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A REVIEW OF CASH, INVESTMENT, AND FUNDING MANAGEMENT PRACTICES IN SCHOOL DISTRICTS

August 6, 1997

To the People of Kentucky
The Honorable Paul E. Patton, Governor
Wilmer S. Cody, Ph.D., Commissioner
Department of Education

Re: Review of Cash, Investment, and Funding Management Practices In School Districts

Ladies and Gentlemen:

We present our report on cash, investment, and funding management practices in school districts. Our report examines the management practices necessary to accelerate cash receipts, increase interest earnings, minimize the cost of financial services, and optimize program funding. We estimate that Kentucky school districts could increase annual available financial resources by approximately $22 million by strengthening their cash, investment, and funding management practices.

Our report demonstrates that cash and investment management policies and practices have a significant impact on the financial health of school districts. For example, districts that conduct business with banks selected through competitive bidding processes generally earn higher yields on investments than districts that do not solicit bids for banking services. These school districts also have more sophisticated cash management programs, including projecting periods of cash surpluses and utilizing cash flow forecasts to make investment decisions. They also pool financial resources, and minimize the number of district bank accounts, and deposit their cash in interest-bearing checking and savings accounts.

Our report also shows that school districts are not receiving public school funds from the State on the first day of each month as required by statute. We find that school districts often use district resources to fund federal programs or fail to secure federal funding as early as possible, thereby driving up operating costs. In addition, we report on selected issues warranting management attention in the school districts we reviewed. Finally, we offer recommendations throughout the report that will result in better business practices, increased available resources for school districts, and better management control of cash, investments, and funding.

Respectfully submitted,

Edward B. Hatchett, Jr.

FOREWORD

One of the responsibilities of the Auditor of Public Accounts (APA) is to help those who manage public resources identify and implement good business practices. In 1987, the APA issued a report to the Kentucky Department of Education (KDOE), which recommended that KDOE improve its monitoring and technical assistance efforts pertaining to cash management programs in local school districts. In January 1997, the APA embarked on a training initiative to improve fiscal responsibility and accountability in state and local government. This review is consistent with the purposes of that initiative and addresses many of the subjects of the 1987 audit. By providing training and examining and showcasing practices, APA can assist, advise, and guide public officials toward meeting their responsibilities to:

- Apply public resources efficiently and effectively so as to achieve the purposes for which the resources were appropriated
- Establish and maintain effective financial and other management controls to ensure that appropriate goals and objectives are met, resources are safeguarded, laws and regulations are followed, and reliable data are obtained, maintained, and fairly disclosed; and
- Provide informative reports to the public, the General Assembly, and government officials to promote fiscal and program accountability in government.

To gain a statewide perspective of financial practices, we developed a questionnaire (Appendix III) for surveying all of the State's 176 school districts. We received responses from all 176 districts and included the survey results in the following cash management areas: policies and general practices, banking relations, revenue collections, and investments.

EXECUTIVE SUMMARY

1. 176 school districts collected more than $3 billion in revenues during fiscal year 1995-1996 from the following:
    - State contribution, $1.859 billion
    - Local taxes, property and utility, $825 million
    - Federal grants, $305 million
    - Interest on bank accounts and investments, $21 million

2. Facilitating the Flow of Cash Into The District
    - Additional resources of $7 million if property taxes were assessed, collected, and remitted on time
    - Additional resources of $3+ million if SEEK funds were received on 1st of each month
        - Establish business-like practices designed to increase cash available for investment
        - Draw down federal resources at the beginning of federal programs instead of using the district's resources

3. Improving District Cash and Investment Management
    - Additional resources of $4-$8 million if districts strengthened cash management practices
        - Competitive procurement of financial services
        - Cash flow forecasts
        - Using business-like investment practices
        - Investing idle balances
        - financial Oversight

4. Optimizing District Resources
    - Additional resources of $4 million if federal funds were requested at the earliest possible time
    - Avoid Using current resources to cover prior year cash deficits

5. Strengthening District Financial Control
    - Expenditure of funds in excess of income and revenue
    - Credit cards and travel reimbursement
    - Collateralization of public deposit

T A B L E O F C O N T E N T S

TABLE OF CONTENTS (continued)

INTRODUCTION

Background

Since the passage of the Kentucky Education Reform Act (KERA) in 1990, Kentucky taxpayers have invested more than $20 billion in elementary and secondary education. Currently, elementary and secondary education spending accounts for nearly 16 cents of every tax dollar. State law imposes time restrictions on the collection and transmission of property and utility taxes to school districts, and also establishes collection procedures for local taxes and fees. Furthermore, state law prescribes the types of investments that may be purchased and defines the financial institutions in which districts may maintain accounts.

An increasing number of school districts are improving their cash management programs as a means to

- increase control of cash resources
- increase accountability through improved reporting and forecasting
- increase revenue by making more cash available for investment at relatively high short-term interest rates

A well-managed investment program can produce additional revenue for districts with little risk or expense.

OVERVIEW OF CASH MANAGEMENT OBJECTIVES

Cash management is the process of ensuring maximum cash availability and maximum yield, while making sure that taxpayer dollars are protected. Effective cash management systems for school districts must focus on three primary objectives:

> **Facilitating Cash Flow:** This objective addresses the means by which a school district can maximize the amount of cash available for both daily operations and investments.
>
> **Improving Cash and Investment Procedures:** Banking services and investment practices affect operating costs and determine a district's ability to maximize interest income. School officials should determine the range of available investments, evaluate competing institutions which provide banking and investment services, establish sound investment procedures, and periodically evaluate cash management and investment goals.
>
> **Strengthening District Financial Controls:** A financial control system helps ensure that cash is received in a timely manner, that collections and disbursements of district resources are adequately controlled, and that excess cash balances earn the highest fiscally responsible investment yield. This requires accurate, timely information, and controls on actual cash balances.

Cash management objectives are tempered by factors such as legal restrictions on investments, local policies established by school boards, safeguards against loss, and the need for cash to cover daily operations. Nevertheless, school districts can establish effective cash management programs that achieve these three primary objectives.

FACILITATING THE FLOW OF CASH INTO THE DISTRICT

All Parties Responsible For The Flow Of Revenues Into School Districts Should Accomplish These Duties In The Most Timely Manner

Local Resources

We examined the effects of slow tax collections on school districts. We found that over 70 counties were collecting taxes well into the next calendar year. These late tax collections prevented districts from utilizing desperately needed tax revenue during the school year.

The timely collection and distribution of property tax receipts is crucial to the proper funding of education in every school district. Our review of property tax assessment, and collection practices reveals the process does not provide safeguards to prevent delays or bottlenecks. Any impediment to receipt of taxes forces school districts to borrow or divert cash to meet operating shortfalls. That borrowing or diversion drives up operating costs and reduces needed resources.

We assessed the loss of tax income for school districts from the year 1992 through 1996 (see chart below). The ineffective collection process deprived schools of timely utilization of approximately $200 million each year. The chart indicates that for 1992 through 1996, the school districts have lost the opportunity to earn almost $8 million in interest income.

