

Initial Statement of Reasons

SECTIONS 19810 and the 2018-19 Guide for Annual Audits of K-12 Local Education Agencies and State Compliance Reporting (July 1, 2018) incorporated by reference.

Specific Purpose of the Regulations

The regulation to be amended, Education Code Section 19810, is that which incorporates the Audit Guide by reference. The Audit Guide defines terms and specifies procedures to guide accountants in the conduct of statutorily required financial and compliance audits of local education agencies (LEAs). (Ed. Code §§ 14502.1, 14503, 41020.) The Education Audit Appeals Panel (EAAP) must adopt the Audit Guide by July 1 of the fiscal year to be audited, and must adopt any supplement to address legislative changes to the conditions of apportionment before March 1 of the audit year. (Ed. Code § 14502.1(b)).

The Controller, pursuant to Education Code Section 14502.1, has proposed the Audit Guide for fiscal year 2018-19, based on certain amendments of the language used in the 2017-18 Audit Guide (as revised, effective March 1, 2018). EAAP proposes to amend Ed. Code section 19810 and adopt the incorporated by reference 2018-19 Guide for Annual Audits of K-12 Local Education Agencies and State Compliance Reporting.

Necessity/Rationale

These amendments are necessary to implement Education Code sections 14502.1, 14503, 41020, 47612 and 47634.2. The rationale for each amendment is provided below, the overall purpose being to guide the conduct of audits and the content of audit reports consistent with Legislative intent and the Controller's proposals.

Problem to be Addressed in this Rulemaking

The proposed regulatory changes will make clarifying revisions and specify audit procedures to guide accountants in the conduct of the statutorily required financial and compliance audits of K-12 LEAs to address issues resulting from new legislation that affected conditions of apportionment.

Title 5, Division 1.5 **Chapter 3. Audits of California K - 12 Local Education Agencies** **Article 1 General Provisions**

§ 19810. Annual Audit Guides.

The “~~2017-18~~ 2018-19 Guide for Annual Audits of K-12 Local Education Agencies and State Compliance Reporting,” (~~July 1, 2018~~March 1, 2018), adopted by the Education Audit Appeals Panel, is incorporated by reference. The guide provides the audit steps, reporting requirements, and other guidance, for the required annual financial and compliance audits, subject to auditor judgment where alternative or additional audit steps may be appropriate. The annual guide is superseded by a supplemental audit guide, if needed, adopted before March 1 of each fiscal year. Each annual guide and any applicable supplement are available on www.eaap.ca.gov/audit-guide, with paper or electronic copies available on request.

Note: Authority cited: Sections 14502.1 and 47612, Education Code; California Constitution, Article XIII, Section 36, subdiv. (e), subpara 7, and Article XIII A, Section 1, subdiv. (b), subparas 3(C) and 3(D). Reference: California Constitution Article XIII B, Section 1.5; and Sections ~~8482.3(f)(5)~~, 2574(b)(3)(C), 8482.3(f)(5), 14501, 14502.1, 14503, 14509, 15286, 41024, 42238.02(b)(3)(B), 47612.5, 47634.2 and 48000, Education Code.

Audit Guide Amendments

The proposed annual 2018-19 Audit Guide uses the text of existing 2017-18 Audit Guide with the following deletions, amendments, and additions, and the rationale for each substantive amendment:

Deletion:

- *Section R Educator Effectiveness* was funded for fiscal years 2015-16, 2016-17 and 2017-18, with LEAs to submit a final report on the use of those funds on July 1, 2018 (Assembly Bill 104, Section 58(b)(1) (Chapter 13, Statutes of 2015), as amended by Senate Bill 103, Section 8 (Chapter 324, Statutes of 2015). The Controller recommended not including this item in the audit guide for 2018-19 because the funding period was over and there were no expenditures that had not been evaluated as consistent with that program.

