

## **Initial Statement of Reasons**

**SECTIONS** 19815, 19816, 19816.1, 19821.5, 19825.1, 19828.3, 19828.4, 19837.2, 19837.3, 19839, 19845.1, 19845.2, and 19846.

### **Specific Purpose of the Regulations.**

The purpose of these regulations is to provide definitions of terms and specification of procedures to guide accountants in the conduct of statutorily required financial and compliance audits of local education agencies. Effective February 20, 2009, education trailer bill Senate Bill 4 of the 2009-10 Third Extraordinary Session (SBX3 4; Chapter 12, Statutes 2009) made several changes in law, some of which impact the conduct of audits for the 2008-09 fiscal year.

Significantly, for fiscal years 2008-09 through 2012-13, Education Code Section 42605 provides for flexibility, with specified exceptions, in the use of funds from 39 itemized programs for any educational purpose (subdivisions (a), (e)); and provides that local education agencies will be deemed in compliance with the program and funding requirements associated with those programs (subdivision (d)). The bill was enacted too late for EAAP to promulgate supplementary regulations to incorporate the changes into the 2008-09 Audit Guide before March 1 as required by Education Code Section 14502.1(b). Changes that conform the sections of the audit regulations applicable to audits of 2008-09 to these statutory changes are included in this rulemaking, as well as the annual update of the guide for 2009-10 as proposed by the State Controller pursuant to Education Code Section 14502.1(a).

### **Necessity/Rationale**

These regulations are necessary to implement Education Code sections 14501, 14502.1, 14503, and 41020.

### **Title 5, Division 1.5 Chapter 3. Audits of California K - 12 Local Education Agencies Article 2 Audit Reports**

#### **§ 19815. Report Components**

This section specifies the format of the LEA audit reports as proposed by the State Controller. (Educ. Code § 41020(d).)

Subparagraph (c) is amended as proposed by the State Controller to specify that, beginning with audits of the 2009-10 fiscal year, the schedule of budgetary comparison data be reported by object. Some audit firms have reported this information by function and some have reported by object. Reporting by object is more meaningful than reporting by function for budgetary projections and trend analyses, and consistency will facilitate state agency reviews of fiscal solvency.

#### **§ 19816. Definitions.**

This section defines terms used in Section 19815 of these regulations that pertain to state program compliance and to federal publications referenced in Section 19815.

Subparagraph (e) is amended as proposed by the State Controller to conform the language used in the report on internal control to current audit standards. Minor wording changes were also made for style consistency within this subparagraph.

Subparagraph (f)(6) is amended to modify the numbers of audit procedures included in the audit guide for fiscal year 2008-09 to reflect audit procedure amendments.

Subparagraph (f)(7) is added to specify the numbers of audit procedures proposed for inclusion in the audit guide for fiscal year 2009-10.

Subparagraph (h) is amended as proposed by the State Controller to specify that, beginning with audits of the 2009-10 fiscal year, the schedule of Average Daily Attendance (ADA) is to include additional columns displaying the final ADA for both the Second Period and the Annual reports after any ADA adjustments resulting from audit findings. The additional information will facilitate audit resolution by state agencies.

### **§ 19816.1. Applicability of Audit Procedures by Audit Year.**

This section specifies which sections of the audit guide are applicable to each audit year.

Pursuant to the Controller's proposals and consistent with subdivisions (a) and (d) of recently enacted Education Code Section 42605, the following sections are omitted from subparagraph (a)(6) for audits of fiscal year 2008-09: 19821 Adult Education, 19822 Regional Occupational Centers and Programs, 19827 Morgan Hart Class Size Reduction Program, and 19838 Mathematics and Reading Professional Development. New Section 19845.2 Class Size Reduction is included in subparagraph (b)(6).

The sections that are applicable to audits of fiscal year 2009-10 are listed in new subparagraph (a)(7) for Article 3, new subparagraph (b)(7) for Article 3.1, and new subparagraph (c)(5) for Article 4. Section 19818 Kindergarten Continuance was omitted from the 2008-09 audit guide as proposed by the Controller, but for one year only. That section is again included in the 2009-10 audit guide as reflected in subparagraph (a)(7).

