

Legislative Research Commission

Reporting Total Revenue: On-behalf Payments and Local Activity Funds

Research Report No. 388

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Foreword

The Education Assessment and Accountability Review Subcommittee directed the Office of Education Accountability to study the state's system for reporting educational revenues, including state and federal on-behalf payments and district and school activity funds. This report is the result of the study.

Office of Education Accountability staff would like to acknowledge the Kentucky Department of Education staff and district finance officers for providing assistance.

Robert Sherman
Director

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Summary

Comprehensive accounting of state and district education revenue is necessary to provide policy makers and the public with accurate profiles of revenue at the national, state, and local levels. District annual financial reports (AFRs) are the primary source of data for district revenue and are also used to calculate total state revenue as reported to the federal government. This study identifies and reports revenue that has not been reported on AFRs in the past and revenue inconsistently reported among districts. It focuses on two broad sources of revenue: on-behalf payments and local activity funds. On-behalf payments are those made by the Kentucky Department of Education (KDE) and other entities on behalf of local school districts. The majority of state on-behalf payments are made up of teacher retirement and health benefits. Local activity funds are revenues collected locally for functions such as textbook rental, athletics, and student clubs.

Federal guidelines outlined by the National Center of Education Statistics (NCES) require reporting of both on-behalf payments and local activity fund revenue on district AFRs. KDE requires districts to report the majority of state on-behalf payments, but it does not require districts to report local activity funds, technology-related on-behalf payments, or debt service on-behalf payments made by the School Facilities Construction Commission (SFCC). In 2010, local activity funds totaled \$184 million. On-behalf payments totaled \$1.06 billion, \$120 million of which were technology and SFCC-related payments.

This study provides a more comprehensive accounting of total state and district revenue than has been provided in the past. In conducting the study, staff analyzed fiscal year 2006 through fiscal years 2010 AFR data as well as additional data for revenue not reported or reported inconsistently on AFRs in those years. The study identifies two additional sources of revenue that are required by NCES but not reported or underreported on AFRs: federally donated commodities, and local contributions and donations from private sources such as parent-teacher groups and booster clubs. However, staff were not able to capture these revenues because comprehensive data are not available.

Also described in detail are discrepancies or omissions identified by staff in the way districts are recording revenue on AFRs. Six recommendations are made on steps that can be taken by KDE to ensure more comprehensive and consistent reporting of revenue in the future. OEA has made similar recommendations in two previous reports. In response, KDE has updated the chart of accounts to mirror NCES standards but has not yet taken the steps necessary to ensure that total revenue is accurately recorded and reported.

The report makes six recommendations.

Recommendation 1

The Kentucky Department of Education should update the *Accounting Procedures for School Activity Funds*, known as the Redbook, to reflect federal activity fund guidelines and the inclusion of contributions and donations from booster clubs and parent-teacher groups.

The department should also require districts to record activity funds and booster clubs' and parent-teacher groups' revenue and expenditures on the annual financial reports.

Recommendation 2

The Kentucky Department of Education should ensure that district financial audits include activity fund receipts and expenditures per the audit contract. The department should also require auditors to follow National Center for Education Statistics and Governmental Accounting Standards Board requirements in reporting school activity funds as fiduciary funds and reporting district activity funds as special revenue funds.

Recommendation 3

The Kentucky Department of Education should require all districts to use Fund 400 to record all debt service payments, including on-behalf payments from the School Facilities Construction Commission. The department should eliminate Fund 410 so that all debt service is recorded in one fund per Governmental Accounting Standards Board requirements. The department should also provide guidance to district finance officers and auditors on how revenues and expenditure should be recorded consistently in Fund 400.

Recommendation 4

The Kentucky Department of Education should ensure that all on-behalf payments are accurately coded and recorded on annual financial reports.

Recommendation 5

The Kentucky Department of Education should audit district payroll accounts or take other steps to ensure that districts accurately reimburse the department for employee benefit payments made on behalf of employees paid out of federal grants at the local level.

Recommendation 6

The Kentucky Department of Education should advise districts and auditors on how to correctly code federal government-donated commodities on the district annual financial reports.

Reporting Total Revenue

Introduction

Comprehensive and correct reporting of revenue and expenditures on district annual financial reports (AFRs) is critical to provide policy makers and the public with accurate fiscal data.

State and local education expenditures and revenues are used in many ways to compare and contrast funding of states and districts. Accuracy of data is paramount, especially in reviewing equity and adequacy, comparing state revenue and expenditures at the national level, and transparent reporting at the local level. The National Center for Education Statistics (NCES) establishes revenue and expenditure categories to be used by school districts to record and report fiscal data on annual financial reports (AFRs) and by states to report fiscal data to the federal government. In Kentucky, substantial amounts of state, local, and federal revenue that are required by NCES are either not reported on district AFRs or are reported inconsistently from district to district. This has resulted in underreporting of total education revenue to the federal government and in difficulty making accurate comparisons among Kentucky districts.

This study identifies revenue from on-behalf payments and local activity funds. On-behalf payments are underreported on AFRs, and activity funds are not reported at all.

This study identifies revenue from on-behalf payments and local activity funds. On-behalf revenue is currently underreported on AFRs, and activity fund revenue is not reported at all. On-behalf revenue comes from payments made by the Kentucky Department of Education (KDE) and others on behalf of local school districts. Districts are required by KDE to record most on-behalf payments on AFRs but are not required to record on-behalf payments for technology programs or School Facilities Construction Commission (SFCC) debt service. These two sources totaled nearly \$120 million in fiscal year 2010. Activity funds are revenues collected locally for functions such as textbook rental, athletics, and student clubs. They totaled more than \$184 million in FY 2010.

Two revenue sources are required by National Center for Education Statistics (NCES) but are underreported or are unreported on AFRs: federally donated commodities and local contributions and donations from private sources.

The report identifies two additional sources of revenue that are required by NCES but that are underreported or not reported on AFRs: commodities, such as food, donated by the federal government to districts; and local contributions and donations from private sources, such as parent teacher organizations and booster clubs. Data for private local contributions and donations are not collected by KDE in any form, and AFRs do not contain data from federally donated commodities for all districts.

This report identifies five categories of revenue that should be reported or reported more consistently on AFRs.

In total, staff identified five categories of revenue that must be reported or reported more consistently on AFRs to ensure that revenue data are accurate in the Commonwealth:

1. State revenue from on-behalf payments that are not reported.
2. State revenue from on behalf payments that are reported but coded incorrectly or inconsistently from district to district.
3. Local revenue from activity funds that are not reported.
4. Local revenue from private contributions and donations that are not reported.
5. Federal on-behalf revenue from federally donated commodities that are not reported consistently.

Previous Reports and Recommendations

The Office of Education Accountability (OEA) previously identified concerns about accurate reporting of on-behalf payments and local activity funds. The Kentucky Department of Education (KDE) has yet to address these concerns.

In two previous reports, OEA identified concerns and made recommendations related to data integrity issues. Its *Indicators of Efficiency and Effectiveness in Elementary and Secondary Education Spending* reported in 2006 that Kentucky was not adhering to NCES guidelines on school and district activity fund accounting requirements and was, therefore, understating revenues and expenditures in data for federal reporting. The study also noted that some on-behalf payments were neither reported on district AFRs nor reported to the federal National Public Education Financial Survey that allows national comparisons of state financial data. The report recommended that KDE review and take steps to address these issues by enforcing and monitoring district use of existing protocols, providing detailed descriptions in the Chart of Accounts, and providing regular training to school and district financial staff. OEA's *Fees, Dues, and Supplies in Kentucky Schools* report in 2008 reiterated concerns that local activity funds are not reported and recommended that KDE update the *Accounting Procedures for School Activity Funds*, known as the Redbook, to reflect NCES guidelines for reporting these funds. In response, KDE has made adjustment to the chart of accounts but has yet to address the other concerns identified in previous OEA reports about proper recording of on-behalf payments or activity funds.

