

Initial Statement of Reasons

SECTIONS 19810, 19811, 19812, 19813, 19814, 19815, 19816, 19817, 19818, 19819, 19820, 19821, 19822, 19823, 19824, 19825, 19826, 19827, 19828, 19829, 19830, and 19831.

Specific Purpose of the Regulations.

The purpose of these regulations is to provide an audit guide for local education agencies (LEAs) that serve kindergarten and grades 1 through 12 (K-12), as required by Education Code sections 14502.1 and 14503. Specifically, these regulations will provide definitions of terms and audit procedures to guide accountants in the conduct of statutorily required financial and compliance audits of LEAs.

Necessity/Rationale

In 1999, the Education Audit Appeals Panel (EAAP) was constituted as a three-member panel to hear and decide appeals by LEAs of apportionment significant audit exceptions that require repayment to the State Treasury. (Education Code Section 41344(d), Stats. 1999, c. 78 (AB 1115).) In 2002, EAAP was established as a separate state agency; and significant changes were made to the laws governing the audit appeals process. In addition, the 2002 law required the State Controller to submit the proposed content of the audit guide to EAAP for review and possible amendment, and adoption pursuant to the rulemaking procedures of the Administrative Procedures Act. (Stats. 2002, c. 1128 (AB 2834), Education Code Section 14502.1(a) and (b).) In July 2003, the State Controller submitted the proposed audit guide content by providing EAAP with the draft *Standards and Procedures For Audits of California K-12 Local Educational Agencies* for fiscal year 2003-04 as it had been developed pursuant to Education Code Section 14502.1(a).

These regulations are necessary to implement Education Code sections 14501, 14502.1, 14503, and 41020, and Section 1.5 of Article XIII B of the California Constitution.

Title 5, Division 1.5

Chapter 3. Audits of California K - 12 Local Education Agencies

Article 1. General Provisions.

§ 19810. Scope.

This section clarifies that, as provided in Education Code sections 14503(a) and 41020(g)(1)(A), these regulations are the audit guide that must be followed in conducting the audits of LEAs required by Education Code Section 41020. These regulations supersede the audit guide formerly published by the State Controller; the title of that guide is continued in these regulations.

This section further clarifies that auditors must exercise professional judgment in the conduct of these audits. Education Code Section 14503(a) specifically provides that auditors must follow the audit procedures included in the audit guide—or, if not, state in the audit report what other procedures were followed, thus implicitly authorizing auditor judgment.

Moreover, sections 14503(a) and 41020(b)(4) require that these audits be conducted in compliance with the *Government Auditing Standards* issued by the Comptroller General of the

United States. (See Section 19814(a) of these proposed regulations for a definition for “*Government Auditing Standards*.”) *Government Auditing Standards* provides, in part, that “3.33 The general standard related to professional judgment is: Professional judgment should be used in planning and performing audits and attestation engagements and in reporting the results. ... 3.35 Auditors should use professional judgment in determining the type of assignment to be performed and the standards that apply to the work; defining the scope of work; selecting the methodology; determining the type and amount of evidence to be gathered; and choosing the tests and procedures for their work. Professional judgment also should be applied in performing the tests and procedures and in evaluating and reporting the results of the work.” (*Government Auditing Standards: 2003 Revision*, by the Comptroller General of the United States, United States General Accounting Office, at page 29.)¹

§ 19811. Qualifications of Auditors.

These regulations will constitute the audit guide to be used in the performance of audits required by Education Code Section 41020. This section accordingly includes in the guide the recently enacted provisions of subsections (1) and (2) of Education Code Section 41020(f), which set forth important requirements regarding the qualification and selection of accountants to conduct the annual LEA audits, including the fact that violation of the auditor rotation provisions is unlawful, and delegate authority to EAAP to waive the rotation requirements.

Article 2. Audit Reports.

§ 19812. Auditing Standards.

