



Joint Legislative Audit Committee
Office of the Auditor General



**DEVELOPMENT AND IMPLEMENTATION
OF STANDARDS AND PROCEDURES
FOR AUDITS OF CALIFORNIA LOCAL
EDUCATION AGENCIES**

We have found that the state Department of Finance, the state Department of Education, and the Chancellor of the California Community Colleges have acted appropriately in updating standards and procedures for audits of California Local Educational Agencies. Further, through an examination of district audit reports, we found instances of noncompliance related to (1) district claims for federal and state categorical aid programs, (2) average daily attendance, and (3) specific areas of concern to the State. We also reviewed actions taken by the state Department of Education and the California Community Colleges in reviewing district audit reports and eliminating audit exceptions. This study indicated that the review process and actions to eliminate the audit exceptions should be strengthened.

REPORT TO THE
CALIFORNIA LEGISLATURE

REPORT OF THE
OFFICE OF THE AUDITOR GENERAL

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DEVELOPMENT AND IMPLEMENTATION OF
STANDARDS AND PROCEDURES FOR AUDITS OF
CALIFORNIA LOCAL EDUCATIONAL AGENCIES

JULY 1980



California Legislature

Joint Legislative Audit Committee

GOVERNMENT CODE SECTION 10500 et al

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The Honorable Speaker of the Assembly
The Honorable President pro Tempore of the Senate
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members of the Legislature:

Your Joint Legislative Audit Committee respectfully submits the Auditor General's report entitled "Development and Implementation of Standards and Procedures for Audits of California Local Educational Agencies.

The auditors are Richard I. LaRock, CPA; Mildred Kiesel, CPA; and Del Pelagio, CPA.

Respectfully submitted,

S. FLOYD MORI
Chairman, Joint Legislative
Audit Committee

Attachment

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SUMMARY

We have reviewed the development and implementation of standards and procedures for audits of California Local Educational Agencies (LEAs). Sections 41020.5 and 84040.5 of the Education Code require the Auditor General to cooperate with the state Department of Finance (SDF), the state Department of Education (SDE), and the Board of Governors of the California Community Colleges (CCC) in updating the standards, procedures, and statements required of independent accountants who audit LEAs.

Generally, we found that the responsible parties have acted appropriately in updating the audit procedures in view of the changing audit environment. The state Department of Finance issued an audit manual prescribing standards independent auditors must follow in auditing LEAs. This manual did not include detailed audit procedures, program descriptions, or federal compliance objectives. To assure compliance with new audit guidelines issued by the federal Office of Management and Budget, the state Department of Education developed compliance guidelines for auditors to consider in auditing federal programs.

In examining a sample of district audit reports, we found instances of noncompliance related to (1) district claims for federal and state categorical aid programs and allowances, (2) average daily attendance, and (3) specific areas of compliance of concern to the State. Additionally, we found that despite the potential for losing state and federal funds and noncompliance with several statutory and regulatory requirements, no state agency has assumed continuing responsibility to determine and to require compliance with the audit standards.

Further, we reviewed actions taken by the SDE and the CCC to review districts' audit reports, eliminate audit exceptions, and report to the Joint Legislative Audit Committee. Our review disclosed that the overall review process and actions to eliminate the audit exceptions should be strengthened. The SDE and the CCC reported many exceptions which may affect state funding; however, neither report to the Joint Legislative Audit Committee disclosed the amount of state funds involved in these exceptions. Also, the reports did not indicate adjustments necessary to eliminate the exceptions.

Based upon our review, we recommend that the Legislature clarify the responsibility for determining and requiring compliance with audit standards and for filing audit reports within the time allowed. We further recommend that the SDE and the CCC adopt procedures for (1) correcting audit exceptions, (2) matching audited data with data used to disburse state funds, and (3) reporting auditors' opinions.

INTRODUCTION

In response to a resolution of the Joint Legislative Audit Committee and the statutory requirements of Education Code Sections 41020 and 84040 et seq., we have reviewed the development and implementation of standards and procedures for audits of California Local Educational Agencies (LEAs). This review was conducted under the authority vested in the Auditor General by Section 10527 of the Government Code.

Sections 41020.5 and 84040.5 of the Education Code require the Auditor General to cooperate with the state Department of Finance (SDF), the state Department of Education (SDE), and the Board of Governors of the California Community Colleges (CCC) to update the standards, procedures, and statements required of independent accountants who audit local educational agencies.*

Background

This section describes current requirements for auditing local educational agencies, presents a history of audit guidelines developed by the SDF, and provides information about the support and administration of LEAs.

* LEAs include kindergarten through grade 12 school districts; community college districts; county superintendents of schools; and regional occupational centers and programs maintained by the county superintendent of schools, school districts, or pursuant to a joint powers agreement.

Annually, each LEA is to provide for the audit of all funds under its jurisdiction. The audit reports prepared by independent accountants are to include (1) a statement that the audit was conducted pursuant to the standards published by the SDF and (2) a summary of audit exceptions and management improvement recommendations. The audit reports are to be filed with the SDE and the CCC by November 15 of each year. However, the reports may be filed by December 31 if the auditor obtains an extension of time for filing.

Beginning on June 30, 1979, the SDE and the CCC are to report to the Joint Legislative Audit Committee (1) the number and nature of the audit exceptions and the amount of funds involved, (2) a listing of LEAs that failed to file their reports as required, and (3) actions taken to eliminate audit exceptions and to comply with management improvement recommendations.

Since 1951, the Legislature has required annual audits of local educational agencies, and since 1953, the SDF has been responsible for prescribing statements and other information to be included in the audit reports. Prior to the implementation of Chapter 936, Statutes of 1977, which added amendments to Education Code Sections 41020 and 84040, the SDF provided two documents for independent auditors' use in

auditing school districts. The first, entitled Contents of Reports on Audit Examination of California School Districts or Funds Under the Control of County Superintendents, outlined a reporting format; it detailed minimum contents for audit reports filed with the State. The second publication, Selected List of Audit Procedures Applicable to Examination of California School Districts or Funds Under Control of County Superintendents of Schools, was a guide for independent auditors in adapting generally accepted auditing procedures to the special conditions affecting the audit of school districts. These documents were last revised in 1975.

In January 1979, the SDF issued Standards and Procedures for Audits of California Local Educational Agencies. This manual reflects the provisions of Chapter 936, Statutes of 1977 and Chapter 207, Statutes of 1978.* In accordance with the new standards, the auditor must comply with reporting requirements, must state whether or not the claims filed for reimbursement are tested to the extent considered necessary, and must respond to specific compliance questions.

Independent auditors must apply these requirements in auditing the local educational agencies, which comprise approximately 1,040 kindergarten through grade 12 (K-12) school districts, 70 community college districts, 58 county offices of education, and 18 regional occupational programs and centers.

* Appendix A contains the text of both Chapter 936 and Chapter 207.

The 1980-81 Governor's Budget reports General Fund revenues of K-12 and community college districts for fiscal year 1978-79 at nearly \$9.6 billion. The following table illustrates the federal, state, and local share of these revenues to the districts.

LOCAL EDUCATIONAL AGENCIES
GENERAL FUND REVENUES
(1978-79)

<u>Districts</u>	<u>Federal</u>	<u>State</u>	<u>Local</u>	<u>Total</u>
K-12	\$648,693,192	\$5,424,359,585	\$2,183,042,000	\$8,256,094,777
Community College	<u>92,500,171</u>	<u>850,995,268</u>	<u>376,340,038</u>	<u>1,319,835,477</u>
Total	<u>\$741,193,363</u>	<u>\$6,275,354,853</u>	<u>\$2,559,382,038</u>	<u>\$9,575,930,254</u>

As illustrated above, state support of LEAs totaled approximately \$6.3 billion in fiscal year 1978-79. This figure represents 36.2 percent of the total \$17.4 billion in state-generated revenues for that year.

Each LEA is administered by a local governing board. The county offices of education and county auditor-controllers initially monitor certain financial activities of LEAs. Furthermore, the state Department of Education and the Chancellor's Office are responsible for administering most state and federal funds that are made available to the LEAs. Federal agencies also monitor state and district administration of federal funds.

Scope

This study reviewed the actions taken by the SDF, the SDE, and the CCC in updating the audit standards and procedures. We met frequently with staff from these organizations to discuss progress on the audit standards and other issues. Staff members of the SDF and the SDE submitted various drafts of their material to us and we responded with our comments and recommendations. In addition, we participated in many statewide meetings to present the SDF's exposure draft and the requirements of the legislation to independent auditors, school business officials, and other interested parties.

We examined the SDE's June 30, 1979 report to the Joint Legislative Audit Committee in which the department reviewed the 1977-78 audit reports. We also analyzed the SDE's methodology for accumulating the data in its report.* To determine districts' compliance with the SDF's audit manual, we conducted an independent analysis of a sample of the LEA audit reports for the 1978-79 fiscal year. Finally, we evaluated the reports submitted by the SDE and the CCC on the reviews of all LEA audit reports for the 1978-79 fiscal year.

* The Auditor General's Letter Report Number 735, issued in September of 1979, contains the results of this review.

This is the only report required of the Auditor General by Sections 41020.7 and 84040.7 of the Education Code. However, we have a continuing responsibility to cooperate with the SDF in updating the Standards and Procedures for Audits of California Local Educational Agencies every two years.

We have been favorably impressed by the business-like attitude, patience, and cooperation of the government agencies and professional organizations involved with this project.

STUDY RESULTS

Aside from requiring the Auditor General to cooperate with the SDF, the SDE, and the CCC in updating audit standards, the Education Code also requires the Auditor General to report to the Legislature information relating to audits of local educational agencies. Specifically, Sections 41020.7 and 84040.7 require the Auditor General on July 30, 1980 to report

- Actions taken to update the audit procedures;
- A sample review of individual district audits to determine compliance with audit procedures;
- A review of actions taken by the state Department of Education and the Office of the Chancellor of the California Community Colleges to review the audit reports, eliminate audit exceptions, and report to the Joint Legislative Audit Committee;
- Recommendations for future action to assure increased utility of the audits.

Accordingly, the remainder of this report addresses each of these areas.

ACTIONS TAKEN TO UPDATE
THE AUDIT PROCEDURES

We reviewed the state Department of Finance's actions to update procedures for auditing local educational agencies. The SDF produced Standards and Procedures for Audits of California Local Educational Agencies after considering comments and suggestions from state agencies and the accounting profession. This manual, which supplements generally accepted auditing and reporting standards, does not contain detailed audit procedures, program descriptions, or federal compliance objectives. Because the SDF's standards omit federal compliance questions, the state Department of Education developed guidelines for independent auditors to consider in auditing specific federal programs. In this way, the SDE attempted to assure compliance with federal regulations and thus protect the State's right to federal funds.

During the period in which the state audit standards were being developed and implemented, certain factors, such as the issuance of federal audit guidelines and the passage of State legislation, influenced the actions taken to update the state audit procedures. Nationally, authoritative publications on governmental accounting principles, auditing guidelines, and reporting requirements were issued by the United States General Accounting Office (GAO), the National Council on Governmental Accounting, and the federal Office of Management and Budget (OMB). In June 1978, voters of the state adopted Article III A

of the California Constitution (Proposition 13), a property tax initiative which substantially reduced a major source of financial support for LEAs. In the following section, we detail the SDF's actions and assess the impact of external factors on those actions.

Development of Contents
of Audit Standards
January - July, 1978

Education Code Sections 41020.5 and 84040.5 required the state Department of Finance in cooperation with the Auditor General, the state Department of Education, and the Chancellor of California Community Colleges to begin by January 1, 1978 a review of existing audit procedures, statements, and other information to be included in the audit reports. As discussed in the Introduction, the SDF's guidelines were last revised in 1975 and were somewhat outdated in relation to new legislative programs and professional auditing and reporting standards.

Using its 1975 publications as a basis, the SDF began updating the procedures to comply with the legislation and current auditing and reporting standards during the early months of 1978. To make the audit standards responsive to the needs of those using the audit reports, the SDF held many meetings with representatives from the SDE and the CCC. The SDF also solicited suggestions from federal agencies, the

California Association of School Business Officials, the California Society of Certified Public Accountants, and many other interested individuals from the accounting profession and from local educational agencies.

Additionally, the SDE, in cooperation with the SDE and the CCC, developed compliance objectives in the form of questions to be included in the audit standards. Answers to these questions would indicate whether the local educational agencies were complying with various state and federal laws and regulations.

