

# STEILACOOM HISTORICAL SCHOOL DISTRICT NO. 1 BOARD OF DIRECTORS

Board Meeting Date: July 19, 2023

## **Agenda Item: Independent Limited Scope Fiscal Review**

### **Strategic Focus Area**

- Achieve
- Support
- Connect
- Plan

### **BACKGROUND INFORMATION**

At the April 12<sup>th</sup> and May 17<sup>th</sup> Board Meetings, the Board asked staff to research a limited scope fiscal review (“fiscal audit”) to be conducted by an independent source.

The District contacted our insurance pool provider, Washington State Risk Management Pool, who researched our liability coverage and determined our policy covers expenses incurred by WSRMP to conduct an investigation, up to the coverage limit of \$20,000, for the fees and expenses of the independent fiscal review. After the Board articulated the scope of the fiscal review, the District was assigned counsel, who hired the fiscal investigator and also served as a monitor of the investigation.

The final report of the independent limited scope fiscal review is attached.

### **RECOMMENDED ACTION:**

No action needed. Informational purposes only.

### **Report prepared by:**

Dr. Kathi Weight, Superintendent

# Steilacoom Historical School District No 1

## Report on 2023 Budget Issue



**Prepared By:**

**Calvin W. Brodie**

**July 3, 2023**

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## **INTRODUCTION**

In March 2023 the Washington State Risk Management Pool, WSRMP, requested a review of the Steilacoom School District General Fund budget issue and an evaluation of the district's internal review for consideration of the presence of material fraud. The Steilacoom School District initiated the request to have this review be performed by WSRMP.

This review was performed as an independent contractor for the WSRMP and consisted of interviews with district Board and staff, and a review of board minutes, data, and various other materials.

## **EXECUTIVE SUMMARY**

### **District Budget Issue:**

This review identified several possible root causes for the significant and material errors in the 2022-23 original budget. For each of the potential root causes this report indicates the potential of each cause contributing to the identified errors. This report also provides recommendations or modifications that would address reduce or eliminate such root causes. Based on a review of district documents and interviews some of these modifications have already been implemented and/or incorporated into the district's 2023-24 budget process.

### **Consideration of Internal Controls and Fraud**

Based upon the review of State Auditor reports, internal control documentation of key areas, district staff review procedures, analytical review and limited transactional testing, nothing came to my attention that would indicate a material internal control weakness or material fraud in the financial records of the district. The material errors identified were limited to the budget development process.

## **BACKGROUND**

### *Budget*

In November 2022, the Steilacoom Historical School District Board of Directors was informed of the inadequacy of their 2022-23 adopted budget. At that time, projections indicated the district would likely need to file a “Budget Extension” with the Office of Superintendent of Public Instruction to increase their legal expenditure authority for the 2022-23 school year. Additionally, such projections also indicated that the budgeted district revenues were higher than the amount the district could expect to receive. While the inadequacy of the budget was identified, the extent of the budget issues had not yet been identified and therefore had not communicated with the Board of Directors.

## **CONSIDERATION OF FRAUD**

The district performed an internal review of transactions as questions of fraud had been raised.

Washington School districts do not receive or hold significant levels of cash. The county treasurer typically receives and holds all State and Federal revenues that a district receives and pays all warrants drawn against the district funds held. Cash receipts at a district level consist primarily of remittances from Associated Student Body activities and student payments for school meals. In Steilacoom each of these areas, are actively managed by individuals outside of the business office.

In early 2023 Steilacoom performed an internal review focused on the primary areas that are subject to fraud, or that may be managed in a way to obfuscate such activity. This work was summarized in an internal April 10, 2023 memo to the Superintendent. The work plan was appropriately focused and designed to detect any fraud that would be material to the School District.

Based upon the work performed the district concluded that:

- There was no identified loss of public funds.
- Expenditures of district resources were made for district purposes.
- Revenues that were expected were deposited into the district’s account.

The work performed was not designed for detecting small or immaterial theft or irregularities. A wide net approach to detect immaterial irregularities is difficult, with the cost of work potentially exceeding the loss, if any.

