures, taking a physical count of items at the end of year, valuing them at the most recent acquisition price, and making the closing entries.

Inventory accounting is required for districts using central warehouses. This is because items are purchased for which the using program and activity is unknown, and therefore expenditure coding is impossible at the time of purchase. Additionally, there may be a timing problem when items are received prior to the fiscal year in which they will be consumed. For districts not using a central warehouse, the use of the inventory accounts is optional.

In the Capital Projects Fund, the use of inventory accounts is optional and limited in scope. Inventory in the Capital Projects Fund is limited to situations where there is a districtwide project, such as the implementation of new technology systems, and the district purchases items in advance of their distribution into schools. When the equipment is placed into service in the schools within the district, it would be recorded as an expenditure in the Capital Projects Fund and a reduction in the inventory account. Inventory accounts should not be used when purchasing items that relate directly to a construction project (such as new construction or modernization). For those projects, purchases of equipment are recorded as expenditures when incurred, even if the items are stored in advance of being placed into the building.

Inventory accounting for food service programs (separate inventory is optional for USDA commodities) is required because goods may be stored in both the central warehouse or in the building kitchen area(s) (General Ledger Account 420). (See Child Nutrition Bulletin 065-13 and 7 CFR §250.59(c).) If USDA commodities are inventoried separately (optional), items are considered to be in inventory only when the unit (e.g., package, crate, container, or box) remains unopened. Once the unit is opened, the entire unit is recorded as an expenditure, even though not fully consumed.

Inventory Cost Valuation Methods

The inventory cost valuation method selected should clearly reflect the flow of resources. Two methods are commonly used in school districts:

- The *first-in, first-out* (FIFO) method assumes costs are charged against revenue in the order in which they occur. This means the remaining inventory consists of the most recent costs.
- The *weighted-average* method assumes costs are charged against revenue based upon an average of the number of items acquired at each of the price levels. This amount is determined by dividing the total cost of an inventory item by the total number of items purchased, including beginning inventory, and applying it to the ending inventory.

Expenditure Recognition Alternatives

Inventory items may be considered expenditures either when purchased (purchases method) or when used (consumption method), but significant amounts of inventory at year-end should be reported on the balance sheet (GASB Cod. Sec. 1600.127).

Prepaid Items

Generally, prepaid items refer to services to be provided (consumed) in a future fiscal period but for which payment has been made in a prior fiscal period. Expenditures of these items are prorated to the period during which the services were provided.

The value of tangible materials acquired for future fiscal period consumption may be debited to prepaid items when timing of the expenditure is relevant to the proper recognition of expenditures. This situation arises primarily at the end of one fiscal period and the beginning of another and generally involves districts using the periodic method of inventory.

CAPITAL ASSETS

Designing and establishing the capital asset accounting system of a school district requires systematic planning in basic areas such as:

- Establishing the objectives of the capital asset system and making permanent policy decisions that will affect the initial establishment and maintenance of the system.
- Designing the plan for taking the initial inventory, verifying and testing the data, and establishing a value for each recorded asset.
- Determining when and how to implement controls over additions and deletions to the inventory.
- Fixing accountability for the custody of individual items and in determining who is responsible for seeing that care and maintenance are attended to.

Although capital assets are not reported in the fund financial statements (F-196), districts will need capital asset information to prepare required note disclosures and ensure accountability for their assets.

Capital assets, net of accumulated depreciation or amortization, are reported on the districtwide Statement of Net Position. In Note 1 of the Notes to the Financial Statements, the district must disclose its policy for capitalizing and depreciating capital assets and its policy for estimating the useful lives of those assets. See Chapter 8 for additional information and conversion schedule.

The Individual Capital Asset Record

An adequate capital asset accounting system ensures the school district will meet statutory requirements, produce records and reports, and properly guard assets. A policy on the dollar value at which capital assets will be included in the system is referred to as the “capitalization” policy. Consideration needs to be given to the uses of the system for insurance recoveries or other determinations of what is a permanent asset and what is a consumable. The capital asset record contains the information necessary to identify each item or lot in the inventory and may include:

- Description of the property identifying the category of the asset (land, building, transportation vehicles, or equipment), including legal descriptions of real property and improvements.
- A serial number or other identification number or information.
- The source of property (purchased, constructed, or donated).
- The acquisition, completion, or donation date.
- Reference to a source document (voucher, invoice, construction contract, trust agreement, etc.).

- The acquisition or construction cost of assets or the estimated fair market value of donated assets or assets held by the district before the capital asset system was established.
- Documentation of who holds title to the property.
- Source of the resources used for the acquisition (local, state, federal or percentage of each).
- The location and condition of the property.
- Special insurance, maintenance, and repair instructions.
- Dates of physical inspections and physical inventories. Physical inventories are required for assets purchased with federal resources at least once every two years.
- Disposition information on assets removed from inventory (date of disposal and sales price, lost, stolen, or surplus).

Asset Cost

The original cost of an asset is referred to as the "historical cost." It is the amount paid to acquire an asset, including the price of the asset, related taxes, commissions, installation charges, consultant fees, architects, construction contractors, and any other costs related to acquiring the asset or preparing the asset for use. Expenditures that do not add to the utility of the asset should not be capitalized. Therefore, repairs to damaged equipment should be charged to an expenditure account and not entered in the capital asset record. Judgment should be exercised in determining which portions of the asset cost should be capitalized in the capital asset record.

Donations of cash to be used in conjunction with the construction or purchase of a specific asset should be reported as revenue in a governmental fund type.

Major repairs or improvements are capitalized. If the outlay adds to a capital asset or enhances the value of an integral part of it, the outlay should be capitalized. Thus, drainage to land, addition of a room to a building, and changes in equipment that increase its output or reduce its cost of operation are recognizable as additions to assets. Difficulty arises when large-scale outlays are partial replacements and additions or betterments. For example, a composition roof is replaced with material that is more durable. To the extent that the project replaces the roof, outlays should not be capitalized unless the cost of the old roof is removed from the accounts; to the extent that the project provides a better roof, outlays should be capitalized. The distribution of the total cost in such a case is largely a matter of managerial determination. Perhaps the best result might be obtained by crediting the appropriate asset account for the cost of

the replaced part, thus removing the amount, and then debiting the asset account for the total cost of the replacing item.

Maintaining a Capital Asset System: Accounting

The school district should adopt appropriate policies and procedures that will ensure that assets that should be capitalized are properly recorded and records are adjusted when assets are disposed of or revalued. Standard data collection processes and periodic physical inventories ensure correct information is recorded in a reasonable time frame and provide a basis for reconciliation of accounting and inventory records.

Other than the acquisition and disposal of assets, other events that may require entries to the accounting system are location transfers, additional construction or demolition, and other improvements or changes in the physical appearance of the asset that should be reflected in its valuation. These adjustments should be recorded in the individual capital asset record. The internal control system should ensure that transactions are noted and recorded. If adjustments are numerous, a capital assets journal may need to be maintained to accumulate the database necessary for adjusting the general ledger and individual asset records.

The capitalization policy of the district defines the dollar limits at which assets will be entered into the capital asset records. The policy should also consider treatment of capitalized leases; cost accumulation on self-constructed assets; control of small attractive assets that are not capitalized; and accounting for any infrastructure such as roadways, utility lines, etc. District personnel should be trained on the appropriate application of the capitalization policy to each acquired or disposed of tangible asset. Assets purchased with federal funds costing \$5,000 or more must be capitalized.

Internal control and information flow regarding asset additions or deletions should ensure that the individual responsible for maintaining the capital asset records is included in the cycle. Documents that may be required are receiving reports, invoices, lease agreements, progress billings on construction contracts, itemized work sheets of costs on self-constructed assets, board resolutions of declared surplus items, property insurance claims, etc. Small attractive assets that are not capitalized, but to which the district desires to apply a security control, will need a similar internal control and information flow scheme.

When assets are transferred from locations or sites, or when they change internal ownership by fund type, the district should ensure these changes are communicated to the area responsible for the capital asset records.

Maintenance of the capital asset records implies that several reconciliations and reports will be performed or generated as follows:

- Reconcile physical inventory to individual capital asset records.
- Reconcile individual capital asset records to general ledger accounts for both asset and equity information.
- Reconcile capital outlay expenditures to total additions in capital assets.
- Analyze expenditure object details for additions to lists of noncapitalized assets.
- Reconcile significant capital grants shown on the grant inventory for governmental type funds with increases to the investment in capital asset accounts.
- Analyze proceeds from insurance claims and sales or auction lists, claim reports, etc., to total capital asset disposals.
- Reconcile capital assets transferred to other locations, custody, fund, or account groups with assets transferred from the same.

Maintaining a Capital Asset System: Physical Inventory

A physical inventory of capital assets verifies the existence and the condition of the asset (required every two years for assets purchased with federal sources). The inventory is useful in determining the value of the asset, both for market value and insurance claim processing.

Board policy and procedure should determine when inventory is to be taken, who conducts the inventory, and what training, skills, and knowledge the conductors of the inventory should have.

To conduct the inventory, the district should have a work plan based on district control over the inventory process with responsibility assigned for supervision of the process and training of the staff. The work plan may include pre-listings of existing asset records sorted by building, floor, room, or other location identifiers, or sorted by asset type. A systematic checklist approach should be employed to ensure that locations are not missed or duplicated in the inventory process. Procedures should instruct the staff about processes to employ when locating assets that appear to meet the capitalization policy but do not appear on the prelists. Procedures should

also include clear instructions on how to record observations about the condition of assets.

Internal control guidelines should be employed in determining who will conduct the inventory to ensure that whoever has day-to-day custody of the asset is not the individual conducting the inventory. If the practical situation calls for the custodian of the asset to take the inventory, then the inventory results should be spot-checked for accuracy by the inventory supervisor.

Completed inventory records should be reconciled to the individual capital asset records. If the inventory process is conducted on a routine periodic basis, then the prelists would have been reasonably accurate and up-to-date, resulting in the reconciliation concerning itself with (1) identifying those assets that were not added to or deleted from the capital asset records at the time of their acquisition or disposal, and (2) investigating and making a final determination of assets not located. Other reconciliations mentioned in the prior section on accounting for capital assets might also need to be conducted as a result of the physical inventory.

Depreciation of Capital Assets

Depreciation of capital assets is not required under the F-196 other comprehensive basis of accounting (OCBOA) method as prescribed by the State Auditor's Office. However, depreciation is required under GASB 34 for all fund types for those districts who issue GAAP financial statements.