### **Article 3. State Compliance Requirements: Local Education Agencies Other Than Charter Schools.**

#### **§ 19821.5. California Work Opportunity and Responsibility to Kids (CalWORKs)**

Subdivision (a) of Education Code Section 42605 includes adult education funding (budget act Item 6110-156-0001) and regional occupational centers or programs (ROC/P) funding (budget act Item 6110-105-0001), and subdivision (d) provides that local educational agencies "shall be deemed to be in compliance with the program and funding requirements contained in statutory, regulatory, and provisional language, associated with the items enumerated in subdivision (a)." However, subdivision (e) provides

- (e) Notwithstanding subdivision (d), the following requirements shall continue to apply:
- (1) For Items 6110-105-0001 and 6110-156-0001, the amount authorized for flexibility shall exclude the funding provided for instruction of CalWORKs eligible students pursuant to schedules (2) and (3), and provisions 2 and 4.

Because compliance with the referenced provisional language in the budget act is not deemed, the audit procedures in Section 19821.5 direct the auditor, for those school districts and ROC/Ps that serve CalWORKs eligible students, to determine whether the school district or ROC/P met the requirements for claiming CalWORKs funds provided for instruction of CalWORKs eligible students pursuant to schedules (2) and (3), and provisions 2 and 4, as specified in Provision 4 of Budget Act Item 6110-156-0001 (Statutes of 2009, Chapter 1 (SBX3 1)). If the school district or ROC/P did not meet those requirements, the funds must be reported as disallowed.

The auditor is also directed to verify that that the funds received for instruction of CalWORKs eligible students were used only as specified in Provision 2 of Budget Act Item 6110-156-0001 (Statutes of 2009, Chapter 1 (SBX3 1)). If the school district or ROC/P did not expend the funds in compliance with those requirements, the portion of the funds expended for other purposes or that was used to supplant existing funds and services for CalWORKs eligible students must be reported as disallowed.

### **§ 19825.1. Community Day Schools**

The Community Day School Program was established by the Legislature in 1995 for the purpose of providing school districts with additional resources to provide instructional programs for pupils who have been expelled or who need a highly structured school setting.<sup>1</sup> The program is governed by Education Code sections 48660 and following. Community day schools must provide a minimum schoolday of 360 minutes of instruction. (Educ. Code § 48663(a).)

Regular ADA for all pupils in community day schools is funded from continuous appropriations, not annual budget act appropriations. Subparagraphs (a) through (c) of Section 19825.1 direct auditors in the procedures to verify that school districts that operate community day schools provide a 360-minute minimum day through checking bell schedules and scheduling practices; checking schedules for individual pupils in a sample selected from all enrolled pupils; and checking staffing assignments and employment records. Subparagraph (d) provides for reporting any findings identified through these procedures.

Budget act Item 6110-190-0001 is included in the flexibility provision of Education Code Section 42605(a), allowing use of funds for any educational purpose, and subdivision (d) of that statute provides that school districts will be deemed in compliance with the associated program and funding requirements. Item 6110-190-0001 provides the additional funding available pursuant to Education Code sections 48663(c) and 48664(a) for actual attendance in the fifth and sixth hour of instruction (“fifth and sixth hour ADA”) for pupils whose expulsion was not mandatory – that is, for those pupils expelled for any other reasons – and for all other pupils referred to community day school for one of the conditions specified in subdivision (b) of Education Code Section 48662. (Educ. Code § 48664(f).)

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<sup>1</sup> School districts are required to provide an educational program for any pupil who is subject to an expulsion order for the period of expulsion (Educ. Code § 48916.1). County superintendents of schools that operate county community schools pursuant to Education Code Section 1980 are required, in conjunction with superintendents of school districts in the county, to develop a plan for providing education services to all expelled pupils in the county (Educ. Code § 48926).

The additional funding available for fifth and sixth hour ADA for mandatorily expelled pupils is provided from continuous appropriations; these funds are not included in the flexibility provisions of Education Code Section 42605. Subparagraph (e) of Section 19825.1 directs auditors to determine whether any of the pupils whose attendance was claimed for fifth and sixth hours were identified as other than mandatorily expelled. If so, subparagraph (f) directs the auditor to report the attendance for those pupils who were not identified as mandatorily expelled as disallowed.