This section specifies the standards applicable to LEA audits. The phrase “auditing standards generally accepted in the United States of America” has a specialized meaning among accountants. It refers to the standards established by the auditing profession for the conduct of all financial audits in the United States. The U.S. General Accounting Office publication *Government Auditing Standards* specifies additional standards that are applicable to audits of government agencies. See sections 19813(e)(1), 19814(a), and 19814(d) of these regulations for further information about this publication and its role in LEA audits. These proposed regulations also set forth standards for the audit of specific state funded programs.

§ 19813. Report Components.

This section specifies the format of the LEA audits. These sections and subsections, and their required order, were submitted to EAAP by the State Controller in the proposed audit guide. The State Controller has authority to specify the format of these audit reports. (Education Code Section 41020(d).)

§ 19814. Definitions.

This section defines terms used in Section 19813 of these regulations that pertain to state program compliance and to federal publications referenced in Section 19813. Additionally, this section specifies that the audit report sections and subsections in Section 19813 that are not defined here have the meaning those terms have in the *Codification of Governmental Accounting*

¹ *Government Auditing Standards* can be downloaded from the U.S. Government Accounting Office web site: <http://www.gao.gov/govaud/ybk01.htm>

and *Financial Reporting Standards* that is published annually by the Governmental Accounting Standards Board (GASB).

The terms pertaining to state program compliance are defined in subdivisions (c) through (l). These terms are taken from the proposed audit guide submitted to EAAP. Subdivisions (c), (g), (h), (i), and (k) specify the content of schedules required in the Supplementary Information section of the audit report (see Section 19813(d) of these regulations). These schedules display information specific to California LEAs that is not a part of audits of other types of entities.

Subdivisions (d), (e), and (f) describe the Other Independent Auditor's Reports specified in that section of the audit report (see Section 19813(e) of these regulations). Both the compliance report described in subdivision (d) and the Report on State Program Compliance are required by Education Code Section 14503(a). The listing provided in this subdivision of the numbers of audit procedures by program facilitates the auditors' report of whether every specified procedure was followed, as well as the State Controller's Office's review of these audits as required by Education Code sections 14504 and 14504.2. The third report is required only where an LEA is required by the terms of OMB Circular A-133 to provide an audit report on the LEA's compliance with certain requirements pertaining to the LEA's expenditure of federal funds.²

Two federal publications are identified in subdivisions (a) and (b). *Government Auditing Standards* is the document made applicable to LEA audits by Education Code sections 14503 and 41020(b)(4). OMB Circular A-133 is addressed above.

The remaining components of the LEA audit reports specified in Section 19813 are described in the referenced GASB publication which is readily available to all certified public accountants and public accounting firms.

Article 3. State Compliance Requirements.

This article lists the particular state-funded education programs that are required to be audited for the 2003-04 fiscal year if the materiality requirements of Section 19815 are met in an LEA, and clarifies the application of auditor judgment in the conduct of these audits. The programs to be audited and the audit procedures are from the proposed audit guide content submitted to EAAP. Education Code Section 41020(c) requires the annual audit to include all funds under the jurisdiction of the LEA; Section 14502.1 requires the State Controller to recommend statements and other information to be included in the annual audit report and to propose the content of the audit guide; and other statutes, as cited below, require the inclusion of specific programs.

Education Code Section 14503(a) requires that audits specify whether an LEA is in compliance with each of the state program compliance requirements in the audit guide, and include a statement of the number of units of Average Daily Attendance (ADA), if any, that were inappropriately reported for apportionment by the LEA. Sections 19817 through 19831 set forth

² OMB Circular A-133 is online at <http://www.whitehouse.gov/omb/circulars/index.html>

audit procedures that direct the auditor to the documents and reports and guide the auditor in steps to determine whether the auditee was in compliance with the relevant statutory and regulatory requirements during the period audited. These sections further direct the auditor to calculate, consistent with the provisions of Education Code Section 46303, the inappropriately reported ADA units, or to calculate any other appropriate penalty as specified in referenced statutes, if the auditee was not in compliance.