Circulation of the State
Department of Finance
Exposure Draft
July - December, 1978

In July 1978, the state Department of Finance distributed approximately 2,000 copies of the exposure draft, Standards and Procedures for Audit of California Local Educational Agencies and requested comments and suggestions for the improvement of the draft. The exposure draft contained a detailed list of educational programs, procedures for the auditors to follow in reviewing programs, and numerous compliance objectives for state and federal educational programs.

In addition, the exposure draft as well as the provisions of Chapter 936, Statutes of 1977 became topics on the agenda of various organization meetings. Many regional workshops were held to introduce and discuss the exposure draft. A list of some these meetings follows.

HIGHLIGHTS OF MEETINGS TO DISCUSS
CHAPTER 936, STATUTES OF 1977
AND EXPOSURE DRAFT

April, 1978	SDF and Auditor General (AG) make presentations on legislation and responsibility for compliance at annual meeting of California School Business officials.
May, 1978	SDF and AG outline requirements of Chapter 936 to California CPA Foundation for Education and Research at two regional meetings.
September and October, 1978	Representatives of SDF, SDE, CCC, and AG conduct approximately 25 regional seminars statewide to invite comments and suggestions for improvement of exposure draft.
December 1, 1978	At the joint annual meeting of the California School Administrators, representatives of SDF, SDE, and AG present a workshop on SDF exposure draft.

As illustrated by this listing, the exposure draft was widely circulated among members of the accounting profession and school district representatives.

Final Revision of
Audit Standards
December, 1978

Late in December 1978, the SDF substantially altered its draft, deleting detailed audit procedures, program descriptions, and federal compliance objectives. In our opinion, this revision resulted from the impact of several external factors, including the passage of Proposition 13, the issuance of federal audit guidelines, and encouragement by independent auditors to delete mandated audit procedures.

In June 1978, voters of the State passed Proposition 13 which limited the amount of revenue that could be produced by property taxes. The exact effect of this legislation on LEAs was not known; however, it pointed to the need for discretion in mandating requirements which might increase the costs of auditing LEAs. The SDF also sought to keep from increasing state costs since increased LEA audit costs may result in district claims against the State for state-mandated local costs.

New audit guidelines were introduced by the United States General Accounting Office in October 1978. The GAO issued Guidelines for Financial and Compliance Audits of Federally Assisted Programs, commonly referred to as the Red Book. One objective of these guidelines was to provide a

uniform audit approach and uniform documentation procedures for financial audits of organizations receiving funds from several federal agencies or under several federally assisted programs. These standards advanced the single audit concept--one audit satisfies the information needs of all users of the report. Thus, the Red Book was designed to provide one audit guideline to replace many existing federal audit guidelines.

Independently, the National Council of Governmental Accounting was circulating a draft of Governmental Accounting and Financial Reporting Principles, Statement 1. This restatement changed the reporting format of financial statements for governmental units and the focus of the accountant's opinion. Following minor revisions, Statement 1 was issued in March 1979. Coupled with the changes introduced in these authoritative publications was encouragement from independent auditors to delete detailed audit procedures and so allow the auditors to use professional judgment in conducting the audits.

Immediately before issuing the standards, the SDF deleted most detailed audit procedures from the draft. The SDF explained that audit standards and procedures need not be detailed in the audit manual since independent accountants were able to write their own audit programs and questionnaires. The SDF also deleted from the draft an extensive list of detailed

program descriptions, all compliance objectives related to federally supported programs, and some of the compliance objectives related to state-supported programs. Furthermore, the required financial statements and the suggested reporting format were changed to conform with the exposure draft of Statement 1.

In our opinion, the SDF extensively altered the exposure draft for several reasons:

- Passage of Proposition 13 caused uncertainty regarding increased audit costs and speculation about how these costs would be met;
- Issuance of the Red Book created uncertainty about the extent and nature of compliance audits of federal programs;
- Statement 1 had introduced a substantial revision of the reporting format of financial statements for governmental units;
- Independent accountants encouraged deletion of mandated audit procedures.

The SDF submitted the revised draft of the manual to the SDE on December 29, 1978, requesting that the SDE forward its comments by January 2, 1979.* In January 1979, the SDF published its revision of the Standards and Procedures for Audits of California Local Educational Agencies.

The State Department of Education's
Reaction to Standards
January - December, 1979

After reviewing the SDF's revision of the audit standards, the state Department of Education became concerned at the deletion of compliance objectives related to federally supported programs. To safeguard the State's right to receive federal funds, the SDE decided to issue compliance audit guidelines separately. However, the SDE was reluctant to require auditors to follow its audit guidelines because of federal Circular A-102 which establishes audit requirements for state and local governments receiving federal assistance. Consequently, the SDE released its guidelines, specifying that auditors consider them in reviewing federal programs.

On January 2, 1979, the SDE responded to the SDF's request for comments on the revised draft. Although, in its response, the SDE noted that the revision was substantial, it did not protest the changes. Yet the SDE was concerned because

* This revised draft was not submitted to the Auditor General for comment.

the compliance portion of the standards was greatly reduced, and the compliance matters related to federal programs were nearly deleted.

In prior years, the SDE had relied on the SDF's guidelines to satisfy federal audit requirements for both financial and compliance reporting. But after reviewing the altered exposure draft, the SDE believed that federal compliance questions should be restored to the state standards for audit of LEAs to protect the State's right to receive federal funds for various federal programs. Because the SDF was reluctant to revise the new audit standards, the SDE decided to issue compliance audit requirements separately from those issued by the SDF.

The SDE's first draft of Standards for Audits of Federally Assisted Programs in Local Public Educational Agencies, dated April 1979, was developed from material deleted from the SDF exposure drafts. In October 1979, a subsequent draft of this supplement that the SDE prepared in conjunction with the SDF was sent to county and district superintendents of schools and other interested parties for comment. The SDE also held nine regional workshops on the proposed supplemental audit requirements.

On December 5, 1979, the SDF advised the SDE that although compliance objectives may be needed, it had decided not to publish those developed by the SDE. The SDF gave various reasons for this delay in publishing the compliance audit guidelines. The primary reason related to the issuance of the federal Office of Management and Budget's Circular A-102, Attachment P.

This circular, issued on October 22, 1979, established audit requirements for state and local governments receiving federal assistance. Also, it stated that these federal grant recipients must require their subrecipients to adopt Circular A-102 requirements. Basically, Circular A-102 requires an independent organization-wide audit of financial operations; the audit must include compliance with federal laws and regulations. Further, the audit must be conducted in accordance with generally accepted auditing standards and the GAO Red Book. Except where specifically required by law, additional audit requirements may not be imposed unless these requirements are approved by the Office of Management and Budget. Therefore, Circular A-102 substantially altered requirements for compliance audits of federally assisted programs.

The SDF cited other reasons for the delay in publishing compliance audit guidelines. The department stated that no specific indicators were available to show which audit objectives should be used or the extent of auditing that would be sufficient for a realistic organization-wide compliance audit. Also, the SDF noted that the basis and methodology for funding the costs of federal compliance audits had not been established. Finally, in view of the impact of Proposition 13, the SDF reasoned that precautions should be taken in requiring local governments to assume costs resulting from mandated audit requirements.

In January 1980, the SDE advised districts that they must undergo a compliance audit as provided for in Circular A-102 and included guidelines for auditors to consider in the audit of specific federal programs.

Current Status

At the time of this writing, no further clarification from the federal level has been received. Issues related to the scope and funding of compliance audits are still unresolved. However, the National State Auditors Association (NSAA) has noted certain inconsistencies in the application of the Red Book and Circular A-102 and has requested that the GAO resolve these problems. Specifically,

the NSAA has recommended that the GAO reevaluate the Red Book, Circular A-102, and other authoritative literature to achieve consistency within these documents. Circular A-102 requires a single organization-wide audit while the GAO Red Book focuses upon audits of federal grants. The NSAA further recommends that the GAO and the OMB develop a detailed timetable for the review and implementation of Circular A-102 to resolve the inconsistencies among the documents; to clarify the reimbursement issues; and to revise the criteria so it satisfies tests of compliance with state, local, and federal requirements. The GAO Comptroller General has indicated that he will consider these recommendations and attempt to implement them.

Additionally, the California Auditor General is working to obtain direct federal reimbursement for mandated increases in audit costs and to affect the timing of these audits.

CONCLUSION

In our opinion, the responsible parties have acted appropriately in updating the audit procedures in view of the changing audit environment. Guidelines issued by the federal Office of Management and Budget may have usurped the State's authority to issue audit standards for federal programs. Still unresolved are questions related to the scope and funding of the federally mandated audits.

SAMPLE REVIEW OF INDIVIDUAL DISTRICT
AUDITS TO DETERMINE COMPLIANCE
WITH AUDIT PROCEDURES

To determine districts' compliance with the audit manual, Standards and Procedures for Audits of California Local Educational Agencies, we randomly selected and reviewed 110 out of 1,040 audit reports for kindergarten through grade 12 districts. We also reviewed 69 out of 70 audit reports for community college districts.

We found that out of the reports reviewed, 22 of 110 K-12 audit reports and 24 of 69 community college audit reports omitted required assurances related to (1) districts' claims for federal and state categorical aid programs and allowances, (2) average daily attendance (ADA), or (3) specific areas of compliance of concern to the State. Additionally, we found that, despite the potential for losing state and federal funds and noncompliance with several statutory and regulatory requirements, no state agency has assumed continuing responsibility to determine and to require compliance with the audit standards.

Below we have summarized our findings into the areas which we consider most significant.

<u>Category of Reporting Requirements</u>	<u>Audit Reports Omitting Required Assurances</u>	
	<u>K-12</u>	<u>Community College</u>
Categorical Aid Programs	16	18
Average Daily Attendance	11 ^a	10 ^a
Compliance with Statutory and Regulatory Requirements	<u>5^a</u>	<u>8^a</u>
Total Number of Reports out of Compliance with One or More above Requirements	22 ^a	24 ^a
Reports in Compliance with above Requirements	<u>88</u>	<u>45</u>
Total Reports Reviewed	<u>110</u>	<u>69</u>

^a Eight K-12 and ten community college reports which omitted assurances regarding claims filed for federal and state categorical aid also omitted assurances on ADA. Two K-12 and two community college reports which omitted assurances regarding compliance with statutory and regulatory requirements also omitted assurances on categorical aid programs.

Appendix B amplifies this brief summary of the reporting requirements within the audit manual and details the specific instances of noncompliance we found. These findings were referred to the state Department of Education and the Chancellor's Office of the California Community Colleges for comments. The remainder of this section presents an analysis of significant requirements that the audit reports did not meet.

Categorical Aid Programs

The reports of 16 K-12 districts and 18 community college districts did not include positive statements that districts' claims for reimbursement of federal and state categorical aid programs were tested. Sections 41020 and 84040 of the Education Code require an audit of school district income and expenditures by source of funds. In this respect, the audit manual requires the auditor (1) to make a positive statement that he tested the districts' claims as a basis for reimbursement for federal and state categorical aid programs and (2) to report his findings.

The State and the Federal Government provide funding in excess of the basic state support for LEAs to meet the special educational needs of students. The programs serving these students are referred to as categorical aid programs. Each has specific rules and regulations relating to the use of the funds. The mechanisms for determining the amount of funding for each of the programs vary, but in general, the LEAs are required to file some form of cost or reimbursement report with the SDE or the CCC to justify the allocation. The audit manual requires auditors to examine and report on these reports so that the State may be assured of the appropriate use of the funds.

The positive statement is required since audit procedures necessary to make the positive statement are more extensive than if the same item or information were only part of an examination of the financial statements taken as a whole.

Average Daily Attendance

During our review, we found that 11 reports for K-12 districts and 10 reports for community college districts omitted positive statements on average daily attendance. Of these same audit reports, eight for K-12 districts and ten for community college districts also omitted positive statements on claims filed for reimbursement.

The audit manual requires the auditor to include a positive statement that he tested, to the extent he considered necessary, the reports submitted by the district as a basis for state apportionments and allowances. The average daily attendance that the LEAs report to the SDE and the CCC becomes a part of the formula used to determine the amount of each district's share of the state funding. Since the passage of Proposition 13, the State has assumed a much larger proportion of the total funding for LEAs. Consequently, errors or misstatements in the ADA reports may have a significant impact on total state support.

Statutory and Regulatory Requirements

We found that four K-12 and four community college audit reports did not include a statement relating to tests of compliance to determine with reasonable assurance whether the district is in compliance with statutory and regulatory requirements. The state Department of Finance, with the assistance of the SDE and the CCC, developed these compliance areas upon which the auditor is required to comment.

