

Final Statement of Reasons

The Initial Statement of Reasons is included in the file. The information contained therein is updated as set forth below.

At its January 26, 2004, meeting, the Education Audit Appeals Panel (EAAP) considered regulations to establish the audit guide for K-12 local education agency (LEA) audits for the 2003-04 fiscal year. The Panel authorized staff to begin the regular rulemaking process for the eventual adoption of *permanent* regulations to govern LEA audits and put over to its next meeting action to adopt the audit guide regulations as *emergency* regulations.

The Notice of Proposed Rulemaking for the *permanent* regulations was published in the California Notice Register on February 6, 2004. With further input from interested parties, EAAP staff revised the proposed regulations, which the Panel, at its February 23, 2004, meeting, then adopted as *emergency* regulations. The *emergency* regulations were filed with the Secretary of State on March 15, 2004.

The public hearing on the proposed *permanent* regulations was held March 22, 2004. One written comment was received during the 45-day comment period, and the same comment was presented orally at the public hearing. Following the hearing, the Panel directed staff to revise the regulations proposed for *permanent* adoption by incorporating into them the *emergency* regulations, along with some technical changes proposed by staff.

The Notice of Modifications to Text of Proposed Regulations and the modified text were then made available to the public from March 24, 2004, through close of business on April 7, 2004. No comments were received during that time, and no further modifications were made after the 15-day comment period.

Public Comment and Response:

The written and oral comment received during the initial comment period and at the public hearing came from Richard L. Hamilton on behalf of the California School Boards Association, its Education Legal Alliance, the California Association of School Business Officials, the California County Superintendents Educational Services Association, and the California Society of Certified Public Accountants. After recounting his understanding that staff would recommend to the Panel that the proposed *permanent* regulations be amended to incorporate the changes made before adoption of the *emergency* regulations and that an additional comment period would follow, Mr. Hamilton limited his comments to the portion of the proposed *permanent* regulations that would remain unchanged after incorporation of the amendments recommended by staff.

Comment: Subsection (c)(7) of Section 19819, Independent Study, requires the auditor to verify that every written agreement contain all the required elements set forth in subparagraphs (A) through (I). Education Code Section 51747 conditions receipt of independent study apportionments by local education agencies on the adoption of written policies that include these elements; it is beyond the authority of EAAP to require that the elements also be contained in each individual written agreement with pupils enrolled in independent study. Resolution of conflicting appeal decisions by EAAP on this issue is pending in the Court of Appeals, Third

Appellate District (*Modesto City Schools v. EAAP; Office of the State Controller, California Department of Finance, Real Parties in Interest* (CO44993)).

Response: No change was made. Pursuant to Education Code Section 14502.1, the Panel promulgated a regulation to direct auditors to verify compliance with the requirements of statute. Education Code Section 51747 does condition receipt of apportionments for attendance generated through independent study on the adoption by the local education agency of a written policy that includes, among other things, “(c) A *requirement* that a current written agreement for each independent study pupil shall be maintained on file including, but not limited to, *all* of the following ...” (Emphasis added.) The statute specifies eight required elements, which are listed in the regulation in subparagraphs (A) through (I) of Section 19819(c)(7). As part of its decision in the matter of Modesto City Schools, fiscal year 1999-2000, the Panel stated, “Interpreting the term ‘adopted’ to mean simply a board enactment without any action in accordance with the enactment would lead to absurd consequences unintended by the legislature. No school would be required to actually use the independent study contracts the legislature carefully fashioned to address its concerns.” (*In the Matter of the Statement of Issues Against: Modesto City Schools*, (2002) EAAP Case No. 01-41; OAH Case No. N2002050257, p. 10.)

Explanation of changes made to the proposed permanent regulations by incorporation of the emergency regulations and technical changes proposed by staff:

Article 2. Audit Reports.

§ 19812. Auditing Standards.