Local Resources (continued)

IMPACT OF LATE TAX COLLECTIONS ON SCHOOL INTEREST INCOME 1992-96

YEAR	**TAX DOLLAR AMOUNT**	**INTEREST LOST**
1992	$184,523,198.16	$1,636,495.21
1993	219,099,352.97	1,924,544.40
1994	207,641,142.77	2,348,466.68
1995	195,141,944.88	1,577,358.41
1996	54,187,863.18	422,554.16
TOTAL	**$860,593,501.96**	**$7,909,418.86**

The following school district exemplifies the effects of late property tax collections:

Pike County did not begin 1995 property tax collections until October of 1996. The inability to utilize the tax revenue resulted in cash flow difficulties for the school district. The 1994-95 school year began with a cash balance of $80,948 but at the end of the year the account contained a deficit of $1.5 million. By June 30, 1996, the cash deficit in the operating account climbed to $3,065,327. Pike county will not start 1996 collections until midway through the school districts' 1998 fiscal year. For further details, please see the Pike County School District management letter in Appendix IV.

RECOMMENDATION 1

We recommend that the Revenue Cabinet, KDOE, the Kentucky Sheriffs' Association, the Kentucky PVA Association, legislative leaders, and other interested parties create a tax assessment, collection, and remittance system that allows for the timely receipt of funds necessary to educate the children of Kentucky.

State Resources

The Finance and Administration Cabinet (Finance) is persistently late in paying school districts their monthly Support Education Excellence in Kentucky (SEEK) funds. KRS 157.410 requires Finance to pay SEEK funds on the first day of the month. All seven of the school districts we reviewed received their SEEK payments on or about the twentieth day of the month.

KRS 157.410 states the following:

> For each school year, the Finance and Administration Cabinet, on the certification of the chief state school officer, shall draw warrants on the State Treasurer for the amount of the public school funds due each district. Checks shall be issued by the State Treasurer and transmitted to the Department of Education for distribution to the proper officials of the school districts when the districts have fully complied with the school laws and administrative regulations of the Kentucky Board of Education. The chief state school officer shall determine on or before August 15 of each year the tentative allotment of school funds to which each district is entitled under provisions of KRS 157.310 to 157.440. On July 1, August 1, and September 1, of each fiscal year, one-twelfth (1/12) of the prior year's allotment minus the capital outlay shall be paid each school district. On the first of each month thereafter until the final calculation is completed, one-twelfth (1/12) of each district's share of the tentative calculation for instructional salaries, current expenses, and transportation of the public school funds shall be distributed.

The seven sample districts received more than $96,265,000 in SEEK funds during the fourteen-month period of our review. The delay between the first day of the month and the date the districts received the funds averaged 19 days. Had funds been received by the first day of the month, these districts could have earned approximately $201,000 in additional interest, assuming the funds were invested at a conservative four percent rate. The delay of SEEK funds becomes even more significant considering that Franklin County and Russell County have been declared to be in a state of emergency, and funds were neither adequate nor timely to meet their operational needs.

Statewide, school districts received $1,641,000,000 in SEEK funds during the review period, which, if invested for 19 days at the assumed rate of four percent, could have earned $3,427,000. With an active cash management program and more available cash, the districts could significantly increase their investment returns.

The delay by Finance in paying SEEK funds to the local school districts is a continuing problem. In fact, our office reported this same problem in an audit issued in 1987. KDOE officials state that they authorize the distribution of SEEK funds before the first of every month; however, Finance delays the payments until approximately the twentieth day of the month. Finance officials stated that, due to cash flow cycles, funds are not available until the twentieth day of the month and that this delay has occurred for years.

State Resources (continued)

Late receipts adversely affect the cash flow of school districts and produce cash management dilemmas. In addition, some districts, such as Franklin County, incurred the cost of borrowing money to meet immediate cash flow needs.

The following chart depicts the borrowing problems found in Franklin County School District:

Franklin County Board of Education
Loans to Meet Cash Shortfalls

Loan Date	Loan Amount	Payoff Date	Payoff Amount	Interest Paid
09/15/95	$800,000	09/20/95	$800,630	$ 630
09/29/95	800,000	10/20/95	802,646	2,646
10/13/95	500,000	11/20/95	502,993	2,993
10/31/95	800,000	11/20/95	802,520	2,520
11/15/95	700,000	12/20/95	703,859	3,859
11/30/95	650,000	12/20/95	421,140	0
		12/22/95	230,979	2,120
12/29/95	450,000	01/12/96	450,850	850
TOTAL				$15,620

Finally, after many months of rotating loans, the board signed a note with the Kentucky Association of Counties (KACO) for $4,202,870 to satisfy cash flow problems. Although this temporarily cured their shortfalls, it dramatically increased the district's burden of debt. For further details, see Franklin County management letter in Appendix IV.

RECOMMENDATION 2

We recommend that KDOE, the Finance and Administration Cabinet, and the Treasury Department develop procedures to ensure that school districts receive SEEK funds on the first business day of each month as required by KRS 157.410.

Federal Resources

All school districts in Kentucky participate in programs funded in part or entirely by the federal government. To receive these federal funds, school districts must request payment. Many programs are structured to allow districts to project costs and request money in advance of incurring expenditures.

RECOMMENDATION 3

We recommend that school districts request federal program funds at the earliest possible time.

Federal Resources (continued)

However, in far too many districts local and state resources are used to fund the costs of these federal programs, with lengthy delays before requests for payment. This practice increases the cost of education and results in unnecessary expense to local taxpayers. In addition, investment opportunities are lost.

IMPROVING DISTRICT CASH AND INVESTMENT MANAGEMENT

School Districts Should Strengthen Cash and Investment Management

Based on the results of our fieldwork and the responses to our statewide survey, we conclude that there are significant opportunities for districts to improve their cash and investment management. We estimate that school districts could have earned, without sacrificing investment security, between $3.8 million and $6.6 million in additional interest income for fiscal years 1995 and 1996 respectively, had they implemented better business practices. We strongly urge districts to competitively bid their financial services and improve their cash flow forecasting.

We found that districts with weak cash management practices earned lower rates of return compared to districts with formal cash management programs. We found that many districts did not bid or actively control their banking services, incurring higher than necessary costs.

Competitive Bidding of Banking Services

School districts that use a formal competitive process to obtain and negotiate banking services achieve a higher rate of return than those that do not. Slightly more than half of all school districts reported that they bid banking services at least every three years (see Exhibit 1). Sixty-seven percent of the "high return" districts solicited bids for banking services at least every three years. Comparatively, only 28.6 percent of the "low return" districts solicited bids for banking services. [1]

[1] For the purpose of this study, we define a "high return" district as one that achieves interest earnings of one percent or more on total revenues, and "low return" as interest earnings of less than one-half percent. We identified 64 "high return" districts and 42 "low return" districts out of a total of 175 districts that provided usable survey responses.