Study Objectives and Methodology

Data for this report are taken from AFRs and additional sources that provide more accurate data than are currently available on AFRs.

Data for this report are taken primarily from FY 2006 through FY 2010 district AFRs; district financial audits; SFCC data showing on-behalf payments for districts; and KDE data on technology-related on-behalf payments made to districts. To

capture local activity funds that have not been recorded on AFRs, staff analyzed school-level statements of receipts, disbursements, and fund balances that accompany audits each year. Staff used SFCC and KDE data to capture construction- and technology-related on-behalf payments that have not been recorded in the past. Staff analyzed district AFRs to determine whether currently reported on-behalf payments are being coded to the appropriate funds or revenue codes. Because of the high number of errors found in recording of on-behalf payments on AFRs, staff used KDE data rather than AFR data to capture on-behalf revenue for all sources.

In conducting this study, staff consulted with the KDE personnel who work in the Office of Administration and Support and the Office of Knowledge, Information and Data Services. Staff also contacted district finance officers to resolve apparent discrepancies in the way that on-behalf payments have been coded and spoke with staff at two Kentucky educational cooperatives.

Guidance on Reporting of Revenue

Federal

NCES requires districts to report revenue from on-behalf payments, local activity funds, and all other revenue sources discussed in this report.

NCES, which is located in the federal Department of Education, is the primary federal entity that collects and reports education data. NCES established the Financial Accounting for Local and State School Systems, which is a chart of accounts used by states to uniformly report financial data that can be compared across districts and states. The 2003 version described how district and school activity funds and local private donations and contributions should be identified and reported as revenues and expenditures. In 2003, NCES also updated the document to include the mandated reporting of direct cost payments made by the state or federal government on behalf of school districts in the national chart of accounts (United). In conversations with OEA staff, NCES representatives indicated that revenue from activity funds, technology services, and SFCC debt service payments should be reflected on AFRs and included in the data reported annually to the federal government. NCES also indicated that these data are routinely reported by other states.

Kentucky Department of Education

The KDE chart of accounts contains revenue and expenditures reporting categories that are consistent with NCES guidelines.

KDE has adopted its own chart of accounts that establishes uniform revenue and expenditure reporting categories to ensure standard reporting among Kentucky districts. The KDE chart of accounts mirrors the NCES broad guidelines for establishing account classification descriptions, including the codes and accounting structures necessary to comply with NCES reporting requirements for on-behalf payments, local activity funds and private local contributions and donations, and federally donated commodities.

KDE has promoted consistent reporting of state, local, and federal revenue. Most of this revenue is reported accurately.

Through its monitoring and guidance, KDE has promoted consistent reporting of direct state, local, and federal revenue on district AFRs. In this report, the term “direct revenue” refers to those sources of revenue that are received directly by districts and deposited in district accounts. Finance reporting software requires that these funds be coded as they are deposited, and KDE monitors correct reporting of direct revenue through its review of annual audits. For these reasons, the overwhelming majority of direct revenue is reported accurately on AFRs.¹

Beginning in 2004, KDE required districts to report most on-behalf revenue. KDE has yet to require districts to report revenue from on-behalf payments for technology, debt service on-behalf payments made by the School Facilities Construction Commission (SFCC), local activity funds, private local donations and contributions, and federally donated commodities.

Proper recording of other revenue, including activity funds and on-behalf payments, has received relatively less attention, however. Beginning in 2004, districts were required by KDE to record most types of on-behalf payments. These included teacher retirement, health insurance, flexible spending, health insurance administrative fees, life insurance, and expenses for state-run vocational schools. In 2009, KDE provided districts with an updated version of the audit contract that specifies components required in audits. The updated version required that audit statements include on-behalf payments. To date, however, KDE has not required districts to record technology-related on-behalf payments, SFCC payments, local activity funds, and private local donations and contributions. While districts are supposed to report federally donated commodities, about one-third of districts do not.² KDE has not required audit contracts to include attention to these revenue sources.

¹ Staff did find and correct some errors in reporting of direct revenue. However, these errors represent a small percentage of total direct revenue. Direct revenues were adjusted in this report to correct these errors.

² In 2007 and 2008, KDE did direct districts to include on-behalf payments for the instructional device upgrade.

Annual District Financial Audits and Guidance From the Governmental Accounting Standards Board

Districts must undergo annual financial audits. The State Committee for School District Audits ensures that audits are conducted and establishes procedures and standards to be used by auditors.

As required by KRS 43.073, school districts must undergo annual financial audits. Districts contract with a certified public accountant to conduct the audit. As established by KRS 156.265, the State Committee for School District Audits ensures that districts are audited annually and establishes auditing procedures and standards to be used. The committee is made up of the governor, the attorney general, the auditor of public accounts, the staff of the Office of Education Accountability, and the commissioner of education. To ensure accurate reporting of revenue not currently reported, the committee would have to add those revenue sources to the auditing procedures and standards that guide district audits.

The Governmental Accounting Standards Board guides practices used by auditors. It issued statements describing correct reporting of on-behalf payments and local activity funds.

The Governmental Accounting Standards Board (GASB) is a nonprofit, independent organization that establishes financial accounting and reporting standards for local and state governments. GASB standards should guide the practices used by certified public accountants and others conducting district audits. Beginning in 1995, GASB's standards included on-behalf payments for fringe benefits and salaries. GASB also issued guidance regarding financial statements that accompany district audits and how they should be reported to include specific governmental funds such as the general fund, special revenue, capital projects, debt service and permanent funds, and the modified accrual basis of accounting (Governmental. Summary of Statement No. 24). In 1999, GASB established accounting standards for district and school activity funds specifying how these funds should be reported on audits (Governmental. Summary of Statement No. 34).

State and Local Revenue Trends With and Without On-behalf Payments and Activity Funds

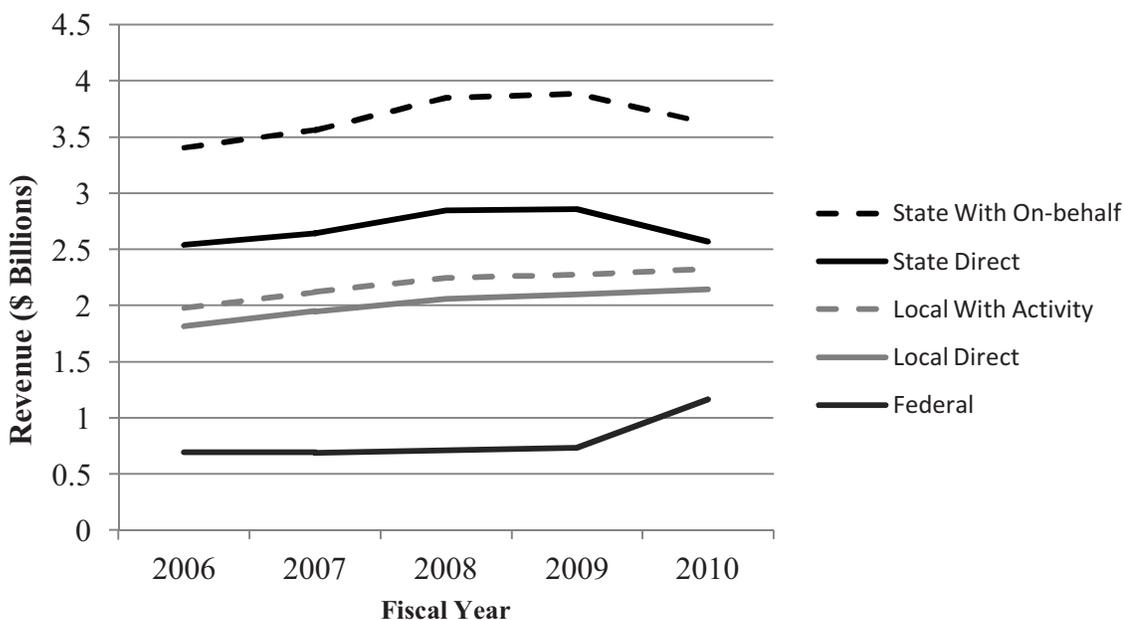
Comprehensive reporting of revenue should include direct sources of state, local, and federal revenue along with additional sources of data analyzed for this study. Because data for these additional sources are not reported accurately on AFRs, OEA used alternative sources of data to capture total revenue.