## **INTERNAL CONTROLS**

Proper internal controls provide a structure that is likely to call out irregular transactions. The district maintains adequate key separation of duties for accounts payable and district payroll. These transactional areas comprise the majority of district general fund disbursements.

Under RCW 43 – All Washington state school districts are subject to an annual independent audit by the Washington State Auditor’s office. The reports from such audits encompass the following areas:

Accountability Audits – an assessment that the district’s funds and assets are protected and accounted for and that they are following applicable laws and local policies.

Financial Audits – an opinion on the accuracy and completeness of the annual school district financial reports.

Federal Audits – an opinion that federal money is spent according to the federal laws and regulations for each federal program.

These audits, while unable to provide certainty, do report any internal control deficiencies that are noted.

The reports issued for the past five years reported no deficiencies in the design or operation of internal controls over financial reporting that the Auditors considered to be significant deficiencies.

A minor weakness was noted for 2020 that resulted in a double entry to record tax revenues at year end. These revenues are collected and held on the district’s behalf by the county. The district made the required entry correction and a review process to identify book entry errors in the future.

## **CONCLUSION**

The district focused on the correct transactional areas and performed their review in a manner likely to reveal any unusual expenditures or patterns. As part of this review, transactions were selected and reviewed to determine that they were for district approved purposes. Additionally, as part of this review, recorded revenues were also reviewed. In conducting this review nothing came to my attention that indicated material fraud or loss that would be covered by the district’s Risk Pool policy. Based upon my review I concur with the district’s conclusion that the review demonstrated no material fraud within the business operations.

## CONSIDERATION OF DISTRICT BUDGET 2022-23 BUDGET

### Budget Adoption

The 2022-23 budget was presented in the July 2022 Board Meeting and adopted at the August meeting. The budget reflected an August 31<sup>st</sup> fund balance of \$5 million dollars and projected an expenditure level that relied upon a fund balance reduction of \$3,795,700 or 7.57% of budgeted expenditures at the end of school fiscal year.

Internal district budget reviews performed after the November board meeting showed several omissions in both expenditure and revenues as well as double counting of certain revenues. A quick summary of various variances yields the following with their estimated impact upon the 2022-23 budget as adopted:

- The Beginning Fund Balance was overestimated by \$1,092,135.
- Revenues were overbudgeted \$1,500,000.
- Expenditures were underbudgeted \$4,105,000.

The net impact of correcting for these errors and omissions impacted the 2022-23 budget by reducing the available resources from revenues and fund balance by \$2,592,135 and increasing the expenditure levels beyond that budgeted by \$4,105,000. In aggregate these variances created a projected expenditure level \$6,634,135 greater than available revenues and planned fund balance usage.

A budget in its most simple form is a district's plan to financially operate for the school year. Realistically, school district budgets cannot precisely capture the year ahead and are reliant upon numerous professional estimates and judgements concerning the uncertainties. These estimates and uncertainties include student enrollment, final legislative actions, state administrative actions, employee bargaining outcomes, individual teacher and employee characteristics, and other uncertainties that will not be known or complete at the time of the budget adoption; some will not be known until the completion of the fiscal year. The magnitude of Steilacoom's budget variances and omissions for operations within the 2022-23 budget are not typical.

## **CAUSES**

The district process for preparing its budget and communicating budget information to the Board did not appear adequate to identify why the 2022-23 budget was below the 2021-22 school year actual.

### **Possible Root Cause**

No evidence was found that an analytic comparison between the 2021-22-year actual expenditures to the 2022-23 proposed budget was prepared and presented to the Board. Such a review should have raised valid questions as to the adequacy of the 2022-23 proposed budgeted levels before adoption.

- Significance and Likelihood of Root Cause: Moderate

### **Possible Root Cause**

The preparation of the district budget was performed by the CFO without a separate knowledgeable review. The superintendent and cabinet were not apprised of the budget development and the key budget information throughout the development process. While district budgets, F-195, are subject to review by the Educational Service District and the Office of the Superintendent of Public Instruction, these are not extensive and should not be relied upon to identify errors in the school district budget(s).