Sections 19817 through 19822 of these regulations address attendance reporting related to general procedures, and specific issues with regard to kindergarten, independent study, continuation education, adult education, and regional occupational centers and programs. Education Code Section 41601 prescribes the reporting of ADA to the Superintendent of Public Instruction at certain times and prescribes the manner of computation. Section 46300 provides that ADA includes only that attendance of a pupil while under the “immediate supervision and control” of a properly certificated employee of the LEA (except as provided in subdivisions (b), (c), and (e) for specified settings). Title 5, California Code of Regulations, sections 400 and following,³ further implements the statutes on attendance records and accounting.

§ 19815. Materiality Levels for Compliance Auditing.

This regulation establishes the minimum level of ADA reported by an LEA for an individual program that will trigger the audit requirement for that program. The levels were established by the State Controller.

§ 19816. Auditor Judgment.

This section implements the provision of Education Code Section 14503(a) that auditors must use the audit procedures in this audit guide or state what other procedures were followed by clarifying that the auditor’s determination of what procedures to follow is made in the exercise his or her professional judgment in the circumstances. See Section 19810, above.

§ 19817. Attendance Reporting.

Education Code Section 41020(c) specifically requires that the annual LEA audit include an audit of pupil attendance procedures.

§ 19818. Kindergarten Continuance.

Education Code Section 48011 provides that a child who was properly admitted to kindergarten and has completed one year of kindergarten shall be admitted to first grade unless the parent and the school district agree that the child may continue in kindergarten for not more than one additional school year. Section 46300(g) provides that the district may claim ADA for a kindergarten pupil after completion of one year of kindergarten only if the district has on file an agreement approved in form and content by the California Department of Education (CDE) and signed by the parent.

§ 19819. Independent Study.

Independent study is not an educational program but an alternative instructional methodology that is authorized by Education Code sections 51745 and following. The governing statutes (sections 51745 and following, 46300(e), 46300.1, 46300.2, 46300.4, 46300.6, 46300.7,

³ All references to Title 5 are to the California Code of Regulations.

and 49176.2) and regulations (Title 5, sections 11700 and following) specify a number of conditions that must be met for an LEA to be eligible to receive apportionments for independent study by pupils or adult education students, and place some limitations on claiming independent study ADA.

The audit procedures specified in subdivision (a) address requirements at the agency level. Subsection (1) is a mathematical process. Subsection (2) directs the auditor to verify the ratio limitations prescribed in Education Code Section 51745.6. Subsection (3) directs the auditor to determine whether participation in independent study continues only so long as it is the voluntary choice of the pupil as provided in Title 5 Section 11700(d)(2). Subsection (4) addresses the prohibition in Education Code Section 51747.3(a) on providing funds or things of value to those in independent study that are not equally available to those in the regular classroom settings.

The audit procedures specified in subdivision (b) address requirements at the school level. Subsection (1) directs the auditor to confirm compliance with Title 5, Section 11703(b)(4), with regard to separate attendance records. Subsections (2), (3), and (5) are mathematical verifications. Subsection (4) directs the auditor to verify compliance with the requirement of Education Code Section 51747.5(a) with regard to general supervision of each pupil's or adult education student's independent study.

Subsection (6) of Section 19819(b) directs the auditor to ensure that apportionment credit is not "banked" for claiming in a subsequent assignment period, and is not counted as "make-up" apportionment credit for a prior assignment period. Education Code Section 46300(e)(1) limits crediting of apportionment for independent study to one day per calendar day. The proxy for classroom attendance in independent study is the time value of the pupil's work product as specified in Education Code Section 51747.5(a) and (b). All attendance accounting necessarily incorporates a basic accounting time frame, as appropriate to each program (such as one "day" in most classroom settings). For independent study, that time frame is the assignment period that is required to be established pursuant to Education Code Section 51747(a) and (b). To allow attendance credit for pupil work product submitted after the due date for the assignment would be inconsistent with the requirement of Education Code Section 51747(a) to establish a maximum amount of time that may elapse from the time an assignment is made to the due date.