No change was made in this section. Additional rationale for the standards specified in this section of the proposed regulations is found in the fact that Section 58 of Title 16, California Code of Regulations, provides that, “Licensees engaged in the practice of public accountancy shall comply with all applicable professional standards, including but not limited to generally accepted accounting principles and generally accepted auditing standards.” Further, Education Code sections 14503(a) and 41020(b)(4) both require that audits be conducted in compliance with the *Government Auditing Standards* issued by the Comptroller General of the United States.

§ 19813. Report Components.

The first sentence of this section was modified to provide that the order of the sub-elements in subsection (d) may vary in audit reports.

The word “section” was added to subdivisions (a) and (b) for clarity. This terminology is consistent with conventional usage in audit reports.

Subdivision (c) was revised for clarity; the omitted portion was redundant.

A new subsection (7) was added to subdivision (d). If an LEA is required by the terms of the Office and Management Budget (OMB) Circular A-133 to prepare a Schedule of Expenditures of Federal Awards, that schedule must be included in the audit report submitted to the State.

Former subsection (7) was renumbered to (8) and now clarifies, with the addition of the words “if required,” that the Notes to Supplementary Information may be omitted if no explanations are necessary.

Subdivision (e)(2) was modified by deleting the word “Auditor’s” for consistency with the titles of the other two reports specified under subdivision (e).

Subdivision (e)(3) was modified to specify that the edition of OMB Circular A-133 that is to be used is the one that applies to the fiscal year being audited.

§ 19814. Definitions.

The first paragraph of this section was modified to specify two additional references for the meaning of the audit report sections and subsections in Section 19813 that are not defined here. These additional reference materials are the *Codification of Statements on Auditing Standards*, published by the American Institute of Certified Public Accountants (AICPA), and *Government Auditing Standards*, published by the Comptroller General of the United States. This paragraph also provides that the editions of all three of the documents to be referenced are those that are applicable to the fiscal year being audited.

The three publications named in this section are readily available to all certified public accountants and public accountants. *Government Auditing Standards* is the document made applicable to LEA audits by Education Code sections 14503 and 41020(b)(4). As stated above, Section 58 of Title 16, California Code of Regulations, provides that, “Licensees engaged in the practice of public accountancy shall comply with all applicable professional standards, including but not limited to generally accepted accounting principles and generally accepted auditing standards.” The GASB *Codification* sets forth generally accepted accounting principles, and the AICPA *Codification* sets forth generally accepted auditing standards. Business and Professions Code Section 5062 provides that “A licensee shall issue a report which conforms to professional standards upon completion of a compilation, review or audit of financial statements.”

Other clarifying changes were made in the subdivisions that define terms pertaining to state program compliance. In subdivision (e), the word “program” was deleted in four places and the term “compliance requirement” was substituted for one of those deletions. The number of audit procedures for Class Size Reduction general requirements was changed from 8 to 7, and the phrase “or charter schools” was added, consistent with changes made in Section 19826 of these regulations (explained below).

In subdivision (h), changes were made to clarify that, with regard to charters granted by the school district or county office of education being audited, the auditor is reporting only whether charter schools are included in the audit report or not; the auditor is not required to attest that charter schools not included in the report are submitting a separate report.

Subdivision (i) was modified for clarity in reference to the information displayed “regarding the auditee’s financial position and going concern status,” because this information may not be all of the information used to evaluate those matters. This subdivision was further modified to clarify that more than the most recent three years of financial and attendance figures may be displayed, and that the three-year period is to end with the audit year, not begin with the

audit year. A clarifying grammatical change was made with regard to the list of funds that may have available reserve balances by changing “or” to “and.”

Subdivision (j)(7) was clarified by the addition of the word “report,” because it is the audit report that is prepared, not the audit.

Subdivision (l) was clarified by changing the final word from “corrected” to “resolved.” This change is consistent with the terminology used in Education Code Section 41020(l).