In the kindergarten through grade 12 districts, the auditors were required to address these ten compliance areas: excess ending balances, federally impacted aid program, average daily attendance--adult education, special purpose taxes, master plan for special education, school improvement program, educationally disadvantaged youth, impounded taxes, salaries of classroom teachers, and state instructional materials program.

Compliance areas for the community colleges included available district reserves, student financial aid, open courses, special purpose taxes, parking services fees and transportation service fees, health fee fund, impounded taxes, salaries of classroom instructors, and federally impacted aid program.

Other Areas of Noncompliance

Many audit reports for both K-12 districts and community college districts were not in compliance with the audit manual in other respects. These areas of noncompliance, further detailed in Appendix B, are summarized below:

- Five audit reports for K-12 districts and 17 audit reports for community college districts did not contain a statement required by the Education Code that the audit was conducted pursuant to the standards developed by the state Department of Finance;
- Five audit reports for K-12 districts and six reports for community college districts did not include reasons for omitting the general fixed assets account group from the financial report;
- Six reports for K-12 districts and six for community college districts failed to include a reconciliation of the fund balances as reported to the State on the Annual Financial and Budget Report with those reported in the audited financial statements;
- Thirteen K-12 and 16 community college district reports omitted references to the status of audit findings and recommendations from prior years.

Responsibility to Determine
and Require Compliance

Despite the potential for loss or misuse of state and federal funds and noncompliance with statutory and regulatory requirements, no state agency has assumed continuing responsibility to determine and require compliance with the audit standards. The State has not in recent years notified LEAs or auditors of instances of failure to comply with the audit manuals issued by the state Department of Finance.

As stated previously in this section, we informed both the SDE and the CCC of districts' failure to comply with audit standards. Both agencies responded to our findings; their comments are reprinted in Appendix C. The SDE has stated in its response that the responsibility to determine and require compliance with audit standards should be performed by the state Department of Finance. Further, the CCC explained in its response that although the auditor's performance and compliance is important, it does not have the resources and staff expertise to perform this function.

To clarify this responsibility, we requested an opinion from the Legislative Counsel concerning provisions of the Education Code. This opinion, which is contained in Appendix D, states that the responsibility to determine and require compliance is divided among several state agencies and is stratified into various levels.

CONCLUSION

The incidence of noncompliance with state audit standards for local educational agencies is high. Significant areas of noncompliance relate to reporting on (1) districts' claims for federal and state categorical aid programs and allowances, (2) average daily attendance, and (3) specific areas of compliance of concern to the State. Further, no state agency has assumed responsibility to determine and require compliance with audit standards.

REVIEW OF ACTIONS TAKEN BY THE
STATE DEPARTMENT OF EDUCATION
AND THE OFFICE OF THE CHANCELLOR
TO REVIEW DISTRICT AUDITS, ELIMINATE
AUDIT EXCEPTIONS, AND REPORT TO THE
JOINT LEGISLATIVE AUDIT COMMITTEE

We reviewed the actions taken by the state Department of Education and the Office of the Chancellor of the California Community Colleges to review the audit reports of local educational agencies, to eliminate audit exceptions, and to comply with management improvement recommendations. We found that generally the review process and the actions to eliminate audit exceptions could be strengthened. For example, the review process included only a limited determination of compliance with audit standards. The SDE and the CCC also did not compare data from the audit reports to data used to disburse state funds. In reviewing the actions to eliminate audit exceptions, we found that neither the SDE nor the CCC reported amounts of adjustments related to the future apportionment of state funds. Further, the time required to obtain responses to audit exceptions and management improvement recommendations could be shortened.

We also examined the SDE's and the CCC's reports to the Joint Legislative Audit Committee. These reports listed various audit exceptions which may affect state funding but did not disclose the dollar amounts of these exceptions. The reports also did not indicate adjustments made or necessary to future apportionments of state funds. Further, the SDE and the CCC reported that some districts' reports omitted auditors' opinions or included qualified opinions; some of these variations could indicate serious financial problems at LEAs. Both agencies relied on audit exception checklist procedures to correct these problems. Additionally, most audit reports were filed with the SDE or the CCC after the November 15 deadline.

Filing Requirements and Procedures

As stated in the Introduction, the LEA audit reports are to be filed with the SDE and the CCC by November 15 of each year. Then, to comply with Education Code Sections 41020.6 and 84040.6, these agencies are to report to the Joint Legislative Audit Committee (1) the number and nature of the audit exceptions and the amount of funds involved, (2) a listing of LEAs that failed to file their reports as required, and (3) actions taken to eliminate audit exceptions and to comply with management improvement recommendations.

To prepare their reports to the Joint Legislative Audit Committee, the SDE and the CCC summarized audit exceptions and recommendations reported by auditors into six specified categories: auditor's opinion, expenditures by source of funds, average daily attendance, internal control, compliance areas, other recommendations, and status of prior year findings. The SDE and the CCC sent summaries of audit exceptions and management improvement recommendations to officials of the County Superintendents of Schools for response. These officials compared the state review with the county's own review. If there were differences in interpretations or questions of actions to be taken, state and county officials reached a consensus before contacting the district. Then, county officials requested that the district involved provide the county superintendents a report of action to be sent to the SDE or the CCC. (These procedures for handling audit exceptions and management improvement recommendations are discussed on page 35 of this report.)

Actions to Review
District Audit Reports

Reviews of district audit reports performed by the SDE and the CCC focused upon identifying audit exceptions and management improvement recommendations and determining when the reports were filed. The reviews, however, included only a limited determination of compliance with audit standards.

Additionally, the SDE and the CCC did not validate disbursements of state funds made to districts by comparing audited data to data used to disburse these funds.

The SDE and the CCC applied the same interpretation to the Education Code requirement that they report to the Legislature on LEAs that failed to file their reports as required. Both agencies interpreted the mandate to mean that auditors' reports must meet the November 15 filing date. Neither SDE nor CCC satisfactorily examined the districts' compliance with audit standards. Thus, the agencies provided limited evaluations of the quality of the audits. We believe that the review should be a single, comprehensive evaluation which includes a determination of compliance with audit standards.

Furthermore, the SDE and the CCC have not matched audited data with data submitted by counties or districts for average daily attendance apportionments. The agencies also did not match audited data related to claims for reimbursement for federal and state categorical aid programs or allowances with claims submitted to them as a basis for payments to districts. We believe that this is an area in which the State could use the audit reports more effectively.

Actions to Eliminate Audit
Exceptions and Comply with
Management Improvement
Recommendations

We found that procedures for handling audit exceptions, as previously outlined in this section, could be strengthened. Sections 41020 and 84040 of the Education Code provide that "the Superintendent of Public Instruction and the CCC shall make any adjustments necessary in future apportionments of all state funds, to correct any audit exceptions revealed by such audit reports." Neither the SDE nor the CCC reported the amounts of adjustments related to the apportionment of state funds. In addition, these procedures may not resolve more serious problems such as those related to the omission or qualification of auditors' opinions.

In view of the provisions of the Education Code, we believe that the SDE and the CCC should follow up, determine the amount of the audit exception, make adjustments when these relate to the apportionment of state funds, and report the adjustment to the Joint Legislative Audit Committee.

Also, the time required to obtain responses to audit exceptions and management improvement recommendations from county officials could be shortened and the rate of response could be increased. As of June 30, 1980, less than 39 percent

of the K-12 districts had responded to audit exceptions and management improvement recommendations for audits for the year ended June 30, 1979. The CCC had received responses from 81 percent of the community college districts. This problem could be alleviated if the audit report included the comments of responsible school district officials just as the Auditor General's reports include the comments of audited agencies.

Reports to the Joint
Legislative Audit Committee

The SDE's and the CCC's reports to the Joint Legislative Audit Committee disclose various categories of audit exceptions but do not include the amount of state funds related to these exceptions. Further, LEA audit reports with no auditor's opinions or other than unqualified opinions may indicate serious financial problems at the LEAs. The SDE and the CCC relied on audit exception checklist procedures to correct these problems.

The June 30, 1980 reports of the SDE and the CCC to the Joint Legislative Audit Committee disclosed audit exceptions related to:

- Average daily attendance of 26 K-12 districts;
- Categorical aid programs of 65 K-12 districts;
- Excess ending balances of 95 K-12 districts;

- Transportation reports of 62 K-12 districts;
- School improvement program average daily attendance of 35 K-12 districts;
- Average daily attendance of 8 community college districts;
- Available district reserves of 7 community college districts.

The reports of the SDE and CCC, however, did not disclose the amount of state funds related to exceptions such as those listed above. Also, there was no indication of the adjustments made or necessary to future apportionments of state funds.

In addition, the SDE reported that some audit reports contained no auditors' opinions. Both the SDE and the CCC noted that other reports contained other than unqualified opinions on some funds. The auditor is required by generally accepted auditing standards to express an opinion in one of four forms: unqualified, qualified, adverse, or disclaimer. An unqualified opinion means that the auditor found nothing so material that it would prevent him from concluding that the financial position of the LEAs is fairly presented. The auditor gives a qualified opinion when he has a limited reservation as to the fair presentation of financial position.

An adverse opinion states that the statements are not fairly presented. A disclaimer of opinion occurs when the auditor has not performed, for various reasons, an examination sufficient in scope to allow him to form an opinion.

The SDE recognized the significance of the auditor's opinion, and accumulated data on the number of each form of the opinion by fund. (This information is presented in Appendix E.)

The SDE reported that 5 district reports on the General Funds, 5 reports on Cafeteria Funds, 2 reports on Trust Funds, and 8 reports on other funds contained no auditor's opinion. These audits are substandard and unacceptable by both the SDF and professional auditing standards. The SDE further reported that for 89 General Funds, 82 Cafeteria Funds, 84 Debt Service Funds, and 122 Trust Funds, the auditor expressed an opinion other than an unqualified opinion. The CCC reported a summary of reasons for qualified and disclaimed opinions, but did not report the auditor's opinion by fund.

Both the SDE and the CCC rely on the audit exception checklist sent to the County Superintendents of Schools to assure correction of these conditions. We believe that these conditions may indicate serious financial problems at the LEAs and, as such, they warrant more attention by the State than is given to the routine management improvement recommendations.

Reports Filed by November 15

Only 15 percent of the K-12 and 16 percent of the community college audit reports were filed with the SDE or the CCC to meet the November 15 deadline. There is considerable confusion as to responsibility for filing audit reports and no penalty for not meeting the filing date.

CONCLUSION

Actions taken by the SDE and the CCC to compile audit exceptions and management improvement recommendations were adequate; however, the overall review process and actions to eliminate the audit exceptions should be strengthened. Although many exceptions which may affect state funding were reported by the SDE and the CCC, neither report to the Joint Legislative Audit Committee disclosed the amount of state funds involved in exceptions or adjustments necessary to eliminate the exceptions.

CONCLUSIONS AND RECOMMENDATIONS
FOR FUTURE ACTION TO ASSURE
INCREASED UTILITY OF THE AUDITS

The conclusions and recommendations presented in this section are based upon our review of (1) actions taken to update the audit procedures; (2) a sample review of individual district audits to determine compliance with audit procedures; and (3) a review of actions taken by the Department of Education and the Office of the Chancellor of the California Community Colleges to review district audits, eliminate audit exceptions, and report to the Joint Legislative Audit Committee.

CONCLUSIONS

We found that responsible parties have acted appropriately in updating the audit procedures in view of the changing audit environment. Guidelines issued by the federal Office of Management and Budget may have usurped the State's authority to issue audit standards for federal programs. Still unresolved are questions related to the scope and funding of the federally mandated audits.

Our sample review of audit reports of local educational agencies indicated that the incidence of non-compliance with state audit standards is high. Significant areas of noncompliance relate to reports on (1) districts' claims for federal and state categorical aid programs and

allowances, (2) average daily attendance, and (3) specific areas of compliance of concern to the State. Further, no state agency has assumed the responsibility for determining and requiring compliance with audit standards.

Additionally, the actions taken by the state Department of Education and the Board of Governors of the California Community Colleges to compile audit exceptions and management improvement recommendations were adequate. However, the overall review process and actions to eliminate the audit exceptions should be strengthened. Although many exceptions which may affect state funding were reported by the SDE and the CCC, neither report to the Joint Legislative Audit Committee disclosed the amount of state funds involved in exceptions or adjustments necessary to eliminate the exceptions.

RECOMMENDATIONS

In the recommendations that follow, we suggest that the Legislature clarify the responsibilities for determining and requiring compliance with audit standards and for filing audit reports within the period specified. Other recommendations, directed to the state Department of Education and the Board of Governors of the California Community Colleges, suggest procedures for correcting audit exceptions, matching audited data with data used to disburse state funds, and reporting auditors' opinions.

