

## **Initial Statement of Reasons**

### **SECTIONS 19814, 19814.1, 19827, 19851, AND 19853.**

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

Education Code Section 14502.1 directs the Controller to submit, and requires the Education Audit Appeals Panel (EAAP) to review, revise, and adopt, audit guide regulations for inclusion in the audit guide required by that statute. Local education agencies (LEAs) that serve kindergarten or any of grades 1 through 12 (K-12) are required to contract for an annual independent audit (Education Code § 41020), and the audit guide adopted by EAAP must be used in the performance of these audits (Education Code § 14503). Specifically, these regulations define terms and specify audit procedures to guide accountants in the conduct of the statutorily required financial and compliance audits in the areas proposed by the Controller for inclusion in the audit guide for the 2005-06 fiscal year.

#### **Necessity/Rationale**

These regulations are necessary to implement Education Code sections 14501, 14502.1, 14503, 41020, 47612.5, 47634.2, and 52084(i).

### **Title 5, Division 1.5**

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

#### **Article 2. Audit Reports**

#### **§ 19814. Definitions.**

Subdivision (e)(3) is amended to include the number of audit procedures for state compliance requirements in the Morgan-Hart Class Size Reduction Program (new § 19827) applicable to fiscal year 2005-06.

A nonsubstantive change is made in this section by amending subdivision (i) to add the phrase, “for fiscal year 2003-04,” and adding a new subdivision (j) to make clear that, for fiscal year 2004-05 and thereafter, the Schedule of Financial Trends and Analysis will not display information for “any Article XIII-B Trust Fund.” The reference to such a trust fund is omitted because any such funds were phased out in conformity with guidance in GASB (Government Accounting Standards Board) Statement 34 relating to fiduciary funds concurrently with implementation of GASB 34 by local education agencies. (See California School Accounting Manual, 2002 edition, as updated March 17, 2003, pages 203-14 and 203-15 [Education Code Section 41010].)

Another nonsubstantive change is made in Section 19814 by amending former subdivision (j) [now (k)] to add category codes for review of audit findings pursuant to subdivisions (i)(2) and (n) of Education Code Section 41020 (Education Code § 41020(i)(2), added by Stats. 2004, c. 900 [SB 550], § 13, effective September 29, 2004).

Former subdivisions (k) and (l) are relabeled (l) and (m), respectively.

**§ 19814.1. Applicability of Audit Procedures by Audit Year.**

This section specifies which sections of the audit guide are applicable to each fiscal year. Subdivision (a)(3) is amended to add proposed new Section 19827 to the set of sections applicable to audits of fiscal year 2005-06.

**Article 3. State Compliance Requirements.**

This article lists the particular state-funded education programs that are required to be audited, and sets forth audit procedures that guide auditors in steps to determine whether an auditee was in compliance with the relevant statutory and regulatory requirements during the fiscal year audited. These sections further direct auditors to prepare schedules and include statements in the Findings and Recommendations section of the audit report, identifying any instances of noncompliance and specifying or estimating the dollar value of the noncompliance.

**§ 19827. Morgan-Hart Class Size Reduction Program.**

This section is added pursuant to subdivision (i) of Education Code Section 52084, following adoption of permanent regulations (sections 15140 and 15141) by the State Board of Education (SBE) effective August 31, 2005, pursuant to subdivision (h) of Education Code Section 52084.

Subdivision (a) directs the auditor to begin by determining whether the school district received funding under this program. Subdivisions (b) and (c) direct the auditor to review the specified records for mathematical accuracy and compliance with the various elements of the statute and regulations. Subdivision (d) directs the preparation of a schedule of any findings for inclusion in the audit report.

**Article 4. Different or Additional Provisions for Charter Schools**

This article addresses audit requirements that apply only to charter schools. Education Code Section 47634.2(d) provides, “Notwithstanding any other provision of law, charter schools shall be subject, with regard to subdivisions (c) and (d) of Section 47612.5 and this section, to audits conducted pursuant to Section 41020.” The title of the article is modified for clarity.

**§ 19851. Nonclassroom-Based Instruction/Independent Study.**

Subdivision (b) of this section is amended to reflect a legislative change (Education Code Section 51745.6(e), as added by Stats. 2005, c. 543 [SB 1610], § 7, effective January 1, 2006) that requires charter schools to count all independent study pupils, regardless of age, in calculating the pupils-to-certificated-employee ratio prescribed in subdivision (a) of Education Code Section 51745.6. SBE revised Section 11704 effective December 6, 2005, and is in the process of further revising that section to conform fully with the changes made in Education Code Section 51745.6 effective January 1, 2006.

**§ 19853. Determination of Funding for Nonclassroom-Based Instruction.**

Subdivision (c)(4) of this section is amended for the same reasons stated above with regard to Section 19851(b).

Subdivision (c)(5) is amended by the addition of “or 10 percent or more,” to conform to the change in Section 11963.3(b)(3) made by SBE effective December 6, 2005.

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