The most comprehensive overview of total revenue should include direct sources of state, local, and federal revenue, along with the additional sources of revenue analyzed for this study. Figure A shows direct state, local, and federal revenue between FY 2006 and FY 2010, along with state revenue that includes all on-behalf payments; revenues both previously reported and those not reported; and local revenue, including activity funds. Direct data reported in the figure are taken from AFRs. The remaining data come from OEA's analysis of data from KDE, SFCC, and documents submitted by districts with annual audits.

In FY 2010, state on-behalf payments totaled \$1 billion above what districts received in direct state funding. Between 2006 and 2010, local funding increased at a faster pace than state funding. Federal funding increased substantially in FY 2010 because of the American Recovery and Reinvestment Act.

Most noticeable in the figure is the substantial addition to state funding provided by state on-behalf payments. In FY 2010, direct state funding was \$2.6 billion, compared to total state funding of \$3.6 billion with the inclusion of on-behalf payments—an increase of \$1 billion, or 29 percent. Local funds have increased steadily, whereas state funds increased between FY 2006 and FY 2009 but declined in FY 2010. Between 2006 and 2010, local revenue increased from 58 percent to 64 percent of state revenue. Federal funds increased substantially in FY 2010 because of additional funding from the American Recovery and Reinvestment Act (ARRA).

Figure A
State, Local, and Federal Revenue and On-behalf Payments and Local Activity Funds Fiscal Years 2006 Through 2010



Note: Appendix C includes adjustments to direct revenues and on-behalf of payments included in this figure.

Source: Staff analysis of district annual financial reports, district audit data, KDE on-behalf program data, and SFCC on-behalf data.

With the inclusion of on-behalf payments and local activity funds in total revenue, it is possible to derive a more accurate accounting of revenue provided by state, local, and federal sources.

Failure to include certain on-behalf payments and local activity funds on AFRs impacts analyses of total revenue, including the relative percentage of revenue made up of state, local, and federal sources. Table 1 shows the share of total revenue comprises state, local, and federal sources when state on-behalf payments and local activity funds are included in the revenue totals. Percentages for FY 2010 are influenced by the substantial influx of federal funding through ARRA.

Table 1
State, Local, and Federal Sources as
Percentages of Total Revenue
Fiscal Years 2009 and 2010

Fiscal			
Year	State	Local	Federal
2009	56.4%	33.0%	10.6%
2010	50.9%	32.7%	16.3%

Source: Staff analysis of data from the Kentucky Department of Education

Specific Sources of Additional Revenue
Captured in This Report

Table 2 shows the FY 2010 total dollar amounts of local activity funds and specific sources of on-behalf payment revenue captured for this report. The table also provides a brief description of each revenue source and whether it has been reported on AFRs in the past. Because staff found problems in the way that on-behalf payments are currently recorded in AFRs, revenues reported in Table 2 are taken directly from KDE data showing payments made on behalf of districts rather than from AFRs of on-behalf revenue. Appendix A describes each revenue source in greater detail, and Appendix B contains revenue by source from FY 2006 through FY 2010

Health insurance and teachers' retirement premiums are the largest sources of on-behalf revenue. While AFRs generally include these and other on-behalf revenue required by KDE, they contain frequent coding errors.

Health insurance and teachers' retirement premiums are the largest sources of on-behalf revenue. Together they totaled nearly \$942 million in FY 2010. Staff analysis indicated that while AFRs appear to include most of these and other on-behalf payments required by KDE, they frequently include miscoded underreported and overreported on-behalf revenue. This concern is addressed later in this report and in detail in Appendix C.

Activity funds and technology on-behalf payments are not reported on AFRs and totaled \$202 million in 2010. Only 17 percent of the \$102 million in SFCC payments was recorded on AFRs.

Activity funds and technology on-behalf payments are not reported on AFRs. Together these totaled \$202 million in FY 2010. SFCC payments are only partially reported on AFRs. In 2010, only 17 percent of the \$102 million in SFCC payments was recorded on AFRs.

Table 2
On-behalf Payments and Activity Funds
Descriptions, Reporting Status, and Total Revenue
Fiscal Year 2010

Revenue Source	Description	Status of Report on AFRs	Total Revenue
Activity Funds	Revenues collected at each school to support cocurricular and extracurricular activities	Not required or reported	\$184,478,599
On-behalf Payments			
Health Insurance	State health insurance payments for full-time employees	Reported	592,001,915
Kentucky Teachers' Retirement System	Contributions paid to KTRS for eligible employees	Reported	349,694,235
Flexible Spending	State payments of \$2,100 for full-time employees who opt out of the health insurance	Reported	42,448,788
Administration Cost	Fees paid to the Department for Employee Insurance to manage the applications for health insurance plans	Reported	5,894,921
Life Insurance	Basic life insurance payments for full-time employees	Reported	1,849,563
Vocational Education	Salaries paid for employees who work at vocational schools operated by the Career and Technical Education Center	Reported	4,181,332
School Facility Construction Commission	Bond principal and interest payments to finance construction of new facilities, major renovation of existing facilities, and category 5 facility funding	Not required; partially reported	101,793,178
Technology	State payments for technology systems such as Infinite Campus and MUNIS	Not required or reported	17,813,485
Federal Reimbursement	District payments made to KDE for federally funded employees		(59,109,651)
Total On-behalf and Activity Fund Revenue	All on-behalf and activity fund revenue minus the federal reimbursement funds		1,241,046,365

Source: Staff calculations using data provided by the Kentucky Department of Education and district financial audits.

Revenue Previously Not Reported to the Federal Government

Staff conducted analyses of district AFRs to identify discrepancies between on-behalf payments that were disbursed to districts by KDE and other state entities and those that were reported on AFRs. The analysis divided these payments into those that were reported on AFRs and those that were not.

Staff conducted in-depth analyses of district AFRs for fiscal years 2006 through 2010 to identify discrepancies between payments made on behalf of districts by KDE and other state entities and those that were reported on AFRs. The analysis divides all on-behalf payments into those that were reported on AFRs and those that were not. On-behalf payments that were not reported included those related to technology, most SFCC payments, and other on-behalf payments that should have been reported but were not recorded by individual districts.