Article 3. State Compliance Requirements.

Throughout this article, the subdivisions that direct the auditor to calculate and report any inappropriately reported ADA were rewritten for consistency with the style of these regulations, by beginning with the instruction to apply the subdivision if any noncompliance was found, and by including instructions to include a statement of the finding in the Findings and Recommendations section of the audit report along with an estimate of the dollar value of the inappropriately reported ADA. These sections were further rewritten to reflect the fact that the auditee’s reported ADA must be recalculated to determine the correct number of units of ADA that should have been reported, in a manner consistent with the provisions of Education Code Section 46303.

§ 19815. Materiality Levels for Compliance Auditing.

This regulation was modified to clarify that it is the number of ADA units reported and not the amount of funds received that is determinative.

§ 19816. Auditor Judgment.

The word “program” was deleted from the first line in this section, consistent with changes made in Section 19814.

§ 19817. Attendance Reporting.

In subdivision (b), a comma was added in the second line. Subdivision (d), which directs the auditor to calculate and report any inappropriately reported ADA, was rewritten as explained above.

§ 19818. Kindergarten Continuance.

Subdivision (a) was modified by deleting the second sentence. The term “representative sample” in the first sentence is sufficient direction to the auditor.

Subdivision (d) was modified to substitute the term “local education agency” for “district,” because school districts are not the only education agencies that offer kindergarten.

Subdivision (e), which directs the auditor to calculate and report any inappropriately reported ADA, was rewritten as explained above.

§ 19819. Independent Study.

The first sentence was converted to a general instruction and the specific “at the agency level” was converted to the first subdivision of this section. This change provides consistency in the structure of the section.

Subdivision (b) was modified to substitute the term “local education agency” for “district,” because school districts are not the only education agencies that offer independent study.

Subsection (b)(7) was modified by the addition of the phrase “or adult education student’s,” to clarify that the same procedure applies to the work of K-12 pupils and to adult students in adult education programs.

Subdivision (c) further clarifies “short term” with the addition of the word “intermittent,” to further describe the use of independent study by students who temporarily engage in independent study.

Subsection (c)(1) was modified to substitute the term “local education agency” for “district,” because school districts are not the only education agencies that offer independent study.

Subsection (c)(2) was modified for consistency with the statute (Education Code § 51747.3(b)).

Subsection (c)(4) was revised for clarity and consistency with the language of the statute (Education Code § 46300(e)(2)).

Subsection (c)(7)(E) was revised for clarity and consistency with the language of the statute (Education Code § 51747(b)) and the program regulation (Title 5, § 11701).

Subsection (c)(7)(I) was revised to tabulate the list of signatories for clarity.

Subsection (c)(10) was revised for clarity and consistency by substituting “pursuant to” for “under.”

Subdivision (d), which directs the auditor to calculate and report any inappropriately reported ADA, was rewritten as explained above.

§ 19820. Continuation Education.

Subdivision (e) was modified to substitute “district” for the term “local education agency,” because only school districts are authorized to provide continuation education (Education Code § 48432).

Subdivision (g), which directs the auditor to calculate and report any inappropriately reported ADA, was rewritten as explained above.

§ 19821. Adult Education.

Subdivision (a) was modified to substitute “district” for the term “local education agency,” because only school districts are authorized to offer adult education (Education Code § 52501).

Subdivision (f) was revised for clarity. The reference to “pupils or students” makes clear that the reference is to the minimum class time required generally to receive credit, and not to an individual student’s or adult’s attendance.

Subdivision (j), which directs the auditor to calculate and report any inappropriately reported ADA, was rewritten as explained above.

§ 19822. Regional Occupational Centers and Programs.

Subdivision (f) was revised for stylistic consistency (deletion of the word “has” in the first line). This subdivision was also modified to clarify that the reference to the minimum number of attendance hours needed for credit is a general requirement, and not one that applies to an individual pupil or student.