Clarifying Responsibility
for Determining and Requiring
Compliance With Audit Standards

We recommend that the Legislature clarify the responsibility for determining and requiring compliance with audit standards. The Legislature should consider assigning the SDE and the CCC these responsibilities as well as the responsibilities to review audit reports, eliminate audit exceptions, and report to the Joint Legislative Audit Committee. We also recommend that the Legislature require the state Department of Finance to assist and cooperate with the SDE and the CCC in reviewing audit reports.

These modifications would provide for a single comprehensive review of audit reports for compliance with both audit standards and audit exceptions. Implementation of these recommendations would increase the utility of the annual report to the Joint Legislative Audit Committee and would also improve the quality of the audits. Further, LEAs would be required to direct their responses to the audit report to only one state agency. In this way, the SDF would receive information concerning the application of its standards.

Clarifying Responsibility for
Filing Audit Reports Promptly

We recommend that the Legislature amend Education Code Sections 41020 and 84040 to specify (1) that the governing board of each district is responsible for filing that district's audit report and (2) that the County Superintendent of Schools for each county is responsible for filing that county's audit report by November 15.

The Legislature should further provide that each audit report include responsible officials' responses to audit exceptions and management improvement recommendations as detailed in the report. Further, the legislation should provide that a report of audit exceptions and management improvement recommendations be filed with the governing board by October 15, that the governing board be allowed 7 days to respond to the report, and that the audit report be delivered to the governing board by November 8.

Since arrangements for the audits must be made before May 1, we believe that a reasonable time is allowed for completion and filing of the audit report by November 15. Additionally, these provisions will increase the number of audit reports that are filed on time and will promptly resolve audit exceptions and ensure compliance with management improvement recommendations.

Correcting Audit Exceptions

We recommend that the SDE and the CCC determine the amount of audit exceptions and make adjustments when these exceptions relate to the apportionment of state funds. The amount of the adjustments to state apportionments should be reported annually to the Joint Legislative Audit Committee. We also recommend that the SDE and the CCC promptly contact the districts to obtain explanations when the auditor reports no opinion or when the opinion is other than unqualified. These situations may indicate serious problems at the LEAs.

We believe these actions are necessary to assure that the amount of audit adjustments necessary to state apportionments are determined and made and that other serious financial problems are promptly resolved.

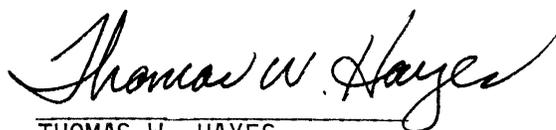
Matching Audited Data with Data Used to Disburse State Funds

We recommend that the SDE and the CCC conduct pilot projects to match audited data reported by auditors with data received by the State from LEAs as a basis for disbursing state funds. This procedure will improve the validation of disbursements of state funds for apportionment purposes and the validation of district claims for categorical aid programs. Should the pilot projects prove to be beneficial, the SDE and the CCC should permanently establish these procedures.

Reporting Auditors' Opinions

Finally, we recommend that the CCC report auditors' opinions by fund in its annual report to the Joint Legislative Audit Committee. This procedure will more accurately reflect the conditions found at school districts.

Respectfully submitted,



THOMAS W. HAYES
Auditor General

Date: July 29, 1980

Staff: Richard LaRock
Mildred Kiesel
Del Pelagio

DEPARTMENT OF FINANCE

SACRAMENTO



July 23, 1980

Thomas W. Hayes, Auditor General
Office of the Auditor General
915 L Street, Suite 750
Sacramento, CA 95814

My staff has reviewed your draft report, "Development and Implementation of Standards and Procedures for Audits of California Local Educational Agencies, July 1980."

We have no basic disagreement with your draft report. It contains comprehensive comments on many problems, issues and recommendations that are of concern to all of us. In fact, we and the staff of the State Department of Education and the Chancellor's Office have had frequent discussions on many of the same items covered in your report. Your staff has participated in some of these discussions. It is my hope that we can continue to have further discussions and effectively resolve the problems and issues that have been identified.

In particular, we have recently initiated contacts with the two operating departments and with the various professional organizations concerned with the audit manual, audit reports and related problems and issues. This effort is being directed toward a revision of our audit manual in January 1981. Of more importance, a priority item of my concern is that of obtaining full compliance with the published audit standards and reporting requirements. I concur in your recommendation that the State's role needs to be strengthened to effectively resolve instances of noncompliance, both in audit coverage as well as in reporting audit results. Furthermore, you recognize that a great amount of uncertainty presently exists in the area of fiscal compliance auditing of the federally assisted programs. The Department of Finance will proceed on developing these auditing guidelines as soon as it is appropriate and feasible to do so.

For the immediate future, my staff will closely monitor any new developments and changes with the Federal agencies, particularly concerning the evolving concepts on fiscal compliance audits of Federal funds. I am aware of the potential impacts and ramifications which the new OMB Circular A-102, Attachment P could have on the State of California. The Department will work closely with your office and the State agencies and departments in an attempt to coordinate a reasonable statewide approach to address and resolve the issues embodied in Attachment P.

Thomas W. Hayes

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July 12, 1980

Thank you for this opportunity to review and respond to your draft report.
If you have any questions, please contact Richard L. Cutting on 322-2985 or
Garvin J. Ivans on 322-7775.

for E. E. Goetz
MARY ANN GRAVES
Director

3812P



STATE OF CALIFORNIA
DEPARTMENT OF EDUCATION
STATE EDUCATION BUILDING, 721 CAPITOL MALL, SACRAMENTO 95814

July 28, 1980

Mr. Thomas W. Hayes
Auditor General
925 L Street, Suite 750
Sacramento, California 95814

Dear Mr. Hayes:

This letter is in response to Auditor General's draft Report No. 375, "Development and Implementation of Standards and Procedures for Audits of California Local Educational Agencies".

We wish to comment about a specific statement of fact which we think needs to be clarified in the report before we provide comments regarding the defined topics in the report. The specific reference is relative to the identification of General Fund revenues on page 7. The chart reflects more than \$600,000,000 in Federal General Funds for K-12 school districts and we don't believe that is an accurate portrayal. Although many of the federal funds pass through a local educational agency's General Fund, the funds must retain their specific identity for program purposes.

In general, we find the report accurately reflects the situation relative to local agency audits. An issue that is not sufficiently addressed involves the amount of state staff available to carry out the Legislature's intent relative to follow-up audit procedures. The legislation created new responsibilities and we agree that more clarity is needed as to which agency is responsible for specifics; however, the legislation did not carry an appropriation for additional staff for the Department of Education or any other state agency involved in the audit process. Therefore, we find it necessary to explicitly note that our Department had to redirect staff in order to accomplish the task required to implement the "audit" legislation. It is our opinion that the report should reflect this situation.

The following comments are keyed to the headings in the draft report.

Clarifying Responsibility for Determining and Requiring Compliance with Audit Standards - p. 42

We concur with the Auditor General that a problem exists in the substantial numbers of audit reports filed that did not comply with Department of Finance reporting requirements. We also agree that legislation clarifying state agencies' responsibilities in those cases is desirable. The Department of

Education will, in the interim, modify its review procedures so as to identify the incomplete or substandard audit report and notify the affected local educational agency. We believe, in addition, that some means should be developed to deal with the question of whether the audit reports are based on competent, professional audit work. We recommend that any proposed legislation deal with both issues.

Clarifying Responsibility for Prompt Filing of Audit Reports - p. 43

It should be noted that there has been a substantial improvement this year in on-time filings. For the most recent year, 76.5 percent of reports were filed by December 31. In the previous year, only 53.5 percent of reports were filed by the same date in the year. If this represents a trend, which is probable, it is questionable whether modification of filing dates is necessary to stimulate more prompt resolution of audit exceptions. If any modification is considered, elimination of the extension by the county superintendent at auditor request should be explored.

We agree with the Auditor General's recommendation that the Legislature should require that each audit report include responsible officials' responses to audit exceptions and management improvement recommendations. Such a procedure would potentially reduce the time lag in implementation of corrective measures within the local educational agency.

Correcting Audit Exceptions - p. 44

The Department of Finance reporting requirements do not require auditors to report the dollar amounts of audit exceptions. Accordingly, most audit reports do not contain such data. We question the cost versus the benefits achieved for the department to be staffed to independently determine such amounts and to report them to the Joint Legislative Audit Committee.

Matching Audited Data With Data Used to Disburse State Funds - p. 44

In like manner, we question the cost/benefit assumptions in this recommendation. If audit reporting detail requirements were raised to the degree necessary to compare line-item data with the districts' original reports as is recommended by the Auditor General, there would be a significant increase in the cost of audits and an increase in the claims filed for recovery of locally mandated costs. Further, such checking by the Department of Education would create significant staffing and data processing equipment needs.

The primary purpose of an audit is to obtain an independent opinion on the fair presentation of financial statements and accuracy of claims. If there is some question of the reliability of local auditors' opinions and positive statements, we suggest that audit work be subjected to some form of quality review as stated in our earlier comments.

Mr. Thomas W. Hayes

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July 28, 1980

Again, thank you for the opportunity to review the draft report.

Sincerely,

A handwritten signature in black ink, appearing to read "W. Whiteneck", with a large, sweeping flourish at the end.

William D. Whiteneck
Deputy Superintendent for Administration
(916) 445-8950

WDW:ds

CALIFORNIA COMMUNITY COLLEGES

1238 S STREET
SACRAMENTO, CALIFORNIA 95814
(916) 445-8752
(916) 445-7911



July 23, 1980

Mr. Thomas W. Hayes
Auditor General
925 L Street, Suite 750
Sacramento, CA 95814

Dear Mr. Hayes:

This is in response to your July 21 request to comment by 5:00 p.m. today on your report to the Joint Legislative Audit Committee on the "Development and Implementation of Standards and Procedures for Audits of California Local Educational Agencies, July 1980."

We agree with you that our efforts to resolve audit exceptions need to be strengthened, and, I am confident, that they will be over time. As you may know, we got a late start in addressing this audits-review function. Considering the resources and time available to us, I believe we have made significant progress in this effort.

One of the difficulties in providing your staff with the ". . . amount of state funds involved in . . . exceptions" by the submittal due date of our annual report is that the impact may not always be determinable at that time. As stated in our report, resolution of audit exceptions will be an on-going process assigned to appropriate staff at this office. The report submitted next June 30 will include the status of prior year findings. In passing, I would remind you that for fiscal year 1978-79, State funding of the community colleges was not based on ADA generated in that year.

We also agree with the need for the Legislature to clarify the responsibility for determining and requiring compliance with the audit standards. Discussion of this matter among representatives of this office, SDE, SDF, and your staff has been initiated recently.

Mr. Thomas W. Hayes

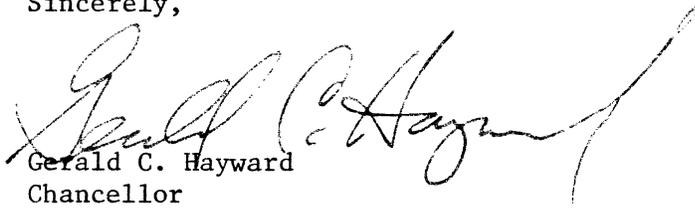
-2-

July 23, 1980

May I suggest that in your final report, comments primarily applicable to one agency not be addressed equally to both.

We look forward to continuing inter-agency cooperation in fulfilling the intent of Education Code Section 84040.

Sincerely,



Gerald C. Hayward
Chancellor

cc: Gus Guichard
Joseph Freitas
Gary Cook

Senate Bill No. 787

CHAPTER 936

An act to amend Sections 41020 and 84040 of the Education Code, as proposed by the 1977 Education Code Supplemental Act, and to add Sections 41020.5, 41020.6, 84040.5, and 84040.6 to, and to add and repeal Sections 41020.7 and 84040.7 of, the Education Code, relating to school and community college audits.

[Approved by Governor September 21, 1977. Filed with Secretary of State September 21, 1977.]

LEGISLATIVE COUNSEL'S DIGEST

SB 787, Smith. Schools, community colleges: audits.

Under current law, governing boards of school districts and community college districts are required to provide for an audit of the books and accounts of the district. Reports of such audits must be filed with various agencies, including the Department of Education and the Department of Finance, in the case of school districts, and the Board of Governors of the California Community Colleges and the Department of Finance, in the case of community college districts. If an audit is not provided for at the local level, the Department of Finance is authorized to make arrangements for the audit, the costs of which would be paid by the local entity. The Department of Finance, in cooperation with the Department of Education or the board of governors, as the case may be, is required to provide statements and other information to be included in the audit reports filed with the state. The Department of Finance is authorized to make audits, surveys, and reports, and to develop procedures, to carry out these provisions.