Subparagraph (g) directs that a sample of pupils be selected from among those pupils claimed for fifth and sixth hour ADA and identified as mandatorily expelled. The auditor is directed to verify that these pupils were actually expelled pursuant to subdivision (d) of Education Code Section 48915 for one of the acts specified in subdivision (c) of Education Code Section 48915. Subparagraph (h) directs the auditor to report any inappropriately reported fifth and sixth hour ADA for those pupils who were not mandatorily expelled, along with the estimated dollar value of that ADA.

Education Code Section 48663(c) sets forth the requirements that must be met in order for school districts to claim the additional funding provided by Education Code Section 48664: attendance must be reported in clock hours and districts must maintain a record of hourly pupil attendance configured so as to substantiate that each hour or portion of an hour of a pupil's scheduled and credited attendance was separately determined. Attendance of less than five clock hours is disregarded, five hours of attendance is deemed one-half day of attendance, and six hours or more of attendance is deemed to be one day of attendance. Subparagraph (i) directs the auditor to verify compliance with these provisions for mandatorily expelled pupils whose attendance was claimed for fifth and sixth hour ADA. Subparagraph (h) directs that any inappropriately reported units of fifth and sixth hour ADA identified through subparagraph (i) be reported as disallowed.

### **§ 19828.3. Instructional Materials**

To be eligible to receive funds available from the State Instructional Materials Fund, school districts and county offices of education must meet the requirements of Education Code Sections 60119. (Educ. Code §§ 60118, 60119, 60252.) There have also been restrictions on the expenditure of those funds. (Educ. Code §§ 60242, 60242.5.)

This section is amended to modify the introductory sentence to indicate its applicability only to fiscal year 2008-09 and not fiscal years thereafter. Subparagraph (a) is amended to clarify that the audit regulation refers to subdivision (d) of Education Code Section 60119 as it read until amended effective February 20, 2009. Prior to that amendment, the audit procedures set forth in subparagraph (b) applied only in those years in which the school district or county office of education received an increase in the base revenue limit of at least 1 percent per unit of ADA from the prior fiscal year.

Subparagraphs (e) and (f), related to expenditure of monies from the Instructional Materials Funding Realignment Program, are omitted consistent with the provisions of subdivisions (a), (d), and (e) of Education Code Section 42605.

#### **§ 19828.4. Instructional Materials.**

This successor section will apply to audits of fiscal year 2009-10 and each fiscal year thereafter. Subdivision (d) of Education Section 60119 was amended effective February 20, 2009, to omit the trigger (an increase in the base revenue limit of at least 1 percent per unit of ADA from the prior fiscal year) and provide instead that “The governing board of a school district<sup>2</sup> that receives funds for instructional materials from any state source is subject to the requirements of this section” every year.

Subparagraphs (a) through (c) of Section 19828.4 direct the same audit procedures as subparagraphs (b) through (d) of Section 19828.3. Even though the funds received for the purposes of the Pupil Textbook and Instructional Materials Incentive Program (Article 7 of Chapter 1 of Part 33 of the Education Code, commencing with Section 60117) that are made available pursuant to Item 6110-189-0001 of the annual budget act may be used for any educational purpose (Educ. Code § 42605(a)), the school district or county office of education is not eligible to receive those funds unless it takes the actions prescribed in Education Code Section 60119, including the provision of sufficient standards-aligned textbooks and instructional materials within two months of the beginning of the school year. (Educ. Code §§ 60119, 60252(a)(1), 60422.1(b) and (c).)

Subparagraph (d) of Section 19828.4 directs the auditor to determine whether any of the funds received by the local education agency from any of the programs identified in subdivision (a) of Education Code Section 42605 were expended to purchase any instructional materials. If so, then the auditor is to verify that materials purchased meet the requirements of subdivision (e)(2) of Education Code Section 42605 (also see Educ. Code § 60400). Subparagraph (e) directs the auditor to report the amount inappropriately spent, if any, in a finding as disallowed.

#### **§ 19837.2. School Accountability Report Card**

Education Code Section 33126 specifies the elements of the School Accountability Report Card, which provides data to allow meaningful comparisons among public schools. The audited elements are teacher misassignments (Educ. Code § 33126(b)(5)), textbooks and instructional materials (Educ. Code § 33126(b)(6)(B)), and school facilities (Educ. Code § 33126(b)(9)). (Educ. Code § 14501(b)(3).)

This section has been amended to modify the introductory sentence to indicate its applicability only to fiscal year 2008-09.