Districts who choose not to depreciate assets for accounting purposes may choose to keep depreciation records for other reasons, such as providing management a means of budgeting for replacement of capital equipment.

Depreciation is required for districts reporting on GAAP basis. It is suggested that districts depreciate their capital assets using the straight-line method using the useful lives prescribed by the state Office of Financial Management. These are available at <http://www.ofm.wa.gov/policy/30.20.htm> and <http://www.ofm.wa.gov/policy/30.50.htm#30.50.10>.

General guidelines regarding the recording of depreciation on capital assets are:

- Depreciation of capital assets is not required under the other comprehensive basis of accounting, but it may be part of a district cost accounting system.

- Scrap value can be ignored in establishing the amount to depreciate, unless it is expected to exceed 10 percent of the original cost of the asset.
- Depreciation must be based on a reasonable estimate of the length of time that the district expects to use the asset in its operations.
- An asset that is declared surplus or is held for possible future use is an investment and should not be depreciated.
- The amount of depreciation charged must be constant for each time period, called the straight-line depreciation method, or for each unit of service such as quantity of output, hours or miles of operation, etc.
- Depreciation must be based on the entire cost of the asset including any donated or contributed amounts.
- Assets may have components that will have an estimated useful life considerably shorter than the asset taken as a whole. Component depreciation for such assets may be much more accurate and simpler to maintain.
- When it is necessary to revise the estimates of useful life of an asset, such changes should be applied prospectively. The rate should be recalculated based on the remaining useful life at the time of the revision, and the new rate should be applied in the present and future accounting periods with no changes made to prior periods.

GAAP require that depreciation be reported in the districtwide financial statements.

There are two different applications of group-life depreciation:

- One type is applied to assets of a similar nature acquired at about the same time. The group is treated as a single asset; any gain or loss upon disposal is deferred until the entire group has been retired. When items within the group are retired ahead of schedule, the original cost of that item is removed from both the asset account and the accumulated depreciation account. Depreciation continues to be charged on the remaining assets at the original rate. If some items within the group are subject to major repair, the periodic depreciation should be adjusted for the change in useful life and the new rate charged for the remaining life.
- The second type is applied to dissimilar assets that are related by the mode of operation in which they are used. The rate of depreciation is a weighted average of the rates applicable to the individual assets that comprise the group. This method is intended to eliminate gains and losses on asset

retirements, except when an entire operating system or facility is retired from service.

INVESTMENTS

Each school district should, by action of the board of directors, authorize any moneys which are not required for immediate expenditure and which are in the custody of the county treasurer to be invested. All school districts are empowered by statute to invest in the following types of securities:

- Certificates, notes, or bonds of the United States, its agencies, or any corporation wholly owned by the government of the United States.
- Obligations of government-sponsored corporations which are eligible as collateral for advances to member banks as determined by the Board of Governors of the Federal Reserve System.
- Bankers' acceptances purchased on the secondary market.
- Repurchase agreements for securities listed in the three items above, provided that the transaction is structured so that the public treasurer obtains control over the underlying securities.
- Investment deposits with qualified public depositories.
- Offerings of the Washington State Treasurer's Investment Pool.

To the extent that a school district has moneys not required for immediate expenditure, and such moneys are in the control of the county treasurer, and the district has not exercised authority to request the county treasurer to invest the moneys on behalf of the district, the county treasurer may invest such moneys on behalf of the county.

DEBT AND LEASES

Limitations of Indebtedness

RCW 39.36.015 and 39.36.020 provide that debt cannot be incurred in excess of certain percentages of the taxable real and personal property in the district without the assent of the voters stated as follows:

- 3/8ths of 1 percent—Without a vote of the people.
- 2 1/2 percent—With a vote of the people, 60 percent assent of those who voted.

- 5 percent—With a vote of the people, provided the indebtedness in excess of 2 1/2 percent is for capital outlay, 60 percent assent of those who voted.

These debt limits range from the least restrictive to the most restrictive, without a vote, with a vote, with a vote for capital purposes, and are cumulative for overall debt authority.

Claims and Judgments

Filed and unfiled claims and other impairments of the district's assets should be recorded in the district's accounts or otherwise disclosed in the financial statements. Such claims may include:

- Job-related illness, injury to employees, workers' compensation claims.
- Unemployment compensation claims.
- Compensated absences, vested and accrued sick leave, and vacation time.
- Arbitrage rebate.
- Judgments and other damages.
- Auditor's exceptions and monetary findings.
- Acts of God.

The accounting treatment of claims and judgments is dependent upon the degree of likelihood that can be attributed to the occurrence of the event or events. If the likelihood is:

- Probable, where the future event(s) occurrence is likely. If the future event is probable and the amount can be reasonably estimated, then expenditure is made for the liability known and estimated (incurred but not reported), and a fund payable is recorded for amounts that would normally be liquidated with current financial resources. If the amount is one of a range, then the amount posted is the minimal most likely.
- Reasonably possible, where the change of the future event or events occurring is more than remote but less than likely. This situation would require a note disclosure using amounts as calculated above.
- Remote, where there is a slight chance of the future events occurring. This would not require any action on the part of the statement preparer.

Auditor's Exceptions and Monetary Findings

Audit reports with material monetary findings or internal control findings that could cast doubt on the validity of the financial reports are subject to a broad array of accounting treatments.

The audit report is subject to a desk review by the Superintendent of Public Instruction (chapter 392-115 WAC). The audit monetary finding is *prima facie* case for recovery of funds that, unless rebutted, is sufficient to sustain the conclusion drawn in the audit.

The timing of the exception determines how it will be reported in the district's year-end financial report. If the item of dispute is discovered before the books for the current fiscal year have been closed, the necessary adjustment to the records can be made. If the finding arises after the books have been closed but before the financial statement has been published, a note disclosure would be included. Any questions as to materiality of the finding should be addressed first.

Short-Term and Long-Term Obligations

When a school district borrows money, it can face some difficult budgeting and accounting issues. Short-term debt is very different from long-term debt in terms of creating a financing source. Long-term debt creates an Other Financing Source. Short-term debt does not.

This section discusses accounting and budgeting for the following four types of school district debt:

- Short-term obligations (Chapter 39.50 RCW)
- Conditional sales contracts for acquisition of property (RCW 28A.335.200)
- General obligation notes and bonds issued without vote of the people for the purchase of real and personal property (RCW 28A.530.080)
- Capital leases (RCW 28A.335.170)

Short-Term Obligations

For accounting purposes, any debt obligation (hereafter just referred to as "obligation") that has an original maturity date of less than twelve months from the date of issue is considered to be a short-term obligation. Short-term obligations are anticipated to be repaid (liquidated) with currently available financial resources, and so are reported as liabilities on the balance sheet.

Under chapter 39.50 RCW, municipal corporations, including school districts, may issue short-term obligations to provide current financial resources for any lawful purposes of the municipal corporation. These obligations include notes, warrants, capital leases, or other forms of indebtedness, except for bonds. There is no statutory definition of "short-term," as it is used in chapter 39.50 RCW, nor is there an express limit on when short-term obligations mature, except for short-term obligations payable from the receipt of taxes (see below). However, it is generally accepted that "short-term obligations" should not have a maturity date in excess of five years from the issue date.

Long-Term Obligations

In school district budgeting and accounting, the use of conditional sales contracts, capital leases, or nonvoted bonds is considered to be long-term financing if the obligation matures at least twelve months from the date of inception of the conditional sales contract or capital lease, or the date of issuance of the bond. Under GAAP, certain notes (RANs and TANs, see below) are considered to be, and reported as, short-term obligations and thus fund liabilities regardless of the length of maturity of the note.

Budgeting Short-Term vs. Long-Term Obligations

RCW 39.50.020 states that short-term obligations are subject to "any applicable budget requirements." An often-overlooked problem associated with the use of short-term obligations is that the proceeds cannot be used to balance budgets. A school district must balance its budget on a fund balance basis. Short-term obligations simply increase cash balances, but they do not increase fund balances. The increase is in the form of an obligation that is recorded as a liability of the fund issuing the debt.

Financing acquisitions using long-term obligations creates a budgetable resource. This is because the liability that would otherwise be created is not accounted for as a liability of the issuing fund under modified accrual accounting. Thus, the fund balance of the acquiring fund is increased by the amount of the liability that is excluded from the fund's balance sheet. Two subsidiary revenue accounts to General Ledger Account 965 Other Financing Sources are used to recognize the amount financed in the acquiring fund. These accounts are Revenue 9100 Proceeds from the Sale of Bonds and Revenue 9500 Long-Term Financing.

Revenue Anticipation Notes (RANs)

One of the varieties of short-term obligations that are available for districts to issue are revenue anticipation notes, or RANs. These are promises to pay a specified amount of money to the hold of the RAN at a future date, out of specific revenue sources that are identified in the RAN and authorizing resolution. RANs may be repaid from any legally available, non-tax revenue of the district, such as state apportionment, state financing assistance under chapter 28A.525 RCW, federal Impact Aid, etc. RANs are not repaid from the receipt of tax revenues or future bond proceeds. RANs may also be secured by the district's full faith, credit, and resources. To the extent a district pledges its full faith, credit, and resources to repay the RAN, the RAN should be treated as nonvoted debt of the district.

According to GAAP, a RAN is to be reported as a liability in the fund that receives the proceeds, regardless of the length of the maturity of the RAN. When a district issues a RAN, it records the amount of the principal in Account 606 Anticipation Notes Payable. A district may utilize RANs to purchase capital equipment. Districts that choose to issue RANs for the purpose of purchasing equipment need to be aware that this may result in a deficit fund balance: the fund will have a large liability that is not offset by an asset (as districts do not report capital assets on their financial statements). Districts in such a situation should work with their ESD to prevent being required to budget receivables.

RANs may also be issued with a maturity that exceeds one year. These issues are rare, and districts considering issuing a long-term RAN should consult with their bond counsel, financial advisor, or underwriter prior to issuing such a RAN. Even though such a RAN has a long-term focus, it is still reported as a liability of the fund receiving the proceeds, and not as an Other Financing Source.

Generally a RAN is considered to be nonvoted debt of the district. However, school districts may issue long-term RANs that do not constitute nonvoted debt, provided that the RAN is payable ***only*** from non-tax revenues that are deposited into and paid from a special fund. Such a RAN may not be secured by the district's taxing power or full faith, credit, and resources. A RAN that is neither backed by the full faith, credit, and resources of the district, nor payable from any form of tax-based revenue is not considered "debt" for debt limit purposes. This is known as the "special fund doctrine" which holds that any obligation that is payable only from non-tax money deposited into a special fund is an obligation of that special fund, not a general obligation, and therefore does not constitute debt for debt limit purposes. Districts choosing to issue a long-term RAN that does not constitute

nonvoted debt are cautioned to work closely with their bond counsel, financial advisor, or underwriter prior to issuing the RAN.