- Significance and Likelihood of Root Cause: Moderate

### **Possible Root Cause**

The budget as developed for and adopted by the board of directors was not shared or used by the internal departments or schools for monitoring their budgets or activity. Schools and departments were not key partners in the budget development process.

- Significance and Likelihood of Root Cause: Low

### **Possible Root Cause**

The Board lacked the appropriate training in budget and financial oversight to understand the routine documents that should be provided and their role in reviewing them. The Board did not actively review the monthly status reports provided by the CFO. In reviewing Board agendas and minutes, the Board meetings did not include a standing agenda item to routinely review the monthly budget to actual results.

Comparing the monthly actual expenditures and revenues to budgeted levels is a key metric in determining how the district is financially functioning. It provides key information as to whether the district is operating within the framework of the Board's adopted budget.

- Significance and Likelihood of Root Cause: High

**Possible Root Cause**

The budget information provided to the Board and the Superintendent was incomplete. The formal F-195 budget document was not provided to either prior to adoption. Additionally, the Board and Superintendent did not receive an analysis comparing the revenues and expenditures in the proposed budget to the current year-end revenues and expenditures.

- Significance and Likelihood of Root Cause: Moderate

**Possible Root Cause**

The variations noted within the adopted budget indicate that the CFO did not exercise due professional care and judgement in developing the expenditure and revenues levels included in the budget. Several estimates were not reasonable given the 2021-22 information and results. The underlying cause of the lack of due professional care is not known.

- Significance and Likelihood of Root Cause: High

## **RECCOMENDATIONS TO ADDRESS ROOT CAUSES**

The district for several years has not developed and maintained an open budget process. The district was reliant upon a key business office staff to develop each year's budget. As conducted, the development did not build in leadership collaboration and review at multiple levels. This collaboration and review would be likely to identify significant budget development issues and increase understanding of the district budget picture among the district leadership.

The School Board and District leaders have expressed a high desire to establish a strong process for budget development including greater leadership involvement and review. I offer the following "best practices" for Steilacoom consideration.

### **District Administration**

The budget is the Steilacoom School District's largest policy document. It defines the financial blueprint for its annual operations. The Superintendent and their cabinet should be involved in and apprised of the budget development at appropriate development check-ins points as the budget is assembled.

A monthly budget to actual information should be routinely provided to the Superintendent and their cabinet. Adequate meeting time for narrative and discussion should be provided to address significant variances or changes that may occur within the budget and how the district may plan on addressing. This narrative and discussion should be captured monthly.

### **Board**

Monthly Board agendas should contain a budget presentation item to review the current year-to-date results versus the adopted budgeted.

The district should provide Board training and orientation on interpreting the district's monthly financial reports and the annual budget development process. In this training course a list for Board members of what to look for in the monthly financial information should be addressed. See Appendix for a suggested framework.

### **Budget Development**

The development of a district's budget should be structured and developed based upon the current year's actual projected year-end revenues and expenditure outcomes. An overview of budget development should be regularly provided to the Superintendent, Cabinet and Board as key progress is made. This information would encompass both financial and district staffing levels.

A suggested framework for a budget development structure would include the information at the following levels.

- Current Year expected revenues and expenditure outcomes.
  - The first step is creating a baseline on how the district is operating now.
- “Maintenance Level” – includes only externally required revenue/cost changes that must be made for the following year.
  - These encompass changes in district revenues/ costs that are required due to contractual obligation or are legally imposed by outside entities. Costing would be based on current year operational/staffing levels.
  - This answers the question “If we only make required changes what are the revenues and expenditures be for next year?”
- Funding or regulatory changes - legislative or federal changes required that have a budgetary impact.
  - These may not be final at time of budget, however, should be considered.
- District policy or discretionary changes to be enacted at the Superintendent or Board direction.
  - What choices is the district making in developing the budget?
- Significant estimates of unknowns should be called out with the consideration made to determine the estimate.

This structure presets a clear picture of the various inputs to be considered and develops the level of discretionary impact that the Superintendent or Board may affect.