Competitive Bidding of Banking Services (continued)

Exhibit 1

Banking Services	Request for Proposals (RFP)	Verbal Bidding	Written Bidding	Negotiate costs with the bank	None of the listed options
Interest-Bearing Checking	23	8	53	37	20
Non-Interest Bearing Checking	5	4	9	15	8
Certificates of Deposit	8	20	29	34	6
Passbook Savings Account	1	1	6	4	5
Wire Transfers	17	4	27	16	23
Investment Services	20	8	19	10	6
Zero-Balance Accounts	10	1	12	3	7
Lock Box System	6	1	8	5	7

********BEST PRACTICE********

Kenton County School District submits a Request for Proposals (RFPs) to several banks, including banks outside of the school district. RFPs solicit information on interest rates to be offered for bank accounts, the amount of compensating balances required, the cost of various banking services, and the types of services available. A cost-benefit analysis and/or negotiation can be used to determine which bank is providing the best offer.

Five of the districts we visited did not bid their banking services and illustrate the disadvantages of not bidding. The bank bidding practices for these districts were:

> **Russell County School District** maintained its primary deposit account in a local bank that paid a NOW account rate of 2.78 percent, even though it received an unsolicited offer from another bank that offered 4.25 percent. According to district staff, banking services were not bid because of community support provided by their existing bank.
>
> **Pike County School District** did not bid for banking services; instead it used five banks, each offering different interest rates, but only one that offered over four percent.

Competitive Bidding of Banking Services (continued)

Trigg County School District did not bid its banking services, but annually alternated between two banks for routine services and as the official financial depository. This practice may not fully maximize potential investment income or minimize bank service costs.

Providence Independent School District deposited all district resources, except for a $5,000 CD, in a NOW account that earned a low rate of return of 2.5 percent. The district does not bid its banking services.

Laurel County School District banked with the three largest banks in the county. The district called each bank and requested interest rates, but did not bid for other banking services.

Many districts resources are not deposited in interest-bearing accounts (see Exhibit 2). Some amounts maintained in non-interest-bearing accounts represent compensating balances to offset the costs of services provided, for which financial institutions do not charge specific fees. Most districts invest some of their idle cash in interest-bearing checking and savings accounts, and many invest in higher-yielding certificates of deposit (CDs) and repurchase agreements. Most districts did not use competitive procurement practices to obtain CD rates, but limited purchases of CDs to those banks where they maintained their checking and savings accounts.

Exhibit 2

Which of the following funds does your school district invest in interest bearing checking accounts or money market funds?

Number of Schools Districts	Fund Type
170	General
159	School Lunch
141	SEEK Capital Outlay
148	Facility Support Program
86	Lease, Bond & Interest Redemption
142	School Construction
120	Special Revenue (Grant)
153	Technology
120	Activity
32	Other

RECOMMENDATION 4

We recommend school districts select their banks through a competitive bidding process. We suggest the district first determine the necessary basic banking requirements needed, then decide what it is willing to pay for those banking services. We then recommend the district prepare an RFP and send it to competing financial institutions, including institutions outside the county. Finally, we recommend the district evaluate the RFPs and select its financial institution(s) based on predetermined criteria. These criteria might include, but are not necessarily limited to, the following considerations:

- Qualifications of the institution
- Compensating balance requirements
- Negotiated interest yields on accounts such as interest-bearing checking and money market accounts
- Need for diversification
- General conditions and length of the contract
- Capacity to provide desired services (such as sweep accounts) and the cost of those services

Using Cash Flow Forecasts

Cash flow forecasts compare the timing of receipts and disbursements, identify basic cash flow patterns, and determine the amount and timing of idle cash balances that can be invested. Only 62 districts, approximately 35 percent, prepared formal cash flow forecasts.

Typically, the "low return" programs generally did not use cash flow forecasts to make investment decisions. Only 23 percent of the low return districts used forecasting methods compared to 45 percent of the "high return" districts. Fourteen relatively "low return" districts have deficit fund balances and are on a watch list of financially troubled school districts maintained by KDOE. Only two of these 14 financially troubled districts, Elliott and Nelson, report using cash flow forecasts.

Clark County	Martin County	Jenkins County
Harlan Independent	Metcalfe County	Russell County
Elliott County	Pike County	Harlan County
Floyd County	Owen County	Nelson County
Franklin County	Middlesboro Ind.	

School districts that use cash flow forecasts also tend to achieve greater interest earnings. We found that districts that use cash flow forecasting average approximately 23 percent more in interest earnings than the 106 districts that fail to use cash flow forecasting methods.

RECOMMENDATION 5

We recommend that school districts prepare cash flow forecasts and use them to determine the amount of idle cash that can be invested. Then, considering the level of risk, the districts should invest in eligible instruments that offer more favorable yields than checking accounts.

Pooling Resources

A good cash management system also permits the combining of separate cash into one or a few bank accounts for investment purposes. There are several good reasons for pooling financial resources: it permits larger investments, tends to smooth out fluctuations in cash flow, makes investing easier, and reduces paperwork. Our study found that the "high return" districts pooled their resources for investment purposes and generally maintained fewer bank accounts than the "low return" districts.

RECOMMENDATION 6

We recommend that districts consolidate bank accounts and pool resources to the greatest extent possible.

Using Business-Like Investment Practices

Of the 64 "high return" districts we found 42 districts which used business-like practices such as

- Pooling the cash balances of multiple accounts
- Adopting and documenting cash management policies and procedures
- Using cash flow forecasting to make investment decisions
- Obtaining collateral statements from banks to compare the amounts of collateral pledged to the amounts of resources deposited
- Maintaining a central record of all investments
- Not limiting the purchases of certificates of deposit to banks that handle their checking accounts unless that practice is part of a negotiated depository contract
- Periodically sweeping checking account balances into higher-yielding interest-bearing instruments

Districts which reported using at least four of these seven practices generally achieved a greater return on their investments. These districts achieved approximately 27 percent more in interest earnings than those that did not.

RECOMMENDATION 7

We recommend that districts initiate business-like practices to enhance opportunities for greater investment returns.

Investing Idle Cash Balances

In 104 school districts, less than one percent of general fund revenues is attributable to interest income. Had these districts increased interest income to an amount equal to at least one percent of general fund revenues, they would have earned an additional $7.9 million during the year ended June 30, 1996.

Local school districts may associate to create investment pools pursuant to KRS 66.480(10)(a). We believe that district officials should be aware of the investment options permitted under state law, periodically evaluate available interest rates, and invest idle balances in a combination of instruments which minimize risk and offer the most favorable rate of return.

********BEST PRACTICE********

To increase interest income, school districts may wish to consider repurchase agreements or overnight investment accounts with their bank(s). School districts using these instruments report that, on average, they receive 1.52 percent more yield than those districts that do not. Overall, the fourteen districts which used repurchase agreements and overnight investments tended to solicit bids for banking services and operate at a higher level of operating sophistication.