Tax Anticipation Notes (TANs)

Another variety of short-term obligation that can be issued is a tax anticipation note, or TAN. Similar to a RAN, a TAN allows the district to borrow money that will be repaid from future inflows of financial resources. Unlike a RAN, a TAN is repaid from taxes that the district expects to collect. (Typically, this will be taxes relating to a maintenance and operations levy, or other tax revenue source.)

Like a RAN, a TAN is reported under GAAP to be a liability of the fund that has received the proceeds. TANs are required to be repaid within six months of the end of the fiscal year in which it is issued (if tax exempt, the Internal Revenue Code further limits the term of the TAN to 13 months). TANs are considered to be a short-term liability of the district, and will always be shown as such on the financial statements. TANs that are outstanding at the time of the financial statements are reported in GL 606 Anticipation Notes Payable.

TANs are typically secured by the full faith, credit, and resources of the district. In the event insufficient taxes are collected to repay the TAN by the due date, the district will need to repay the TAN from other legally available sources.

Bond Anticipation Notes (BANs)

A third variety of short-term obligation is the Bond Anticipation Note, or BAN. Similar to RANs or TANs, a BAN allows the district to borrow money that will be repaid from future inflows of financial resources. Although BANs may be issued in anticipation of the sale of both nonvoted or voter-approved general obligation bonds, BANs are more frequently issued in anticipation of the sale of voter-approved bonds.

Typically, the district may issue a BAN in anticipation of selling the bonds once the election authorizing the bonds has been certified.

BANs must be backed by the full faith, credit, and resources of the district. In the event the bonds have not been sold in time to repay the BAN, the district will need to repay the note from any source that is legally available.

The reporting of a BAN for financial statement purposes, under GAAP, is dependent of the repayment terms of the BAN. However, as school districts do not present a government-wide statement of net assets when reporting on the F-196, BANs should

be reported as liabilities in the fund that issued them, typically the Capital Projects Fund, in General Ledger 606 Anticipation Notes Payable.

Relation to Debt Limit

In general, the issuance of a RAN, TAN, or BAN is considered to be debt of the district. Accordingly, a district may not issue a RAN, TAN, or BAN (that is issued in anticipation of the issuance of an LGO bond) if the issuance would cause the district to exceed its statutory authority for issuing non-voted debt, which is $\frac{3}{8}$ of 1 percent (0.00375) of the assessed value of the taxable property within the district. A BAN issued in anticipation of the issuance of voter-approved UTGO bonds must not exceed 5 percent of the assessed value of taxable property within the district. The exception (as discussed above) are RANs that are not secured by the full faith, credit, and resource of the district (i.e., only non-tax revenues are pledged for repayment of the RAN), and that the county treasurer has agreed to place in a special fund for the district. Such RANs, even if not considered "debt," are still reported as a fund liability on the financial statements, must be reported on the Schedule of Long-Term Liabilities on the F-196, and must be fully disclosed in the Notes to the Financial Statements.

Repayment of Short-Term Obligations

Under RCW 39.50.070, districts have the authority to create a "special fund" (or funds) to provide for the payments of principal and interest on those short-term obligations. Districts wishing to create such a special fund will need to include the authority to create such a fund in the authorizing resolution and contact their county treasurer to set up the procedural requirements for establishing a separate fund within the fund that will be receiving the proceeds of the obligation. For financial reporting purposes, all special funds created in such a manner will be consolidated into the reporting fund that they are a part of. Additional disclosures in the Notes to the Financial Statements will also be required.

Section B50.102 Reporting in Fund Financial Statements—Governmental Funds

For governmental funds, if all legal steps have been taken to refinance the bond anticipation notes and the intent is supported by an ability to consummate refinancing the short-term notes on a long-term basis in accordance with the criteria set forth in FASB Statement 6, they should be reported only as general long-term liabilities in the governmental activities column of the government-wide statement of net assets. If the necessary legal steps and the ability to consummate refinancing criteria have not been met, then the bond anticipation notes should be reported as a liability in the governmental fund receiving proceeds as well as in the government-wide statement of net assets. Tax and revenue anticipation notes should be reported as a liability in the governmental fund receiving proceeds. (NCGAI 9 GASBS 34 82.)

Accounting and Budgeting for Conditional Sales Contracts and Long-Term Notes

A Conditional Sales Contract is a form of sales contract in which the seller retains title until paid off. The seller may provide the needed financing in the form of a capital lease.

A note is a loan from a bank or similar lender, or a transaction that has the elements of a conditional sales contract, except that the district receives title to the acquisition immediately and the original vendor is paid off with the loan proceeds.

Long-term conditional sales contracts or notes shall be reported at face (gross) value, instead of net of trade-in and other costs. The fact that payment is made directly to a vendor on a district's behalf does not alleviate the need for fully reporting the transaction in the district's accounting system.

Initial and Periodic Expenditures in Long-Term Conditional Sales Contract or Nonvoted Note Financing

Financing through the use of a long-term conditional sales contract requires the school district recognize the expenditure (debit Account 530) and an Other Financing Sources (credit Account 965) equal to the net present value of the minimum lease payments in governmental funds.

This equipment expenditure amount must be budgeted accordingly. The debt payments of principal and interest at maturity are to be charged to Account 530 (Expenditures), Program 97, Activity 84 (Principal) and Activity 83 (Interest) in governmental funds. The district must remember to budget both the initial expenditure for the recognition of the purchase of the asset and the periodic expenditures for the payments for the current year.

The initial expenditure arises because the acquiring fund must recognize as an expenditure the full purchase amount of the asset when it is acquired, regardless of the method of financing its purchase. This expenditure should be recorded as a Capital Outlay (Object 9) if it meets the district's capitalization policy or Supplies (Object 5) if it does not, in either the General Fund or the Transportation Vehicle Fund, or in the appropriate expenditure type in the Capital Projects Fund.

The periodic expenditures arise when the current principal portion of conditional sales contracts or nonvoted notes becomes due. The principal expenditures should be charged to Program 97, Activity 84, Object 7. The current interest portion of any debt payment should be recorded in Program 97, Activity 83, Object 7. Unmatured principal is recorded in the Schedule of Long-Term Liabilities. See sample journal entries in Chapter 7.

Nonvoted Bonds Under RCW 28A.530.080

Bonds issued by the district without a vote of the people are defined as non-voted bonds. Examples include Limited General Obligation (LGO) bonds and, typically, Qualified Zone Academy Bonds (QZABs).

Under RCW 28A.530.080 nonvoted bond proceeds must be deposited in the district's General Fund, Transportation Vehicle Fund, or Capital Projects Fund as applicable. All bonds are accounted for and retired in the Debt Service Fund, including nonvoted bonds issued under RCW 28A.530.080. This differs from the retirement of notes or conditional sales contracts, in which the debt is retired in the fund that received the proceeds.

Bonds are more formal than notes. Bonds are usually underwritten by an underwriter, frequently for placement with another client of the underwriter. Bonds are accompanied by a legal opinion and are almost always long-term. Payments for maturing bonds and payment of interest are usually, but not necessarily, paid by a fiscal agent. See sample journal entries in Chapter 7.

Under RCW 28A.530.080(2), districts that wish to issue non-voted bonds in excess of \$250,000 must first hold a public hearing about the bonds, and are required to give notice of the hearing. The notice must be published in a local newspaper at least once a week for two weeks, with the last publication date being no later than seven days before the hearing. The notice must include information about the time and location of the hearing, the amount of the bonds, the nature and terms of the bonds, and the means for repayment of the bonds. This requirement does not apply to any refinancing or refunding of outstanding bonds, whether voted or non-voted.

Local Option Capital Asset Lending (LOCAL) Program

LOCAL program financing is administered through the Office of the State Treasurer (OST) and is a type of Certificate of Participation (COP). A COP is a third-party borrowing option for financing capital acquisitions. Other COPs are typically lease-purchase agreements.

The LOCAL program is an expanded version of the state agency lease and purchase program. The program was originally created by the Legislature in 1989 (RCW 39.94) to provide the lowest cost financing for state agency purchases by pooling funding needs into larger offerings of securities. The Legislature passed legislation in 1998 to provide local governments, including school districts, access to the program. Local government agencies can finance equipment or real estate needs through OST subject to existing debt limitations and financial considerations.

LOCAL financing agreements must be recognized as long-term debt. As such, they are included in the district's Schedule of Long-Term Liabilities and Notes to the Financial Statements, recorded in, and paid from the Debt Service Fund. Districts should recognize the "revenue" or money provided by the financing agreement by booking General Ledger Account 965 Other Financing Sources and expenditure account 530, equal to the amount of the financing agreement. See sample journal entries in Chapter 7.

Districts who participate in the LOCAL program have the option to run all transactions through OST in lieu of receiving the proceeds themselves. In these cases, OST will retain the money, and the district will send the appropriate invoices to OST for payment out of the district's LOCAL proceeds. In this case, districts would still recognize the revenue using General Ledger Account 965 Other Financing Sources, with an offset to General Ledger Account 250 Cash with Fiscal Agent. Invoices that have been received by the district, approved for payment and submitted to OST should be recorded with a debit to

General Ledger Account 530 Expenditures and a credit to General Ledger Account 250 Cash with Fiscal Agent when OST pays the invoice. See sample journal entries in Chapter 7.

Per RCW 39.94.030, districts who have passed a voter-approved levy to issue general obligation bonds may take some of that bonding authority and issue contracts under the LOCAL program. The collected levies can be used to pay the district's obligations for any contracts issued under the LOCAL program in accordance with the new laws.

Regular Method of Advance Bond Refunding

In this method, the proceeds from the sale of refunding (new) bonds are placed in the custody of the trust department of a bank through the county treasurer. The bank establishes an escrow account and invests the proceeds. The cash realized from the maturing investments, together with interest earned, is used to meet the debt service requirements of the refunded (old) bonds and to redeem the balance of the old bonds when they become callable or mature. The old debt is removed from the appropriate fund and the new debt is added to the appropriate fund at the time the proceeds of the sale of the new bonds are paid to the trust department of a bank.