The district should provide to the Board copies or links to the final annual budget, financial statements, and four-year forecast as filed with the Office of Superintendent of Public Information. The four-year forecast should be reviewed annually with the Board.

### **Departments and Programs**

Department and program leaders are charged with operating their respective areas within their budget within the district’s annual adopted budget. Changes as they occur should be approved by the Superintendent and CFO before expenditure commitments are made, when possible.

1. Department & program managers must be provided their program budgets at an appropriate level.
2. Monthly reports of their actual to budget must be provided to managers.
3. Routine meetings including the business office and manager(s) should be conducted to review financial status as well as identify any key changes or concerns within the program.
4. The Superintendent and their cabinet should routinely be provided information on actual to budget by program and department for discussion and consideration.

## **REVIEW DEFINITION**

Review services rely upon an external independent professional to perform analytical procedures, inquiries and other procedures to obtain “limited assurance” on the financial statements or practices and is intended to provide the users with a level of comfort on their accuracy.

A review is substantially narrower in scope than an audit. A review does not contemplate obtaining a full understanding of your district’s internal control; assessing fraud risk\*; testing accounting records through inspection, observation, outside confirmation or the examination of source documents or other procedures ordinarily performed during an audit.

A review typically is useful when you, as the School District, are seeking greater confidence in your financial statements for the purpose of evaluating results and making key operational decisions.

*\* At the district’s request this review for Steilacoom School District did consider the district’s internal controls and their work performed to identify any material fraudulent transactions.*

## **APPENDIX**

The following questions are provided as suggested “Look For” questions to be answered within the School District Board of Directors meetings.

Framework questions

### **Monthly Reports:**

1. How is reported enrollment tracking against enrollment as budgeted? Impact?
2. Projecting these results out through year end how do they compare with our adopted budget?
3. Are revenues tracking within the budget amounts? Any significant variances by program or revenue stream? Why?
4. Are expenditures tracking within the budget amounts? Any significant variances within program or class of expenditures? Why?

### **Budgeting:**

1. What are the projected year end results for the current year?
  2. Are projected expenditures less than the projected revenues?  
If not, how, and when will the district address this.
  3. What changes must be made for next year’s budget based upon contract or external factors.  
Examples:
    - a. Employee experience increase,
    - b. Bargained increases, inflation,
    - c. Payroll tax or benefit rate changes,
    - d. Known increases in external costs such as insurance, city, or county fees,etc.
  4. What is our forecasted enrollment for next year. How does this compare with current year results?
  5. Is there any significant expenditure reduction next year from the current year level?  
Examples.
    - a. Curriculum adoptions costs,
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- b. Significant one-time repairs,
  - c. Significant non-recurring technology purchases.
6. Are there significant unknown expenditures? How have they been built into the budget?
7. What capacity has been built into the budget for reasonable variations between proposed budget and actual expenditure or revenue levels?

## About Calvin W. Brodie

Mr. Brodie has worked in Washington State School finance since 1998.

At the Office of Superintendent of Public Instruction, he held the following roles:

- Supervisor of Student Enrollment, and Institutional Funding
- Director of School Apportionment and Financial Services
- Director of School Apportionment, Financial Services and Education Funding Reform

Mr. Brodie was responsible for the administrative operation of the state's funding of K-12 education, the financial accounting and budgeting rules for school district reporting, and revising, drafting, and adopting the Washington Administrative Code addressing K-12 funding, budgeting and financial reporting.

Mr. Brodie was the Executive Sponsor of the project that developed and implemented an overhaul of Washington State's school funding system in 2011 commonly known as the McCleary change.

At the Capital Region Educational Service District 113, Mr. Brodie was the Deputy Superintendent of Business and Operations. This role oversaw the financial operations of the ESD and supported the financial operations of the 44 school districts in his region with training, consulting, and support.

Mr. Brodie has twelve years audit experience with the WA State Auditor's Office and private CPA firms.

Mr. Brodie was a key annual presenter at the annual WASBO conference and has frequently presented for Washington State School Directors, Washington Association of School Administrators, and other groups on matters of K-12 funding.

Mr. Brodie is a past board member and president of WASBO, the Washington Association of School Business Officers.