

Educational Service District Audit Planning Guide



December 21, 2022 For Fiscal Year 2022 Audits

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Planning Guide Information

Supersedes previous planning guide dated December 27, 2021. Please direct questions or suggestions to Team School Programs.

Guidance is intended for internal use only as a general resource to help auditors gain an understanding of educational service districts (ESDs). Guidance is based on the extensive research, brainstorming and reviews conducted as part of the [planning guide update process](#).

The guide is not intended to supplant audit plans or planning for individual audits. While auditors should consider all information in the planning guide, comments need to be evaluated in terms of the individual entity under audit and in light of other planning procedures and auditor's judgment. Also, while guidance is designed to be as comprehensive as feasible, auditors must be alert for audit issues and situations not specifically addressed.

This guide is used by the State Auditor's Office staff as they plan audit engagements. Information presented in this document does not represent policy or legal guidance. State agencies and local governments should contact their legal counsel with specific questions.

WHAT'S NEW

Auditors should be aware of the following significant updates:

- [Leases](#) – Beginning the 2021-2022 school year, GASB 87 is expected to have an impact on educational service districts and require a re-evaluation of lease agreements and changes in reporting for both lessor and lessee situations.

REQUIRED RISKS TO ASSESS

The following risks must be documented as red flags and discussed during brainstorming to ensure sufficient consideration. They should be prioritized for audit to the extent they are applicable and significant to the district.

Authority for Activities

The nature of an ESD's mission often leads ESDs to consider engaging in business type activities which may not be within their authority. Auditors should consider the district's authority for new programs or grants or for any activities that appear to be serving non-schools or that involve partnerships with private or non-profit entities. During planning in gaining an [Understanding of the Entity](#), auditors should inquire of the ESD as to what, if any, non-school contracts and/or services are being performed by the ESD. In situations where an ESD's services are provided to other parties, there must be a clear demonstrated link for how the activity supports the mission and goals of school districts, or other activities as delegated by OSPI or DOE (RCW 28A.310.340(2)). Refer to the [Background section](#) below for additional information.

We have identified arrangements we believe are at risk of being outside of the ESDs authority and are recommending ESDs resolve these arrangements. Team School Programs (SP) is communicating these issues with the ESDs directly. The results of this work may need to be included as part of our ESD accountability audits this year. Team SP will communicate any results of this work directly with local audit teams. Auditors should contact Ryan Montgomery, with any questions.

EFT Controls

Payroll and vendor electronic file transfer (EFT) related cyber frauds continue to occur. Accordingly, controls over EFTs is a required risk to assess for all entities we audit. When assessing this area of risk, auditors should talk with the entity about its controls related to changing existing EFT contact information and associated bank account numbers. The approach perpetrators of these frauds use has evolved to include changing contact information for existing EFT transactions before requesting a change to the associated bank account numbers. Previously, entities were encouraged to follow up with the contact information known at the time of the request for changes to bank account information; however, a stronger control is to independently confirm any change to payroll or vendor profile contact information or banking account information. Individuals with the ability to change or add EFT accounts need to have clear guidance on the process to authorize these changes through a proper validation method. [A testing strategy is available in TeamMate at Accountability | Expenses | EFT Disbursements | Controls over EFTs](#). Contact Team IT Audit at SAOITAudit@sao.wa.gov for additional clarification or guidance.

Financial Condition

Financial condition risk will be assessed as a baseline test for accountability audits and as part of our going concern analysis for financial audits. Governments have experienced a wide range of effects as a result of COVID-19; auditors should be alert for any risks to financial condition and review [FYI 2020-01](#) for expected disclosures. However, serious financial condition issues have been rare for educational service districts. Also see the section below on [Measurement of Financial Health](#).

BACKGROUND

ESDs are formed under Chapter 28A.310 RCW for the purpose of providing cooperative and informational services to school districts and assistance to OSPI and the State Board of Education. ESDs are governed by a 7- or 9-member Board of Directors. Directors are appointed by school districts within the ESD boundaries.

State and federal grants normally comprise the majority of district funding. OSPI also provides “core funding” based on a formula for the provision of basic services to districts. In addition, fees and charges for programs offered to schools may also be a significant source of revenue, depending on the activities and programs of the ESD.

ESD operations can vary significantly based on the types of activities and services they provide. Under RCW 28A.310.340, ESDs “are intended primarily to” (1) provide cooperative and informational services to local districts and to perform functions for those districts when such functions are more effectively or economically administered from the regional level, (2) assist state educational agencies in the performance of their duties and (3) assist in providing students with equal educational opportunities.