Crossover Method of Advance Bond Refunding

This method provides for the sale of refunding (new) bonds whose proceeds are used to purchase certain investments that are placed in the custody of the trust department of a bank. The investments provide interest earnings that are used to pay interest on the refunding (new) bonds until the crossover date when the refunded (old) bonds are callable or mature. When the call date or maturity date arrives, the old bonds are redeemed with the resources in the escrow account. After the old bonds are redeemed, the source of revenue applicable to the old bonds is used to service the new bonds. The refunding (new) bonds are entered in the appropriate fund at the time they are sold. The refunded (old) bonds continue to be reported in the original fund until the crossover date at which time they are removed from the original fund.

Arbitrage

Arbitrage in government finance is generally defined as the process of investing tax-exempt bond proceeds in higher yielding taxable securities with the resulting interest revenues exceeding the interest costs.

The Tax Reform Act of 1986 requires that issuers of tax-exempt debt comply with the arbitrage yield restrictions and the ultimate rebate requirements of any excess earnings in order to maintain the tax-exempt status of the debt instrument. The arbitrage yield restrictions limit the retainable earnings from debt issuance proceeds to the yield rate of the debt instrument issued. Any excess earnings are to be rebated or paid to the U.S. Treasury. These arbitrage rebate requirements are in addition to other pre-existing restrictions that can make a debt issue taxable.

The Treasury Department's arbitrage rules and their application extend far beyond the issuance of general obligation and revenue bonds and notes. Part of the regulation is the requirement that installment purchase agreements of state and local governments are also included and subject to the same limitations. These purchase arrangements go by many names: tax-exempt leases, municipal leases, installment sales, lease-purchase agreements, conditional sales contracts, certificates of participation (COPs), and lease-to-ownership agreements.

Arrangements such as these, coupled with other borrowings or issues, could put a district over the small issuer threshold and subject other borrowings to the rebate calculations and penalties.

Arbitrage rebate is a tax and should be shown as an expenditure like any other tax. Arbitrage rebate is an income tax at a 100 percent marginal rate.

Whether the arbitrage liability is probable or only possible will depend on the circumstances of each case. If the financial report preparer believes that it is probable that an asset has been impaired, or a liability incurred, and the amount of the liability can be reasonably estimated, then a charge to current operating expenditures is appropriate.

The liability represents a claim against the financial resources of the school district. The current portion of the liability is represented in the government that has received the investment proceeds. The current portion is the amount that would be paid with expendable available financial resources regardless of when the amount is due. The amount of the liability is the current value of the future payable and represents a portion of the interest income of the fund (that amount represented as an excess over what the investments would have produced if invested at the issued security net rate).

Arbitrage is a very complicated issue. Districts are advised to seek competent counsel concerning the calculation of the liability.

Capitalized Leases or Leases With Option to Purchase

RCW 28A.335.170 permits the district to enter into contracts with board approval to provide pupil transportation services; rent or lease building space and portable buildings; and rent or have maintained security systems, computers, and other equipment.

If a lease meets any of the criteria listed below for capitalized leases, it is accounted for as if a purchase contract had been entered into (GASB Statement 62, paragraph 213).

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains a bargain purchase option.
- The lease term is equal to 75 percent or more of the estimated economic life of the leased property.
- The present value of the minimum lease payments at the inception of the lease, excluding executory costs, equals at least 90 percent of the fair value of the lease property.

Capital assets acquired through a capital lease agreement should be recorded in the appropriate fund at the lesser of (1) the present value of the rental and other minimum lease payments or (2) the fair value of the leased property. This amount should be established in the appropriate fund as other financing sources and an expenditure. Outstanding principal should be disclosed on the Schedule of Long-term Liabilities.

The budgets for General, Capital Projects, and Transportation Vehicle Funds of each school district shall contain a schedule which identifies that portion of each non-cancellable contractual liability incurred per RCW 28A.335.170 which extends beyond the fiscal period being budgeted. Said schedule shall list for each such contractual liability a brief description, the accounting code, the beginning and ending dates, the total dollar amount, and the estimated dollar amount extending beyond the end of the fiscal period being budgeted.

Note disclosure is required for capitalized leases.

See RCW 28A.335.200 for conditional sales contracts for the acquisition of property or property rights as this pertains to limitations of indebtedness. See sample journal entries in Chapter 7.

Operating Leases

RCW 28A.335.170 permits the district to enter into contracts with board approval to provide pupil transportation services; rent or lease building space and portable buildings; and rent or have maintained security systems, computers, and other equipment.

Leases that do not satisfy any of the criteria for capitalization are operating leases. Operating leases do not generate asset or liability recognition at their inception. The lease payments are recognized as expenditures as they become payable.

The budgets for General, Capital Projects, and Transportation Vehicle Funds of each school district shall contain a schedule which identifies that portion of each non-cancellable contractual liability incurred per RCW 28A.335.170 which extends beyond the fiscal period being budgeted. Said schedule shall list for each such contractual liability a brief description, the accounting code, the beginning and ending dates, the total dollar amount, and the estimated dollar amount extending beyond the end of the fiscal period being budgeted.

Note disclosure is required for operating leases.

Compensated Absences

Compensated absences are absences for which employees will be paid, such as vacation and sick leave. Consideration should be given to the different characteristics of various types of compensated absences. For example, employees usually receive full compensation for vacation leave—either as paid time off or as compensation at termination or retirement. Thus, employees earn the right to be compensated for vacation leave based only on rendering past service. On the other hand, paid time off for earned sick leave is contingent on an illness—a specific event that is outside the control of the employer and employee. In some cases, however, subject to board policy, employees may be compensated for a portion of their sick leave when they die, terminate employment under certain circumstances, or retire. In those cases, employees earn the right to be compensated for sick leave at termination based only on rendering past service (RCW 28A.400.210, WAC 392-136-020).

Vacation leave and other compensated absences with similar characteristics should be accrued as a liability as the benefits are earned by the employees if the leave is attributable to past service and it is probable that the employer will compensate the

employees for the benefits through paid time off or some other means, such as cash payments at termination or retirement.

Sick leave and other compensated absences with similar characteristics should be accrued as a liability as the employees earn the benefits, but only to the extent it is probable that the employer will compensate the employees for the benefits through cash payments conditioned on the employees' termination or retirement (termination payments). Alternatively, the liability should be measured based on the sick leave and other compensated absences with similar characteristics accumulated at the balance sheet date by those employees who currently are eligible to receive termination payments as well as to other employees who are expected to become eligible in the future to receive such payments. When the liability is calculated, these accumulations should be reduced to the maximum amount allowed as a termination payment.

The compensated absences liability should be measured using the pay or salary rates in effect at the balance sheet date. Certain salary-related payments directly and incrementally associated with the payment of compensated absences, for example, the employer's share of social security and Medicare taxes, should also be accrued. Payments made that are not ordinarily directly and incrementally connected with the amount of leave paid to employees (such as life insurance and health insurance) should not be accrued.

For governmental and permanent funds, the current portion of the liability should be reported as a current liability in the funds; the remainder of the liability should be reported as a long-term liability in the funds. Compensated absences expenditures should be recognized using a modified accrual basis of accounting. A complete explanation of the method of calculating accruals, including examples, can be found in Appendix B – Additional Accounting Guidance.

Unemployment Compensation, Self-Insured

The unemployment compensation laws codified in Title 50 RCW are administered by the Employment Security Department.

The self-insurance provision of the unemployment compensation act makes no provision for group coverage. The act provides only for the election to make payments in lieu of contributions or to reimburse the department for payments made on behalf of the school district to the district's ex-employees (RCW 50.44.20 and 50.44.060).

If an employer has elected the reimbursement method, they will be billed at the end of each calendar quarter for payments made by the Employment Security Department for that quarter.

The Employment Security Department may require a surety bond or the deposit of money or securities in an amount estimated to cover one year's claims, but not to exceed an amount equivalent to one year's premium. The amount of the security is subject to review and renewal by the department.

The school district will have to be certain that the rate of accrual at which the expense is incurred will produce an estimated benefit payable sufficient to cover:

- Claims incurred and claimed but not paid
- Claims incurred but not claimed
- Claims not yet incurred but highly possible

If excess insurance is purchased, the cost of the insurance should be charged to the benefit accrual.

Workers' Compensation, Self-Insured

Claims for injury resulting from employment exposures are not subject to regular civil action. The jurisdiction of courts for this class of torts has been abolished by legislative action and industrial accidents and resulting compensated losses are administered by the state (Title 51 RCW).

The self-insured portion of workers' compensation covers two items: medical aid that pays for illness or injury medical treatment, and workers' compensation that provides compensation for losses including wages and survivor benefits. Both of these are the district's expense. A third element, prior pension and asbestos fund, is an assessment against the employee with an equal amount paid by the employer (RCW 51.32.073).

Districts can become self-insured by application to the Department of Labor and Industries either on an individual basis, or there is a provision for group insurance where any two or more school districts or educational service districts may form a group for purposes of self-insuring workers' compensation benefits.

The agreement between the school district and the risk pool may transfer part or all of the risk to the risk pool. Self-insurers may reinsure their risks but not to exceed 80 percent.

There is a surety requirement for school districts that shall be an amount that will satisfy 100 percent of the claims for the succeeding fiscal period. The minimum security requirement shall be \$100,000; in addition, a cumulative reserve of no less than 25 percent of the surety requirement must also be established.

The Department of Labor and Industries may require a deposit to be placed in an escrow or depository account, the deposit of money or securities, or the posting of a surety bond.

Monetary assets are accumulated for the purpose of meeting claims or expenses by the same payroll process that would accumulate and transmit the premium for state insurance claims processing. This procedure assesses the district a monetary amount for each hour of employment with the employees classified into three groups. The three classes are:

- Professional (e.g., clerical, teaching, administrative)
- Maintenance workers, bus drivers, food service workers
- Volunteers (medical aid only)

If the district lacks a system of recording hours of attendance and absences for salaried employees, the district is to use the assumed hours rule and report salaried employees at 40 hours per week and 160 hours per month. The assumed hours for premium calculation for teachers are to be calculated at 180 days at eight hours per day—1,440 hours. This can be reported at either 120 hours per month for 12 months or 160 hours per month for nine months.

The accumulation of most of the accrued liability, estimated industrial insurance benefits payable, takes place during the payroll taxes and benefits calculation portion of the payroll process.

If there are enough volunteer hours in the district to justify the entry, a periodic journal voucher charging the appropriate programs with the equivalent standard premium should be prepared. The number of hours times the medical aid rate for volunteers is the amount that should be charged.

