

BEFORE THE  
COMMISSION ON STATE MANDATES  
STATE OF CALIFORNIA

IN RE TEST CLAIM ON:

Education Code Sections 1040, 14501, 14502, 14503, 14504, 14505, 14506, 14507, 41020, 41020.2, 41202.3, and 41023 as added or amended by Statutes of 1977, Chapters 36 and 936; Statutes of 1978, Chapter 207; Statutes of 1980, Chapter 1329; Statutes of 1984, Chapter 268; Statutes of 1985, Chapters 741 and 1239; Statutes of 1986, Chapter 1150; Statutes of 1988, Chapter 1351, 1461 and 1462; Statutes of 1992, Chapter 962; Statutes of 1994, Chapter 20 and 1002; Statutes of 1995, Chapter 476; and

State Controller's Office Standards and Procedures for Audits of California K-12 Local Educational Agencies

Filed on December 13, 1995;

By the Sweetwater Union High School District and San Diego County Office of Education, Claimants.

No. 4498, 4498A

*Financial and Compliance Audits*

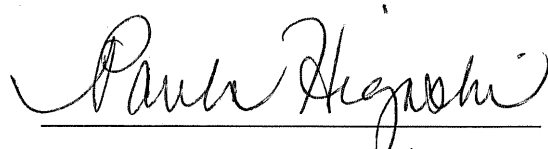
STATEMENT OF DECISION PURSUANT TO GOVERNMENT CODE SECTION 17500 ET SEQ.; TITLE 2, CALIFORNIA CODE OF REGULATIONS, DIVISION 2, CHAPTER 2.5, ARTICLE 7

*(Adopted on July 27, 2000)*

**STATEMENT OF DECISION**

The attached Statement of Decision of the Commission on State Mandates is hereby adopted in the above-entitled matter.

This Decision shall become effective on July 28, 2000.



Paula Higashi, Executive Director

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*(Adopted on July 27, 2000)*

**STATEMENT OF DECISION**

This test claim was heard and decided by the Commission on State Mandates (Commission) on June 29, 2000 during a regularly scheduled hearing. Lawrence L. Hendee appeared for Sweetwater Union High School District and Owen Sweeney appeared for San Diego County Office of Education. Sandra Peck, CPA, of Gilbert Accountancy Corporation appeared as a witness for the claimants. Leslie Lopez represented the Department of Finance. Lynn Podesto and Dan Troy appeared for the Department of Finance.

The law applicable to the Commission's determination of a reimbursable state mandated program is Government Code section 17500 et seq., article XIII B, section 6 of the California Constitution and related case law.

The Commission, by a vote of 5 to 2, approved this test claim.

## BACKGROUND AND FINDINGS OF FACT

Over the past fifty years, the Legislature has enacted many statutes requiring annual financial and compliance audits of school districts and county offices of education (COEs) by certified public accountants to be performed in accordance with the standards and criteria of the State Controller's Office (SCO). Prior to the enactment of the test claim legislation, Statutes of 1976, Chapter 1010 renumbered and reenacted former Education Code section 17206 as section 41020.

Key language from this code section provided:

- 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 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 1, 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 audits shall be made by a certified public accountant or a public accountant, licensed by the State Board of Accountancy.
- ⚡ 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 Superintendent of Public Instruction shall make any adjustments necessary in future apportionments of state funds to correct any discrepancies revealed by such audit reports under the provisions of Section 41341.
- The Department of Finance, with the cooperation of the Department of Education, shall prescribe the statements and other information to be included in the audit reports filed with the state.
- ⚡ The Department of Finance may make such audits, surveys and reports, and may develop suggested procedures for carrying out the purposes of this section, as in the judgment of the department, will serve the best interests of the state.

The test claim arose from amendments to the above statute; enactments or amendments of additional audit-related Education Code sections; and a claim that the Standards and Procedures for Audits of California K-12 Local Educational Agencies ("audit guide") published by the SCO imposes a mandate. In addition, claimants amended the original test claim to add activities arising from May 1997 revisions to the SCO audit guide. The Commission found that the May 1997 revisions constitute an executive order.

Issue:

Do Education Code sections 1040, 14501, 14502, 14503, 14504, 14505, 14506, 14507, 41020, 41020.2, 41020.3, and 41023 and the SCO's audit guide impose a new program or higher level of service within an existing program upon school districts within the meaning of section 6, article XIII B of the California Constitution and costs mandated by the state pursuant to Government Code section 17514,<sup>2</sup> by requiring additional financial and compliance audit procedures?