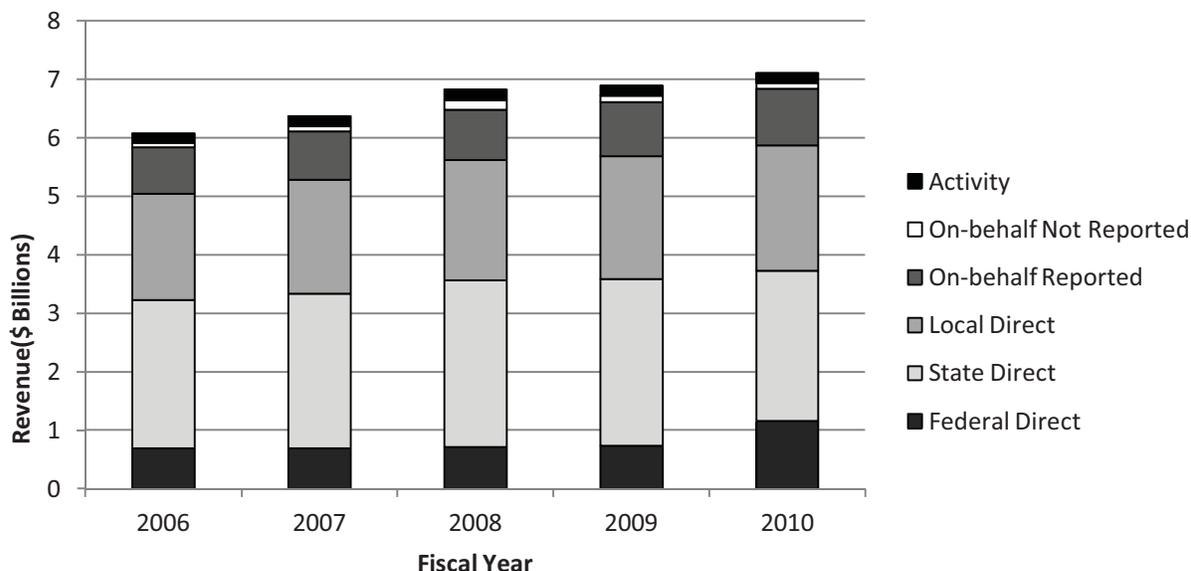
Each year, revenue neither reported on AFRs nor reported to the federal government would have been from 4 percent to 5.3 percent greater had it included all activity fund and on-behalf revenue. In FY 2010, revenue not reported totaled nearly \$281 million, an additional 4.1 percent above what was reported.

Figure B shows total revenue for fiscal years 2006 through 2010, indicating sources and amounts of revenue that had not been reported to the federal government. The amount reported each year is represented by state, local, and federal direct revenue and on-behalf revenue that had been reported. The amount not reported each year is represented by on-behalf payments that had not been reported and by activity fund revenue. Each year, revenue reported to the federal government would have been from 4 percent to 5.3 percent greater had it included revenue not reported. In 2010, revenue not reported totaled nearly \$281 million, an additional 4.1 percent above what was reported.

Between 2006 and 2010, federal funding increased the most, followed by local and state. Increases in state funding were made up almost entirely of on-behalf payments.

The figure also shows substantial increases in total revenue, from \$6.1 billion in FY 2006 to \$7.1 billion in 2010, an increase of 17 percent. During these years, federal funding increased the most, by \$471 million, or a rate of 68 percent. This increase largely comprised additional federal ARRA funds in 2010. Local funding, after including activity funds, increased by \$349 million, or a rate of 18 percent. State funding, including on-behalf payments, increased by \$216 million, or a rate of 6 percent. However, this increase primarily comprised increases in state on-behalf payments. These increased by \$185 million, or 21 percent, between FY 2006 and FY 2010. State funds excluding on-behalf payments increased by \$31 million, or 1 percent.

Figure B
Total Revenue Including Revenue Not Reported to the Federal Government
Fiscal Years 2006 Through 2010



Note: Local, state, and federal direct revenue as reported on annual financial reports was adjusted as described in Appendix C.

Source: Staff analysis of the Kentucky Department of Education and School Facilities Construction Commission data.

Data Accuracy Measures

About 40 percent of Kentucky's budget is allocated to K-12 education. Accurately reported data is necessary to permit policy makers, researchers, and the public to evaluate educational outcomes relative to funding.

About 40 percent of Kentucky's budget is allocated to K-12 public education. Reported revenues permit ranking and comparison of funding and outcome efforts among states and also among districts within the Commonwealth. As Kentucky embarks on a new comprehensive data system, the P-20 Data Warehouse, demanding and ensuring accurate data from all participants is critical. Also, as states vie for federal grants, close attention is paid to state funding efforts. Accurately reported data is necessary to permit policy makers, researchers, and the public to evaluate the educational outcomes of the system.

KDE has made efforts to improve data quality but could take additional steps to improve the quality of data reported by districts.

KDE has made efforts in the past to improve data by updating the chart of accounts, including detailed descriptions for each code, and encouraging districts to use appropriate codes when reporting data. Despite these efforts, there remain data issues that ultimately limit the use of the data to make accurate comparisons and draw conclusions. The following section describes steps that could be taken by KDE to improve the quality of data reported to the public and the federal government.

Local Revenue From Activity Funds and Private Contributions and Donations

KDE does not require districts to report on AFRs revenue from activity funds or from private local donations and contributions. As noted earlier, activity fund revenue is substantial, totaling \$184 million in FY 2010. Because there is no state- or district-level accounting of donations and contributions, it is difficult to estimate the amount of unreported local revenue from these sources. It could be substantial; for example one school booster bingo club reported revenue of a million dollars (Spears).

KDE should provide clear direction to local finance staff about requirements for reporting revenue from activity funds, parent- teacher groups, and booster clubs.

To ensure that districts report local revenue from activity funds and private contributions and donations, KDE should provide clear direction to local finance staff. To do this, KDE should update the *Accounting Procedures for School Activity Funds*, known as the Redbook. This document is not aligned with NCES and GASB requirements. For example, the Redbook requires that booster club organizations submit an annual financial report to the principal but does not require any reporting by parent-teacher groups. The Redbook also lacks guidance on correct reporting of school activity funds as fiduciary funds and district activity funds as special revenue funds.

KDE should also direct district auditors to report revenue from these sources.

After KDE has directed districts to record and report district and school activity funds as well as private contributions and donation revenue on AFRs, it should provide district auditors with specific guidance on how to report these revenues on audits.

Recommendation 1

Recommendation 1

The Kentucky Department of Education should update the *Accounting Procedures for School Activity Funds*, known as the Redbook, to reflect federal activity fund guidelines and the inclusion of contributions and donations from booster clubs and parent-teacher groups. The department should also require districts to record activity funds and booster clubs' and parent-teacher groups' revenue and expenditures on the annual financial reports.

Recommendation 2

Recommendation 2

The Kentucky Department of Education should ensure that district financial audits include activity fund receipts and expenditures per the audit contract. The department should also require auditors to follow National Center for Education

Statistics and Governmental Accounting Standards Board requirements in reporting school activity funds as fiduciary funds and reporting district activity funds as special revenue funds.

On-behalf Payments

To ensure accurate reporting of on-behalf payments, KDE should require districts to report revenue from technology and SFCC on-behalf payments. The department should also update its guidance on recording on-behalf payments. This guidance is provided in spreadsheets that include individual sources of on-behalf payments and instructions associated with recording on-behalf payments within the MUNIS, financial software. These spreadsheets do not include technology and SFCC on-behalf payments.

To promote accurate reporting of SFCC on-behalf payments, KDE should remove confusion that exists about the appropriate fund to which SFCC payments should be coded.

To promote accurate reporting of SFCC on-behalf payments, KDE should remove confusion that exists about the appropriate fund to which SFCC payments should be coded. Standard accounting procedures as described by GASB require that all debt service payments be coded to Fund 400. However, KDE established an additional debt service fund, Fund 410, specifically for SFCC on-behalf payments. Although KDE has not required districts to report SFCC funds, some auditors report them. The majority of these auditors follow standard accounting procedures and code SFCC payments to Fund 400. The existence of two possible funds for reporting SFCC debt service payments conflicts with standard accounting procedures and is adding to confusion among auditors about how these funds should be coded.

Recommendation 3

Recommendation 3

The Kentucky Department of Education should require all districts to use Fund 400 to record all debt service payments, including on-behalf payments from the School Facilities Construction Commission. The department should eliminate Fund 410 so that all debt service is recorded in one fund per Governmental Accounting Standards Board requirements. The department should also provide guidance to district finance officers and auditors on how revenues and expenditure should be recorded consistently in Fund 400.

KDE should require consistent coding of on-behalf revenue by directing districts to correct errors found in recording of revenue on AFRs.