This bill would require that the auditor's report include a statement that the audit was conducted pursuant to standards and procedures developed by the Department of Finance, in cooperation with the Auditor General and the Department of Education or the board of governors, as the case may be, and a summary of audit exceptions and management improvement suggestions. This bill would require, rather than authorize, the Department of Finance to make arrangements for audits at the local level if the local entity does not do so.

This bill would delete the requirement that the Department of Finance and the Department of Education or the board of governors, as the case may be, prescribe audit statements and other information and would instead require that task to be performed by the Department of Finance, in cooperation with the Auditor General and the Department of Education or the board of governors, as the case may be. This bill would require the Department of Finance, in cooperation with the Auditor General and the Department of Education or the board of governors, as the case may be, to review audit proce-

dures, statements, and other information, would require updating of standards, as specified, and would require various specified reports.

This bill would also make various related technical changes.

The people of the State of California do enact as follows:

SECTION 1. Section 41020 of the Education Code, as proposed by the 1977 Education Code Supplemental Act, is amended to read:

41020. It is the intent of the Legislature to encourage sound fiscal management practices among school districts for the most efficient and effective use of public funds for the education of children in California by strengthening fiscal accountability at the district, county, and state level.

Not later than the first day of May of each fiscal year each county superintendent of schools shall provide for an audit of all funds under his jurisdiction and control and the governing board of each district shall either provide for an audit of the books and accounts of the district, including an audit of school district income and expenditures by source of funds, or make arrangements with the county superintendent of schools having jurisdiction over the district to provide for such auditing. In the event the governing board of a school district has not provided for an audit of the books and accounts of the district by April 1st, the county superintendent of schools having jurisdiction over the district shall provide for the audit.

Each audit shall include all funds of the district including the student body and cafeteria funds and accounts and any other funds under the control or jurisdiction of the district; funds of regional occupational centers and programs maintained by the county superintendent of schools, a school district, or pursuant to a joint powers agreement.

The cost of the audits provided for by the county superintendent of schools shall be paid from the county school service fund and the county superintendent of schools shall transfer the pro rata share of the cost chargeable to each district from district funds.

The cost of the audit provided for by a governing board shall be paid from district funds. The audit of the funds under the jurisdiction and control of the county superintendent of schools shall be paid from the county school service fund.

The audits shall be made by a certified public accountant or a public accountant, licensed by the State Board of Accountancy.

The auditor's report shall include (1) a statement that the audit was conducted pursuant to standards and procedures developed in accordance with Section 41020.5 and (2) a summary of audit exceptions and management improvement suggestions.

Not later than November 15th, a report of each audit for the preceding fiscal year shall be filed with the county clerk and the county superintendent of schools of the county in which the district is located, the Department of Education, and the Department of

Finance. The submission date may be extended to, but not later than, December 31 for justifiable cause upon written request by auditor and approval by the county superintendent of schools. The Superintendent of Public Instruction shall make any adjustments necessary in future apportionments of all state funds, to correct any discrepancies revealed by such audit reports.

Each county superintendent of schools shall be responsible for the correction of any discrepancies revealed by audit reports issued pursuant to this section which do not affect state funds and are not corrected by the Superintendent of Public Instruction when the discrepancies affect any revenue and expenditures under his control or the control of any school district within his jurisdiction. The county superintendent of schools shall adjust the future local property tax requirements to correct audit discrepancies relating to school district tax rates and tax revenues.

If a governing board or county superintendent of schools fails or is unable to make satisfactory arrangements for audit pursuant to this section, the Department of Finance shall make arrangements for the audit and the cost of such audit shall be paid from school district funds or the county school service fund as the case may be.

Audits of regional occupational centers and programs are subject to the provisions of this section.

Nothing in this section shall be considered as authorizing examination into or report on the curriculum used or provided for in any school district.

SEC. 2. Section 41020.5 is added to the Education Code, to read:

41020.5. The Department of Finance, in cooperation with the Auditor General and the Department of Education, shall prescribe the statements and other information to be included in the audit reports filed with the state and shall develop audit procedures for carrying out the purposes of this section. The Department of Finance may make audits, surveys, and reports which, in the judgment of the department will serve the best interest of the state.

A review of existing audit procedures, statements, and other information required to be included in the audit reports shall be commenced on January 1, 1978, by the Department of Finance, in cooperation with the Auditor General and the Department of Education. Updated standards shall be completed by August 1, 1978, and shall periodically be updated no less than every two years thereafter.

SEC. 3. Section 41020.6 is added to the Education Code, to read:

41020.6. On June 30, 1979, and each year thereafter, the Department of Education shall report to the Joint Legislative Audit Committee on (1) the number and nature of audit exceptions and estimated amount of funds involved in such exceptions, (2) a list of districts or county superintendents which failed to file their audits pursuant to Section 41020, and (3) the actions taken by the department to eliminate audit exceptions and rectify fiscal

discrepancies.

SEC. 4. Section 41020.7 is added to the Education Code, to read:
41020.7. On July 30, 1979, the Auditor General shall report to the Legislature on (1) action taken to update audit procedures pursuant to Section 41020.5, (2) a sample review of individual district audits to determine compliance with audit procedures, (3) a review of actions taken by the Department of Education pursuant to Section 41020.6, and (4) recommendations for future action to assure increased utility of the audits.

This section shall remain in effect only until July 30, 1979, and as of that date is repealed.

SEC. 5. Section 84040 of the Education Code, as proposed by the 1977 Education Code Supplemental Act, is amended to read:

84040. It is the intent of the Legislature to encourage sound fiscal management practices among community college districts for the most efficient and effective use of public funds for the education of community college students in California by strengthening fiscal accountability at the district, county, and state level.

Not later than the first day of May of each fiscal year each county superintendent of schools shall provide for an audit of all funds under his jurisdiction and control and the governing board of each community college district shall either provide for an audit of the books and accounts of the district, including an audit of community college district income and expenditures by source of funds, or make arrangements with the county superintendent of schools having jurisdiction over the district to provide for such auditing. In the event the governing board of a community college district has not provided for an audit of the books and accounts of the district by April 1st, the county superintendent of schools having jurisdiction over the district shall provide for the audit.

Each audit shall include all funds of the district including the student body and cafeteria funds and accounts and any other funds under the control or jurisdiction of the district.

The cost of the audits provided for by the county superintendent of schools shall be paid from the county school service fund and the county superintendent of schools shall transfer the pro rata share of the cost chargeable to each district from district funds.

The cost of the audit provided for by a governing board shall be paid from district funds. The audit of the funds under the jurisdiction and control of the county superintendent of schools shall be paid from the county school service fund.

The audits shall be made by a certified public accountant or a public accountant, licensed by the State Board of Accountancy.

The auditor's report shall include (1) a statement that the audit was conducted pursuant to standards and procedures developed in accordance with Section 84040.5 and (2) a summary of audit exceptions and management improvement suggestions.

Not later than November 15th, a report of each audit for the

preceding fiscal year shall be filed with the county clerk and the county superintendent of schools of the county in which the district is located, the board of governors and the Department of Finance. The submission date may be extended to, but not later than, December 31 for justifiable cause upon written request by the auditor and approval by the county superintendent of schools. The board of governors shall make any adjustments necessary in future apportionments of all state funds, to correct any discrepancies revealed by such audit reports.

Each county superintendent of schools shall be responsible for the correction of any discrepancies revealed by audit reports issued pursuant to this section which do not affect state revenue and expenditures and are not corrected by the board of governors when the discrepancies affect any funds under his control or the control of any district within his jurisdiction.

If a governing board or county superintendent of schools fails or is unable to make satisfactory arrangements for audit pursuant to this section, the Department of Finance may make arrangements for the audit and the cost of such audit shall be paid from district funds or the county school service fund as the case may be.

Nothing in this section shall be considered as authorizing examination into or report on the curriculum used or provided for in any community college district.

SEC. 6. Section 84040.5 is added to the Education Code, to read:

84040.5. The Department of Finance, in cooperation with the Auditor General and the board of governors, shall prescribe the statements and other information to be included in the audit reports filed with the state and shall develop audit procedures for carrying out the purposes of this section. The Department of Finance may make audits, surveys, and reports which, in the judgment of the department will serve the best interest of the state.

A review of existing audit procedures, statements, and other information required to be included in the audit reports shall be commenced on January 1, 1978, by the Department of Finance, in cooperation with the Auditor General and the board of governors. Updated standards shall be completed by August 1, 1978, and shall periodically be updated no less than every two years thereafter.

SEC. 7. Section 84040.6 is added to the Education Code, to read:

84040.6. On June 30, 1979, and each year thereafter, the office of the chancellor shall report to the Joint Legislative Audit Committee on (1) the number and nature of audit exceptions and estimated amount of funds involved in such exceptions, (2) a list of districts or county superintendents which failed to file their audits pursuant to Section 84040, and (3) the actions taken by the department to eliminate audit exceptions and rectify fiscal discrepancies.

SEC. 8. Section 84040.7 is added to the Education Code, to read:

84040.7. On July 30, 1979, the Auditor General shall report to the Legislature on (1) action taken to update audit procedures pursuant

to Section 84040.5, (2) a sample review of individual district audits to determine compliance with audit procedures, (3) a review of actions taken by the office of the chancellor pursuant to Section 84040.6, and (4) recommendations for future action to assure increased utility of the audits.

This section shall remain in effect only until July 30, 1979, and as of that date is repealed.

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Senate Bill No. 1511

CHAPTER 207

An act to amend Sections 41020, 41020.6, 41020.7, 84040, 84040.6, and 84040.7 of, and to add Sections 41020.3 and 84040.3 to, the Education Code, relating to audits.

[Approved by Governor June 5, 1978. Filed with
Secretary of State June 6, 1978.]

LEGISLATIVE COUNSEL'S DIGEST

SB 1511, Smith. School districts: community college districts: audits.

Under current law, governing boards of school districts and community college districts are required to provide for an annual audit of the books and accounts of the district.

Further, the Auditor General is required to report to the Legislature, by July 30, 1979, regarding various aspects of such audits.

This bill would require school district and community college district governing boards to review the annual audit at a regularly scheduled public meeting, and to place the review on the agenda for such meeting.

This bill would extend the time by which the Auditor General is required to make his report to the Legislature to July 30, 1980.

This bill would also make various related corrective and technical changes.

The people of the State of California do enact as follows:

SECTION 1. Section 41020 of the Education Code is amended to read:

41020. It is the intent of the Legislature to encourage sound fiscal management practices among school districts for the most efficient and effective use of public funds for the education of children in California by strengthening fiscal accountability at the district, county, and state levels.

Not later than the first day of May of each fiscal year each county superintendent of schools shall provide for an audit of all funds under his jurisdiction and control and the governing board of each district shall either provide for an audit of the books and accounts of the district, including an audit of school district income and expenditures by source of funds, or make arrangements with the county superintendent of schools having jurisdiction over the district to provide for such auditing. In the event the governing board of a school district has not provided for an audit of the books and accounts of the district by April 1st, the county superintendent of schools having jurisdiction over the district shall provide for the audit.

Each audit shall include all funds of the district including the student body and cafeteria funds and accounts and any other funds under the control or jurisdiction of the district; funds of regional occupational centers and programs maintained by the county superintendent of schools, a school district, or pursuant to a joint powers agreement.

The cost of the audits provided for by the county superintendent of schools shall be paid from the county school service fund and the county superintendent of schools shall transfer the pro rata share of the cost chargeable to each district from district funds.

The cost of the audit provided for by a governing board shall be paid from district funds. The audit of the funds under the jurisdiction and control of the county superintendent of schools shall be paid from the county school service fund.

The audits shall be made by a certified public accountant or a public accountant, licensed by the State Board of Accountancy.

The auditor's report shall include (1) a statement that the audit was conducted pursuant to standards and procedures developed in accordance with Section 41020.5 and (2) a summary of audit exceptions and management improvement recommendations.

Not later than November 15th, a report of each audit for the preceding fiscal year shall be filed with the county clerk and the county superintendent of schools of the county in which the district is located, the Department of Education, and the Department of Finance. The submission date may be extended to, but not later than, December 31 for justifiable cause upon written request by the auditor and approval by the county superintendent of schools. The Superintendent of Public Instruction shall make any adjustments necessary in future apportionments of all state funds, to correct any audit exceptions revealed by such audit reports.