Additions:

- *Section R Comprehensive School Safety Plan (New)* is added to ensure every public school has reviewed and revised, or adopted, a comprehensive safety plan, by March 1, and has submitted it for approval to the school district or county office of education. The auditor will verify that the LEA has a process in place to ensure that its schools have such a plan and will check a representative sample of schools to verify compliance, or to verify that the LEA notified the State Department of Education by October 15 of any school not having a comprehensive safety plan.
- *Section S District of Choice* is added to verify that school districts electing to be “districts of choice” pursuant to Education Code sections 48300-48317 acted in compliance with the statutory requirements for board resolution, specification of the number of transfer pupils to be accepted, election, registration with CDE, and utilization of a neutral selection process except as to giving priority to pupils eligible for free or reduced-price meals, siblings of current pupils, and children of military personnel; and collected the data required by Education Code section 48313(a) about the district of choice procedure and results.
- *New Appendix B School Facilities Program Bond Fund Audits* fulfills the Legislative mandate in Education Code Section 41024(b)(1) to revamp expenditure audits of State grants for new construction and modernization projects, with distinct provisions for Financial Hardship and Non-Financial Hardship grants, as well as construction and modernization grants for charter schools and career technical education (CTE) schools’ facilities projects. This section is necessary to effectuate Education Code Section

41024(b)(1), as well as the specific citations within the text, namely various sections in Education Code, Public Contracting Code, and title 2, chapter 3, subchapter 4, group 1 of the California Code of Regulations (School Facility Program regulations). For audit guide steps, EAAP relied upon the expert opinion of the audit guide workgroup, led by the State Controller's Office, and including representatives of the Department of Finance, Department of Education, Office of Public School Construction, and stakeholders, including school districts, Certified Public Accounts and education associations. Please see the Attached listing of the categories of necessity for the audit steps in Appendix B.

Amendments:

- *General Provisions Auditing Standards* is revised to adopt a table for guidance as to the size of samples to be tested in audits, parallel to the standards used in federal audits and consistent with the federal compliance requirements contained in the American Institute of Certified Public Accountants, Audit Guide for Government Auditing Standards and Single Audits. Education Code section 41020(b)(4) requires that these annual audits are conducted in accordance with Government Auditing Standards. Minor and technical changes also clarify existing sampling directions in Sections A, D, E, F, M, O, and W.
- *General Provisions Report Components* Item 6.a.(6), is revised for the auditor to add a note if the finding is a repeat of or related to a finding in the previous audit year. This statement is added to ensure consistency with the Government Auditing Standards, under which these audits are conducted. Government Auditing Standards states that auditors should follow up on findings and recommendations from previous audits, and whether the auditee has taken corrective action.
- *Section D Independent Study* is revised as proposed by the Controller to add new paragraph 3(g) which requires the auditor to verify that independent study pupils meet the age requirements of Education Code sections 46300.1 and 46300.4. This amendment is to include the age eligibility requirements to the "Local Education Agencies Other Than Charter Schools" section. The current Audit Guide includes instructions for auditors to check the pupil's age eligibility in order to claim attendance for the purpose of funding for the course-based independent study program (Section Y of the Audit Guide), but did not have a step regarding age eligibility requirements for pupils participating in an independent study program at a district or county school. This amendment corrects that oversight.
- *Section W Unduplicated Local Control Funding Formula Pupil Counts* is revised to clarify that procedure 1 requires the auditor to use the certified report that excludes any transitional kindergarten pupils who had their fifth birthday after December 2, to clarify procedures 1.b. and 1.c. to facilitate identifying which pupils are eligible only under the ELAS (English Learner) designation and which are eligible under both the ELAS and NSLP (National School Lunch Program) designations. In addition, a clarification to sampling procedures authorizes the auditor to substitute a new selection for a pupil who received ELAS designation while enrolled in a different LEA, to avoid uncertainties that can result from delays in obtaining documentation from the LEA for the ELAS designation.