KDE should also require consistent coding of on-behalf revenue from all sources. Appendix C describes in detail errors in reporting of on-behalf payments on district AFRs. Many of these errors have been identified by KDE staff in their comparisons of district audit

data to AFRs. These comparisons are conducted annually and sent to superintendents and finance officers. The worksheets note specific errors identified in individual districts and provide direction to districts about which errors need to be corrected. In cases where districts are not coding revenue or expenditures correctly, this process is critical to ensuring that districts review and correct their practices. However, OEA staff analysis of KDE's internal worksheets indicated that districts are often not directed to address errors that are found in recording on-behalf payments.

Some districts are overreporting on-behalf revenue by including payments made for federally funded employees as state on-behalf revenue on AFRs.

A common error staff identified in analysis of AFRs was districts' failure to remove on-behalf payments for employees holding federally funded positions from their reports of state on-behalf revenue. Because districts must reimburse KDE for on-behalf payments made to these employees, districts should not record districts on-behalf payments as revenue. Doing so will overstate the amount of on-behalf revenue received by districts. Staff analysis also suggests that some districts may not be fully reimbursing KDE for on-behalf payments made to employees in federally funded positions. In FY 2010, AFRs totaled \$1 million more in federal reimbursement expense object codes than KDE received in reimbursements from districts. The cause of this discrepancy is unknown; it is possible, for example, that some districts sent reimbursements to KDE after June 30. These payments would not be reflected on KDE's spreadsheet. It is also possible that some districts miscoded expenses to the federal reimbursement code in error.

Recommendation 4

Recommendation 4

The Kentucky Department of Education should ensure that all on-behalf payments are accurately coded and recorded on annual financial reports.

Recommendation 5

Recommendation 5

The Kentucky Department of Education should audit district payroll accounts or take other steps to ensure that districts accurately reimburse the department for employee benefit payments made on behalf of employees paid out of federal grants at the local level.

Federally Donated Commodities

Although NCES requires districts to record on-behalf payments from federally donated commodities, about one-third of districts are not.

Recommendation 6

Recommendation 6

The Kentucky Department of Education should advise districts and auditors on how to correctly code federal government-donated commodities on the district annual financial reports.

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Appendix A

Description of Revenues

This appendix provides a brief description of state on-behalf revenues that are either paid by the Kentucky Department of Education or another state agency for school districts. Some of these revenues have been reported on annual financial reports and federal reporting; however, the revenue data have not been accurately coded at the district level. Also included are local and federal revenues that are required per National Center for Education Statistics federal accounting guidelines and are currently not being reported.

Revenues	Description
Health Insurance	Employees of local boards of education are included in the state health insurance benefits under the Kentucky Employees' Health Plan. Full-time employees are eligible for the state-paid portion of the health insurance plan.
Kentucky Teachers' Retirement System	The Kentucky Teachers' Retirement System (KTRS) was established by law in 1938. It is an "actuarial reserve, joint-contributory" system where the contributions are paid by members, and any investment earnings are placed in a reserve to pay for the annuity obligation. As a condition of employment, eligible members require a certificate from a 4-year college or university. Eligible members may also be substitute teachers filling in for certified positions that require 4-year degrees.
Flexible Spending	Employees of local boards of education may opt out of the single health insurance plan covered by the state. By doing so, the state will put \$2,100 each year in a flexible benefit plan. Employees can use these funds to pay for items such as dental expenses, eye exams, medications, and doctor co-pays.
Administration Fee	KDE also pays the Department for Employee Insurance an administrative fee to manage the applications and waivers for local school districts' health insurance plans. This is typically a fee of about \$6 per employee.
Life Insurance	District employees of local boards of education also receive a basic life insurance plan paid by the state in the amount of \$20,000 a year. The same rule applies to employees if they are paid from federal grants.

Revenues	Description
Federal Reimbursement	Districts are responsible for paying health insurance or flexible spending funds, Kentucky teacher retirement, life insurance, and administration fees for any employee who is paid from federal grants. Some of these grants include Title 1, Special Education, and Title II. KDE pays for all employees. School districts must reimburse the state for these employees. If an employee only works part time in a federal grant and part time as a regular teacher or another job that is paid from local and state funds, then the district only pays for the full-time equivalent the employee works under the grant. When recording the on-behalf payments on districts' annual financial report, districts are supposed to subtract this amount from the total on-behalf payments because the grant expenditures have already recorded this expense. If districts do not subtract this, they will double count this expenditure payment.
Vocational Education	Vocational schools in Kentucky are operated by the local district or by the state Career and Technical Education Center. There are 53 area technology centers run by the Career and Technical Education Center. The funds to pay for the employees at these schools are allocated to the Career and Technical Education Center in the overall budget for Kentucky. The buildings that house the students in these centers are owned by the districts.
Instructional Device Upgrade **	In 2006, the General Assembly appropriated \$50 million in bonds to replace or add computers for students and teachers. Funds were distributed to districts based on average daily attendance at approximately \$85 per student. Overall, districts purchased 63,758 computers with these funds. It has been 5 years since this project was implemented; most of these computers are now obsolete. The Kentucky Board of Education has asked the General Assembly to fund this project in the next biannual budget.
KY Educational Network*	In FY 2007, KDE needed to increase the bandwidth for Internet use in schools and districts. The General Assembly appropriated \$8.9 million in bond funds for this project. Kentucky was the first state to provide this high-speed connection to all districts so that teachers could incorporate technology instruction in the classroom. This project was completed in April 2008.

Revenues	Description
MUNIS*	Since 1994, the financial management software used by all districts in Kentucky has been MUNIS. The system is used to track personnel, payroll, budgeting, fixed assets, and financial data. This system reports financial information to the local board of education and to the Kentucky Department of Education.
McAfee*	KDE also pays for McAfee, which is the virus protection and Internet security software used for all the computers at each district in Kentucky.
Career Cruising*	To help students plan for their futures, Kentucky purchased a Web-based career and planning system that includes assessment tools to determine what careers they should explore based on their interests and other inputs. While Career Cruising is the software that is used in Kentucky, it is referred to as the individual learning plan. This online software replaced the paper-based individual graduation plan used previously.
Infinite Campus*	Kentucky, unlike most states, has one student information system that every school uses. Some information tracked in this system includes a unique student identifier that tracks enrollment and attendance, grades, behavior, special education plans, and participation in programs such as Extended School Services and Gifted and Talented. Implementation started in July 2007 and was fully implemented by the end of fiscal year 2009. The General Assembly approved \$10 million in bonding to implement the Infinite Campus system. It is now a shared cost between the state and the districts.
Microsoft Exchange*	The technology budget at the Kentucky Department of Education pays for each district's Microsoft Exchange license. This software includes Microsoft Word, Excel, PowerPoint, and Outlook email. The cost for all districts is \$10,000 per year.
Bond principal and interest**	The School Facilities Construction Commission (SFCC) is operated under an independent agency attached to the Finance and Administration Cabinet. The General Assembly appropriates funds to SFCC to pay for debt service payments on behalf of districts. SFCC acts on behalf of school districts to issue bonds in its name and to enter into lease agreements with local boards of education to finance construction of new facilities and major renovation of existing school facilities. This revenue source also includes the bonds sold for the category 5 facilities that the General Assembly approved in past budgets.

Revenues	Description
Activity Funds*	Revenues collected at each school to support cocurricular and extracurricular student activities are called activity funds. Student activity funds are revenues collected for student organizations such as art club, drama club, pep club, and National Honor Society. Approval to spend these funds rests with the student organization. These revenues are to be recorded as fiduciary funds in MUNIS. District activity funds are funds that belong to the district and are administered by the school district. The district determines how district activity funds are to be spent and which programs receive support. Examples are book fairs, athletics, school plays, special field trips, music concerts, and fees. District activity funds are to be coded as special revenue funds. Student activity funds should remain at the school site, while district activity funds should be deposited in the district's bank account.
Contribution and Donations From Private Sources*	The revenue for these types of sources includes educational foundations, parent-teacher groups, campus booster clubs, and private individuals. Contributions often include supplies, materials, equipment, and school facilities such as weight-training rooms.
Federal On-behalf**	Revenue includes contributions such as food donations by the federal government to the school district for the food service operation.