Each county superintendent of schools shall be responsible for the correction of any audit exceptions revealed by audit reports issued pursuant to this section which do not affect state funds and are not corrected by the Superintendent of Public Instruction when the audit exceptions affect any revenue and expenditures under his control or the control of any school district within his jurisdiction. The county superintendent of schools shall adjust the future local property tax requirements to correct audit exceptions relating to school district tax rates and tax revenues.

If a governing board or county superintendent of schools fails or is unable to make satisfactory arrangements for audit pursuant to this section, the Department of Finance shall make arrangements for the audit and the cost of such audit shall be paid from school district funds or the county school service fund, as the case may be.

Audits of regional occupational centers and programs are subject to the provisions of this section.

Nothing in this section shall be considered as authorizing examination into or report on the curriculum used or provided for

in any school district.

SEC. 2. Section 41020.3 is added to the Education Code, to read:

41020.3. Each school district governing board shall review the annual audit prescribed pursuant to Section 41020 at one of its regularly scheduled public meetings; and such review shall be placed on the agenda of such meeting pursuant to Section 35145.

SEC. 3. Section 41020.6 of the Education Code is amended to read:

41020.6. On June 30, 1979, and each year thereafter, the Department of Education shall report to the Joint Legislative Audit Committee on (1) the number and nature of audit exceptions and estimated amount of funds involved in such exceptions, (2) a list of districts or county superintendents which failed to file their audits pursuant to Section 41020, and (3) the actions taken by the department to eliminate audit exceptions and comply with management improvement recommendations.

SEC. 4. Section 41020.7 of the Education Code is amended to read:

41020.7. On July 30, 1980, the Auditor General shall report to the Legislature on (1) action taken to update audit procedures pursuant to Section 41020.5, (2) a sample review of individual district audits to determine compliance with audit procedures, (3) a review of actions taken by the Department of Education pursuant to Section 41020.6, and (4) recommendations for future action to assure increased utility of the audits.

This section shall remain in effect only until July 30, 1980, and as of that date is repealed.

SEC. 5. Section 84040 of the Education Code is amended to read:

84040. It is the intent of the Legislature to encourage sound fiscal management practices among community college districts for the most efficient and effective use of public funds for the education of community college students in California by strengthening fiscal accountability at the district, county, and state levels.

Not later than the first day of May of each fiscal year each county superintendent of schools shall provide for an audit of all funds under his jurisdiction and control and the governing board of each community college district shall either provide for an audit of the books and accounts of the district, including an audit of community college district income and expenditures by source of funds, or make arrangements with the county superintendent of schools having jurisdiction over the district to provide for such auditing. In the event the governing board of a community college district has not provided for an audit of the books and accounts of the district by April 1st, the county superintendent of schools having jurisdiction over the district shall provide for the audit.

Each audit shall include all funds of the district including the student body and cafeteria funds and accounts and any other funds under the control or jurisdiction of the district.

The cost of the audits provided for by the county superintendent of schools shall be paid from the county school service fund and the county superintendent of schools shall transfer the pro rata share of the cost chargeable to each district from district funds.

The cost of the audit provided for by a governing board shall be paid from district funds. The audit of the funds under the jurisdiction and control of the county superintendent of schools shall be paid from the county school service fund.

The audits shall be made by a certified public accountant or a public accountant, licensed by the State Board of Accountancy.

The auditor's report shall include (1) a statement that the audit was conducted pursuant to standards and procedures developed in accordance with Section 84040.5 and (2) a summary of audit exceptions and management improvement recommendations.

Not later than November 15th, a report of each audit for the preceding fiscal year shall be filed with the county clerk and the county superintendent of schools of the county in which the district is located, the board of governors and the Department of Finance. The submission date may be extended to, but not later than, December 31 for justifiable cause upon written request by the auditor and approval by the county superintendent of schools. The board of governors shall make any adjustments necessary in future apportionments of all state funds, to correct any audit exceptions revealed by such audit reports.

Each county superintendent of schools shall be responsible for the correction of any audit exceptions revealed by audit reports issued pursuant to this section which do not affect state revenue and expenditures and are not corrected by the board of governors when the audit exceptions affect any funds under his control or the control of any district within his jurisdiction.

If a governing board or county superintendent of schools fails or is unable to make satisfactory arrangements for audit pursuant to this section, the Department of Finance shall make arrangements for the audit and the cost of such audit shall be paid from district funds or the county school service fund, as the case may be.

Nothing in this section shall be considered as authorizing examination into or report on the curriculum used or provided for in any community college district.

SEC. 6. Section 84040.3 is added to the Education Code, to read:

84040.3. Each community college district governing board shall review the annual audit prescribed pursuant to Section 84040 at one of its regularly scheduled public meetings; and such review shall be placed on the agenda of such meeting pursuant to Section 72121.

SEC. 7. Section 84040.6 of the Education Code is amended to read:

84040.6. On June 30, 1979, and each year thereafter, the office of the chancellor shall report to the Joint Legislative Audit Committee on (1) the number and nature of audit exceptions and estimated

amount of funds involved in such exceptions, (2) a list of districts or county superintendents which failed to file their audits pursuant to Section 84040, and (3) the actions taken by the department to eliminate audit exceptions and comply with management improvement recommendations.

SEC. 8. Section 84040.7 of the Education Code is amended to read:

84040.7. On July 30, 1980, the Auditor General shall report to the Legislature on (1) action taken to update audit procedures pursuant to Section 84040.5, (2) a sample review of individual district audits to determine compliance with audit procedures, (3) a review of actions taken by the office of the chancellor pursuant to Section 84040.6, and (4) recommendations for future action to assure increased utility of the audits.

This section shall remain in effect only until July 30, 1980, and as of that date is repealed.

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SUMMARY OF REVIEW OF DISTRICT AUDITS TO
DETERMINE COMPLIANCE WITH STANDARDS AND PROCEDURES
FOR AUDITS OF CALIFORNIA LOCAL EDUCATIONAL AGENCIES

1978-79

REPORTING REQUIREMENTS	<u>K-12</u>		<u>Community College</u>	
	<u>YES</u>	<u>NO</u>	<u>YES</u>	<u>NO</u>
Does the audit report contain:				
I. <u>Scope Paragraph</u>				
A. Identifying the financial statements of funds or account groups examined period covered?	<u>109</u>	<u>1</u>	<u>67</u>	<u>2</u>
Including a statement that the audit was made in accordance with:				
B. Generally accepted auditing standards?	<u>110</u>	<u>--</u>	<u>66</u>	<u>3</u>
C. Standards prescribed by the state Department of Finance?	<u>105</u>	<u>5</u>	<u>52</u>	<u>17</u>
D. Does the statement include all funds and account groups?	<u>105</u>	<u>5</u>	<u>63</u>	<u>6</u>
E. If one or more funds are omitted, is a separate paragraph included in the report stating the substantive reason for the omission?	<u>105</u>	<u>5</u>	<u>63</u>	<u>6</u>
II. <u>Opinion Paragraph</u>				
A. If an unqualified opinion is not expressed for an fund or account group or statement thereof, is the nature of the qualification or disclaimer explained?	<u>108</u>	<u>2</u>	<u>69</u>	<u>--</u>
B. Statement clearly establishing the auditor's responsibility regarding the other data shown in the supplementary information section?	<u>104</u>	<u>6</u>	<u>68</u>	<u>1</u>

<u>AUDITOR'S REPORT (Cont'd)</u>	<u>K-12</u>		<u>Community College</u>	
	<u>YES</u>	<u>NO</u>	<u>YES</u>	<u>NO</u>
Paragraph on:				
C. A statement that auditor has made a study and evaluated internal control (See V).	<u>105</u>	<u>5</u>	<u>64</u>	<u>5</u>
D. A statement that auditor has made all tests of compliance as required by state Department of Finance standards (See V).	<u>105</u>	<u>5</u>	<u>61</u>	<u>8</u>
III. <u>Detailed Financial Statements</u>				
A. Combined Balance Sheet--all fund types and account groups or statements by fund	<u>110</u>	<u>--</u>	<u>68</u>	<u>1</u>
B. Combined Statements of Income, Expenditures, and Changes in Fund Balances--All Governmental Fund Types and expendable trust funds.	<u>109</u>	<u>1</u>	<u>69</u>	<u>--</u>
C. Statement of Income, Expenditures, and Changes in Fund Balance - Budget and Actual--General and Special Revenue Fund Types and similar fund types for which annual budgets have been adopted.	<u>110</u>	<u>--</u>	<u>69</u>	<u>--</u>
D. Notes to Financial Statements including summary of significant accounting policies.	<u>110</u>	<u>--</u>	<u>69</u>	<u>--</u>
IV. <u>Supplemental Information (See II.B)</u>				
A. Organization	<u>110</u>	<u>--</u>	<u>69</u>	<u>--</u>
B. Income and Expenditures by Source of Funds.				
(1) A breakdown of income and expenditures by federal and state categorical aid programs, special education, and other federal or state allowances.	<u>110</u>	<u>--</u>	<u>68</u>	<u>1</u>
(2) A positive statement that claims filed by the district as bases for reimbursement and the supporting records were tested to the extent considered necessary.	<u>94</u>	<u>16</u>	<u>51</u>	<u>18</u>

<u>AUDITOR'S REPORT (Cont'd)</u>	<u>K-12</u>		<u>Community College</u>	
	<u>YES</u>	<u>NO</u>	<u>YES</u>	<u>NO</u>
C. Assessed Valuation and Tax Rates	<u>109</u>	<u>1</u>	<u>68</u>	<u>1</u>
D. Average Daily Attendance				
Including:				
(1) A summary of the average daily attendance for the second and annual attendance periods.	<u>110</u>	<u>--</u>	<u>69</u>	<u>--</u>
(2) A positive statement that reports submitted by the district as a basis for principal and general purposes, state apportionments and allowances were tested to the extent considered necessary (This statement applies not only to attendance reports but to other reports submitted as bases for special purpose apportionments and allowances).	<u>99</u>	<u>11</u>	<u>59</u>	<u>10</u>
E. Legal Debt Margin Section	<u>107</u>	<u>3</u>	<u>56</u>	<u>13</u>
F. Insurance Coverage Section	<u>109</u>	<u>1</u>	<u>68</u>	<u>1</u>
G. Reconciliation of Annual Financial and Budget Report				
Including a reconciliation of the fund balance as reported to the State on the Annual Financial and Budget Report (Forms J-41, CCAf or J-73) and the Annual Supplemental Report (J-41A) as reported in the audited financial statements.	<u>104</u>	<u>6</u>	<u>63</u>	<u>6</u>
V. <u>Comments and Recommendations</u>				
A. Internal Accounting Control - A statement relative to internal control (See page B-2).				
A statement of findings and recommended corrective action.	<u>110</u>	<u>--</u>	<u>69</u>	<u>--</u>

<u>AUDITOR'S REPORT (Cont'd)</u>	<u>K-12</u>		<u>Community College</u>	
	<u>YES</u>	<u>NO</u>	<u>YES</u>	<u>NO</u>
B. Compliance - A statement of examination for test of compliance as required by the state Department of Finance standards (See page B-2). A statement of findings and recommended corrective action relative to areas of noncompliance.	<u>110</u>	<u>--</u>	<u>69</u>	<u>--</u>
VI. <u>Other Audit Exceptions and Management Improvement Recommendations</u> A summary of audit exceptions and management improvement recommendations, including a summary of management letters issued to communicate findings and recommendations not included in the internal accounting control or compliance sections.	<u>110</u>	<u>--</u>	<u>69</u>	<u>--</u>
VII. <u>Status of Prior Year Findings and Recommendations</u>	<u>97</u>	<u>13</u>	<u>53</u>	<u>16</u>

WILSON RILES
Superintendent of Public Instruction
and Director of Education



STATE OF CALIFORNIA
DEPARTMENT OF EDUCATION
STATE EDUCATION BUILDING, 721 CAPITOL MALL, SACRAMENTO 95814

Mr. Richard I. LaRock
Audit Manager
Office of the Auditor General
925 L Street, Suite 750
Sacramento, California 95814

Dear Mr. LaRock:

We have reviewed the material sent to us as a result of your review of school district reports for compliance with reporting requirements contained in the Department of Finance's audit guide. As you are aware, we believe that the responsibility for quality control on audit reports received from districts lies with the Department of Finance. Because of staff limitations, they are unwilling to assume this role. Therefore, we have included a limited review of compliance with the reporting requirements on the checklist which we send to the counties.