Subsection (7) of Section 19819(b) directs the auditor to verify that attendance credit for independent study is recorded as daily attendance accounting for pupils whose regular school program (see Title 5 Section 11700(h)) is not one specified in Title 5, Section 406, as hourly. The apportionment credit must be based on teacher judgment of the time value of work product as specified in Education Code Section 51747.5(b).

The audit procedures specified in subdivision (c) address the pupil/student level. Directions for drawing the sample direct the auditor to include pupils on "short term" independent study if that option is offered. Some districts or county offices of education allow only "full time," that is, full semester, participation in independent study, while others allow pupils to temporarily engage in independent study for shorter periods. Subsection (1) directs the auditor to verify compliance with Education Code Section 51747.3(c). The statutory provision referenced therein was formerly in Education Code Section 48204(f) but is now found in Section

48204(b). Subsections (2) and (3) direct the auditor to verify compliance with Education Code Section 51747.3(b), known as the “contiguous county rule.” Subsection (4)(A) and (B) direct the auditor to review the records of pupils with multiple program enrollment to verify compliance with the limitation on crediting attendance in Education Code Section 46300(e)(2). Subsection 5 addresses the requirement of Education Code Section 51747(c) to have a written agreement for each pupil/adult education student engaged in independent study. Subsection (6) directs the auditor to verify that the agreement is for a minimum of five consecutive school days as required by Education Code Section 46300(3e)(1). Subsection (7) directs the auditor to verify that every written agreement contains the eight elements required by Education Code Section 51747(c). Subsection (9) addresses the requirement of Title 5, Section 11703(b)(3). Subsection (10) addresses Education Code Section 51747(a)(3). Subsection (11) addresses at the pupil level the requirement that independent study be voluntary and uncoerced as required in Title 5, Section 11700(d)(2).

Subdivision (d) directs the auditor to calculate and report any inappropriately reported ADA.

§ 19820. Continuation Education.

Continuation education is governed by Education Code sections 48400 and following. The minimum number of required attendance hours per week are set forth in Education Code sections 48400 and 48402. The minimum day of 180 minutes and the maximum attendance credit per week are set forth in Section 46170. Title 5, sections 404 and 406, governs clock hour attendance accounting. The requirement of Education Code sections 51760.3(b) and the limitation in Education Code Section 51745(b) are addressed as well as directions to the auditor to verify various mathematical calculations.

§ 19821. Adult Education.

Adult education is governed by Education Code sections 52500 and following. Section 52523 addresses concurrent enrollment in adult education classes by high school pupils. Section 41976 specifies the authorized classes and courses for apportionment purposes. Education Code Section 52515 requires course approval by the California Department of Education. Title 5, sections 404 and 406, governs clock hour attendance accounting.

§ 19822. Regional Occupational Centers and Programs.

Regional occupational centers and programs are governed by Education Code sections 52300 and following. Sections 52324, 52325, and 52326 address attendance credit and computation. Title 5, sections 404 and 406, governs clock hour attendance accounting.

§ 19823. Instructional Time and Staff Development Reform Program.

The auditor is directed to verify compliance with Education Code Section 44579.1 and Title 5, Section 6001.

§ 19824. Instructional Time.

Incentives for Longer Instructional Day and Year are provided in Education Code sections 46200 and following. Sections 46200 and 46200.5 address longer year requirements for school districts and county offices of education, respectively. Sections 46201 and 46202 specify the requirements for numbers of instructional minutes by grade span and specify the penalties for

failure to meet the requirements for school districts, while Section 46201.5 establishes the minutes requirements and penalty for county offices of education.

§ 19825. Community Day Schools.