Several districts used a variety of investment options. For instance, many used interest-bearing checking accounts for demand deposits. Some districts also transferred idle balances from checking accounts into CDs, which offered higher interest rates than did interest-bearing checking accounts. Table 1 below shows the major types of investments used by school districts, the number of districts using each type of investment, and the average yield obtained by the districts.

Table - 1
Reported Rates of Return on
Various Investment Instruments

Investment Instrument	Average Rate of Return	Number of Districts
Interest-Bearing Checking Accounts	3.63%	96
Certificates of Deposits	5.29%	64
Repurchase Agreements & Overnight Investments	5.15%	14
Treasury Bills	5.00%	11
Other Investments	4.10%	21

The use of interest-bearing checking accounts was followed in popularity by CDs. Sixty-four districts reported their earnings on CDs averaged 5.29 percent and ranged from approximately three to seven percent. Only four districts reported earning lower yields on CDs than they earned on checking accounts.

As long as statutorily-allowable investments have acceptable risk-to-return characteristics, we believe that districts should invest idle balances at the most favorable rates. While we do not recommend one investment option over another, Table-2 illustrates that certain investment options offer higher rates of return than others.

Financial Officer's Oversight

We asked the districts to identify the person who regularly monitors the investment of idle resources. Our statewide survey indicated regular investment oversight is currently provided by:

- Finance Officer - 140 (80%)
- Superintendent - 115 (66%)
- Entire School Board - 44 (25%)
- Other - 17 (10%)
- Not Regularly Monitored - 6 (3%)
- School Board Investment Committee - 2 (1%)

Of the seven districts visited, only one was among the six reporting no regular monitoring of uninvested cash.

Russell County School District reported it had no individual charged with the overall responsibility for oversight of the district's financial practices, consequently transactions were not being handled consistently throughout the district.

RECOMMENDATION 8

We recommend that all school districts institute a Board-approved, written cash management and investment policy. Included in the policy should be procedures to

- consolidate multiple bank accounts
- prevent the under-collateralization of public deposits
- ensure that cash and investment management policies and day-to-day financial operations are the responsibility of a designated official
- pool idle cash balances to obtain higher interest rates, including pooling resources with other districts

RECOMMENDATION 9

We recommend that all school districts adopt written policies and procedures to improve investment yields. These policies and procedures should include:

- A listing of permitted investments
- Procedures designed to secure the district's financial interest in the investments
- The specific standards for investment qualification
- A mandate to use interest-bearing rather than non-interest-bearing accounts whenever possible
- A mandate to pool cash balances to obtain higher investment yields, including pooling with other districts
- A mandate to seek interest rate quotations from several financial institutions
- A designation of the optimum levels of cash to remain in time deposits and demand deposits, with idle balances swept into higher-yielding instruments, such as certificates of deposit, repurchase agreements, or other eligible investments

OPTIMIZING DISTRICT RESOURCES

School Districts Should Use Current Designated Funds For Budgeted Programs

Diverting District Operating Resources to Federal Programs

School districts should request payment of federal program expenses at the earliest allowable time rather than use district funds budgeted for other programs. All districts operate federally-funded programs, many of which allow advance drawdowns for the payment of operating expenditures such as salaries, benefits, supplies, and materials.

In many cases, districts use their own funds to pay for these federal programs, then apply for reimbursements. For most of the federal grant expenses, the district could have requested the federal program funds in advance of need.

Not only did some districts not request advances; many were late submitting their requests for reimbursements. Requests for reimbursement were frequently not made for periods that ranged from 30 days to more than one year after the expenditures were made. In October 1996, KDOE listed those school districts that were a year or more behind in requesting their federal reimbursements. Table 2 reflects that information.

Because the districts had not requested or collected federal drawdowns for these programs, they used district resources which had been budgeted for other purposes. The use of local money to pay for federal programs also reduces resources available for investment. The worst consequence is that the districts are not permitted to request further federal drawdowns until they have requested and collected the prior year program resources such as those listed in Table 2.

<u>Diverting District Operating Resources to Federal Programs</u>(continued)

Table 2

KENTUCKY SCHOOL DISTRICTS
AT LEAST ONE YEAR BEHIND
IN COLLECTING FEDERAL REIMBURSEMENTS
June 30, 1996

Federal Program	School District	Amount
Pre-school	Bourbon County	$ 720
	Caverna	10,000
	Ft. Thomas Independent	3,000
	McCreary County	29,000
	Murray Independent	3,000
	Nelson County	18,000
	Todd County	41,000
	Subtotal	$104,720
IDEA Basic	Bourbon County	$ 26,000
Drug and Alcohol	Anderson County	$ 1,500
	Ashland Independent	21,680
	Metcalfe County	1,400
	Middlesboro Independent	3,900
	Murray Independent	7,000
	Subtotal	$ 35,480
Title II	Berea Independent	$ 1,400
	Boone County	1,600
	Bullitt County	5,700
	Estill County	13,843
	Fayette County	58,400
	Jefferson County	15,100
	McLean	918
	Murray Independent	4,700
	Shelby County	14,100
	Subtotal	$115,761
Chapter II	Nicholas County	$ 1,500
	Shelby County	23,326
	Subtotal	$ 24,826
	Grand Total	**$306,787**

Diverting District Operating Resources to Federal Programs (continued)

In addition to the statewide list of districts eligible for federal payments, the following districts were part of our site-testing sample and illustrate the actual weaknesses in management of federal program drawdowns.

- **Trigg County** administered three major federal programs, but made only twelve drawdowns for the period July 1, 1995, through June 30, 1996. The expenditure for these major program represented 91 percent of the total federal program payments for which the district was eligible. Moreover, the expenditures were mostly for salaries, which are fixed in advance and easily scheduled. Over $430,000 in district funds were diverted to pay for the federal programs. The lost interest alone on these diverting funds amount to $1,957.

- **Kenton County** requested between three and eight drawdowns for each of the six major federal grants tested. The school district spent $1,472,884 of the district's resources for these federal programs, which represents $8,000 in lost interest. One reason for this large use of general funds may have been that the grant ledgers were incomplete. Thus, district personnel could not know what the federal/district fund balances were for each grant.

- **Pike County** requested federal drawdowns totaling $3,140,151 during the period July 1, 1995, through August 31, 1996 for their largest federal grant. However, cash totaling $3,249,859 was transferred from the general fund to pay for federal expenses approximately one and one-half months before the request for repayment. Reimbursement of these general funds took from one to two months, which represented a potential loss in interest of approximately $12,000. Further analysis of the federal/district funds transfers revealed that, from August, 1995, through September, 1996, federal reimbursements to the district were short by $109,708, for which lost interest is still accruing.

