



THE AUDIT CONNECTION

Emerging Issues: Financial Guarantees

Local governments commonly issue and receive financial guarantees. These guarantees represent potential claims on a guarantor government's resources and potential resources to the recipient government. Financial guarantees are contingent liabilities for a guarantor and, until recently, the likelihood of being required to honor a commitment to provide resources has been considered remote.

However, with the downturn in the economy, financial guarantees are being called on to support financially strapped recipient governments. This article discusses the consequences of a financial guarantee between two local governments in Washington State. It focuses on the response by the Governmental Accounting Standards Board (GASB) to ensure users of financial statements receive adequate disclosure of financial guarantees.

The City of Wenatchee was one of the founders of the Greater Wenatchee Regional Events Center Public Facility District and issued a financial guarantee for bond anticipation notes for the construction of a regional sport and entertainment center. Revenue generated by the Center did not meet estimates and the City now is in the position of provid-

ing resources to the District. The notes are coming due and the City

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is exploring options for the long-term debt.

The City recently asked a court to determine if a contingent loan agreement with the District would make the District's debt the City's debt for purposes of the City's debt limit. If so, the City would have to ask voters to approve the additional debt. If that effort is not successful, the District and the City will have to explore other options, including a District-wide sales tax increase, defaulting on the notes or renegotiating them.

On September 8, 2011, the court ruled that the debt, include both principal and interest, was the City's responsibility. The ruling also states the inter-local agreement entered into in 2006 exceed-

ed the City's rights and authority.

This scenario is not unique and is happening across the country. As a result, GASB has undertaken a project to address the reporting of financial guarantees.

The project will address the forms of financial reporting display and disclosures that will be required to meet the essential financial statement user needs. This project is in the preliminary stages; GASB is scheduled to have an exposure draft by June 2012 and a final statement by early 2013.

We are committed to ensuring the highest standards of financial reporting are maintained.

Look for future updates on this issue as it progresses.

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New: Client Support Services

As part of our commitment to working with governments to ensure the efficient and effective use of public resources, the State Auditor's Office has launched a Client Support feature on our website. You can find it at:

<http://www.sao.wa.gov/EN/ClientSupport/Pages/default.aspx>

The site provides information on audit preparation, financial accounting and reporting, federal grant management, fraud prevention, and links to our client HelpDesk and various publications.

As a partner in accountability, an important part of our work is to equip governments with tools to help them evaluate and minimize risk, ensure accountability and prepare for audit. This site is designed to do this. We will update it regularly with all kinds of information, with a heavy focus on audit preparation and loss prevention.

It also sets the stage for another project: using the

information we find during performance audits to help local governments work better and cost less.

Through these audits, we have found the examples and leading practices that really work. In the coming months, we will be sharing these best practices through a new resource center for local government leaders.

We are not offering consulting services. It is important that we maintain our independence as auditors. Local government leaders and managers must make the hard decisions themselves. However, we want to provide good and extensive information on which they can base those decisions.

Nothing prevents us from sharing our expertise and offering assessments and reviews, sharing our insights with those who are ready and willing to make their governments better. We believe it's the right thing to do.

Attorney General's Office Weighs in on the Personal Use of Publically Issued Credit Cards

Periodically, we notice guidance from the State Attorney General's Office that applies to our audits of local government. Here is a recent informal Attorney General opinion that falls in that category.

A state Senator asked:

May a local government official or employee use a publically issued credit card for personal purchases?

The opinion contains a detailed analysis, but also provides a brief answer:

Under the Washington State Constitution and the laws of this state, including RCW 43.09.2855 and RCW 42.24.115, a local government official or employee may not use a publically-issued credit card for personal purchases, even if the person

pays off the card prior to the date that the bill becomes due.

The Office issued this informal opinion on June 2, 2011. Since we want to make sure local governments hear of this guidance and have time to put procedures in place to comply, we will not hold local governments to this interpretation for the 2011 fiscal year. We will provide information on this opinion to local governments in various ways. We will begin to audit and report on this issue during 2013 for the 2012 year-end audits.

If you have questions or would like a copy of the informal opinion, please contact Jan Jutte at jan.jutte@sao.wa.gov or (360) 902-0363.

Audit Focus on Alternative Learning Experience Programs

During the past few years, we have audited school districts' enrollment reports in their alternative learning experience (ALE) programs. The broad categories include:

- Brick and mortar alternative schools that students attend at least part time, doing the remainder of their work outside of the classroom environment.
- On-line programs, in which students do not physically attend classes.
- Parent partnership programs, which include significant participation by parents in their children's education.

Districts may contract with vendors, which may be outside of Washington State, to provide ALE services. ALE program regulations require documentation on enrollment beyond what is required for basic education in a traditional classroom setting. Districts interpret these rules broadly. Due to the amount of funding available to districts that operate ALE programs, especially digital online/virtual programs, we believe the programs carry a significant risk of inappropriate funding.

Our audits focus on districts' compliance with Washington Administrative Code (WAC) and guidance provided by the Office of Superintendent of Public

Instruction (OSPI). These regulations were designed to ensure districts provide sufficient documentation to support students who are receiving an appropriate, valuable education and to withhold funding when that is not evident.

ALE programs continue to increase in numbers and size each year and the requirements are many and complex. Since 2007, our audits in this area have recommended funding recoveries exceeding \$10 million. The results of these audits helped drive a change in state regulations governing ALE programs, specifically WAC 392-121-182. Effective September 1, 2011, state regulations now clearly define specific requirements and documentation standards. Districts now are required to report to OSPI the types of ALE programs and the number of students in them. Based on the information reported to OSPI, districts are operating 333 programs in 166 of the 295 districts. Approximately 41,000 students are enrolled in the programs, which generated an estimated \$209 million in revenue in fiscal year 2010.

Due to the many risks identified in ALE programs, we plan to audit them at most districts that will receive accountability audits this year. Additionally, if small districts that would have otherwise been eligible for an audit assessment report ALE students, they may receive an on-site audit.

Audit Areas of Focus for Self-Insurance Programs

During your next audit, we will be asking questions about self-insurance programs. State law (RCW 43.09.260) requires the State Auditor's Office to examine individual local government's benefit plans and local government self-insurance programs at least every two years. Auditors may be asking questions about medical, dental, vision, prescription, unemployment, workers compensation and property and liability risks in your next audit.

Our audits of local government self-insurance will focus on:

- Understanding the self-insurance programs, including internal policies.
- Identifying which risks are insured and assessing whether they are properly covered.

- Determining if third-party administrators are adequately monitored.
- Determining if the program has been approved by the Local Government Risk Pool Manager at the State Department of Enterprise Services (formerly a part of Office of Financial Management).

The State Auditor's Office has been working closely with the Local Government Self-Insurance Program staff to be aware of regulatory concerns and potential law changes.

If you have any questions about the auditing of your self-insurance program, you can contact your local audit manager or Sadie Armijo, Program Manager for Risk Pools at (360) 676-2165 ext. 100 or at sadie.armijo@sao.wa.gov.

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