Community day schools are governed by Education Code sections 48660 and following. Sections 48660, 48663, 48664, and 48667 provide for the establishment of community day schools, prescribe the minimum school day, place limitations on attendance credit, provide for additional funding for instructional hours beyond the minimum six-hour day, and provide for participation of county offices of education in the operation of community day schools.

In this instance, there are three points at which an auditor may need to calculate overstated ADA: subdivisions (a) through (d) address failure to provide the minimum six-hour day, subdivisions (e) and (f) address attendance during the fifth and sixth hours in relation to requirements for payment of additional ADA funding, and subdivisions (g) and (h) address attendance requirements for funding for the seventh and eighth hours.

§ 19826. Class Size Reduction.

The statutes governing Class Size Reduction (CSR) for kindergarten and grades 1 through 3 (Education Code sections 52120 and following) set forth provisions applicable to Option One programs (full school day), Option Two programs (one-half of the instructional minutes offered per day), programs in districts that have only one school that serves kindergarten and grades 1 through 3, and requirements applicable to all CSR programs. The audit procedures specifically address the requirements of Education Code sections 52121, 52121.5, 52122, 52123, 52124, 52124.5, 52126, and 52127.

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

The program to reduce class size in grade 9 is governed by Education Code sections 52080 and following. The audit procedures specifically address the requirements of sections 52081, 52082, 52084, 52086, and 52090. The procedures direct the auditor to determine whether the LEA had an approved waiver that would impact the calculation of any overstated ADA.

§ 19828. Instructional Materials.

The audit procedures for instructional materials funds address the requirements of Education Code sections 60118, 60119, 60242, and 60242.5.

§ 19829. Ratios of Administrative Employees to Teachers.

Education Code sections 41402, 41403, 41404, and 41407 set forth the limitations and the requirements for determining compliance with the limits on the numbers of administrative employees as compared to the number of teachers employed by a school district.

§ 19830. Early Retirement Incentive Program.

Education Code Section 14502.1 specifically directs the Controller to include the early retirement incentive program in the annual audit guide. That program is governed by Education Code sections 22714 and 44929. Effective January 1, 2004, Education Code Section 22714 was amended to delete reference to the requirement for a resolution “prior to January 1, 1999,” and Education Code sections 22714.5 and 44929.1 were added to provide for an additional incentive

for eligible persons who retire between January 1, 2004, and January 1, 2005. (Stats. 2003, c. 313 (AB 1207), §§ 4, 5, and 14.)

§ 19831. Gann Limit Calculation.

Section 1.5 of Article XIII B of the California Constitution requires that the calculation of the appropriations limit under Article XIII B be reviewed as part of an annual financial audit.

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

EAAP relied on the State Controller's *Standards and Procedures For Audits of California K-12 Local Educational Agencies, 2003-04; Government Auditing Standards*, published by the US General Accounting Office; the California School Accounting Manual; the GASB *Codification of Governmental Accounting and Financial Reporting Standards*; and no other technical, theoretical, or empirical studies, reports, or documents in proposing the adoption of these regulations.

Reasonable Alternatives to the Regulations and the Agency's Reasons for Rejecting Those Alternatives.

No other alternatives were presented to or considered by EAAP.

Reasonable Alternatives to the Regulatory Action that Would Lessen Any Adverse Impact on Any Business.

These regulations are applicable only to certified public accountants and public accountants who audit LEAs, and indirectly to the LEAs themselves. As no adverse impact on small business has been identified, there is no need to examine reasonable alternatives to lessen the impact.

Evidence Supporting Finding of No Significant Adverse Economic Impact on Any Business.

EAAP has determined that adoption of the proposed regulations would not have a significant impact on any business in the State of California, because the regulations direct accountants to conduct the steps required for audit of state-funded education programs and Education Code Section 14503 provides that auditors are required to use this audit guide, when adopted, in the performance of audits of LEAs, and further provides that, if the auditors do not follow the prescribed procedures, they are to state in the resulting audit report what other procedures were followed.