* Not Reported

** Partially reported

Appendix B

Total On-behalf Revenues and School Activity Funds Fiscal Years 2006 Through 2010

	Fiscal Year				
	2006	2007	2008	2009	2010
On-behalf and Activity Funds					
Health Insurance	\$425,471,243	\$439,093,890	\$478,860,727	\$525,145,624	\$592,001,915
Kentucky Teachers' Retirement System	304,059,407	318,044,393	345,613,986	349,003,917	349,694,235
Flexible Spending	66,801,223	52,031,959	46,935,963	44,963,975	42,448,788
Administration Cost	5,489,615	5,812,280	5,888,035	5,855,669	5,894,921
Life Insurance	2,052,268	2,160,426	2,180,789	2,175,675	1,849,563
Federal Reimbursement	(43,800,660)	(40,885,555)	(43,414,459)	(40,853,946)	(59,109,651)
Vocational Education	16,531,466	16,693,357	17,382,268	17,045,783	4,181,332
Instructional Device Upgrade	0	24,862,290	24,862,290	0	0
Kentucky Educational Network	1,100,831	2,725,828	11,457,852	12,268,887	11,641,774
MUNIS Software and Services	1,622,371	1,412,078	1,390,906	1,528,671	1,507,921
McAfee Virus Protection Software and Services	984,356	0	478,192	510,278	563,688
Career Cruising	0	182,500	610,140	440,240	365,000
Infinite Campus	0	0	3,819,013	5,977,533	3,725,102
Microsoft Exchange	10,000	10,000	10,000	10,000	10,000
School Facility Construction Commission	90,995,097	97,706,810	107,933,362	103,964,186	101,793,178
School Activity Funds	163,850,576	173,938,058	181,926,245	176,065,149	184,478,599
Totals	\$1,035,167,793	\$1,093,788,314	\$1,185,935,309	\$1,204,101,641	\$1,241,046,365

Source: Staff calculations using data provided by Kentucky Department of Education, School Facilities Construction Commission and district financial audits.

Appendix C

Data Corrections

This appendix contains revenue data issues that Office of Education Accountability (OEA) staff found and corrected while producing this report. Some issues described below include missing data that staff were unable to correct. Some adjustments were in expenditure object codes; however, these are not identified below because this report focused only on revenues. It is imperative that data are reliable and valid for Kentucky district and national comparisons as well as for research that is performed within this office and others. All corrections were also used in OEA's *2011 School Finance Report* to examine equity. Staff used data from annual financial reports, Kentucky Department of Education on-behalf spreadsheets, and Instructional Device Upgrade spreadsheets, School Facilities Construction Commission debt service payment spreadsheet, district audits, and information obtained from district finance officers. It should be noted that some of the errors made on the annual financial reports were audit adjustments, which reinforces the need for more communication and training provided to auditors on the chart of accounts.

Table C.1

Data Concerns Related to District Annual Financial Reports		
Year	Amount Corrected	Problem/Issue
2006	\$215,440	District coded on-behalf revenue code to direct state revenue object code 3200 in the food service fund (Fund 51).
2006	\$1,527,363	Four districts coded School Facilities Construction Commission (SFCC) payment as an on-behalf revenue code in the general fund (Fund 1). This should be in debt service fund.
2006	\$15,274	District coded state revenue in lieu of taxes as on behalf revenue code in the general fund (Fund 1).
2006	\$145,557	District coded fund transfer to direct state revenue in the debt service fund (Fund 400).
2006	\$11,181,511	Nine districts coded SFCC revenue to direct state revenue object code 3200 instead of to on-behalf revenue in Fund 400.
2006	\$163,850,576	Activity fund totals that were reported on district audits. However, 14 district audits only reported high school receipts for activity funds, and 10 district audits reported no receipts for any of the schools in the district. These are currently not reported on district annual financial reports, nor are they being reported correctly on district audits as district activity funds recorded to special revenue fund. Audits are reflecting all activity funds as fiduciary funds, when only school activity funds should be included here.
2006	\$8,287,872	Across the state, this amount was recorded in excess of on-behalf revenue that was provided on the Kentucky Department of Education (KDE) spreadsheet.
2006	Unknown	KDE did not provide data on how much the state paid for the Student Information System (now Infinite Campus) for this year for districts.

Year	Amount Corrected	Problem/Issue
2006	\$1,100,831	Amount provided by KDE for the Kentucky Educational Network but was not recorded as on-behalf revenue.
2006	\$1,622,371	Amount provided by KDE for the MUNIS financial software but was not recorded as on-behalf revenue.
2006	\$984,356	Amount provided by KDE for the McAfee Virus Protection Software and Service but was not recorded as on-behalf revenue. KDE paid for both FY 2006 and FY 2007 this year.
2006	\$10,000	Amount provided by KDE for Microsoft Exchange but was not recorded as on-behalf revenue.
2006	\$79,668,029	After making adjustments for SFCC revenues recorded to direct state revenue in Fund 400 on the annual financial reports, this is the amount of SFCC revenues that was not reported to feds. KDE does not report Fund 410 to feds, so this fund was not used. It should be noted that only nine districts in the state are using Fund 410, and all districts are coding this revenue as direct state revenue. Fund 410 and Fund 400 are optional funds in the KDE chart of accounts.
2007	\$87,074	Two districts coded on-behalf revenue code to direct state revenue object code 3200 in the food service fund (Fund 51).
2007	\$2,712,144	Two districts coded state revenue in lieu of taxes as on behalf revenue code in the general fund (Fund 1).
2007	\$1,272,960	Four districts coded SFCC payment as an on behalf revenue code in the general fund (Fund 1). This should have been in debt service fund.
2007	\$10,462,461	Nine districts coded SFCC revenue to direct state revenue object code 3200 instead of to on-behalf revenue in Fund 400.
2007	\$173,938,058	Activity fund totals that were reported on district audits. However, 14 district audits only reported high school receipts for activity funds, and 1 district audit reported no receipts for any of the schools in the district. These are currently not reported on district annual financial reports, nor are they being reported correctly on district audits as district activity funds recorded to special revenue fund. Audits are reflecting all activity funds as fiduciary funds, when only school activity funds should be included here.
2007	\$6,380,671	Across the state this amount was recorded in excess of on-behalf revenue that was provided on the KDE spreadsheet.
2007	Unknown	KDE did not provide data on how much the state paid for the Student Information System (now Infinite Campus) for this year for districts.
2007	\$2,725,828	Amount provided by KDE for the Kentucky Educational Network but was not recorded as on-behalf revenue.
2007	\$1,412,078	Amount provided by KDE for the MUNIS financial software but was not recorded as on-behalf revenue.
2007	\$0	KDE paid for FY 2007 McAfee Virus Protection software and services in FY 2006.
2007	\$10,000	Amount provided by KDE for Microsoft Exchange but was not recorded as on-behalf revenue.
2007	\$182,500	Amount provided by KDE for Career Cruising but was not recorded as on-behalf revenue.