#### **§ 19837.3. School Accountability Report Card.**

This successor section will apply to audits of fiscal year 2009-10 and each fiscal year thereafter. Subparagraph (b) is amended to change the reference to the “school facilities evaluation instrument” to the name of the document approved for that use by the State Allocation Board.

Subparagraph (c) is amended to change the cross references made to Section 19828.3 to the appropriate subparagraphs of the successor regulation, Section 19828.4.

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<sup>2</sup> Education Code Section 60118 provides, in pertinent part, that “For the purposes of this article, the terms ‘governing board of a school district’ and ‘governing board’ are deemed to include county boards of education.”

### **§ 19839. Public Hearing Requirement – Receipt of Funds**

Subdivision (c)(2) of Education Code Section 42605 provides that, as a condition of receipt of funds from the 39 programs identified in subdivision (a), the governing board “at a regularly scheduled open public hearing shall take testimony from the public, discuss, and approve or disapprove the proposed use of funding.” This new audit guide section directs auditors to verify, by reviewing the governing board’s minutes or other records,<sup>3</sup> that the school district governing board or the board of the county office of education conducted the regularly scheduled open public hearing (or hearings)<sup>4</sup> required as a condition of receipt of any or all of these funds. The burden is on school districts to maintain records sufficient to show that the governing board not only took action regarding the use of the funds under these programs, but also that a regularly scheduled open public hearing was held at which public testimony was taken, the proposed use of the funds was discussed, and action was taken to approve or disapprove the proposed uses.

If the auditor determines (1) no regularly scheduled open public hearing was held, (2) testimony was not taken, or the proposed use of funding was not (3) discussed and (4) approved or disapproved, the auditor is directed to include a finding in the audit report showing the full amount of funding received for any and all of the 39 programs as disallowed.

### **Article 3.1. State Compliance Requirements: School Districts and Charter Schools.**

#### **§ 19845.1. Class Size Reduction**

The statutes governing Class Size Reduction for kindergarten and grades 1 through 3 (K-3 CSR; 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 K-3 CSR programs. Charter schools are eligible for K3 CSR funding and must comply with all of the program requirements. (Educ. Code § 52121.5.)

This section has been amended to modify the introductory sentence to indicate its applicability through fiscal year 2007-08.

#### **§ 19845.2. Class Size Reduction**

This successor section is applicable to fiscal years 2008-09 through 2011-12 only. K-3 CSR is not included in the flexibility provisions of Education Code Section 42605. However, the penalty provisions set forth in subdivision (e) of Education Code Section 52124 were modified for fiscal years beginning with 2008-09 by subdivision (a) of Education Code Section 52124.3. Subparagraph (f) directs the auditor in applying the revised ranges and penalty percentages.

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<sup>3</sup> Education Code § 35145 requires, in pertinent part, “... All actions authorized or required by law of the governing board shall be taken at the meetings and shall be subject to the following requirements: (a) Minutes shall be taken at all of those meetings, recording all actions taken by the governing board. The minutes are public records and shall be available to the public.”

<sup>4</sup> Education Code Section 42120 and following addresses annual budget requirements, including requirements for public hearings for the adoption of the budget for the subsequent fiscal year. The hearing required for eligibility for funding under the 39 programs included in budget flexibility could be included in this same budget adoption process.

**§ 19846. After School Education and Safety Program.**

This section directs the auditor to check for compliance with the requirements of the After School Education and Safety Program (Ed. Code § 8482 et seq.). Charter schools are included in the definition of local education agencies as eligible applicants for this program (Ed. Code § 8482.3(e)(1)). All applicants are required to agree to follow all fiscal reporting and auditing standards required by the California Department of Education (Ed. Code § 8482.3(e)(5)).

Subparagraph (a) addresses the after school component; subparagraph (b) addresses the before school component; subparagraph (c) addresses general requirements applicable whether the local education agency operates either or both program components.

Subparagraph (b)(4) is amended to correct the word “and” to “or” in compliance with Education Code Section 8483.1(a)(2)).

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

EAAP did not rely on any 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.

**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. The regulations direct accountants to conduct the steps required for audit of state-funded education programs and Education Code Section 14503 requires the use this audit guide in the performance of audits of LEAs, and provides that, if auditors do not follow the prescribed procedures, they are to state in their audit reports what other procedures were followed.