Subdivision (g), which directs the auditor to calculate and report any inappropriately reported ADA, was rewritten as explained above.

§ 19823. Instructional Time and Staff Development Reform Program.

Subdivision (b) was modified for clarity by inserting the word “additionally.” A comma was inserted in subdivision (e) before the last phrase.

Subdivisions (f) and (g) were reversed, because the determination of the length of each staff development day logically should precede the determination whether each participant was present for the full time required. Subdivision (g) was then further revised for clarity and consistency with the language of the applicable regulation (Title 5, § 6001).

Subdivision (h) was revised to add the direction to the auditor to “estimate the dollar value” of the disallowance. The fiscal impact of disqualification of days, unlike the fiscal impact of disqualified ADA, is not readily calculable by LEA officials.

§ 19824. Instructional Time.

Subsection (a)(1) was modified to substitute “district” for the term “local education agency,” because subdivision (a) applies only to school districts.

The second and third sentences of subsection (a)(3) were modified for clarity.

The word “sampled” was deleted from subsection (a)(4) and from subsection (b)(3), because these audit procedures are not limited only to sampled schools.

Subsections (a)(5) and (b)(4) were edited for style and clarity (insertion of commas and deletion of “or Section”; insertion of “such”).

§ 19825. Community Day Schools.

Subdivision (c) was modified to substitute “school district or county office of education” for the term “local education agency,” because only these agencies are authorized to offer community day school (Education Code §§ 48660, 48667).

Subdivisions (d) and (f), which direct the auditor to calculate and report any inappropriately reported ADA, were rewritten as explained above.

Subdivision (h), which directs the auditor to calculate and report any inappropriately reported hours of attendance, were rewritten for clarity and consistency.

§ 19826. Class Size Reduction.

The first paragraph of this section was revised with the insertion of “or charter school,” because Education Code Section 52125.5 specifically provides for participation of charter schools in this program. Education Code Section 52121 specifically prohibits the participation of county boards of education or county superintendents of schools. Consistent changes were made by inserting reference to charter schools or deleting reference to only districts, in subsections (b)(1), (b)(2), (c)(1), (c)(1)(D), (c)(2), (d)(4), and (e)(1), and in subdivision (d).

Several minor modifications were made. A comma was added for clarity to subsections (b)(2) and (c)(2). Hyphens were added to “pupil-to-teacher” in subsections (d)(2) and (4). The word “comprised” was replaced with the appropriate “consisting” in subsection (e)(2)(A). Subsection (e)(2)(D) was revised for number agreement between “any pupil” and the remainder of the subsection. Subdivision (f) was modified only to correct “level” to “levels.”

Subsections (e)(2)(B) and (C) were revised for clarity and for consistency with the statute (Education Code § 52123(b)).

Subdivision (e) was revised by deleting paragraphs (4) and (5), renumbering paragraphs (6) and (7), and deleting the word “has” in the first line of the latter two paragraphs. The original paragraphs (4) and (5) of subdivision (e) presented audit steps related to the staff development requirements that are set forth in Education Code Section 51727. The placement of these audit steps preceding subdivision (f), which is the direction to the auditor for reporting various instances of noncompliance in Class Size Reduction, was inappropriate. Instead, a new subdivision (g) was added to address staff development.

§ 19827. Program to Reduce Class Size in Two Courses in Grade 9 (Morgan-Hart Class Size Reduction Program).

[Withdrawn by action of the Education Audit Appeals Panel at its June 3, 2004, meeting.]

§ 19828. Instructional Materials.

In addition to the Education Code sections specified in the Initial Statement of Reasons, the audit procedures for instructional materials funds also address the requirements of Education Code section 60420 and following.

In subsection (b)(3), “that” was changed to “whether” for clarity.

The reference to “Instructional Materials Funding Realignment Program/Instructional Materials Block Grant” was revised to “Instructional Materials Funding Realignment Program (Instructional Materials Block Grant)” in subdivisions (c) and (d) and in subsection (d)(1).

