ACCOUNTING FOR SELF-INSURANCE FUNDS IN SCHOOL DISTRICT AUDITS

SUMMARY

In 1976, school districts and community colleges in San Diego county formed a Self-Insurance Joint Power Authority (JPA) to cover workers' compensation losses. In 1981, they added property, liability and medical benefits coverage. In 1994, the medical benefits were moved into a separate JPA.

The San Diego County Office of Education administers the two JPAs, which currently have 37 school district and college members. The two JPAs have a combined balance of over $100 million in the county treasury plus $300,000 in a regular bank account to pay current liabilities.

In accounting terms, these JPAs use a Banking Pool – an arrangement by which monies are loaned to pool members in event of a loss.[1] Each loan is a debt that should be shown as a liability in a district's financial statements. Each member's balance, after deducting the cost of losses, insurance and administration, is owned by that member (including negative balances).

The 2011/2012 San Diego County Grand Jury evaluated JPA audits along with a sample of school district audits to determine if districts were reporting their JPA insurance balances in their individual annual audits. The Grand Jury found that the JPA audits reflect the insurance pool balances correctly. However, none of the school districts sampled report their JPA balance in their individual annual audits. Therefore, their individual audits do not show the true fiscal balance, data that is important to district stakeholders in making informed decisions.

INTRODUCTION

The Grand Jury received a citizen complaint about the possible lack of transparency in school district general fund balances. The complainant was concerned that district audits do not reflect the true balance because balances in the self-insurance fund were not included. This lack of information would constrain district stakeholders in making informed decisions. This could affect things like staffing levels, new school programs, or union contracts.

PROCEDURE

The Grand Jury interviewed staff from the San Diego County Office of Education to learn what is reported in a school audit and what oversight the Office provides. The Grand Jury examined the self-insurance JPA audit report, a sample of school district

[1] Governmental Accounting Standards Board, Statement 10, para. 13-c

audits, and Governmental Accounting Standards Board rules. The Grand Jury also interviewed representatives of:

- school districts,
- audit firms, and
- the Governmental Accounting Standards Board.

DISCUSSION

The San Diego County Self-Insurance Joint Powers Authorities (JPAs) are "Banking Pools" as defined by the Governmental Accounting Standards Board. Each district in the JPA is responsible for its own claims and liabilities.[2] The 2010/2011 JPA audit states: "The combined financial statement presents the aggregate financial position, result of operations and cash flow of the individual participation districts."[3]

According to Governmental Accounting Standards Board rules, "If that entity's losses exceed the initial charge, it will be assessed an additional amount to fully reimburse the insurer for those losses. On the other hand, if the premium exceeds the losses, the entity will receive a refund. In this situation, risk has been retained, the annual premium is more in the nature of a deposit, and the insurer is functioning more as a claims servicer."[4]

Every year, each school district must undergo an independent financial audit. In those individual audits, the Independent Auditor's report states that the financial statements present fairly in all material respects, the financial position of the school district as of June 30 of the audit year. Yet the audits' district management discussion and analysis do not include the self-insurance JPA balances. According to Governmental Accounting Standards Board rules, these should be reported as part of each district's general fund balance. "This interpretation requires entities to report capitalization contributions made to public entity risk pools with transfer or pooling of risk as a deposit if a return of those contributions is probable. Otherwise, entities should report the contributions as a prepaid insurance (an Asset) to be allocated as expenditures/expenses over future periods."[5]

One independent auditor told the Grand Jury the equity balance should be reported as a pre-paid insurance balance. The balance in question was over $1 million yet that district audit did not show this balance in the district's general fund. Furthermore, the Grand Jury found that districts with negative balances did not report them as liabilities.

San Diego County Office of Education staff told the Grand Jury they believed it would be double accounting if the JPA balances were reported in both the combined JPA audit and by each district. As a result, it is likely that only a school district's business manager

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[2] Governmental Accounting Standards Board, Statement 10, para. 51.
[3] San Diego County Schools, Risk Management Joint Powers Authority, Financial Statements and Supplemental Schedules, Year ended June 30, 2011, p. 6.
[4] Governmental Accounting Standards Board, Statement 10, para. 7
[5] Governmental Accounting Standards Board, Interpretation 4, Summary.

would know its JPA balance. Key stakeholders of the school district would never see these balances and what effect they might have on fiscal management.

