

## **Initial Statement of Reasons**

**SECTIONS** 19810 and the 2018-19 Guide for Annual Audits of K-12 Local Education Agencies and State Compliance Reporting (Supplemented effective March 1, 2019) incorporated by reference.

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

The regulation to be amended, 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, 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 amending and supplementing the Audit Guide for fiscal year 2018-19. After review and some amendment, EAAP proposes to amend Section 19810 and the 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 affects 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 Guide for Annual Audits of K-12 Local Education Agencies and State Compliance Reporting," (~~July 1, 2018~~March 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](http://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 supplemental 2018-19 Audit Guide includes the following changes:

- *Auditing Standards Item 4, Tables 1 and 2* makes a technical change to delete “(Step 6)” from the heading of each table. This heading was used in a different document and copied to the audit guide. There is no “Step 6” that this heading refers to. To avoid confusion, a technical change should be made to remove these words.
- *Auditing Standards Item 4, Table 2* adds a note to specify that for populations between 52 and 250 items, the auditors may test a sample size of approximately 10% of the population. This is standard practice in auditing, and this technical amendment avoids confusion to assure auditors that they can continue this method of sampling.
- *Report Components Section, Item 6. Findings and Recommendations* makes a technical change to add a finding code, 43000, to the Apprenticeship audit findings. The new code categorizes the findings related to the Chancellor of the California Community Colleges.
- *Sections A Attendance, D Independent Study, E Continuation, M Juvenile Court Schools, Y Independent Study-Course Based, AA Attendance, CC NonClassroom-Based Instruction/Independent Study, DD Determination of Funding for NonClassroom-Based Instruction*, deletes reference to ungraded units of ADA, since LEAs no longer report any ungraded units of ADA. This phrase throughout the audit guide is obsolete.
- *Section D Independent Study*, deletes the reference to Education Code Section 46300.4, which applies to the old adult education program, making the reference obsolete.
- *Section P Transportation Maintenance of Effort Item 2* makes technical amendments to make clearer the steps auditors can follow to access the exhibit on California Department of Education’s website, which details revenue received by the LEA.
- *Section R Comprehensive School Safety Plan* makes a technical amendment to procedure 1 to clarify that the school safety plan was approved by the school district or county office of education, rather than the LEA.
- *Section W Unduplicated LCFF Pupil Counts* makes a technical amendment to reflect that California Department of Education transitioned from the California English Language Development Test (CELDT) to the English Language Proficiency Assessments for California (ELPAC), in 2018.

NOTE: The changes described above, with the exception of the deletion of words in Auditing Standards Item 4, Tables 1 and 2, are in effect on an emergency basis.

Document incorporated by reference: 2018-19 Guide for Annual Audits of K-12 Local Education Agencies and State Compliance Reporting (March 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**

EAAP relied upon the Controller's Office letter of January 2, 2019, which proposed changes to the 2018-19 Audit Guide.

### **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 Supplemental 2018-19 Audit Guide clarifies and revises the language used in the 2018-19 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 "Audit Standards" paragraph of the Audit Guide's General Provisions.) 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. (Audit Guide General Provisions, "Scope/Auditor Judgement.")

### **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, Supplemented effective March 1, 2019, as “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 ensure adequate review of LEA compliance with new or revised 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. EAAP does not anticipate that these proposed amendments would create specific benefits for the protection of public health and safety, worker safety, or the environment, the prevention of discrimination, the promotion of fairness or social equity, nor the increase in openness and transparency in business and government.