********BEST PRACTICE********

***Providence Independent* - The district requested all federal drawdowns prior to expending the funds. The transfer of federal funds was tracked through "due to" and "due from" accounts which were cleared each month.**

***Russell County* - All of the district's federal programs were advancement programs, meaning no district funds were tied up with the federal programs and no interest was lost.**

***Laurel County* - The district requests federal drawdowns usually within eight days of month end and receives both advance and reimbursement payments.**

Diverting District Operating Resources to Federal Programs (continued)

RECOMMENDATION 10

We recommend that school district officials request all federal resources at the earliest opportunity. This will minimize the use of the districts' own resources and increase cash available for investment.

Using Current Resources To Cover Prior Year Cash Deficits

Although only Pike County, out of the seven districts visited, had serious problems with delayed tax collections, each district must be aware that improper recording of receivables causes misleading account balances and distorted budgets.

Pike County has not been on a regular tax collection schedule in ten years and is at least one year behind in tax collections. The 1995 property taxes were not collected until the end of 1996. According to the School District Audit Report prepared by the independent CPA firm, the district booked over $5 million of 1995 tax receipts as an accounts receivable. American Institute of Certified Public Accountants standards allow revenues to be recognized in the accounting period in which they become susceptible to accrual, that is, when they become both measurable and available. Property taxes are considered available if they are levied and due before year end and collected within 60 days following the end of the fiscal year.

The improper accounting for these receivables gave the appearance that Pike County's financial position was stronger than it actually was and School Board officials made management decisions based on misleading financial data. The Board, as a result of this misinformation, approved a budget in which expenditures exceeded receipts by a million dollars. The 1994-95 school year began with a $80,948 cash balance, but at the end of the year the cash deficit had grown to $1,519,739. This deficit in the checking account was offset by depositing money received for 1995-96 operations into the deficit-stricken 1994-95 cash accounts. This maneuver caused the 1996 school year to begin with $1.5 million less than anticipated and budgeted.

By June 30, 1996, the deficit in the general fund had climbed to $3,065,327. To compensate for this deficit, a transfer was made from the 1996-97 general fund. We realize that late tax collections are a major part of these cash flow problems; however, unless the Pike County Sheriff collects two years' property tax receipts in one year, a highly unlikely scenario, this deficit will likely never totally be made up.

Although the district has no control over timely collection of property tax receipts, the proper accounting for these resources is essential. The fiscal decisions made in any district are complex and there is very little room for error. Reliable, straightforward financial data are imperative in this process.

Using Current Resources To Cover Prior Year Cash Deficits (continued)

RECOMMENDATION 11

We recommend that auditors employed by school districts closely adhere to accounting standards which limit the booking of late tax collections.

RECOMMENDATION 12

We recommend that school districts encourage local tax collection authorities to maintain the collection schedule required by law and inform the public how much late tax collections drive the cost of elementary and secondary education.

RECOMMENDATION 13

We recommend the Pike County Board of Education, other affected officials, and KDOE research legal remedies for the collection of late taxes and spur the immediate collection of all outstanding property taxes.

RECOMMENDATION 14

We recommend the Revenue Cabinet, local sheriffs, PVA and other parties comply with KRS KRS chapters 133 through 135 by implementing a tax assessment and collection policy and procedure that would provide timely distribution of tax revenue to school districts.

RECOMMENDATION 15

We recommend that school districts avoid using future year receipts to cover current year expenditures.

STRENGTHENING DISTRICT FINANCIAL CONTROLS

School Districts Should Safeguard District Resources With Proper Financial Controls

Expenditure of Funds in Excess of Income and Revenue

KRS 160.550 prohibits the Superintendent and any Board member from knowingly voting for an expenditure in excess of the income and revenue of any year. The statute reads, in part,:

1) No superintendent shall recommend and no board member shall knowingly vote for an expenditure in excess of the income and revenue of any year, as shown by the budget adopted by the board and approved by the State Board of Elementary and Secondary Education, except for a purpose for which bonds have been voted or in case of an emergency declared by the State Board for Elementary and Secondary Education.

2) Any school district having authorized an expenditure in violation of subsection (1) of this section may be so certified at any time by the State Board of Elementary and Secondary Education. A district so certified shall thereafter, any contrary statutory provisions notwithstanding, make no expenditure of money, give no authorization involving the expenditure of money, and make no employment, purchase, or contract, unless the chief state school officer has approved in writing, as fiscally sound and necessary, the expenditure, authorization, employment, purchase, or contract. Any expenditure, authorization, employment, purchase, or contract made in violation of this subsection shall be void.

Our review of the annual audit report submitted by Franklin county to KDOE reveals that the school district's officials have approved budgets that contain expenditures in excess of income and revenues during the years 1994, 1995, and 1996 (see table below). Not only may this practice lead to deficits and cause financial problems for the district, it also appears to violate KRS 160.550.

Expenditure of Funds in Excess of Income and Revenue (continued)

Franklin County School District
Comparison of Receipt and Disbursements to Budget
General Fund

Year	Budgeted Receipt	Budgeted Disbursements	Difference	Actual Receipts	Actual Disbursements	Difference.
1994	$25,544,659	$26,687,037	($1,142,378)	$28,042,189	$27,990,884	$ 51,305
1995	$20,586,236	$23,263,212	($2,676,976)	$22,081,078	$23,459,209	($1,378,131)
1996	$20,860,825	$20,898,946	($ 38,121)	$20,840,162	$21,423,989	($ 583,827)

RECOMMENDATION 16

We recommend that the Kentucky Board of Education implement controls to properly monitor the operation of districts submitting budgets containing expenditures in excess of the income and revenue for the year.

Credit Card and Travel Reimbursements

Three of the seven districts where on-site work was conducted: Franklin, Trigg, and Laurel Counties used credit cards for district functions, training, and trips. We found that credit card expenditures were not adequately supported by receipts; proper authorization for payment was not always documented, and there were no written policies covering the use of the districts' credit cards in Franklin and Laurel Counties. Although the appropriate use of credit cards can make travel and other necessary functions more convenient, credit card usage without proper authorization or supporting documentation may allow taxpayer dollars to be used in an inappropriate manner.

Districts should require proper authorization and supporting documentation before reimbursing expenses, thus protecting against unauthorized credit card use. The districts should ensure that controls are in place to closely monitor the distribution of those resources.

KRS 160.280 (3) states, "Members of boards of education may be reimbursed for actual and necessary expenditures incurred outside the district in the performance of their duties, authorized by the board."

In addition, OAG 76-329, in the interpretation of this statute, states, "A board of education may not pay a travel reimbursement claim of a board member unless that expense was authorized by the board before the expense was incurred, nor may the board authorize the incurring of out-of-district expenses by board members and then refuse to pay upon presentation to the board of a valid documented claim for the actual expenses incurred."

Furthermore, *Funk v. Milliken,* 317 S.W.2d 499(Ky.1958) dictates that for an expense to be allowable it must be necessary, reasonable in amount, beneficial to the public, and official rather than personal in nature.

Credit Card and Travel Reimbursements (continued)

Based on our review, we found several examples where school districts did not appropriately monitor the use of credit cards and the distribution of funds for travel reimbursements. The following problems should be resolved immediately and stronger controls implemented.