Document incorporated by reference: 2018-19 Guide for Annual Audits of K-12 Local Education Agencies and State Compliance Reporting (July 1, 2019). After a number of years' experience, it proved cumbersome to set out the parts of the audit guide in regulations, some of which applied to different sets of fiscal years, and some applicable to past audit years. Incorporation by reference simplified the process of adopting annual audit guides and annual supplements, by putting the guide directly in usable format. Annual audit guides, audit guide supplements, and the steps of the rulemaking progress are readily available on EAAP's website.

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

In preparing the proposed regulations, EAAP did not rely on any technical, theoretical, or empirical studies or reports.

Reasonable Alternatives to the Regulations, Including Alternatives that Would Lessen Any Adverse Impact on Small Business, and the Agency's Reasons for Rejecting Those Alternatives.

The Audit Guide regulations are applicable only to certified public accountants and public accountants who audit LEAs, and indirectly to the LEAs themselves. No alternatives to these amendments have been proposed which would reduce any impact on small business; in any case, no adverse impact on small business has been identified. No other alternatives were presented to or considered by EAAP. Particularly where the Legislature has ordered that specific matters be included in the Audit Guide and/or stated that compliance is a condition of apportionment, there is no alternative consistent with legislative intent.

Alternatives Proposed as Less Burdensome and Equally Effective in Achieving the Purposes.

No other alternatives were presented to or considered by EAAP.

Prescribed Audit Procedures.

The proposed 2018-19 Audit Guide clarifies and revises the language used in the 2017-18 Audit Guide to conform to legislation. These audits must be performed by licensed public accountants who must conduct the audits in accordance with generally accepted auditing standards. (Ed. Code §§ 14501, 14503, and 41020; Title 5, §§ 19811 and 19812.) The Audit Guide includes provisions that authorize an auditor to use alternative procedures if, in the exercise of professional judgment, the auditor determines other procedures are more appropriate in particular circumstances. (Title 5, §§ 19814 and 19816(h)).

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

EAAP has prepared the following Economic Impact Assessment pursuant to Government Code Section 11346.3(b) and has made an initial determination that adoption of the proposed regulations would not have a significant adverse economic impact on any business in the State of California. The regulations direct accountants to perform the steps necessary for the annual audits required by Education Code Section 41020. Education Code Section 14503 requires the use of this Audit Guide in the performance of those audits of LEAs. In brief, any economic impact

derives from the statutory audit requirement and changes in substantive law already subject to audit.

Economic Impact Assessment

Staff of EAAP performed an economic impact assessment of the proposed regulations, in compliance with Government Code section 11346.3(b).

What would the proposed regulations do?

This rulemaking adopts the Audit Guide for 2018-19, required by Section 14502.1, through incorporation by reference in a revised Education Code Section 19810. The Audit Guide provides guidance, through definitions of terms and specification of procedures, to auditors in the conduct of the annual financial and compliance audits required of K-12 local education agencies by Education Code Section 41020. The guidance facilitates auditors in conducting audits and readers of audit reports by directing the manner of presenting findings.

Creation or Elimination of Jobs Within the State of California

The activities specified in the regulations, or auditor-selected alternative activities, are necessary to implement existing Education Code sections. There will be no jobs created or eliminated as a result of these proposed regulations.

Creation of New or Elimination of Existing Businesses Within the State of California

These regulations will make only technical and conforming changes to Section 19810 and the K-12 Audit Guide. There will be no businesses created or eliminated as a result of these regulations.

Expansion of Businesses or Elimination of Existing Businesses Within the State of California

The proposed regulations will not expand or eliminate business. Education Code Section 41020 requires that these audits be conducted by professional accounting firms under contract to local education agencies, and requires that those firms use the standards and procedures developed pursuant to Section 14500 and following.

Benefits of the Regulation to the Health and Welfare of California Residents

These regulations make technical and conforming changes to the K-12 Audit Guide to ensure its compliance with existing statutes. The proposed regulations will update and improve audit procedures of K-12 local education agencies, which would ultimately benefit the welfare of California residents by ensuring that local education agencies are in compliance with regulatory requirements.