Other RCWs describe authority to engage in specific activities, including:

- Assistance with creating new school districts and transferring territory.
- Providing cooperative administrative services to school districts, such as assistance in fiscal services, grants management services, special education services and transportation services.
- Providing personnel services to school districts, such as certification/registration services.
- Providing network and software support.
- Providing learning resource services to school districts, such as audio visual aids.
- Providing cooperative curriculum services to school districts, such as health promotion and health education services, in-service training, workshops and assessment.
- Contracting with third parties to lease building space and portable buildings for school district, lease or maintain security systems for schools, and lease or maintain computers and other equipment for schools.
- Providing services to meet the special needs of schools in their area.
- Operating educational programs for juvenile inmates under Chapter 28A.193 RCW.
- Performing “all other duties prescribed by law and the educational service district board”, such as programs, projects or services of OSPI that are delegated to an ESD by OSPI or the State Board of Education.

The district’s authority to provide services only extends to school districts, OSPI, the State Board of Education and (for limited depository and distribution center services in exchange for adequate compensation) private schools.

Industry, Regulatory and Other External Factors

The ESDs have no taxing authority, but receive core funding from OSPI as a stable source of revenue for basic services. Other programs are either funded by grants or are self-supported by charges for services. Participation by school districts in ESD programs, beyond basic services, is strictly voluntary. As a result, ESDs must market their services to public school districts.

Measurement of Financial Health

Unrestricted cash & investments and operating income are the best measures of a district’s financial health. Unrestricted cash & investments is a measure of the district’s ability to cover deficits in individual programs. Operating Income is a measure of the district’s ability to continue its current level of service. See also [Required Risks to Assess](#).

Auditors should also consider:

- If any major grants have been reduced, discontinued or lost.
- If there are any new programs or services or if any previously offered programs or services have been discontinued or divested.
- The sufficiency of estimated liabilities recorded for self-insurance risk pools (if any).
- The ESD’s analysis of the financial performance of individual programs or services.
- If the ESD has any contractual obligations to continue poorly performing programs or services.

PLANNING & ADMINISTRATION

ESDs use the WSIPC Skyward / WESPac system as their general ledger and accounting software. Data is available via the FAP menu. Auditors can use the Revenue and Expenditure by Fund queries to tie to the ESDs financial statements. Auditors can find information about the Skyward / WESPac software used by ESDs on the Team IT Audit's [Common System Reviews](#) SharePoint site. For questions related to CAATs or Information Systems contact Local IT Audit by emailing SAOITAudit@sao.wa.gov.

Key Entity Information

Key information about ESD operations the auditor should document in the permanent file includes:

- Description of major programs or services offered to school districts.
- Any programs or services offered to private schools, charter schools, or non-school entities.

ACCOUNTABILITY

Under RCW 28A.310.410, districts must use the county treasurer as their fiscal agent.

Revenues

ESD programs are normally supported by fees or charges. Risks associated with charges for services include billing (unbilled accounts, inaccurate or unsupported billings or calculations), receivables (invalid adjustments, unauthorized write-offs), receipting (skimming, lapping or check for cash substitution schemes) and collections (lack of follow-up or monitoring of unpaid accounts). If internal controls over billing and receipting are inadequate, this would be considered a high-risk area.

Expenditures

Credit cards are an area where we are seeing fraud trends increase. Inadequate segregation of duties increases the risk that disbursements may be made without adequate supporting documentation and/or approval and may not be for a public purpose. Risks to consider include: Is someone independent reviewing all of the charges? Is the reviewer looking at the itemized receipts/invoices? Is the reviewer ensuring the purchaser is not also seeking personal reimbursement for the same items bought on the card/account?

Most software programs used by the Districts have an electronic approval process for expenditures. A TeamMate testing strategy is available at [Accountability | IT Controls | Electronic Approval](#). However, credit card payments are generally handled through alternative approval processes creating a high risk. Credit card transactions can be easily downloaded by the District from their bank account web site to support more effective audit testing. Team IT Audit's CAATS team can assist with credit card queries. Please submit a request to SAOITAudit@sao.wa.gov approximately two-weeks prior to needing the additional queries.

Restricted Funds

Restricted funds include state and federal grants, fiduciary funds (if any) and certain local programs (depending on their structure). ESDs often will have special programs supported by fees or joint venture contributions; if these programs or services constitute a "department, public improvement, undertaking, institution, and public service industry" within the meaning of RCW 43.09.210, they would be considered restricted. Often, the interlocal agreement will specifically state that the fees charged for these special programs will be restricted for use in the program or that a special account or fund be set up to account for the program (which would imply a restriction).