Our questions were limited to those items which would have a material affect on discovery of audit exceptions in the districts. Thus, we did not review many of the items you included in your survey.

Although we do not have a count of the cases of non-compliance, it appears that the limited review by Finance and this review by your staff are indicative of all reports. Of course, since neither sample was drawn with the intent of projection to the universe, we cannot draw valid inferences from them.

The most common omissions from reports that we have noted concern the positive statements on income and expenditures by source of funds or on ADA, the required compliance items in Chapter 2 of the audit guide, and the report on the review of internal control. Where these items are missing, our checklist so noted.

As of this date we have responses on only 42 percent of the checklists sent to county superintendents. These have elicited a variety of responses, such as:

"This is not the responsibility of the county. Please refer to the Department of Finance."

- . Complete ignoring of the item.
- . Referral on to the district who sometimes ignored the comment.
- . Response from the CPA that included the missing items.
- . Information from the county that the CPA would be sure to include the items next year.
- . Response from CPAs that such statements are unnecessary, because their auditors' report covered the matter.

We have recently made overtures to representatives of the California CPA society requesting informal review of what appear to be the most deficient audit reports. Some individuals in the Society have offered to assist us by making such an informal review and making recommendations to us for further action. Their desire is to see the overall quality of school district audits improve. We have also contacted the CPA Foundation to see how we can refer reports to their Reporting Practice Review Program. The thrust of this program is improvement of the skills of the individual practitioner. This may be the avenue to pursue in cases which are not sufficiently serious to warrant referral to the Board of Accountancy.

One serious concern that has emerged is the difference of opinion from within the accounting profession relative to the positive statements. We are proposing to request assistance from the Society's State Committee on Governmental Accounting and Auditing in defining just how this can be resolved. The Federal Government has long required a positive statement about their programs, and this is made stronger by Attachment P to OMB Circular A-102. Hopefully, a conference on this topic can be held this summer. This would give sufficient time for dissemination of our results before reports are actually written this fall.

We are also planning to distribute to all involved a listing of the deficiencies found in audit reports. Hopefully, this will be used, first, by the CPAs to evaluate their own work, second, by LEAs to evaluate the reports they pay for, and finally, by the counties in their reviews. We feel this will greatly reduce the number of reports not meeting the standards of the profession.

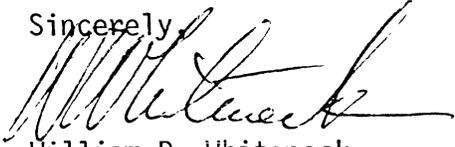
We would, of course, be willing to assume the responsibility for doing the careful review for compliance on all reports, as your staff did on the sample, if we had sufficient staff. However, the Legislature mandated that this Department review the reports for audit exceptions reported, and to report on the results of this review. We do not have sufficient work years available to discharge this further responsibility. Therefore, we can only propose that we undertake the activities outlined above to try and reduce the incidence of non-compliance to the extent possible within our limited time and effort.

Mr. Richard I. LaRock

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If you have any further questions or suggestions, please contact Sam Johnson or his staff in the Audit Bureau at 322-4014.

Sincerely,

A handwritten signature in black ink, appearing to read "William D. Whiteneck". The signature is fluid and cursive, with a prominent initial "W".

William D. Whiteneck
Deputy Superintendent for Administration
916-445-8950

WDW:rpf

CALIFORNIA COMMUNITY COLLEGES

1238 S STREET
SACRAMENTO, CALIFORNIA 95814
(916) 445-8752



June 19, 1980

Richard I. La Rock, Audit Manager
Office of the Auditor General
925 L. Street, Suite 750
Sacramento, CA 95814

Dear Dick:

In response to your June 5 letter, we have reviewed Mr. Pelagio's list of community college districts audit reports which did not comply with one or more of the reporting requirements in the Standards and Procedures for Audits of California Local Educational Agencies.

Our SB 787/1511 audit review process also identified most of the items cited as noncompliance. We concur with Mr. Pelagio's findings except for the following:

<u>District</u>	<u>Item</u>	<u>Audit Report Reference</u>
Los Rios CCD	VI	Page 57 (see attached)
Saddleback CCD	IV B (4)	Page 15 " "
San Luis Obispo CCD	IV B (4)	Page 16 " "

Because of time constraints in meeting the required date for the report to the Joint Legislative Audit Committee, we have not requested any input on your findings from County Superintendents Offices or community college districts.

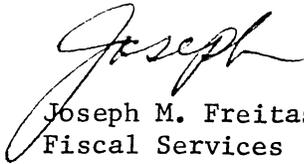
Furthermore, although we feel the question of auditors' performance and compliance with the reporting requirements is of critical importance, we do not have either the resouces or staff expertise to perform this function.

Our responsibility is to review the audits and to "report to the Joint Legislative Audit Committee on (1) the number and nature of audit exceptions and estimated amount of funds involved in such exceptions, (2) a list of districts or county superintendents which failed to file their audit pursuant to Section 84040, and (3) the actions taken by the department to eliminate audit exceptions and comply with management improvement recommendations" (SB 1511, Chapter 207/78).

Our recommendation is that the Department of Finance and the other agencies involved (including the Chancellor's Office) meet to discuss this very important issue. Future audit guides must emphasize the requirement for

compliance by the auditors with, perhaps, some legal sanctions added by the Legislature.

Sincerely,



Joseph M. Freitas, Administrator
Fiscal Services

Attachments

cc: Gerald Hayward
Gus Guichard
Dick Cutting
Delena Bratton
Gary Cook

Compliance

In connection with our audit, we performed an examination for compliance as required by Chapter 2 of the Standards and Procedures for Audit of California Local Educational Agencies issued by the Department of Finance, State of California. The objective of the examination of compliance is to determine with reasonable assurance:

Whether the available district reserves reported to the Department of Education for the 1978-79 Fiscal Year were in compliance with Section 84904(c) of the Education Code, as amended by Chapter 332, Statutes of 1978.

Whether students whose attendance qualifies under PL 81-874 are included in the claim for reimbursement and if the U.S. Office of Education has any pending audit exceptions.

That the revenues from special purpose taxes were accounted and expended in accordance with applicable statutes.

Whether the county notified the Superintendent of Public Instruction and the State Controller of the release of impounded taxes in compliance with Section 14240 of the Education Code.

If the salaries of classroom teachers met the requirements of Section 84362 of the Education Code.

Whether students receiving Educational Opportunity Program Service Grants were also receiving Basic Educational Opportunity Grants and whether the financial aid award package was within the limits established by the college.

Whether in-service training courses, Sections 84500(c) and (d) of the Education code, and allied health courses for which average daily attendance was reported were open for enrollment in compliance with Section 51820, Title 5, California Administrative Code.

Our examination of compliance made for the purposes set forth in the preceding paragraph of this report would not necessarily disclose all instances of non-compliance. Such examination disclosed no conditions that we believe to be instances of non-compliance.

SAN LUIS OBISPO COUNTY
 COMMUNITY COLLEGE DISTRICT
 SCHEDULE OF INCOME AND EXPENDITURES
 BY SOURCE OF FUNDS
 FOR THE FISCAL YEAR ENDED JUNE 30, 1979

	Project Number	Income		Total	Expenditures	Status as of June 30, 1979
		Federal	State			
<u>Federal and State Categorical Aid Programs:</u>						
Vocational Education Act of 1976						
Subpart 2	40-68817	\$125,643	\$	\$125,643	\$1,950,940	Complete
Subpart 3	40-68817	16,201		16,201	54,725	Complete
Subpart 5	40-68817	13,624		13,624	100,442	Complete
Comprehensive Employment and Training Act of 1973						
	78-03840-8001-6881	19,083		19,083	19,083	Complete
	79-03840-09001-6881	155,412		155,412	155,412	In - Progress
Basic Educational Opportunity Grant	P007901143	163,915		163,915	157,832	Complete
Supplemental Educational Opportunity Grant	P007930356	6,705		6,705	7,737	Complete
Supplemental Educational Opportunity Grant	P007940356	2,097		2,097	2,061	Complete
College Work Study Program	P007910356	9,666		9,666	13,151	Complete
Nursing Scholarship Program	09L060049	1,333		1,333	1,331	Complete
Extended Opportunity Program			81,011	81,011	87,127	In - Progress
Total Federal and State Categorical Aid Programs		\$513,679	\$ 81,011	\$594,690	\$2,549,841	
Special Education: Physically handicapped programs			48,574	48,574	70,127	
Total Income and Expenditures		\$513,679	\$129,585	\$643,264	\$2,619,968	

Auditors' Comments

We examined a sample of the claims filed for reimbursement and the supporting records covering the transactions under the programs listed above to the extent considered necessary to assure ourselves that the amounts claimed by the District were proper. We found no exceptions.

SADDLEBACK COMMUNITY COLLEGE DISTRICT
 SCHEDULE OF INCOME AND EXPENDITURES
 FEDERAL AND STATE CATEGORICAL AID PROGRAMS

JUNE 30, 1979

	Project Number	Income		Expenditures	Status as of June 30, 1979
		Federal	State		
Comprehensive Employment and Training Act:					
Multi-office skills	78-03951-8004-6665	\$ 16,774		\$ 16,774	complete
Printing technology	78-03951-8005-6665	39,362		39,362	complete
Printing technology	H87802	33,275		33,275	complete
STIP Secretarial	H84805	32,455		32,455	complete
STIP Electronics	H86505	59,924		67,386	complete
Title III - SPEDY	H83083	323,429		323,429	complete
Title VI - Public Service Employment	H15772	472,365		472,365	complete
Title I - YDPI in-school	H86601	43,503		43,503	complete
Title III - YETP in-school	H83047	52,359		52,359	complete
Title III - YETP in-school	H86603	114,598		114,598	complete
Title III - YETP out-of-school	H83057	25,092		25,092	complete
National Science Foundation Local Needs Assessment					
	SED 78-09687	5,000		7,618	complete
Chancellor Funds:					
Algebra video tape instructional modules	0211		\$4,285	4,367	complete
Summer journalism institute	0213		2,456	2,456	complete
Learning system for word processing education	0215		3,000	3,000	complete
Total income and expenditures		<u>\$1,218,136</u>	<u>\$9,741</u>	<u>\$1,238,039</u>	

Auditors' Comments

This is a schedule of federal and state categorical aid programs engaged in by the District during the 1978-79 year for which the District has filed claims. We have reviewed the claims filed for reimbursement and the supporting records covering the transactions for these programs. Our examination did not constitute a comprehensive review of systems and procedures nor did it include the testing of each applicable transaction and would, therefore, not necessarily disclose all discrepancies in amounts claimed. However, no material discrepancies nor instances of noncompliance with applicable program regulations were noted.

Legislative Counsel of California

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Sacramento, California

June 18, 1980

Mr. Thomas W. Hayes
Auditor General
925 L Street, Suite 750
Sacramento, CA 95814

Annual Audit of School and Community
College Districts - #9951

Dear Mr. Hayes:

QUESTION NO. 1

You have asked which state agencies determine that annual audits of school districts and community college districts are made in compliance with audit procedures prescribed by Sections 41020, 41020.5, 84040, and 84040.5 of the Education Code, and whether the agencies may take corrective action against the individual districts for noncompliance.

OPINION NO. 1

The Department of Finance, the Department of Education, and the Auditor General determine whether the annual audits of school districts are made in compliance with the audit procedures prescribed by Sections 41020 and 41020.5 of the Education Code. The Department of Finance, the Board of Governors of the California Community Colleges, and the Auditor General make that determination with respect to community colleges and Sections 84040 and 84040.5 of the Education Code. Only the Department of Finance, and the Department of Education regarding school districts, and the board of governors regarding community college districts, may take corrective action against individual districts for noncompliance.

ANALYSIS NO. 1

Sections 41020, 41020.3, 41020.5, 41020.6, and 41020.7 of the Education Code* prescribe an annual audit and audit procedures for all school district funds. Sections 84040, 84040.3, 84040.5, 84040.6, and 84040.7 establish a parallel system of audits and procedures for all community college funds. We note at the outset that these code sections are the same except for the references to school district or community college districts and the references to the Department of Education or the Board of Governors of the California Community Colleges. For purposes of clarity, our analysis will focus on the relevant provisions concerning school districts and the matching community college statutes will appear in parentheses. The following analysis of the audit of school districts is equally applicable to community college districts.