In order for a statute, regulation or an executive order, which is the subject of a test claim, to impose a reimbursable state mandated program, the statutory, regulatory, or executive order language (1) must direct or obligate an activity or task upon local governmental entities, and (2) the required activity or task must be new, thus constituting a "new program, " or it must create an increased or "higher level of service" over the former required level of service. The court has defined a "new program" or "higher level of service" as a program that carries out the governmental function of providing services to the public, or a law, which to implement a state policy, imposes unique requirements on local agencies or school districts and does not apply generally to all residents and entities in the state. To determine if a required activity is new or imposes a higher level of service, a comparison must be undertaken between the test claim legislation and the legal requirements in effect immediately before the enactment of the test claim legislation. Finally, the newly required activity or increased level of service must be state mandated.<sup>3</sup>

Before the enactment of the test claim legislation, school districts and COEs were required to undertake annual financial and compliance audits .<sup>4</sup> The subject test claim legislation makes some changes to audit requirements as compared to prior law. The individual issues addressed by this claim are numerous but the Commission found all meet the test of imposing unique requirements that do not apply generally to all residents and entities in the state. Therefore, the Commission found that financial and compliance auditing for school districts and COEs constitutes a "program" within the meaning of section 6, article XIII B of the California Constitution?

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<sup>1</sup> Section 6, article XIII B of the California Constitution provides: "Whenever the Legislature or any state agency mandates a new program or higher level of service on any local government, the state shall provide a subvention of funds to reimburse such local government for the costs of such program or increased level of service, except that the Legislature may, but need not, provide such subvention of funds for the following mandates:

(a) Legislative mandates requested by the local agency affected; (b) Legislation defining a new crime or changing an existing definition of a crime; or (c) Legislative mandates enacted prior to January 1, 1975, or executive orders or regulations initially implementing legislation enacted prior to January 1, 1975. "

<sup>2</sup> Government Code section 17514 provides: "Costs mandated by the state means any increased costs which a local agency or school district is required to incur after July 1, 1980, as a result of any statute enacted on or after January 1, 1975, or any executive order implementing any statute enacted on or after January 1, 1975, which mandates a new program or higher level of service of an existing program within the meaning of Section 6 of Article XIII B of the California Constitution."

<sup>3</sup> *County of Los Angeles v. State of California* (1987) 43 Cal.3d 46, 56; *Carmel Valley Fire Protection Dist. v. State of California* (1987) 190 Cal.App.3d 521, 537; *Lucia Mar Unified School Dist. v. Honig* (1988) 44 Cal.3d 830, 835.

<sup>4</sup> Education Code section 41020, as reenacted by Statutes of 1976, Chapter 1010.

<sup>5</sup> *Long Beach Unified School Dist. v. State of California* (1990) 225 Cal.App.3d 155, 172.

**Original Test Claim:**

**The Commission noted that Claimants and Department of Finance agreed that the following test claim provisions do not impose reimbursable state mandates:**

- Pursuant to Education Code sections 14506 and 14507, claimants contended that school districts and COEs must provide information required **for** any financial and compliance audit conducted by the State Controller, and review and comment on any findings from the SCO.

The Commission found these activities do not constitute a reimbursable state mandate because prior law, found in Government Code section 12410, states that the Controller shall superintend the fiscal concerns of the state, and may make such field audit or other audit of any claim or disbursement of state money as may be appropriate. Although the Education Code was amended in 1984 to specifically allow the SCO to perform school district audits, the general authority for SCO to perform audits is not new, and associated costs incurred by the district would not be reimbursable. In addition, the Commission found responding to SCO comments is not a state-mandated activity. The statute requires the Controller to allow school districts and COEs a reasonable period to review and comment on any findings, prior to reporting to SDE. This gives the local education agencies (LEAs) opportunity to comment, but does not require any response.

Claimants originally asserted that Education Code section 14507 requires “review and comment by the agency on noncompliance issues and on any recommendation taken by the department.” The Commission found that the plain language of section 14507 requires the SCO to *allow* school districts and county superintendents a reasonable period of time to comment on the Controller’s findings, but in no way *requires* a response by the districts or COEs. Consequently, the Commission found that Education Code sections 14506 and 14507 do not mandate a new program or higher level of service upon districts or COEs.

- Pursuant to Education Code section 41020, subdivisions (e), (f) and (p), claimants contended that each school district must pay for its audit from district funds, and the COE must pay for its audit from the county school service fund. **If** any school district fails to arrange **for** an audit by the deadline, the COE must provide **for** an audit by May 1 and pay **for** the audit from the school service fund, then transfer the district’s share **of costs** from district funds. **If** the SCO arranges **for** any audits in place **of** the COE, costs **of** the audits are to be paid from the applicable COE or district funds. The audits shall be performed by a certified public accountant or state licensed public accountant.

The Commission found that these activities do not constitute reimbursable state mandates because prior law required “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,” and that “the audits shall be made by a certified public accountant or a public accountant, licensed by the State Board of Accountancy.”<sup>6</sup> Language in the claimed code sections is nearly identical in form and substance to prior law. Consequently, the Commission

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<sup>6</sup> Education Code section 41020, as reenacted by Statutes of 1976, Chapter 1010.

found the activities under section 41020, subdivisions (e), (f) and (p), do not constitute new requirements or higher levels of service.