Year	Amount Corrected	Problem/Issue
2007	\$10,904,564	Amounts not recorded in Fund 2 for the Instructional Device Upgrade as on-behalf revenue on district annual financial reports. Staff took the KDE total amount allotted for the 2 years and divided it by 2 to get a 1-year total for each year.
2007	\$86,379,742	After making adjustments for SFCC revenues recorded to direct state revenue in Fund 400 on the annual financial reports, this is the amount of SFCC revenues that was not reported to feds. KDE does not report Fund 410 to feds, so this fund was not used. It should be noted that only nine districts in the state are using Fund 410, and all districts are coding this revenue as direct state revenue. Fund 410 and Fund 400 are optional funds in the KDE chart of accounts.
2008	\$98,244	Two districts coded on-behalf revenue code to direct state revenue object code 3200 in the food service fund (Fund 51).
2008	\$45,451	One district coded state revenue in lieu of taxes as on-behalf revenue code in the general fund (Fund 1).
2008	\$573,522	Two districts coded SFCC payment as an on-behalf revenue code in the general fund (Fund 1). This should have been in debt service fund.
2008	\$2,095,946	One district coded bond proceeds as true state revenue in Fund 400, which should not have been coded here.
2008	\$1,638,882	One district coded debt service fund transfer in object code to direct state revenue object code 3200 in the debt service fund (Fund 400)
2008	\$78,464	One district coded on-behalf revenue in Fund 2 instead of coding it to local donated revenue.
2008	\$12,321,438	Nine districts coded SFCC revenue to direct state revenue object code 3200 instead of to on-behalf revenue in Fund 400.
2008	\$181,926,245	Activity fund totals that were reported on district audits. However, 13 district audits only reported high school receipts for activity funds, and 2 districts audits reported no receipts for any of the schools in the district. These are currently not reported on district annual financial reports nor are they being reported correctly on district audits as district activity funds recorded to special revenue fund. Audits are reflecting all activity funds as fiduciary funds, when only school activity funds should be included here.
2008	\$(29,321,338)	Across the state, this amount was not recorded in on-behalf revenue but was provided on the KDE spreadsheet.
2008	\$3,819,013	Amount provided by KDE for the student information software, Infinite Campus, but was not recorded as on-behalf revenue.
2008	\$11,457,852	Amount provided by KDE for the Kentucky Educational Network but was not recorded as on-behalf revenue.
2008	\$1,390,906	Amount provided by KDE for the MUNIS financial software but was not recorded as on-behalf revenue.
2008	\$478,192	KDE paid for FY 2007 McAfee Virus Protection software and services in FY 2006.
2008	\$10,000	Amount provided by KDE for Microsoft Exchange but was not recorded as on-behalf revenue.
2008	\$610,140	Amount provided by KDE for Career Cruising but was not recorded as on-behalf revenue.

Year	Amount Corrected	Problem/Issue
2008	\$5,863,319	Amounts not recorded in Fund 2 for the Instructional Device Upgrade as on-behalf revenue on district annual financial reports. Staff took the KDE total amount allotted for the 2 years and divided it by 2 to get a 1-year total for each year.
2008	\$91,877,096	After making adjustments for SFCC revenues recorded to direct state revenue in Fund 400 on the annual financial reports, this is the amount of SFCC revenues that was not reported to feds. KDE does not report Fund 410 to feds, so this fund was not used. It should be noted that only nine districts in the state are using Fund 410, and all districts are coding this revenue as direct state revenue. Fund 410 and Fund 400 are optional funds in the KDE chart of accounts.
2009	\$81,733	One district coded on-behalf revenue code to direct state revenue object code 3200 in the food service fund (Fund 51).
2009	\$1,574,879	One district coded state revenue in lieu of taxes as on-behalf revenue code in the general fund (Fund 1).
2009	\$1,978,384	One district coded debt service fund transfer in object code to direct state revenue object code 3200 in the debt service fund (Fund 400).
2009	\$1,015,876	One district coded bond proceeds as true state revenue in Fund 400, which should not have been coded here.
2009	\$2,661	One district coded on-behalf instead of coding it to day care fees in Fund 1.
2009	\$12,834,997	Eight districts coded SFCC revenue to direct state revenue object code 3200 instead of to on-behalf revenue in Fund 400.
2009	\$176,065,149	Activity fund totals that were reported on district audits. However, nine districts audits only reported high school receipts for activity funds, and one district audit reported no receipts for any of the schools in the district. These are currently not reported on district annual financial reports, nor are they being reported correctly on district audits.
2009	\$(1,782,542)	Across the state, this amount was not recorded in on-behalf revenue but was provided on the KDE spreadsheet.
2009	\$5,977,533	Amount provided by KDE for the student information software, Infinite Campus, but was not recorded as on-behalf revenue.
2009	\$12,268,887	Amount provided by KDE for the Kentucky Educational Network but was not recorded as on-behalf revenue.
2009	\$1,528,671	Amount provided by KDE for the MUNIS financial software but was not recorded as on-behalf revenue.
2009	\$510,278	KDE paid for FY 2007 McAfee Virus Protection software and services in FY 2006.
2009	\$10,000	Amount provided by KDE for Microsoft Exchange but was not recorded as on-behalf revenue.
2009	\$440,240	Amount provided by KDE for Career Cruising but was not recorded as on-behalf revenue.
2009	\$88,134,929	After making adjustments for SFCC revenues recorded to direct state revenue in Fund 400 on the annual financial reports, this is the amount of SFCC revenues that was not reported to feds. KDE does not report Fund 410 to feds, so this fund was not used. It should be noted that only nine districts in the state are using Fund 410, and all districts are coding this revenue as direct state revenue. Fund 410 and Fund 400 are optional funds in the KDE chart of accounts.

Year	Amount Corrected	Problem/Issue
2010	\$100,325	One district coded on-behalf revenue code to direct state revenue object code 3200 in the food service fund (Fund 51).
2010	\$23,228,466	Twenty-eight districts coded federal state fiscal stabilization funds to state revenue instead of to federal revenue.
2010	\$100,325	One district coded state revenue to on-behalf instead of to true state revenue.
2010	\$2,456,275	One district coded debt service fund transfer in object code to direct state revenue object code 3200 in the debt service fund (Fund 400).
2010	\$377,528	Two districts coded federal Build for America bonds as true federal revenue when they did not receive these funds directly. This should have been coded to federal on-behalf revenue.
2010	\$14,449,216	Thirteen districts coded SFCC revenue to direct state revenue object code 3200 instead of to on-behalf revenue in Fund 400.
2010	\$184,478,599	Activity fund totals that were reported on district audits. However, two district audits reported no receipts for any of the schools in the district. These are currently not reported on district annual financial reports, nor are they being reported correctly on district audits correctly.
2010	\$6,211,278	Across the state, this amount was recorded in excess of on-behalf revenue that was provided on the KDE spreadsheet.
2010	\$3,725,102	Amount provided by KDE for the student information software, Infinite Campus, but was not recorded as on-behalf revenue.
2010	\$11,641,774	Amount provided by KDE for the Kentucky Educational Network but was not recorded as on-behalf revenue.
2010	\$1,507,921	Amount provided by KDE for the MUNIS financial software but was not recorded as on-behalf revenue.
2010	\$563,688	KDE paid for FY 2007 McAfee Virus Protection software and services in FY 2006.
2010	\$10,000	Amount provided by KDE for Microsoft Exchange but was not recorded as on-behalf revenue.
2010	\$365,000	Amount provided by KDE for Career Cruising but was not recorded as on-behalf revenue.
2010	\$84,887,687	After making adjustments for SFCC revenues recorded to direct state revenue in Fund 400 on the annual financial reports, this is the amount of SFCC revenues that was not reported to feds. KDE does not report Fund 410 to feds, so this fund was not used. It should be noted that only nine districts in the state are using Fund 410, and all districts are coding this revenue as direct state revenue. Fund 410 and Fund 400 are optional funds in the KDE chart of accounts.

Appendix D

Response From the Kentucky Department of Education



Steven L. Beshear
Governor

Terry Holliday, Ph.D.
Commissioner of Education

**EDUCATION AND WORKFORCE DEVELOPMENT CABINET
DEPARTMENT OF EDUCATION**

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February 1, 2012

Marcia Seiler, Executive Director
Office of Education Accountability
475 Coffee Tree Road
Frankfort, KY 40601-8273

Re: OEA Study of On Behalf Payments

Dear Ms. Seiler:

Thank you for the opportunity to review the OEA study of On Behalf Payments. The Department continuously strives to improve data quality and data collection procedures to assist school leaders and policymakers in making informed policy choices and to provide the information the public needs to assure that its tax dollars are being spent wisely. The response to each of the recommendations included in the report is listed below.