In addition to the claims processed which are charged against the accrual generated by the medical aid and workers' compensation charges, the following items are also charged to the account:

- Administration expense assessed by the Department of Labor and Industries
- Second injury fund assessment by the Department of Labor and Industries
- Third party claims management and administrative fees
- Surety bond expense
- Excess insurance premium
- Supplemental pension and asbestos fund (this portion of the accrual was generated by a separate charge on both employee and employer and this portion of the program is handled by Labor and Industries).

A report is due to the Department of Labor and Industries by July 1 of each year showing estimated claims liability and the sources of revenue to meet those obligations. The documentation of the cumulative reserve must specify the type of funding and reflect the account balance. Surety requirements for governmental units are subject to periodic review by the department.

When this report is prepared, it would be the opportune time to assess the validity of the accrued benefit payable to make certain that the accrual rate is providing resources sufficient to pay claims incurred but not paid, as well as claims incurred but not reported. Any projected over- or under-accrual would be compensated for by adjustment of the assessment rates on each class of employee.

INTERFUND ACTIVITIES

Interfund activity is classified as reciprocal and nonreciprocal. Reciprocal interfund activity is the internal counterpart to exchange and exchange-like transactions and includes interfund loans and interfund services provided and used. Nonreciprocal interfund activity is the internal counterpart to nonexchange transactions and includes interfund transfers and interfund reimbursements.

GAAP establish two classes of interfund activity:

- ***Reciprocal interfund activity*** is the interfund equivalent of exchange and exchange-like transactions.
 - *Interfund loans* are amounts for which repayment is expected. They should be reported as interfund receivables to the lending fund and as interfund payables to the receiving fund. They should **not** be reported as other financing sources or uses in the fund financial statements. After adoption of board resolution, WAC 392-123-140 allows loans to the General Fund, Transportation Vehicle Fund, Capital Projects Fund, and Debt Service Fund. Loans are permitted from the General Fund or Capital Projects Fund only. Interfund loans do not increase budget capacity. Appropriate interest shall be charged.
(Reference: WAC 392-123-135 through WAC 392-123-160, RCW 28A.320.320.)
 - *Interfund services provided and used* are sales and purchases of goods and services between funds for a price comparable to their external exchange value. They are reported as revenues in the providing fund and expenditures in the receiving fund. Unpaid amounts are treated as interfund receivables or payables.
- ***Nonreciprocal interfund activity*** is the interfund equivalent of nonexchange transactions or transfers, previously known as "operating transfers" and "residual equity transfers."
 - *Interfund transfers* are defined as "flows of assets (such as cash or goods) without equivalent flows of assets in return and without a requirement for repayment." They should be reported as other financing sources in the receiving fund and other financing uses in the providing fund.
 - *Interfund reimbursements* are repayments from a fund responsible for expenditures to the fund that initially made the disbursement. Reimbursements are treated as adjustments and **not** reported in the financial statements.

Interfund Loans

Interfund loans are authorized (WAC 392-123-135 through 160), when approved by resolution by the school district board of directors as required, subject to the following:

- Loans are allowable to and from specific funds:

FROM:
General Fund (GF)

TO:
Capital Projects Fund (CPF)
Debt Service Fund (DSF)
Transportation Vehicle Fund (TVF)

FROM:
Capital Projects Fund (CPF)

TO:
General Fund (GF)
Debt Service Fund (DSF)
Transportation Vehicle Fund (TVF)

- Loans cannot be made from the ASB Fund, the Debt Service Fund, or the Transportation Vehicle Fund. Loans cannot be made to the ASB Fund.
- An interfund loan is considered to be a temporary loan of moneys between one district fund and another. An interfund loan is not considered to be an investment. As a temporary loan, it is to be completely liquidated in less than one year from the date of issuance.
- Loans shall not be made from any fund to the detriment of any function or project for which the fund was established. Moneys loaned should only include moneys that are clearly inactive or in excess of current needs.
- Interest shall be paid by the borrowing fund to the loaning fund and shall be at a rate not less than the warrant interest rate in the county in which the school district is considered to be located. The interest shall be a revenue of the loaning fund and an expenditure of the borrowing fund. Interest earned cannot be transferred to another fund.
- Financial reports of the district shall specify all outstanding interfund loans and all interest charges involved. The interfund loan shall not be used to balance the budget of the borrowing fund.
- The board of directors shall authorize the interfund loan by adopting a resolution stating the exact amount of the loan, the funds involved, the specific source of the repayment, the schedule for the repayment, and the interest rate involved.

- Interfund loans should be reported as interfund receivables in the lender funds and interfund payables in the borrower funds. This activity should not be reported as other financing sources or uses in the fund financial statements.

Interfund Services Provided and Used

School Districts engage in a variety of interfund services between funds. Examples of services provided and used include: bus-trip charges and printing services; charged from the General Fund to the ASB. These transactions are sales and purchases of goods and services between funds for a price comparable to their external exchange value. They are reported as revenues in the providing fund and expenditures in the receiving fund. Unpaid amounts are treated as interfund receivables or payables.

Interfund Transfers

GAAP defines interfund transfers as “flows of assets (such as cash or goods) without equivalent flows of assets in return and without a requirement for repayment.” Interfund transfers are recorded as other financing uses in the fund making the transfer and other financing sources in the fund receiving the transfer.

A properly executed board resolution authorizing an interfund transfer is required. The district’s board adopted budget resolution, if it accurately reflects the desired transfer, may serve as the required resolution. The board resolution authorizing an interfund transfer may be executed in increments. The amount and frequency of transfers may be determined by the district so long as the total transfer authority within the resolution is not exceeded. A budgeted transfer amount not previously credited into the receiving fund may be rescinded in accordance with the same requirements which were met to initially authorize the transfer.

Transfers of resources between funds are allowed in situations when the transfer is justified by meeting certain criteria outlined as follows:

- Transfers may be made from the General Fund to the Transportation Vehicle Fund as authorized by the adoption of a resolution of the board of directors.
- Transfers may be made to the Debt Service Fund from any fund issuing debt through nonvoted bonds (i.e., General Fund, Capital Projects Fund, and Transportation Vehicle Fund) to meet debt service payments. Authorization for the transfer should have been granted in the resolution authorizing the issuance of the debt.

- Transfers for the redirection of state apportionment may be made from the General Fund to the Capital Projects Fund and Debt Service Fund as authorized under RCW 28A.150.270 and WAC 392-121-445, subject to the following conditions and requirements:
 - The transfer will not result in a negative estimated ending fund balance in the General Fund.
 - The district board of directors must execute a resolution authorizing the transfer. However, the district's board adopted budget resolution, if it accurately reflects the desired transfer, may serve as the required resolution.
 - Whether the transfer resolution is included in the resolution to adopt the budget or if it is a separate, independent board resolution, a copy must be sent to OSPI to approve the transfer.
 - The transfer must specify the justification in detail and the dollar amount to be transferred.
 - This resolution must be received by OSPI on or before the tenth of the month in which the transfer is to begin.
 - Once apportionment moneys have been credited into the receiving fund by the County Treasurer, the resources cannot be subsequently transferred to the credit of another fund. The term "another fund" is not intended to imply the General Fund. Such resources may be credited back to the General Fund, for its original intended use.
 - The redirection of state apportionment is subject to specific use as authorized under WAC 392-121-445.
 - Resources committed to a specific purpose cannot be used for another purpose without the district taking the same type of action it employed to previously commit those amounts (GASBS 54 §10.) This includes, but is not limited to, a copy of the amended-use resolution sent to OSPI.
 - Apportionment, redirected by board resolution, may be transferred back into the General Fund for its original intended purpose, in accordance with the same requirements which were met to initially authorize the transfer.
- Additional statutory authority has been granted enabling districts to:
 - Transfer moneys related to state forest revenue from the Debt Service Fund to the Capital Projects Fund (RCW 28A.320.330(3) and RCW 79.64.110(3)). Districts receive distributions from revenues relating to the sale of harvest timber in proportion to the levies that they have enacted. Districts receiving state forest money in their Debt Service Fund that is not needed for the payment of debt service on district-issued bonds may transfer that money into the Capital Projects Fund.
 - Transfer moneys from the Capital Projects Fund to the General Fund for certain expenditures associated with the application and modernization of

technology systems for operations and instruction including, but not limited to, the ongoing fees for online applications, subscriptions, or software licenses, including upgrades and incidental services, and ongoing training related to the installation and integration of these products and services. (RCW 28A.320.330(2)(f)(ii)).

- Transfer moneys from the Capital Projects Fund to the General Fund for certain major renovation and repairs, and other major preventative maintenance purposes. Based on the district's most recent two-year history of General Fund maintenance expenditures, financial resources used for this purpose may not replace routine annual preventive maintenance expenditures made from the district's General Fund (RCW 28A.320.330(2)(g)).

Residual equity transfers are no longer specifically named in GAAP but are a type of nonreciprocal interfund transfer. Residual equity transfers are included in this section and are allowed in situations when the transfer is justified by meeting certain criteria outlined as follows:

- Equity transfers are initiated by board resolution and occur when the purpose for which a fund was established no longer exists, however, the district's board adopted budget, if it accurately reflects the desired transfer, may serve as the required resolution.
- All claims against the fund to be closed must be resolved before the authority to make the equity transfer is executed.
- All restrictions imposed on the use of resources remaining as residual equity within a fund must be resolved before the authority to make the equity transfer is executed.
- The Debt Service Fund should remain open for the established purpose of subsequent tax collections (RCW 28A.320.330(3)).

Interfund Reimbursements

Interfund reimbursements are repayments from a fund responsible for expenditures to the fund that initially made the disbursement. Interfund reimbursements are **not** Interfund transfers. Interfund reimbursements are treated as adjustments and **not** reported in the financial statements.

A transaction would be reported as a reimbursement when:

- An accounting error has been made (e.g., moneys were deposited or an expenditure was charged to an incorrect fund).
 - When a revenue, intended for deposit in one fund (fund A), is incorrectly deposited into another fund (fund B), fund B reverses the deposit by reimbursing fund A. Fund A records the moneys received as revenue from the original source.
- When a single fund, usually the general fund, pays an invoice or payroll for other funds (i.e., as a convenience), and then charges back the expenditure to the appropriate fund where the cost should be reported.
 - When an expenditure is made from one fund (fund A) on behalf of another fund (fund B), fund B records the expenditure by reimbursing fund A. Fund A records the moneys received as an adjustment to the original expenditure.

Crediting Investment Earnings

When authorized by the board of directors, any interest or earnings on investments being credited to a fund different from that which earned the interest or earnings shall only be expended for instructional supplies, equipment, or capital outlay purposes as long as it is not restricted or prohibited by another statute (RCW 28A.320.320).

