

Initial Statement of Reasons

SECTIONS 19810 and the 2019-20 Guide for Annual Audits of K-12 Local Education Agencies and State Compliance Reporting (July 1, 2019) incorporated by reference.

Specific Purpose of the Regulations

The regulation to be amended, Education Code Section 19810, 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, and 41024.) 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 2019-20, based on certain amendments of the language used in the 2018-19 Audit Guide (as revised, effective March 1, 2019). EAAP proposes to amend Ed. Code section 19810 and adopt the incorporated by reference 2019-20 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 "~~2018-19~~ 2019-20 Guide for Annual Audits of K-12 Local Education Agencies and State Compliance Reporting," (~~March 1, 2018~~ July 1, 2019), 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 2574(b)(3)(C), 8482.3(f)(5), 14501, 14502.1, 14503, 14509, 15286, 41020, 41024, 42238.02(b)(3)(B), 47612.5, 47634.2 and 48000, Education Code.

Audit Guide Amendments

The proposed annual 2019-20 Audit Guide includes the following amendments:

- Report Components, paragraph 4, Supplementary Information, is amended consistently with the amendments to Section F (described next) as the Schedule of Instructional Time no longer needs to differentiate among districts by historical factors rendered moot by the fact that all districts as of Fiscal Year 2019-20 will have met their Local Control Funding Formula (LCFF) targets.
- *Section F. Instructional Minutes* is revised to delete language made unnecessary as a result of all districts having met their LCFF apportionment targets by school year 2019-20. References to districts' history of participation under the old longer day and longer year incentive programs are no longer necessary pursuant to Sections 46207 and 46208 of the Education Code.
- *Section DD. Determinations of Funding for Nonclassroom-Based Instruction* is technically amended, consistent with section 11963.3(b)(3), to include situations in which an entity has received, or will receive in the current fiscal year, \$50,000 or 10 percent of the charter school's applicable total expenditures as defined in subparagraphs (B), (C), (D), and E of subdivision (a) of section 11963.3(a).

Document incorporated by reference: 2019-20 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 process 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. EAAP did rely and take guidance from the State Controller's letter of January 10, 2019, which is the product of consultations among Departments and stakeholders, conducted pursuant to Education Code Section 14502.1(a). A copy of that letter with an enclosure provided by the Department of Education, is available as part of the rulemaking file.

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 2019-20 Audit Guide clarifies and revises the language used in the 2018-19 Audit Guide in order for audits for fiscal year 2019-20 to conform to legislation and to the fact, that as of 2019-20, all district have meet their formerly staged Local Control Funding Formula, after stepped increases over several prior years. 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 and State School Facility Bond Fund performance audits required by Education Code Section 41024. Education Code Section 14503 requires the use of this Audit Guide in the performance of annual those audits of LEAs governed by Education

Code Section 41020. 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 2019-20, required by Section 14502.1, through incorporation by reference in a revised 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. Appendix B likewise guides auditors in the performance audits of construction activity under State School Facility Bond Funds.

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.