Throughout subdivision (d), the term “local education agency” was substituted for “district or county board of education,” because charter schools are also subject to these provisions (Education Code § 60421(b)). (See conforming changes in subsections (d)(1), (3), (4), (5), (6)(B) and (6)(F).)

Subdivision (e), which directs the auditor to calculate and report any inappropriately expended instructional materials funds, was rewritten to provide that only the total amount must be reported, and not each individual expenditure.

§ 19830. Early Retirement Incentive Program.

Subdivision (a) was clarified by the addition of the words “as appropriate” at the end of the sentence.

Technical, Theoretical, or Empirical Studies, Reports, or Documents.

In addition to the materials listed in the Initial Statement of Reasons, EAAP also referred to the *Codification of Statements on Auditing Standards* published by the American Institute of Certified Public Accountants in preparing these regulations.

Incorporation By Reference:

Codification of Statements on Auditing Standards, published by the American Institute of Certified Public Accountants (AICPA)

Codification of Governmental Accounting and Financial Reporting Standards, published by the Governmental Accounting Standards Board (GASB)

Government Auditing Standards, published by the Comptroller General of the United States

Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*

All of the documents were incorporated by reference because it would be cumbersome, unduly expensive, and otherwise impractical to publish all of them in the California Code of Regulations.

The first three of the publications come under the rubric of professional standards that certified public accountants and public accountants are required to follow. These documents are revised from time to time; it would be impractical to include the revision dates in regulations, because doing so could result in a requirement in these regulations for an accountant to apply outdated professional standards or, conversely, current regulations not appropriate to a prior year.

The fourth publication, OMB Circular A-133, is referenced in these regulations to call to the attention of the accountant who is performing the local education agency audit that it may be necessary, under federal law, to comply with this Circular. Circular A-133 is also revised from time to time and is available Circular A-133 is readily available as indicated below.

All of the documents were available upon request directly from the Education Audit Appeals Panel for public review and comment during the public comment periods.

The documents are also available from the respective publishers:

American Institute of Certified Public Accountants (AICPA) \$105 for non-members
<http://www.aicpa.org/index.htm> or go directly to

https://www.cpa2biz.com/CS2000/Products/CPA2BIZ/Codification+of+Statements+on+Auditin+g+Standards.htm?cs_catalog=CPA2Biz

Governmental Accounting Standards Board (GASB) \$65

<http://www.gasb.org/> or go directly to

<http://store.yahoo.com/gasbpubs/publications-governmental-accounting-and-financial-reporting-standards--bound-editions.html>

Federal documents - available online:

Government Auditing Standards:

<http://www.gao.gov/govaud/ybk01.htm>

OMB Circular A-133:

<http://www.whitehouse.gov/omb/circulars/index-slg.html>

Request That Regulations Become Effective Upon Filing

EAAP requests that the regulations in the current rulemaking file become effective upon filing. Beginning with the audit guide for fiscal year 2003-04, Education Code Section 14502.1 requires the State Controller to submit the audit guide to EAAP for review and possible amendment. EAAP is then to adopt the audit guide pursuant to the rulemaking procedures of the Administrative Procedure Act by July 1 of the fiscal year to be audited. (EAAP is also authorized to adopt, before March 1 of the audit year, a supplemental audit guide to address legislative changes in the conditions of apportionment of school funding.) These regulations constitute the audit guide for the fiscal year 2003-04 and were intended by the Legislature to be in place by July 1, 2003. These regulations will replace the emergency audit guide regulations that became effective March 15, 2004.

Alternatives Determination

The Education Audit Appeals Panel has determined that no alternative would be more effective in carrying out the purpose for which these regulations are proposed or would be as effective and less burdensome than the proposed regulations.

Local Mandate Determination

The proposed regulations do not impose any mandate on local agencies or school districts.