For example, RCW 28A.160.130 does not permit transfer of funds from the transportation fund to any other fund. Similarly, RCW 28A.325.030 requires all moneys generated through the programs and activities of any Associated Student Body be deposited in the Associated Student Body program fund. It allows investment *for the sole benefit of the Associated Student Body program fund* in the items enumerated in RCW 28A.320.320.

RCW 28A.530.030 and RCW 28A.320.330 require moneys from bonds issued and sold be deposited to the Capital Projects Fund where they and interest earnings on them be used only for capital purposes under RCW 28A.530.010 or be deposited to the Debt Service Fund. Once in the Debt Service Fund only the interest on the bond interest, not the bond interest itself, would be eligible for credit to another fund for uses described above.

JOINT VENTURES AND INTERLOCAL GOVERNMENTAL AGREEMENTS

Authority

RCW 39.34 authorizes school districts as well as public agencies, to form joint ventures, generally referred to as "Shared Service Arrangements" or "cooperatives," for the provision of services or the sharing of facilities. (More information on accounting for Shared Service Arrangements is available later in this chapter.) Joint ventures can be among school districts, other local government agencies, state government agencies, federal government agencies, or a combination of such governments. Such joint ventures are either "joint operating agencies" or "contracted interlocal agreements" depending on the form of governmental organization that meet the geographic, economic, population, or other factors influencing the decision to form the joint venture. Specific law dictates other limitations or requirements on the joint venture. School districts use these forms of cooperatives to provide athletic league management, special instructional facilities and programs, and employee benefit programs.

Descriptions of cooperative requirements are as follows:

- The interlocal agreement is a contract allowing the parties to jointly exercise some power, privilege, or authority already capable of being exercised by the parties as independent agencies of government. The manner of financing the joint venture shall be as provided by law. The duties, rights, and responsibilities of the cooperating agencies should be delineated in the agreement.
- The agreement may establish a separate legal or administrative entity, which must be legally authorized. The agreement must specify the duration of the agreement, organization of the administrative entity, purpose of the agreement, manner of financing, and the methods of termination. The entity would be subject to audit in the manner provided for all public entities.
- If the agreement does not establish a separate legal entity, the agreement must specify the items in the preceding paragraph and provide for an administrator or a joint board responsible for administering the cooperative undertaking. The agreement must detail the manner of the joint board in acquiring, holding, and disposing of real or personal property used in the joint venture.

RCW 39.34.040 requires interlocal governmental agreements be filed with the county auditor or, alternatively, listed by subject on a public agency's website or other electronically retrievable public source.

Accounting Procedures

To determine the accounting treatment, the interlocal agreement must be evaluated by each member district to determine if there is a financial interest or oversight responsibility for the joint venture. If no equity interest or responsibility is retained by the district, or the district does not exercise oversight responsibility, the interlocal agreement should be footnoted and accounted for in an appropriate fund of the district.

Any district meeting the definition of a "reporting entity" or any district named as the "reporting entity" in the interlocal agreement must take responsibility to account for the joint venture. A "reporting entity" is the district responsible to account for the joint venture if the district exercises substantial control of the joint venture through oversight responsibility. In this case, the joint venture is accounted for as a component unit of the district.

Financial statements of members should contain the following with respect to joint ventures:

- A general description of each joint venture.
- Condensed or summary financial information on each joint venture.
- The debt of the joint venture, both current and long-term.

GASB Cod. Sec. 2100 should be consulted to determine the proper presentation of component units.

Shared Service Arrangements

A Shared Service Arrangement (SSA) is formed when two or more entities agree to join together and perform specific services. SSAs are also referred to as cooperatives or consortiums.

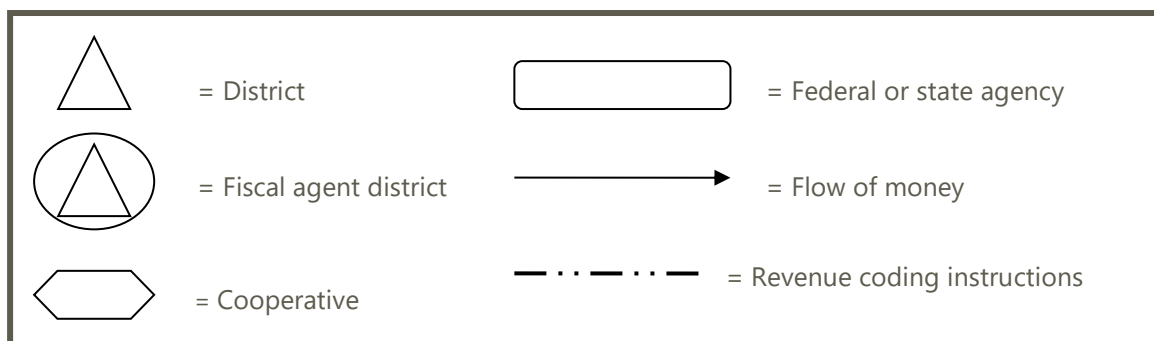
An SSA is not a separate legal entity, but may be governed by a legal document (i.e., interlocal agreement). The legal document may describe the services to be furnished and address the provision of various administrative functions.

Numerous federal programs, as well as many state-funded programs, encourage, and in some instances, require districts to be a part of an SSA. This additional nuance to SSAs requires us to define some specific terms when involved in these arrangements:

- **Fiscal Agent:** An entity that has been empowered to handle fiscal matters for another entity, including disbursement or passing through of funds. This may include ensuring that the funds are used only for specific purposes defined by the grant or agreement.
- **Sub-Recipient:** An entity that expends grants or other financial assistance received from a fiscal agent or a pass-through entity.
- **Pass-Through Entity:** An entity that provides grants or other financial assistance received by a governmental entity to transfer to, or spend on behalf of, a secondary recipient or sub-recipient.
- **Vendor:** A dealer, distributor, merchant, or other seller providing goods or services that is required for the conduct of a federal or state program. These goods or services may be for an organization's own use or for the use of beneficiaries of the federal or state program. (For example, an ESD or school district that provides a service to another ESD or school district would be considered a "vendor.")

The preceding definitions are illustrated in the following charts:

Funding Flow Charts for Shared Service Arrangements Legend:

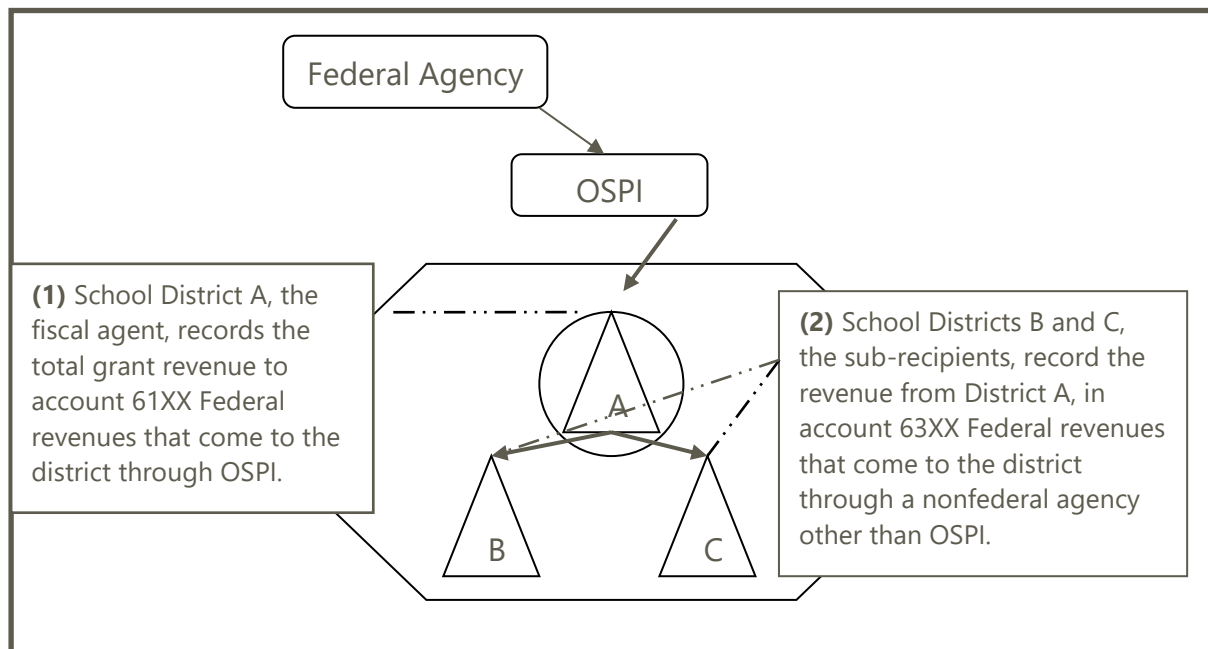


Fiscal Agent and Sub-Recipient

In this example, we have a federal grant that is being passed through from one district to another. The grant requires there to be a fiscal agent who passes through grant money to member districts. Refer to Chapter 7 for more information on participating and non-participating fiscal agents.

- District A is the fiscal agent for the grant.
- Districts B and C are sub-recipients of the grant.
- Districts A, B, and C are in a shared service arrangement.
- When the proceeds of the grant are awarded from the federal agency to OSPI, OSPI passes the funds through to District A (the fiscal agent), who records the total grant revenue to account 61XX, Federal revenues that come to the district through OSPI. See (1) on Chart 1.
- District A will then “pass through” the appropriate amount of grant proceeds to Districts B and C (the sub-recipient districts). Districts B and C then record the grant revenue to account 63XX, Federal revenues that come to the district through a nonfederal agency other than OSPI. See (2) on Chart 1.