> **Franklin County** - Our review noted instances where credit card expenditures were not adequately supported by detailed receipts, and authorization by the Assistant Superintendent was not always documented.
>
> The Franklin County school district had two credit card accounts, both having a $10,000 limit. One credit card was in the possession of the Superintendent at all times. There were also two cards secured in a safe deposit box in the Assistant Superintendent's office when not in use. According to the Assistant Superintendent of Administration and Finance, there were no written policies or procedures for the use of the cards. However, an employee who wished to use the credit card checked the card in and out by signing a log, which was maintained by the Assistant Superintendent.
>
> We reviewed selected transactions from a sample of five months' credit card statements. The transactions selected totaled $3,716.90. Of these expenditures, $2,762.06 (74 percent) were not supported by any receipts. In addition, there was no evidence of the Assistant Superintendent's signature or initials on four of the five billing statements to indicate that the charges had been reviewed and approved. Without adequate supporting documentation and evidence of appropriate approval, we could not determine that the charges were authorized for necessary school district business.
>
> **Laurel County** - Prior authorization for travel by school staff and board members outside the district was not documented. We noted instances where travel expenses for relatives of school board members were charged to the district's credit card and reimbursed at a later date. In addition, charges on the credit card statement were not adequately supported by actual receipts. The business purpose of the travel charges was not apparent or documented.
>
> The district had five VISA credit cards assigned to the Superintendent, two Assistant Superintendents, Maintenance Department, and the Purchasing Agent. Other employees were permitted to use the cards. The five credit cards had separate account numbers, with credit limits of $1,000 (1 card), $3,000 (3 cards), and $5,000 (1 card). There was no written policy addressing the use of the credit cards; however, the Business Manager stated that cash advances were prohibited and charges were to be supported by receipts.
>
> During the period under review total credit card payments made were $20,922.10. Auditors reviewed credit card statements, which totaled $13,079.13, for the four highest months. These charges represented travel expenses, mostly for out-of-state travel. Auditors noted the following:

Ninth Annual National Conference For At-Risk Students

Two employees, traveled by air to Phoenix, Arizona on March 6, 1996 to attend the Ninth Annual National Conference For At-Risk Students in Scottsdale, Arizona from March 7-10, 1996. The majority of the remaining travel expenses related to this conference were charged on a credit card, except cab fare to and from the airport and one meal which were reimbursed on one employee's travel voucher. The two employees stayed approximately one block from the conference site.

The two employees rented an automobile at 2:00 p.m. on March 7, 1996 and returned the rental car at 10:54 a.m. on March 10. The total charge was $254.63, which included mileage. The car rental was charged to the credit card. During the three-day period, the car was driven 1,058 miles. A review of gasoline charges on the credit card statement and supporting receipts revealed the following purchases:

Date	Time	Amount	Location
3-7	5:52 p.m.	$5.16	Oak Creek, AZ
3-8	5:50 a.m.	$4.00	Tempe, AZ
3-8	4:39 p.m.	$9.75	Yuma, AZ
3-9	7:02 p.m.	$9.70	Scottsdale, AZ

The purpose of the time spent away from the conference site was not documented, nor was the employees' attendance at the conference, nor the need for a vehicle, thereby preventing us from determining that the trip was for district business.

National School Boards Association's 56th Annual Conference and Exposition

We noted that an Assistant Superintendent and two school board members attended the National School Boards Association's 56th Annual Conference and Exposition in Orlando, Florida from April 13-16, 1996. The total cost of the trip for the three was $6,356.55, which included $4,931.06 ($280 per night, plus tax) for five nights at the Walt Disney World Swan Hotel, food expenses of $1,295.80, and gasoline expenses of $129.69. The school district paid the majority of the hotel bill directly to the hotel in advance by check ($3,729.60). The remaining travel expenses for the trip were charged to the credit card. The purpose of the trip, according to the Superintendent, was to obtain professional development training credit required by KERA. The Superintendent also admitted that training hours could have been obtained by attending training in Frankfort conducted by the Kentucky School Board Association.

School board minutes of the August 12, 1996 meeting recorded approval of only two hours in-service training credit for only one member's attendance at the conference in Orlando, Florida.

<u>National School Boards Association's 56th Annual Conference and Exposition</u>

On April 29, 1996 the district invoiced each of the two school board members for 20 percent of the food expense, totaling $259 each. The Business Manager stated that the district billed the two board members because they took their wives, and one of the board members took his children. Copies of receipts indicated that both board members reimbursed the school district on April 29, 1996. Auditors also noted that an additional $269.06 was charged to the credit card for hotel expenses in addition to the cost of the lodging. According to the Assistant Superintendent who contacted the hotel to determine what the charge included, approximately $80 was for parking and $189 included room service charges for food and drinks. The majority of meal expenses on the credit card statements were not adequately supported by actual itemized receipts, with only the credit card slip serving as documentation. In addition, in most cases the documentation did not include the persons who incurred the meal expenses, thereby preventing us from determining the amount of meal expenses related to the board members' families.

<u>Russell County</u> - Auditors reviewed travel policies of the Russell County School District. Auditors noted instances where prior authorization of the board for out of district travel was not documented, travel expenses were not properly supported, and expenses for spouses' travel were paid by the district.

KRS 160.280 (3) states, "Members of boards of education may be reimbursed for actual and necessary expenditures incurred outside the district in the performance of their duties, authorized by the board." In addition, OAG 76-329, in the interpretation of this statute, states, "A board of education may not pay a travel reimbursement claim of a board member unless that expense was authorized by the board before the expense is incurred,…".

Russell County's policies governing travel expense reimbursement for school board members and school personnel state that prior board approval is required for attendance at conferences and out of district travel. In addition, the policies require that expenses be documented by receipts. Russell County's policy on board member expense reimbursement clearly states that "All travel expenses of spouses shall be paid by the Board member."

<u>National School Board Association (NSBA) Conference</u>

A school board member and the school board's attorney attended the National School Board Association Conference held in San Francisco, California on April 1-4, 1995. According to travel documentation, both spouses accompanied them.

The school board attorney was reimbursed $770.98 for hotel expenses for five nights (3/29 through 4/2/95). The hotel expense reimbursement was based on the attorney's copy of a personal credit card bill, rather than the actual hotel receipt. Thus, auditors could not determine if there was an additional room charge for the board attorney's spouse, or if other charges besides lodging were included. Registration fees of $852 were paid by the district directly to the NSBA. In addition, the school district paid for two airline tickets -- one for the attorney and one for the attorney's spouse.

National School Board Association Conference (continued)
Auditors noted that the school district reimbursed the attorney $345 on March 21, 1995 for one airline ticket. On May 16, 1995 the school district paid Nouveau Travel $345 for another airline ticket. When our auditors brought the overpayment to the attention of the attorney, he reimbursed the school district $345 on 12/6/96. There was no documentation to indicate that the board member's attendance or the attorney's attendance at the NSBA Conference had the prior approval of the School Board.