Reasonable documentation and indirect cost plans and documentation should be in place to support payroll and indirect cost allocations to restricted funds.

Compliance Requirements

General compliance requirements apply to ESDs, including Open Public Meetings Act, expenditure audit and certification, conflict of interest, insurance / bonding requirements, authorized investments and budgeting.

Other compliance requirements and risks to be aware of are as follows:

- **Interlocal Agreements** – ESDs must enter into interlocal agreements to provide services to school districts. Interlocal agreements should meet requirements of Chapter 39.34 RCW.
- **State and Federal Grants** – State and federal grants represent the majority of an ESD’s funding. Many of these grants are very restrictive regarding allowable costs. Consequently, ESDs may face pressure to support administrative costs. Audits should consider strict federal standards regarding support for payroll and indirect costs charged to federal grants.

In auditing state grants, the focus should be on allowable use of the funds. Reasonable documentation and reasonable indirect cost plans and documentation should be in place to support payroll and indirect cost allocations to state grant funds.

ESDs often pass grant funding on to school districts. In such cases, ESDs must perform reasonable monitoring procedures to ensure that subrecipients are using the funds in accordance with the grant or are following the other applicable compliance requirements.

- **Bid Laws** – Chapter 39.04 RCW requires competitive bidding of public works projects, but does not specify thresholds or a process that must be used. Since Chapter 28A.310 RCW also does not specify the thresholds or process, each District should establish its own policy for competitive bidding. We would expect procurement policies to provide clear expectations for all procurement situations applicable to the District. **However, if the ESD is purchasing for or on behalf of school districts, school district bid laws would apply.** See [the Bidding and Procurement Guide](#) for details.
- **Limitation on Indebtedness – Not Applicable** - Since ESDs have no taxing authority, they must secure their debt with property purchased. During 2011, we found several ESDs had debt, and requested an AGO (2012 no. 5). We determined;
 - ESDs have the authority to issue bonds
 - RCW 28A.310.200 requires ESDs to pledge their property as collateral, and
 - Chapter 39.46 RCW applies to ESDs.

IT Controls

ESDs, especially those that provide IT services to Districts, may be responsible for a significant amount of confidential and private data subject to FERPA laws. Consider [Accountability | IT Control | User Access](#) and [Backup and Recovery](#) testing strategies over Student Management data.

Like School Districts, ESDs that use Skyward systems are converting to the new QMLATIV system. Consider [Permanent File | School F196 | QMLATIV Conversion](#).

Patch Management – Districts have suffered a significant increase in cyber incidents such as breaches and ransomware attacks. Patch management is a front-line defense to ensure operational systems, as well as financial systems, remain strong against known and potential vulnerabilities. Team IT Audit has tested Patch and Change Management at WSIPC without concern. WSIPC is only responsible for the Skyward SMS 2.0 and Skyward QMLATIV financial and student management systems. WSIPC is not responsible for any financial or student data downloaded from other systems, network servers, nor any third-party systems that may, or may not, interface with Skyward, Inc.’s products. [A testing strategy is available in TeamMate at Accountability | IT Controls | Patch Management.](#)

FINANCIAL STATEMENTS

ESDs are considered a proprietary fund, since they provide business type activities supported at least in part by fees or charges. Each fund presented in the financial statements is considered a separate opinion unit (FYI 2006-01).

Financial statements and schedules are prepared in accordance with the Accounting Manual for Educational Service Districts, which is published by OSPI in accordance with WAC 392-125-010. The manual and financial statement template (known as the F-185) requires GAAP-like accounting and reporting with minor variances. These differences are described in the [reporting instructions](#) provided by OSPI. Auditors should consider whether ESDs have evaluated these potential variances.

The manual notes that MD&A is not required since ESDs – as a consistent practice – have chosen not to prepare MD&A. Accordingly, auditors will issue GAAP audit reports with a report modification ([ARS Part 3 Chapter 9 Example 8a](#)) identifying there is no MD&A.

Auditors should use the “GAAP Statements - proprietary only” TeamMate steps. ESDs are expected to prepare their financial statements = based (in-part) on guidance provided by the ESD Accounting Manual. However, the ESD Accounting Manual does not include comprehensive GAAP guidance, and auditors should refer to the BARS manual as the authority for current financial statement reporting and accounting guidance.