It is clear to the Grand Jury that school districts within San Diego County have under-reported assets by $26,852,124 and liabilities by $505,290 in just the largest self-insurance program – the workers' compensation fund.

FACTS AND FINDINGS

Fact: In 1976, San Diego County school districts and community colleges formed a self-insurance Joint Power Authority to cover workers' compensation losses.

Fact: In 1981, property, liability and medical benefits were added.

Fact: In 1994, the medical benefits were formed into a second Joint Power Authority.

Finding 01: As of June 30, 2011 these JPAs had 37 school districts and community college members, and over $100 million in the county treasury.

Fact: The two Self-Insurance Joint Power Authorities operate as a banking pool, as defined by the Governmental Accounting Standards Board.

Fact: The two Self-Insurance Joint Power Authorities' audits report each district's equity and/or liability balances by insurance program.

Finding 02: The two JPA's annual audits show equity balances of over $30 million and liability balances of over $1 million.

Fact: School districts are public entities and their audits must follow Governmental Accounting Standards Board rules.

Fact: The Governmental Accounting Standards Board, Statement 10 and Interpretation 4 say each district should report their JPA balance as an asset or liability.

Fact: None of the district audits examined by the Grand Jury reported self-insurance JPA funds in their asset or liability balances.

Finding 03: District equity or liability balances were over-or under-reported in school district audits.

Finding 04: School district stakeholders cannot discern a district's true financial position from its audit.

RECOMMENDATION

The 2011/2012 San Diego County Grand Jury recommends that the San Diego County Office of Education:

12-26: Ensure that the Independent Auditors who do the annual school district audits follow the Governmental Accounting Standards Board rules in Statement # 10 and Interpretation #4.

REQUIREMENTS AND INSTRUCTIONS

The California Penal Code §933(c) requires any public agency which the Grand Jury has reviewed, and about which it has issued a final report, to comment to the Presiding Judge of the Superior Court on the findings and recommendations pertaining to matters under the control of the agency. Such comment shall be made *no later than 90 days* after the Grand Jury publishes its report (filed with the Clerk of the Court); except that in the case of a report containing findings and recommendations pertaining to a department or agency headed by an elected County official (e.g. District Attorney, Sheriff, etc.), such comment shall be made *within 60 days* to the Presiding Judge with an information copy sent to the Board of Supervisors.

Furthermore, California Penal Code §933.05(a), (b), (c), details, as follows, the manner in which such comment(s) are to be made:

(a) As to each grand jury finding, the responding person or entity shall indicate one of the following:

- (1) The respondent agrees with the finding
- (2) The respondent disagrees wholly or partially with the finding, in which case the response shall specify the portion of the finding that is disputed and shall include an explanation of the reasons therefor.

(b) As to each grand jury recommendation, the responding person or entity shall report one of the following actions:

- (1) The recommendation has been implemented, with a summary regarding the implemented action.
- (2) The recommendation has not yet been implemented, but will be implemented in the future, with a time frame for implementation.
- (3) The recommendation requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a time frame for the matter to be prepared for discussion by the officer or head of the agency or department being investigated or reviewed, including the governing body of the public agency when applicable. This time frame shall not exceed six months from the date of publication of the grand jury report.

(4) The recommendation will not be implemented because it is not warranted or is not reasonable, with an explanation therefor.

(c) If a finding or recommendation of the grand jury addresses budgetary or personnel matters of a county agency or department headed by an elected officer, both the agency or department head and the Board of Supervisors shall respond if requested by the grand jury, but the response of the Board of Supervisors shall address only those budgetary or personnel matters over which it has some decision making authority. The response of the elected agency or department head shall address all aspects of the findings or recommendations affecting his or her agency or department.

Comments to the Presiding Judge of the Superior Court in compliance with the Penal Code §933.05 are required from the:

Responding Agency	Recommendations	Date
San Diego County Office of Education	**12-26**	**8/13/12**