Paragraph 2 of Section 41020 (84040) requires that by May 1 of each fiscal year the county superintendent of schools provide for an audit of all funds under his or her control. Also by May 1, the governing board of each school district must either provide for an audit of the books and accounts of the district or make arrangements with the county superintendent to do so. Paragraph 8 of Section 41020 (84040) provides that:

"... a report of each audit for the preceding fiscal year shall be filed with the county clerk and the county superintendent of schools of the county in which the district is located, the Department of Education, and the Department of Finance.
..."

The nature and parameters of the audit are established by paragraphs 2, 3, and 7 of Section 41020 (84040). In addition, Section 41020.5 (84040.5) provides for the development and review of audit procedures by three state agencies:

* All further section references are to the Education Code.

"41020.5. The Department of Finance, in cooperation with the Auditor General and the Department of Education, shall prescribe the statements and other information to be included in the audit reports filed with the state and shall develop audit procedures for carrying out the purposes of this section. The Department of Finance may make audits, surveys, and reports which, in the judgment of the department will serve the best interest of the state.

"A review of existing audit procedures, statements, and other information required to be included in the audit reports shall be commenced on January 1, 1978, by the Department of Finance, in cooperation with the Auditor General and the Department of Education. Updated standards shall be completed by August 1, 1978, and shall periodically be updated no less than every two years thereafter." (Emphasis added.)

Turning to your question concerning compliance with audit procedures, there are three relevant statutory provisions: (1) paragraph 10 of Section 41020 (84040), (2) Section 41020.6 (84040.6), and (3) Section 41020.7 (84040.7). Each provision will be examined independently.

Paragraph 10 of Section 41020 (84040) provides:

"If a governing board or county superintendent of schools fails or is unable to make satisfactory arrangements for audit pursuant to this section, the Department of Finance shall make arrangements for the audit and the cost of such audit shall be paid from school district funds or the county school service fund, as the case may be." (Emphasis added.)

Thus, the Department of Finance is required to ensure that there is compliance with the audit procedures on the most basic level: the department must make arrangements for the audit prescribed by Section 41020 (84040), if the governing board or the county superintendent does not do so. The arrangement of an audit may be viewed as corrective action against total failure to comply with the audit requirement.

Section 41020.6 (84040.6) requires the Department of Education to report annually on June 30 "... to the Joint Legislative Audit Committee on (1) the number and nature of audit exceptions and estimated amount of funds involved in such exceptions, (2) a list of districts or county superintendents which failed to file their audits pursuant to Section 41020, and (3) the actions taken by the department to eliminate audit exceptions and comply with management improvement recommendations." In order for the department (or the board of governors) to make its report regarding the second element, it must first determine whether or not a district has filed an audit pursuant to Section 41020. It should be noted that a district might fail to file the required audit by either failing to file any audit or by filing an audit which does not conform to the requirements of Section 41020. To determine whether or not the latter type of failure has occurred, the department (or board) must determine compliance with the audit procedures prescribed by Sections 41020 and 41020.5 (84040, 84040.5). That action would be consistent with the general duties of the department respecting the financial affairs of school districts (Sec. 33316; see, also, Sec. 71041 re the board of governors). Furthermore, the third element of the report implies that the department (or board) may take corrective action against individual districts "to eliminate audit exceptions and comply with management improvement recommendations."

Finally, pursuant to Section 41020.7 (84040.7), the Auditor General must "... report to the Legislature on (1) action taken to update audit procedures pursuant to Section 41020.5, (2) a sample review of individual district audits to determine compliance with audit procedures, (3) a review of actions taken by the Department of Education pursuant to Section 41020.6, and (4) recommendations for future action to assure increased utility of the audits." In addition to the clear mandate to the Auditor General to determine compliance with audit procedures by individual districts, the review of actions taken by the Department of Education and the recommendation for future action necessitates a determination of compliance with Sections 41020 and 41020.5 (84040, 84040.5). Section 41020.7 (84040.7) does not provide, however, for any corrective action to be taken by the Auditor General against individual districts which fail to comply with the audit procedures. The only remedial action available to the Auditor General is a report to the Legislature which includes a sample review of individual districts.

Mr. Thomas W. Hayes - p. 5 - #9951

In summary, the Department of Finance, the Department of Education, and the Auditor General determine whether the annual audits of school districts are made in compliance with the audit procedures prescribed by Sections 41020 and 41020.5. The Department of Finance, the Board of Governors of the California Community Colleges, and the Auditor General make that determination with respect to community colleges and Sections 84040 and 84040.5. Only the Department of Finance, and the Department of Education regarding school districts, and the board of governors regarding community college districts, may take corrective action against individual districts for noncompliance.

Very truly yours,

Bion M. Gregory
Legislative Counsel



By
Robin D. Boobar
Deputy Legislative Counsel

RDB:lb

AUDIT EXCEPTIONS
GENERAL FUND OF DISTRICTS AND
COUNTY SCHOOL SERVICE FUND

	<u>Number of Reports</u>
No Opinion Paragraph	5
Qualified Opinion	
Auditors did not observe taking of Inventories	10
Changes in Accounting Method-Auditor concurred	3
Liability for accumulated vacation and sick leave not recorded	19
Stores inventory not in statements	8
Statement of changes in Financial position not prepared	8
Contingent liabilities	5
Certain receivables disputed	1
Cost overruns expected in services to districts	1
Insufficient records in categorical programs	1
Categorical expenditures questioned	2
Unresolved federal audit exceptions	2
Special education attendance reports not supported by records	1
No prior year audit	4
ADA not auditable	<u>2</u>
	67
Opinion Disclaimed	
Revolving Fund records stolen	1
No prior year audit	<u>1</u>
	2
Adverse Opinion	
GAAP* not followed	14
Transactions for past 8 years reclassified	<u>1</u>
	15
Total reports other than unqualified opinion	89
Total reports reviewed as of June 1	1081

*GAAP - generally accepted accounting principles.

AUDIT EXCEPTIONS
CHILD DEVELOPMENT FUND AND
DEVELOPMENT CENTERS FOR HANDICAPPED MINORS FUND

Qualified Opinion	<u>Districts or Counties</u>	<u>Funds</u>
No prior year audit	1	1
Accrued vacation and sickleave not recorded	2	3
Contingent liabilities	1	2
Inadequate attendance records	<u>1</u>	<u>2</u>
Total	5	8

<u>Fund</u>	<u>Qualified Opinions</u>	<u>Number of Funds Reported</u>
Child Development	4	127
Development Centers	4	58

AUDIT EXCEPTIONS
CAFETERIA FUNDS/ACCOUNTS

	<u>Number of Reports</u>
No Opinion Paragraph	5
Qualified Opinions	
No prior year audit	3
Amended claim filed, not year approved by State	1
Records and/or statements no GAAP	7
Inventory taking not observed by auditor	18
Contingent liabilities	1
Accrued vacation and sickleave not recorded	5
Fixed assets not capitalized and depreciated	1
Annual financial report not available for audit	1
Internal controls weak	1
No controls prior to deposit	<u>4</u>
	42

Opinion disclaimed

No prior year audit	1
Applications for free or reduced price meals not kept for audit	1
Records inadequate or incomplete	7
Could not verify cash revenue	1
Poor internal control	<u>24</u>
	34

Adverse Opinion

Accounting records not GAAP	<u>1</u>
Total reports with other than unqualified opinion	<u><u>82</u></u>
Number of reports with cafeteria funds/accounts	951

AUDIT EXCEPTIONS
BUILDING FUND AND
SPECIAL RESERVE FUND

	<u>Districts</u>	<u>Funds</u>
No opinion paragraph	3	4
Qualified Opinion		
Change in Accounting Method	1	1
State Audit not cleared	1	1
Lease corporation transactions not complete	1	1
No prior year audit	1	1
J-41 not available for audit	1	1
Adverse Opinion		
Eight years' expenditures reclassified	1	2
Accounting on cash basis, not GAAP	1	2
Statements omit all assets except cash and all Liabilities	<u>2</u>	<u>3</u>
	12	16

<u>Fund</u>	<u>With Other Than Unqualified Opinion*</u>	<u>Total Number Reported</u>
Building	9	522
Special Reserve	7	406

*12 Districts with a total of 16 funds.

AUDIT EXCEPTIONS
DEBT SERVICE FUND AND
LONG-TERM DEBT ACCOUNT GROUP

No opinion paragraph		4
Qualified Opinion		
Changed basis of accounting		1
County maintains records		11
No prior year audit		4
Leases of equipment not capitalized		8
Statement of changes in financial position not prepared		<u>4</u>
		28
Opinion Disclaimed		
County maintains records		48
Lease purchase records not available for audit		<u>1</u>
		49
Adverse Opinion		
Accounting records - cash basis - not GAAP		<u>3</u>
Total funds with other than unqualified opinion		84

Fund or Account Group	<u>With Other Than Unqualified Opinion</u>	<u>Total Number Reported</u>
Debt Service fund	42	793
Long-term Debt Account Group	42	762

AUDIT EXCEPTIONS
TRUST FUNDS
(Primarily Student Body Funds)

Opinions disclaimed

No records kept	4
Records not available for audit	1
Records stolen	2
Supporting documents not kept for audit	1
Records inadequate or incomplete	15
Poor internal control	<u>52</u>
	75

Qualified Opinion

No records kept prior to deposit	28
Internal controls weak	3
Records Incomplete	2
Statement of changes in financial position not prepared	3
Records kept on cash basis	4
No prior year audit	2
Change in basis of accounting	<u>1</u>
	43

Adverse Opinion

Records kept on cash basis not GAAP	1
Records did not distinguish revenue to groups	<u>1</u>
	2

No opinion Paragraph

Total reports with other than unqualified opinion	<u>122</u>
Total Reports with Trust Funds	850

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
Secretary of State
State Controller
State Treasurer
Legislative Analyst
Director of Finance
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
California State Department Heads
Capitol Press Corps

CALIFORNIA COMMUNITY COLLEGES

1238 S STREET
SACRAMENTO, CALIFORNIA 95814
(916) 445-8752



August 31, 1979

Thomas W. Hayes
Acting Auditor General
Joint Legislative Audit
Committee
925 L Street, Suite 750
Sacramento, CA 95814

Dear Mr. Hayes:

On behalf of the Chancellor I'd like to thank you very much for allowing us the opportunity to comment on Report #735 regarding the development of audit standards for school and community college districts. Our comment is a brief one. You have correctly indicated that we were not able to review the 1977-78 fiscal year district audit reports and hence were not able to report to the Joint Legislative Audit Committee due to the absence of available staff.

I would like to point out one small correction however and to let you know that we did request in the 1979-80 budget a staff position to accommodate this responsibility and I'm happy to say that that position was approved. Therefore, we do plan to submit a report by June 30, 1980 on the 1978-79 audit reports.

Cordially,

A handwritten signature in cursive script that reads "Gus Guichard".

Gus Guichard
Executive Vice Chancellor

cc: Glenn G. Gooder
Joseph Freitas

GG:jk

WILSON RILES
Superintendent of Public Instruction
and Director of Education



STATE OF CALIFORNIA
DEPARTMENT OF EDUCATION
STATE EDUCATION BUILDING, 721 CAPITOL MALL, SACRAMENTO 95814

August 31, 1979

Mr. Thomas W. Hayes
Acting Auditor General
California Legislature
925 L Street, Suite 750
Sacramento, California 95814

Dear Mr. Hayes:

#735

As noted in the report of the Auditor General, the specific recommendations on procedures have already been informally reviewed, and the Department has designed new procedures with input from the Auditor General's staff that will implement most, if not all, of the recommendations. Review and comment has also been obtained from the California Society of Certified Public Accountants and the California Association of School Business Officials.

While the Department does not generally disagree with the report of the Auditor General, we do feel there has been inadequate consideration given to the multi-year steps necessary to implement Chapter 936, Statutes of 1977 (SB 787).

The Auditor General's report is in regard to 1977-78 local education agency audits. Those audit reports were prepared according to the "old" standards of the Department of Finance. The "new" standards required by SB 787 affect audits of 1978-79. Since new audit reporting standards were to be published by Finance in one more year, the Department's decision was to concentrate on establishing or improving the working relationships with county superintendents of schools on resolution of audits for the first year. Then, when new mandated audit standards were published and effective, the priority would be given to development of a more intensive and exacting review of the audit reports along the lines now recommended by the Auditor General.

It should also be noted that the Department has provided an increased level of service and staffing to this function with no additional resources to the Department. The Department, in a time of staffing reductions, finds it difficult to provide, as recommended, additional reviewers with both financial audit expertise and educational program expertise.

Sincerely,

A handwritten signature in cursive script, appearing to read "W. D. Whiteneck".

William D. Whiteneck
Deputy Superintendent for Administration
916-445-8950

WDW:sjf