Recommendation 1

KDE should update the *Accounting Procedures for School Activity Funds* (Redbook) to reflect federal activity fund guidelines and the inclusion of contributions and donations from booster clubs and parent teacher associations/organizations.

KDE should require districts to record activity funds, booster clubs, and parent teacher associations/organization revenue and expenditures on AFRs.

Response to Recommendation 1

The Kentucky Department of Education (KDE), Division of District Support (DDS) has initiated a project to update the Redbook. KDE has requested recommendations for Redbook changes from districts, auditors and other stakeholders. Also, KDE has identified a Redbook Revision Task Force made up of various stakeholders such as the Kentucky Association of School Business Officials (KASBO) Advisory Board members, Office of Education Accountability (OEA), district finance officers and auditors. The task force will begin meeting as a group in January 2012 to discuss Redbook changes. The task force will also utilize the National Center for Education Statistics' (NCES) Financial Accounting for Local and State School Systems, 2009 Edition in making its recommendations. The Redbook Revision Task Force will also make recommendations concerning how best to account/report financial information related contributions and donations from booster clubs and parent teacher associations/organizations.

The target date for implementation of this revision to the Redbook is July 1, 2013. However, that date may change based on the outcome of the Redbook Revision Task Force discussions and recommendations.

Recommendation 2

KDE should ensure that district financial audits include activity fund receipts and expenditures per the audit contract.

KDE should require auditors to follow National Center for Education Statistics (NCES) and Governmental Accounting Standards Board (GASB) requirements in reporting school activity funds as fiduciary funds and district activity funds as special revenue funds.

Response to Recommendation 2

The fiscal year 2010 and 2011 audit contracts required that all school activity funds be reported in the audit, showing receipts, expenditures, beginning balance and ending balance. Prior to fiscal year 2010 the audit contracts stated that the high school activity fund schedules must show receipts, expenditures, beginning balance and ending balance, but stated that elementary and middle school activity funds should be summarized in a single line per school. Currently, KDE's audit review procedures include verifying that the audit reports include a detailed high school activity fund schedule and a summarized elementary and middle school activity fund schedule, and that receipts, expenditures, beginning balance and ending balance are reflected in all schedules. If an audit report does not contain any required schedule or information, KDE staff contacts the auditor and requests the required schedule or information. In general, auditors have complied with the audit contract requirements for the school activity fund section very well.

Over the past fiscal years, the language in the activity funds schedule section of the audit contract has been inconsistent using "shall," "should" and "must" when referring to the requirements for the activity funds schedule. The State Committee for School District Audits (SCSDA) approves the final content in the audit contract. KDE will be working with OEA to prepare and submit audit contract revision recommendations to SCSDA that will make the language in the activity funds schedule section more consistent.

The audit contract (as approved by the SCSDA), the Redbook, GASB statements and other accounting and auditing standards determine the requirements that auditors must follow in reporting school and district activity funds. The audit contract does not currently state in what fund type the school and district activity funds are to be reported; it only states what information is to be reported and the level of detail required. Revisions to the audit contract can be recommended by OEA, KDE or other members of the SCSDA. The final audit contract is the responsibility of the SCSDA. Significant progress has been made towards adopting some of NCES recommendations. Adoption of further NCES recommendations will involve representatives from the SCSDA, OEA, KDE, KASBO, districts and other interested parties to determine what is best for Kentucky's school system and its students.

KDE will continue reviewing districts' audit report activity fund schedule sections per the audit contract. Any revisions to the audit contract will result in appropriate revisions to KDE's audit review procedures.

Recommendation 3

KDE should require all districts to use Fund 400 to record all debt service payments including on-behalf payments from SFCC.

KDE should eliminate Fund 410 so that all debt service is recorded in one fund per GASB requirements.

KDE should provide guidance to district finance officers and auditors on how revenues and expenditure should be consistently recorded in Fund 400.

Response to Recommendation 3

KDE will require all districts to use only Fund 400 to record all debt service related transactions including on-behalf payments from SFCC beginning with FY 2013. The elimination of Fund 410 will be communicated to the districts and guidance will be provided to districts and auditors documenting the appropriate way to record debt service revenues and expenditure in the financial accounting system and statements. KDE will also implement edit checks within the AFR data submission program and process to assure districts are complying with the new standards.

Recommendation 4

KDE should ensure that all on-behalf of payments are accurately coded and recorded on AFRs.

Response to Recommendation 4

KDE will continue to provide on behalf payment guidance to districts in order to ensure consistent coding of on behalf revenues and expenditures in AFRs. Over the past years, KDE has provided districts with the on behalf payments for health insurance, life insurance, administrative fees, Health Reimbursement Accounts (HRAs), Vocational Education (Voc Ed), and Kentucky Teacher's Retirement System (KTRS), along with the Federal Reimbursement amounts that are deducted from the on behalf payments.

Beginning in FY 2012, KDE has been working on providing Technology and SFCC On Behalf Payment information to districts. KDE has provided the FY 2006 through FY 2011 Technology On Behalf Payments information to districts. Currently, KDE is working on compiling the FY 2012 Technology On Behalf Payments that will be provided to the districts and posted to KDE's webpage. In addition, KDE will be working with SFCC to provide the FY 2012 SFCC Debt Service On Behalf Payments. In order to accommodate the additional reporting for debt service and technology on behalf payment, the AFR data submission program must be modified. The target date for implementation is FY 2013. During FY 2012, KDE plans to inform the districts and auditors of the projected FY 2013 on behalf payment changes. DDS will be exploring *additional* potential analysis and/or AFR edit checks that may assist with ensuring that districts accurately code and record all state on behalf payment transactions.

Recommendation 5

KDE should audit district payroll accounts, or take other steps, to ensure that districts accurately reimburse the department for employee benefit payments made by the department out of state funds for district employees paid out of federal grants.

Response to Recommendation 5

DDS will be researching additional analysis that may assist with ensuring that districts accurately reimburse KDE for employee benefit payments paid by KDE for district employees paid out of federal grants. OEA's On Behalf Study referenced discrepancies between the Federal Reimbursement amounts reported by KDE and districts. Some of the discrepancies are due to the timing of the receipt of the district's federal reimbursement payments and the fiscal years in which the districts and KDE record the issuing and/or receipts of the payments. Some discrepancies are due to coding issues, and KDE will continue addressing these issues through additional district training and/or guidance. Also, KDE will be research additional program edit checks that may assist with analysis of the FY 2013 AFRs General Fund - Fund 1 and Special Revenue Fund - Fund 2. Once districts have used all the federal grant funds allocated for benefits then the districts are required to use General Funds. However, some districts did not record a Federal Project Code within General Fund to indicate that and this will continue to be address through additional district training and/or guidance.

Recommendation 6

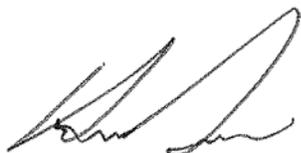
KDE should advise districts and auditors on how to correctly code federal government donated commodities on AFRs

KDE's Response to Recommendation 6

The majority of the districts are recording the federally donated commodities correctly in Food Service Fund 51, Revenue Object Code 4950. KDE reports the amounts recorded in Fund 1, 2, 310, 320, 400, and 51, Revenue Object Code 4950 in the federal reports that are submitted to the federal government. KDE will reiterate to the districts and auditors the need to record federally donated commodities amounts in the correct Food Services Fund and Revenue Object Code. Additionally, KDE will research possible additional program edit checks that require the districts to record amounts for the donated commodities in AFRs prior to submitting to KDE.

Again thank you for the opportunity to review the OEA study of On Behalf Payments and if you have questions or need additional information, please contact Kay Kennedy at kay.kennedy@education.KY.gov or (502) 564-3930.

Sincerely,



Hiren Desai, Associate Commissioner
Office of Administrative Support

cc: Kay Kennedy, Director, Division of District Support