The school board member was reimbursed $915.37, $145 in excess of the board attorney, for hotel expenses for five nights (3/31 through 4/4/95), $330 for airfare, and $190.40 for mileage, cab fares, and meals. Registration fees of $595 were paid by the district directly to NSBA. The hotel expense reimbursement was based on the board member's copy of a personal credit card bill, rather than the actual detailed hotel receipt. Thus, auditors could not determine if there was an additional room charge for the board member's spouse, or if other charges besides lodging were included.

There was no documentation to indicate that the board member's attendance or the attorney's attendance at the NSBA Conference had the prior approval of the School Board.

Our review of travel expenses associated with other conferences, not already mentioned, indicated that the lack of documentation for lodging and meal reimbursements was a recurring problem. Examples where meals were charged to the hotel room and reimbursed without supporting meal receipts were: 1) KSTA Conference, Lexington, KY, November, 1995; and 2) KSBA Conference, Louisville, KY, February, 1996. An example where lodging was reimbursed on a travel voucher from a credit card slip rather than an actual hotel bill was at the Math and Science Conference, Knoxville, TN, October, 1995. Thus, auditors were unable to determine what was included in the charges, or how many persons occupied the room.

RECOMMENDATION 17
We recommend that the Russell County School District require actual hotel bills and meal receipts be received as support for lodging and meal reimbursement requests.

KASA Conference

Nine school district administrators attended the KASA Conference held at the Radisson Plaza Hotel in Lexington, Kentucky on July 14-16, 1996. Several of the administrators' spouses accompanied them. Lodging expenses of $1,490.90 were paid directly to the Radisson for eight of the administrators. One administrator was reimbursed $184.76 for lodging on a travel voucher. The amount paid per night for lodging was $76 plus tax for a single room, $81 plus tax for a double room, and $114 plus tax for a "Plaza Club" room. The school district paid for the additional room charges attributed to the administrators' spouses.

The direct bill from the Radisson, was supported by individual hotel room bills. A review of the hotel bills indicated there were meals charged to various rooms totaling $105.32. No meal receipts were available to support the meal charges. Auditors compared the meal charges on the hotel bills to the administrators' travel vouchers and noted one instance where a meal expense was also reimbursed on the voucher.

KASA Conference (continued)

The practice of utilizing the direct bill method for meal expenses simultaneously with submission of travel vouchers makes it difficult for district's accounting department to ensure that duplicate payments are not made. Auditors also noted on one travel voucher that each meal receipt indicated two meals were purchased; however, there was no documentation to indicate who the extra meal was for.

RECOMMENDATION 18

We recommend that each district develop and implement a written policy regarding credit card issuance and use. Each districts' policy should address, among others, the issues contained in recommendations 19, 20, and 21.

RECOMMENDATION 19

We recommend the Franklin County School District's written policy should require that credit card charge statements be supported by actual receipts. The Superintendent or his designee should review each statement and compare it to supporting receipts prior to approval for payment. This approval should be documented by signing or initialing the statement and payment documents.

RECOMMENDATION 20

We recommend the Laurel County School District's written policy require that credit card charges be supported by actual receipts in order that a comparison may be made to the statement prior to payment.

We recommend the existing expense reimbursement policy be revised to establish reasonable limits for out-of-district travel expenses. In addition, the policy should ensure that board members obtain board approval for out-of-district expenses in advance, as required by KRS 160.280. The approval for all out-of-district travel should be documented and define the purpose of the travel and the benefit to the district. Board members and employees should be required to submit written documentation of attendance at training sessions prior to the reimbursement of the travel expenses. We also recommend that no travel expenses for relatives of board members be charged to or paid by the district.

We further recommend the district consider reimbursing board members and employees for travel expenses upon submission of a reimbursement form rather than using district credit cards. This would allow for more effective review and approval of travel expenses prior to payment.

RECOMMENDATION 21

We recommend that the Russell County School District enforce existing policies to ensure that all reimbursements for travel expenses are adequately supported by receipts, such as actual hotel bills. This procedure allows the district to compare all claims for reimbursement to the supporting documentation prior to payment to ensure that all expenditures are for the benefit of the district. The APA recommends that out of district travel be approved in advance by the School Board, as required by KRS 160.280 and existing district policies. In addition, the school district should never pay travel expenses for the spouses (or other family members) of board members, board representatives, or school personnel, even if the district is reimbursed later.

RECOMMENDATION 22

We recommend that the Russell County School District ensure that all travel expenses are supported by proper documentation and that expenses for family members are not paid by the district. Also, we recommend that proper parties reimburse the school district for inappropriate reimbursements. Furthermore, we recommend that all travel expenses be reimbursed on a travel voucher, with supporting receipts required from the individual incurring the expense.

Collateralization of Public Deposits

Certain school districts allowed their bank balances to become under-collateralized. We found four instances in which district bank balances were under-pledged: $105,126 at Providence Independent on May 31, 1995; $1,006,349 at Trigg County on four occasions from July 1995 through January 1996 1995; and $1,094,606 at Pike County during May 1996. Our survey indicated that 50 percent of all districts did not have a written provision to require the district's cash manager to monitor and document the amount of collateral pledged to secure the districts' deposits.

In order to fully protect a deposit of public resources, a depositor's security interest in collateral pledged to secure the deposit must be enforceable against the receiver of a failed financial institution. Federal law, 12 U.S.C.A. § 1823(e), as amended by the Riegle Community Development and Regulatory Improvement Act of 1994, 12 U.S.C.A. § 4701 et seq., provides that depositor's security interest shall not be valid against the FDIC unless the security agreement between the depositor and the depository:

(1) is in writing,
(2) was approved by the board of directors of the depository or its loan committee, which approval shall be reflected in the minutes of the board or committee, and
(3) has been, continuously, from the time of its execution, an official record of the depository institution.

Our statewide survey asked the districts whether they had written pledge agreements with the banks and whether they obtained safekeeping receipts for the pledged securities in order to secure the funds deposited in excess of FDIC coverage. Ten percent of the respondents replied they did not have written collateralization agreements and 27 districts (15%) replied they did not obtain pledged security safekeeping receipts.

<u>RECOMMENDATION 23</u>

We recommend that all school districts establish and implement procedures to ensure proper collateralization of public deposits as required by state and federal law.

KDOE AND LEGISLATIVE OVERSIGHT

KDOE officials stated that they do not routinely monitor and guide the cash and investment management practices of school districts. Officials indicated that, although KDOE does not have a systematic program to encourage all districts to optimize their cash and investment management, they occasionally advise some district finance officers on investment strategies and procurement of bank services. However, they do not publish guidelines to assist districts with those functions. KDOE does not offer formal cash management seminars or training although they discuss good investment practices at regional meetings for district financial officers. Also, KDOE may work with individual districts that are at financial risk or in a state of emergency.