ESD Notes to the Financial Statements template

Beginning with Fiscal Year 2020 financial statements, ESDs can use the *Educational Service District (ESD) FY20XX Notes to the Financial Statements Template*, found on the [BARS Reporting Templates page](#). This template was developed in-conjunction with ESDs, OSPI, and SAO. The suggested notes represent the general operating assumptions of the ESDs. We would expect ESDs to evaluate the notes for applicability and make any amendments to their notes based on their individual circumstances. Auditors should refer to the ESD template notes when reviewing the notes to the financial statements. For any questions or if issues are identified, auditors should contact Ryan Montgomery, Team School Programs, and Stacie Tellers, Local Government Support.

GAAP reporting changes

All new GASBs are identified and evaluated by the Financial Audit Committee (FAC), as summarized on the [GASB Tracker](#) available on the FAC Sharepoint page. When evaluating implementation of new GASBs for ESDs, auditors should specifically consider:

- **GASB 84** (Fiduciary Activities, original implementation effective FYE 2019, new implementation effective FYE 2021) is expected to have an impact on districts and require re-evaluation and changes to reporting for fiduciary activities. [A TeamMate testing strategy worksheet is available in Financial Statement | GAAP | Worksheets.](#)
- **GASB 87** (Leases, effective beginning with the 2021-2022 school year) is expected to have an impact on districts and require re-evaluating and changes to reporting for leases. [A TeamMate testing strategy worksheet is available in Financial Statement | GAAP | Worksheets.](#)

GASB 95, issued May 8, 2020, delayed the implementation date of certain new standards.

GAAP reporting - Joint Ventures and Shared Service Arrangements

ESDs will often enter into interlocal agreements with other governments (especially schools) to provide services. Many federal and state grant programs encourage or require ESDs to join with other entities to provide services in a Shared Service Arrangement. Accounting for these joint activities may need to be evaluated.

GAAP reporting - Risk Pools

If the ESD operates a risk pool for school districts, the auditor should be aware of unique accounting and reporting requirements for ESD and school district risk pool activities. Many school districts deposit money with their regional ESD to fund future compensated absences, unemployment and workers compensation liabilities. SAO reviewed the deposit arrangement agreements and determined the classification of each ESD pool for financial reporting. A current summary of this analysis is included in the [School District Planning Guide](#).

Several ESDs have revised their risk pool agreements in recent years in order to ensure the risk pools can be reported as “risk sharing” type pools. Auditors should inquire whether any changes or amendments to ESD deposit arrangement agreements have been made. If changes have been made, please communicate these changes to the Team School Programs Audit Manager. Financial Reporting guidance specifically for ESD risk pools can be found in ESD Risk Pool Accounting & Reporting guide located on the [Team School Programs SharePoint Site](#): Resources | ESD Information | ESD_Risk_Pool_Accounting_&_Reporting.

If the ESD relies on an actuary to calculate risk pool liabilities, there is the potential risk the information provided to the actuary is incomplete. Auditors should refer to the “Reliance on Work of an Actuary” section of the [Risk Pool Planning Guide](#) for specific procedures/risks to consider. Contact a Self-Insurance / Risk Pool Subject Matter Expert if assistance is needed when reviewing the actuary report.

FEDERAL PROGRAMS

Online Filing

ESDs file their SEFAs through online filing. Districts should be using the SEFA instructions applicable to the audit period, which can be found [here](#). Auditors must obtain the SEFA and Notes through LGCS reporting and NOT from the District directly. This process will help ensure SEFAs are correctly presented. Refer to the updated Single Audit Planning SEFA procedure step for additional information. As noted in the SEFA procedure step, verify with the District this is the final version before proceeding with vouching the SEFA.

Since the majority ESD funding is from state and federal grants, we expect districts to require a single audit every year.

Federal Procurement

When entities use federal funds to purchase goods and services they must have and use documented procurement procedures (written local policies/procedures), consistent with State and local laws and regulations. Entities documented procurement procedures must conform to the procurement standards identified in sections 200.318-.327 of the Uniform Guidance (2 CFR 200). Since ESDs do not have state-established (statutory) requirements, their documented procurement procedures should ensure the most restrictive of local or federal standards are met. Entities must also have written standards of conduct that cover conflicts of interest and govern the performance of its employees engaged in the selection, award, and administration of contracts/purchases. Refer to the guidance in the procurement testing strategies and the bidding and procurement planning guide.

PERFORMANCE AUDITS

Information on ongoing performance audits can be found on SAO website at: <https://www.sao.wa.gov/performance-audits/performance-audits-in-progress/>. For all other inquiries please contact the Assistant Director for Performance Audit.