Chart 1 – Fiscal Agent and Sub-Recipient

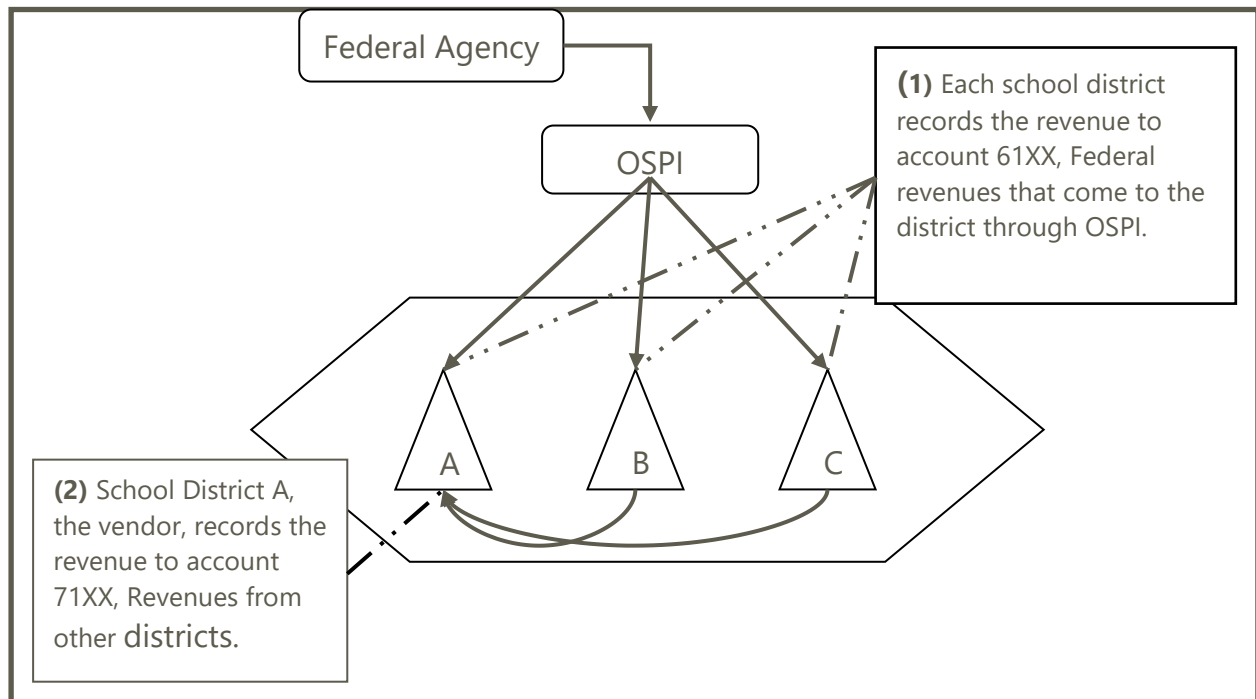


Vendor

This is an example of a school district providing a contracted service to other school districts. School Districts A, B, and C are receiving federal funding from OSPI for xyz program. School Districts A, B, and C have entered into a shared service arrangement (or a cooperative). District A, the **vendor**, provides xyz program services to their own district as well as Districts B and C. School District A bills School Districts B and C, who then pay School District A for services provided.

- All the districts (A, B, and C) record the federal revenue to account 61XX, Federal revenues that come to the district through OSPI.
- School District A, the vendor, bills Districts B and C for services provided. See (1) on Chart 2.
- School District A records the revenue from Districts B and C to account 71XX, Revenues from other districts. See (2) on Chart 2.

Chart 2 – Vendor



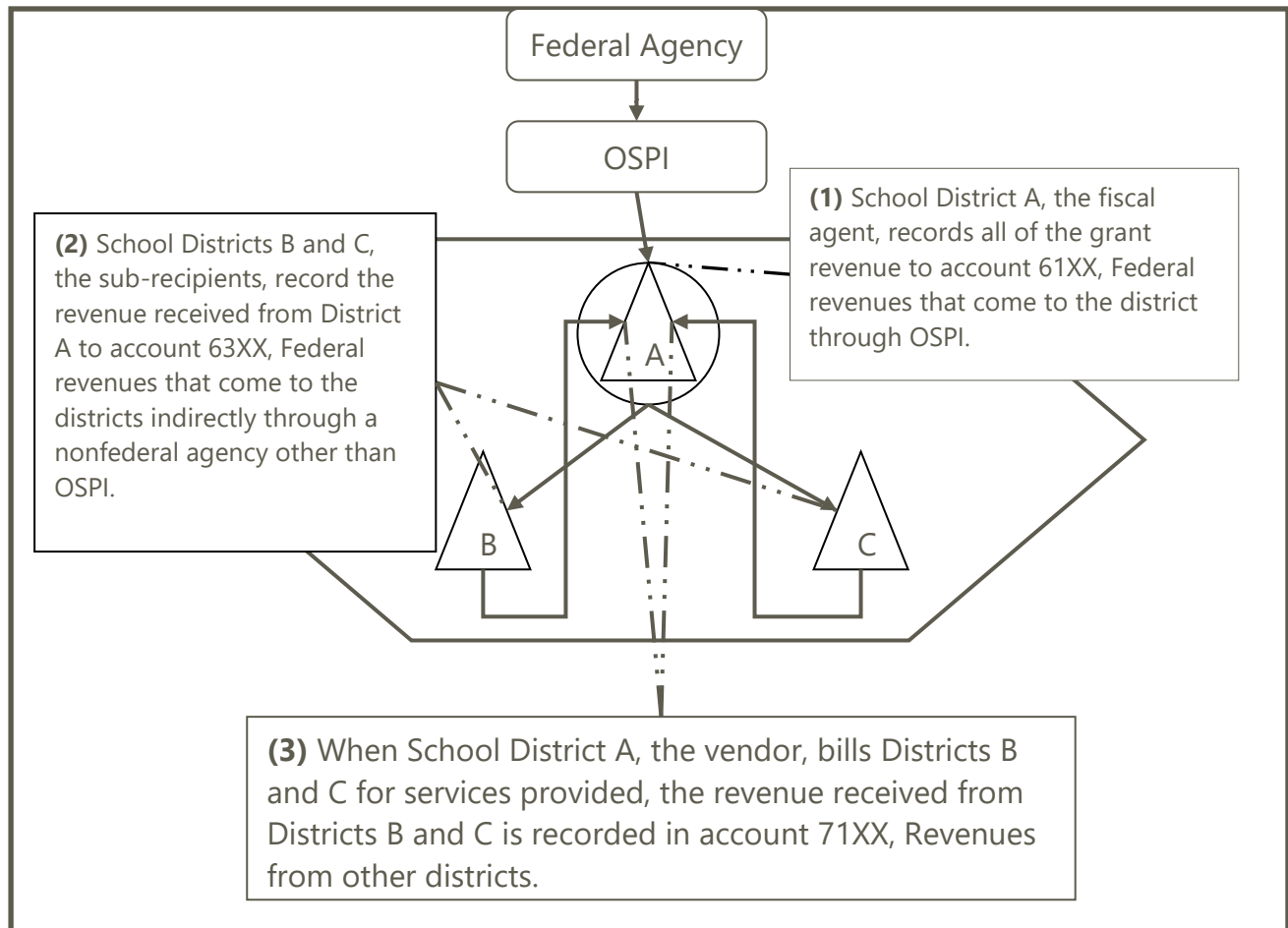
Fiscal Agent, Sub-Recipients, and Vendor

School Districts B and C apply for a federal grant; however, the districts do not qualify for the grant on their own, but may be able to receive the grant money if they use a qualifying school district to be the **fiscal agent**. School District A agrees to be the fiscal agent of the grant for School Districts B and C, the **sub-recipients**. In addition to the fiscal agent responsibilities for the grant, School District A is also providing services to the member districts as a **vendor**.

- School District A, the fiscal agent, receives the federal revenues from OSPI and records all of the grant revenue to account 61XX, Federal revenues that come to the district through OSPI. See (1) on Chart 3.

- School Districts B and C, the sub-recipients, receive their portion of the grant and record the revenue received from District A to account 63XX, Federal revenues that come to the districts indirectly through a nonfederal agency other than OSPI. See (2) on Chart 3.
- When School District A, the vendor, bills Districts B and C for services provided, the revenue received from Districts B and C is recorded in account 71XX, Revenues from other districts. See (3) on Chart 3.

Chart 3 – Fiscal Agent, Sub-Recipients, and Vendor



Responsibilities of the Fiscal Agent

The fiscal agent usually performs the budgeting and accounting responsibilities related to the project. The fiscal agent generally is responsible for ensuring revenues are used in accordance with grant provisions and **may** be responsible for ensuring other requirements, such as matching and maintenance of effort, are met.

If the program revenues are not used in accordance with the grant provisions, the fiscal agent may be financially responsible for the consequences of instances of noncompliance. The fiscal agent may also be financially responsible if a member school district is unable to pay back its respective portion of questioned costs.

As the title suggests, the entity selected as the fiscal agent for a shared service arrangement is responsible for the overall financial management of the program. This **may** include:

- **Processing Financial Transactions:** Includes the request for and deposit of grant revenue, payment of all allowable expenditures, and preparation of journal vouchers.
- **Maintaining Source Documentation:** Includes invoices, bills, payroll records, etc. to substantiate expenditures.
- **Preparing and Submitting Requests:** Includes requests for program revenues to the granting agency.
- **Preparing and Distributing to Member Units:** Includes a final financial report allocating total program costs to each of the member units. (Individual districts are responsible for reporting their share of expenditures on the annual financial reports submitted to the granting agency.)

Responsibilities of Member Districts

Member district responsibilities usually concern employment of personnel, budgeting, accounting, and reporting. A shared service arrangement's agreement should specifically address these or other responsibilities, as appropriate, for the specific agreement. *In general*, the responsibilities may include the following:

- **Budgeting:** It is the responsibility of each member district to budget the portion of the moneys it receives through the fiscal agent.
- **Accounting:** Each member district is responsible for maintaining and having available for audit accounting records for that portion of the moneys it receives from the fiscal agent.
- **Reporting:** The member district is responsible for reporting moneys expended by ***its district only*** to the granting agency. In addition, the member district is responsible for submitting detailed expenditure information to the fiscal agent for required state or federal reporting.

Note: Responsibilities will vary depending on the specific program and agreement. A written agreement, signed by the fiscal agent and all members, is strongly encouraged.

Fiscal Agent Accounting Treatment

The fiscal agent may be a recipient of the program under the arrangement (a *participating district*), or can administer the arrangement and not receive program revenues (a *non-participating district with or without administrative responsibilities*).

- **Fiscal Agent as a Participating District:** A district that enters into an agreement to administer the grant funds. The district receives the specified funds and disburses such funds in accordance with the outside entity's approval. The district is one of the grant recipients and their district is involved in defining the program and is involved in any program decisions over the allocation or expenditures of such funds at their districts.
 - **Accounting Treatment:** This district should recognize all fiscal activity as revenue and expenditures in the fund financial statements. See Chapter 7, Scenario 1.
- **Fiscal Agent as a Non-Participating District with Administrative Responsibilities:** A district that enters into an agreement with another entity to administer the entity's specific grant funds, as prescribed by the grantor. The district receives the specified funds and disburses such funds in accordance with the outside entity's approval. The district is not one of the grant recipients, but is responsible for grant compliance.
 - **Accounting Treatment:** This district should recognize all fiscal activity as revenue and expenditures in the fund financial statements. See Chapter 7, Scenario 2.
- **Fiscal Agent as a Non-Participating District with No Administrative Responsibilities (Cash Conduit Only):** The district does not have administrative responsibilities, but does receive the specified funds, and disburses such funds in accordance with the outside entity's approval. The district is not one of the grant recipients, is not involved in defining the program, and is not involved in any program decisions over the allocation or expenditures of such funds at their district.
 - **Accounting Treatment:** In infrequent cases, in which a recipient entity serves only as a cash conduit, the funds should be reported in the agency fund (fund 7). A recipient government serves only as a cash conduit if it merely transmits grantor-supplied moneys without having administrative or direct financial or programmatic involvement in the program. See Chapter 7, Scenario 3.