KDOE does not require districts to formalize their collection, deposit, and disbursement procedures. However, KRS 156.010 gives KDOE the responsibility for monitoring the management of school districts' administration and finance and for providing technical assistance in school administration and finance. Furthermore, KRS 156.200 gives KDOE access to district financial reports and authorizes it to advise districts on their expenditures and business methods.

KDOE conducts on-site reviews of districts in order to provide technical assistance, but this assistance is general and may touch only briefly on cash management issues.

KDOE prepared and distributed a management manual that addresses the general management practices for school districts. This manual includes a compilation of state, federal, and local laws that affect the districts' cash and investment management practices, but offers little guidance on the business-like practices discussed in this report.

RECOMMENDATION 24

We recommend that KDOE strengthen its oversight of cash and investment management practices. To do so, KDOE must assess how well districts manage cash and investments and fashion additional efforts for advising district officials on those duties, such as:

- Establish procedures to monitor the cash and investment management practices of school districts to ensure that they comply with laws, regulations, and acknowledged best practices

- Regularly advise and guide district officials on cash and investment management programs

- Publish guidelines to assist districts with cash and investment management functions. Guidance should emphasize increasing annual interest income by improving cash management practices

- Encourage districts to use a competitive process to procure financial services

- Mandate that districts establish formal cash management policies and procedures that include

    - A listing of permitted investments
    - Procedures for collateralizing public deposits
    - Standards for written investment agreements
    - Procedures for monitoring the control, deposit, and retention of investments and collateral
    - Standards for security and custodial agreements
    - Standards for the diversification of investments

- Provide guidance on collection, deposit, and disbursement procedures for bringing revenue into the districts as quickly as possible and keeping those dollars as long as possible. Specifically

    - Provide guidance to financial officers to help them understand the rules and regulations under which different programs operate and assist them in submitting their claims for advance funding or in making timely requests for reimbursements
    - Provide guidance on fiscal controls that accomplish more rapid deposit of revenues and more efficient management of bank balances, i.e., electronic funds transfers and sweep provisions
    - Provide guidance on forestalling disbursements and controlling routine disbursements by advance scheduling
    - Require districts to monitor and document the amount of collateral pledged to secure district accounts

__RECOMMENDATION 25__

We recommend that the Kentucky General Assembly consider clarifying its intentions with regard to KDOE's provision of oversight, guidance, and assistance to school districts in the area of cash and investment management. These clarifications should specify a requirement of active KDOE oversight. Oversight should include, but not be limited to, identifying problems, recommending solutions, providing training and guidance, and reporting information on school districts' cash and investment management practices. The clarifications should also authorize KDOE to issue regulations necessary to require districts to establish formal cash and investment management policies and procedures.

We recommend the General Assembly:

- Require KDOE to advise and guide school district officials in the management of cash and investments
- Require KDOE to prepare a comprehensive guide which prescribes effective cash management practices, including the preparation and use of cash flow forecasts and the use of a competitive process to procure financial services
- Require KDOE to monitor cash management activities of school districts and report periodically to the General Assembly
- Require school districts to establish formal cash and investment management procedures

Franklin County Board of Education	No Response
Kenton County Board of Education	No Response
Kentucky Department of Education	See Attached Response
Laurel County Board of Education	See Attached Response
Pike County Board of Education	See Attached Response
Providence Independent School Board	See Attached Response
Russell County Board of Education	No Response
Trigg County Board of Education	See Attached Response

SCOPE AND METHODOLOGY

The primary objective of this review was to assess the cash management and investment practices of school districts while also answering the following specific questions:

- Does the State distribute SEEK funds to school districts on the first of each month as required by statute?
- Are school district budgets based on obtainable tax receipt estimates?
- Are school districts requesting federal resources in advance and, if not, are state resources used to pay for federal programs, pending the receipt of federal resources?
- Do school districts have adequate controls over the authorization and use of credit cards and travel reimbursement?

We conducted on-site audit work at seven school districts: Kenton County, Russell County, Laurel County, Trigg County, Providence Independent, Pike County, and Franklin County for the period ended July 1, 1995 through August 31, 1996. These districts were selected to provide a geographically dispersed representation of both small and large districts. We interviewed district officials and obtained their appropriate documentation in order to gain an understanding of their cash management practices and investment policies.

We used several analytical procedures and modeling techniques in our analyses. We used analysis of variance and multiple regression techniques to determine statistically the significance of cash and investment management practices, operating sophistication, school district size, and banking bidding procedures on the rate of return for school districts. Multiple discriminate analysis was used to determine statistically which factors separate relatively high-earning districts from relatively low-earning districts. The variables selected for discriminate procedures were based on correlational analyses. Trial computer runs were performed to determine the set of variables that correctly classified the highest percent of districts known to have achieved a relatively high rate of return.

We conducted statistical analyses to determine if there were statistically based relationships between cash and investment management practices and the actual rates of return. Similarly, we determined if there were statistically based relationships between rates of return and the following factors: district size, operating business practices of the district, and the use of competitive bidding in procuring banking services. In doing so, we identified the characteristics of school districts which achieve superior rates of return compared to districts which earn relatively low returns. We also determined if the cash and investment management practices of financially troubled districts differ from financially healthy school districts.

We used selected information from Fiscal Year 1995-96 school district annual financial reports and audit reports required by KDOE to calculate a rate of return measure for school districts based on their individual interest earnings and total General Fund revenues.

We also interviewed management staff of KDOE and researched statutes and regulations to gain an understanding of KDOE's responsibilities to oversee, advise, and guide school district officials in cash and investment management functions.

ROLES AND RESPONSIBILITIES

School district administrators are responsible for the fiscal affairs of the school district. They are responsible for establishing and maintaining effective controls to ensure that resources are safeguarded, laws and regulations are followed, and reliable information is maintained to account for those resources. To this end, districts establish formal policies and procedures for managing cash and investments. Their procedures for collecting, depositing, and disbursing resources are possibly the most important factors in determining the maximum availability of money to meet cash needs. Districts can develop procedures which bring revenue dollars into their districts more quickly and keep those dollars longer, so idle cash can be invested to help offset operating costs.

KDOE is responsible for overseeing the operations of the Commonwealth's 176 local school districts. KRS 66.480 permits school districts to invest public resources, within certain restrictions, provided that a school district's general procedures for doing so are approved by the Board. Furthermore, KDOE should examine and inspect reports and advise district officials regarding management of schools under their control.

School districts are authorized to invest idle cash balances and establish cash management policies and procedures. KRS 66.480 also requires each district to adopt a written investment policy to govern the investment of resources. Among other things, this policy must include:

- a list of permitted investments
- procedures for monitoring, controlling, depositing, and retaining investments and collateral
- standards for diversifying investments
- requirements for periodic reporting on the status of invested resources

COMMENDATION

The courtesies and cooperation extended by the management and staff of the school districts and KDOE are greatfully acknowledged.

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A REVIEW OF CASH, INVESTMENT,

AND FUNDING MANAGEMENT

PRACTICES IN SCHOOL DISTRICTS