- **Fiscal Agent as a Participating District and On Behalf Payments:** This is the same as the Fiscal Agent as a Participating District, but the fiscal agent purchases services or equipment for themselves or the sub-recipients of the program (or on behalf of the other district) in addition to the fiscal agent responsibilities. Purchases are made in accordance with the agreement and the program requirements.
 - **Accounting Treatment:** This district should recognize all fiscal activity as revenue and expenditures in the fund financial statements. See Chapter 7, Scenario 4.

INDIRECT COST LIMITS, CARRYOVER, AND RECOVERY

Overview

Indirect cost limits ensure that state and federal moneys are expended for intended uses and for allowable costs. Allowable costs include expenditures directly traceable to the program called **direct expenditures**, plus a limited allowance for overhead or **indirect expenditures**. In addition, some programs permit part of the allocation to be **carried over** from the current fiscal period to a future fiscal period. Indirect cost limits and carryover limits are defined in laws, rules, or program requirements. OSPI recovers money from districts that report insufficient direct program expenditures, after allowance for indirect charges and carryover, if permitted. This section describes indirect cost and carryover limits and recovery procedures for many state and federal programs. For budgeting purposes, districts typically calculate the **minimum direct expenditure** amount by dividing the program revenue by 1.00 plus the district's indirect expenditure rate. The remaining revenue is the maximum indirect charge. For example, if the total allocation is \$100,000 and the indirect limit is 3.0 percent, the following calculations are performed:

$\$100,000 \div 1.03 = \$97,087$ Minimum direct program expenditures.

$\$100,000 - 97,087 = \$2,913$ Maximum indirect charges to the program.

The district may charge **less** than the maximum indirect charges.

Any carryover from the prior year increases the district's minimum direct expenditures in the current year.

State Programs

Many state formula-funded (apportionment) revenues are subject to recovery if not expended for a specific purpose during the school year. In most cases, the recovery calculation is based on school year expenditures as reported on Form F-196, Annual Financial Statement. In some cases, a special report is used to determine recovery.

The 2016–17 school year apportionment recoveries were made in January 2018 based on the final 2016–17 state allocations and year-end expenditures reported to OSPI. The 2017–18 school year recoveries will be made in January 2019 based on final 2017–18 state allocations and year-end expenditures reported to OSPI. At the end of the school year, a spreadsheet for estimating recoveries will be posted on the SAFS Web page under Tools/Forms at the following link: <http://www.k12.wa.us/safs/TT/tt.asp>.

Federal Programs

Indirect expenditure rates allowed on federal grants awarded to school districts are established by the Office of Superintendent of Public Instruction (OSPI) following an agreement with the U.S. Department of Education (ED). This agreement prescribes the method of rate computation and the resulting rates establish the maximum amount of indirect expenditures that may be claimed for a federal grant.

Restricted Versus Unrestricted Indirect Expenditure Rates

One fixed with carry-forward indirect cost rate is calculated for each district for all of its restricted federal grants and another fixed with carry-forward indirect cost rate is calculated for all of its unrestricted federal grants. Rates are annually computed for each district and are unique for each district. Questions regarding restricted and unrestricted rates should be made to School Apportionment and Financial Services.

Restricted rates are used with grants where “supplement but not supplant” language is in the authorizing legislation. Almost all federal programs fall into this category. Restricted rates must be used for all federal programs except those for which the restricted rate is not required.

Unrestricted indirect cost rates are used for the few federal grants that allow its use. Generally these are grants without supplement not supplant limitations. The calculation for the unrestricted rate is similar to the restricted rate except expenditures for maintenance and grounds are included, resulting in a higher rate.

Direct expenditures for determining both federal restricted and unrestricted rates consist of all other General Fund expenditures except those distorting items for capital outlay and debt service interest which are excluded from the calculation.

How the Federal Indirect Expenditure Rates Are Computed

In general the computation for an indirect expenditure rate is: Indirect Expenditure Pool divided by the Direct Expenditure Base. Uniform Guidance outlines many factors regarding the classification of costs. Some of these factors are described later in this section.

Federal indirect expenditure rates for the current year are based upon financial information in each school district's annual financial statement, SPI Form F-196, for the 2 years prior to the current year. Therefore, the rates depend upon base-year data that are two years old.

An indirect expenditure rate determines what proportion each grant or contract shall bear of the joint or common expenditures benefiting all school district programs. These expenditures are specifically allowed by the U.S. Department of Education to be allocated to all other school district programs.

Certification and Documentation of the Federal Indirect Cost Rate Proposal

All school districts must prepare an indirect cost rate proposal (proposal) within six months after the close of the fiscal year end or by a date approved by OSPI. The proposal will include documentation to support the indirect cost rates and must be retained for audit in accordance with the records retention requirements contained in §200.333. Every school district's proposal must be accompanied by a certificate signed on behalf of the school district by an individual at a level no lower than assistant superintendent or chief financial officer of the school district that submits the proposal.

Required Elements of the School District's Federal Indirect Rate Cost Proposal

A school district's proposal must include the following required elements:

- The annual submission of the school district's financial data reported on OSPI's Annual Financial Report, F-196
- The rates proposed, including other relevant data embedded in the F-196

- An Organizational Chart showing the structure of the school district along with a functional statement noting the duties or responsibilities of all units that comprise the school district.
- A Certificate of Indirect Costs

Federal Indirect Rate Cost Proposal

The following format is provided as an example for a school district's Federal Indirect Rate Cost Proposal. A school district may customize the format.

The _____ School District is presenting the following documentation in support of our Federal Indirect Rate Cost Proposal for the fiscal year 20XX – XY

Proposed Federal Restricted Rate	XX.XX%
Proposed Federal Unrestricted Rate	XX.XX%

Relevant data and the methodology which supports the proposed rates are included as supplementary schedules embedded in the school district's Annual Financial Report, F-196, submitted to OSPI per WAC 392-117-035.

An Organizational Chart showing the structure of the school district along with a functional statement noting the duties or responsibilities of all units that comprise the school district is attached.

Required certification of the Federal Indirect Cost Rate Proposal is attached.

Certificate of Indirect Costs

The following Certificate of Indirect Costs format is provided as an example for school districts. A school district may customize the format. The documentation should be retained by the district and available for program review and audit purposes

This is to certify that I have reviewed the indirect cost rate proposal submitted herewith and to the best of my knowledge and belief:

(1) All costs included in this proposal, dated [identify date], to establish final indirect cost rates for fiscal year [identify period covered by rate] are allowable in accordance with the requirements of the Federal award(s) to which they apply and the provisions

of this Part. Unallowable costs have been adjusted for in allocating costs as indicated in the indirect cost proposal.

(2) All costs included in this proposal are properly allocable to Federal awards on the basis of a beneficial or causal relationship between the expenses incurred and the agreements to which they are allocated in accordance with applicable requirements. Further, the same costs that have been treated as indirect costs have not been claimed as direct costs. Similar types of costs have been accounted for consistently and the Federal Government will be notified of any accounting changes that would affect the predetermined rate.

I declare that the foregoing is true and correct.

School District:

Signature:

Name of Official:

Title:

Date of Execution:

Classifications of Costs

Indirect costs are those not readily identifiable with the activities of the grant, but incurred for the joint benefit of those activities and other activities of the organization. In general, indirect costs are selected administrative and service expenditures in Program 97 Districtwide Support. Typical examples of indirect costs may include procurement, payroll, personnel functions, maintenance and operations of space, data processing, accounting, auditing, budgeting, printing, warehousing and distribution, communications (telephone, postage), and selected expenditures that can be documented as allowable costs to be included into the indirect expenditure cost pool.

In accordance with 2 CFR Part 200.414, indirect costs are: (a) Incurred for a common or joint purpose benefiting more than one objective; and (b) Not readily assignable to the cost objectives specifically benefited, without effort disproportionate to the results achieved.

The uniform guidance specifically references what costs may be included within the direct base for fair sharing of the rate within 2 CFR 200.413. Any item not on this listing are unallowable costs and explicitly excluded from the indirect cost pool.

Examples of unallowable costs include: bad debts, contingencies, entertainment, fines/penalties, and general governance.

According to CFR 200.444, certain General Management Costs are unallowable costs and must not be included in the indirect cost pool. These costs are to be included in the base calculation. Washington state school district organizational structures vary greatly and it is the school district's discretion to determine what constitutes its general management costs. Within the CFR guidance, the expenditures that cannot be included in the Indirect Cost Pool for a school district include:

1. The governing body (members of the board of education).
2. Compensation of the chief executive officer (Superintendent of the school district).
3. Compensation of the Heads of Component Offices (Top Executive-Level positions of the school district).
4. The operation of the immediate offices of these officers (Executive Assistants and associated costs).

Salaries, benefits (including termination leave payouts), communications/telephone charges, and other expenditures related directly to the operation of the superintendent's office, the Heads of Component Units of the school district, and board of education offices, specifically, are not included in indirect costs and are considered, for rate purposes, to be unallowable costs in the calculation of the Restricted Indirect Cost Rate.

A cost may not be allocated to a federal program as an indirect cost if any other costs incurred for the same purpose, in like circumstances, has been assigned to a federal program as a direct cost.

OMB Uniform Grants Guidance requires distorting items to be excluded from the distribution expenditure base in the indirect cost computations. Examples of extraordinary or distorting costs include capital outlay, debt service, judgements, and certain transfers. Subaward payments (an award provided by a pass-through entity to a subrecipient to carry out part of a Federal award, not including payments to contractors for goods and services) in excess of the first \$25,000 are distorting items and also excluded from the indirect cost rate calculation.

Indirect Expenditures for Cooperative Projects

When there is a cooperative project, the indirect expenditure rate of the administering district is to be used on all direct expenditures claimed in the cooperative project. The indirect expenditure reimbursement is paid to the administering district.



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