- z *Pursuant to Education Code section 41020, subdivision (h), claimants contended that no later than December 15, each school district must submit a copy of the audit for the preceding fiscal year to its COE, the SDE and the SCO. In the case of COEs, the annual audits are required to be submitted to the SDE and the SCO no later than December 15.*

The Commission found these activities do not constitute reimbursable state mandates because under prior law, districts and COEs were required to submit, not later than November 15, a copy of the audit report to the county clerk, county superintendent of schools, the SDE, and DOF. The prior statute allowed the filing date to be extended to December 31 for justifiable cause, submitted in writing by the auditor, and approved by the county superintendent. Current law requires audit reports to be submitted to the county superintendent, the SDE, and the SCO, by December 15, with no extension provisions. The deadline requirements under the new law are less stringent than those contained in prior law. Accordingly, the Commission found the extension of the report deadline and the minor change in named parties to receive reports does not result in a new program or a higher level of service.

- z *Pursuant to Education Code section 41020, subdivision (q) and section 41023, claimants contended that joint powers agreement agencies and regional occupation centers and programs are subject to the audit requirements.*

The Commission found these provisions are not reimbursable state mandates because school district audits were required under prior law to encompass all funds and accounts of the district, including any other funds under the control or jurisdiction of the district. While prior law did not specifically require joint powers agencies and regional occupational centers and programs to have audits, these entities are supported by school district funds, which would fall under the jurisdiction of the district and therefore were subject to audit under prior law. Consequently, the Commission found this audit requirement is not a new program or higher level of service.

***The Commission noted that Claimants and Department of Finance agreed that the following provisions do impose reimbursable state mandates:***

- z *Pursuant to Education Code section 14504, claimants contended that when contracting for an independent audit, school districts and COEs must ensure that the contract provides for access by the SCO to the auditor's working papers.*

This provision imposes a new requirement that school districts add a clause to the audit contract. Accordingly, the Commission found that this is a reimbursable activity resulting in a one-time cost to add a clause to boilerplate audit contract language. However, the Commission noted that the statutory requirement for the change in contract language was enacted by Statutes of 1984, Chapter 268, effective June 30, 1984. The reimbursement period for this test claim begins on July 1, 1994, therefore the Commission found local educational agencies should have incurred their one-time costs at the time of the enactment of the statute, ten years prior to the beginning of the reimbursement period.

Regarding the actual costs of providing access to the working papers, as a condition of receiving federal funds, school districts and COEs that receive at least \$100,000 in federal funds are required to have a “Single Audit,” pursuant to the Office of Management and Budget Circular A-128 (provisions now contained in Circular A-133). Under the Single Audit Act requirements, audit working papers must be made available, upon request, to the “cognizant agency” or its designee or the GAO, upon completion of the audit. SCO is the designee of the “cognizant agency,” which is the U.S. Department of Education. Government Code section 17556, subdivision (c) provides that no reimbursement for a state mandate is allowed under the state constitution if requirements or provisions of the state statute in question are also required by federal law, unless the statute exceeds the requirements of federal law.<sup>7</sup> Therefore, the Commission found only costs of providing access to the working papers incurred by school districts and COEs receiving less than \$300,000 (\$100,000 for fiscal years beginning before 7/1/96) in federal funds are reimbursable under Education Code section 14504.

- *Pursuant to Education Code section 41020, subdivisions (i) and (j), claimants contended that, starting with fiscal year 1993-94, audits of districts within a COE’s jurisdiction must be reviewed for audit exceptions related to attendance, inventory of equipment, internal control, and other miscellaneous exceptions. Under this law, each COE must determine if its districts’ audit exceptions have been corrected, or if they have developed an acceptable plan of correction. COEs must require each district to submit or resubmit any inadequate response to the COE by March 1.5.*

As agreed by all parties, the Commission found these COE activities constitute a reimbursable state mandate, as COEs were not specifically required by prior law to review school district audit exceptions and follow up on corrective actions taken by school districts.

- *Pursuant to Education Code section 41020, subdivision (k), claimants contended that the COE must certify to the SPI by May 1.5 that the audit and exception review activities have been completed; identify, by school district, any attendance-related audit exception that fiscally impact state funds; and require the school district to submit the appropriate forms for processing by the SPI.*

As agreed by all parties, the Commission found the COE activities constitute a reimbursable state mandate, as COEs were not required by prior law to certify to the SPI that they have reviewed all school district audit exceptions and that those exceptions had been corrected.

- *Pursuant to Education Code section 41020, subdivision (l), claimants contended that COEs must contact any district, as identified by the SDE, which has not resolved all exceptions in the plan of correction for the preceding fiscal year and obtain a resolution **of** the exception.*

This activity was not required by prior law and is now required when the SDE specifically requests the COE to take action on unresolved school district audit exceptions. Specifically, the code states “the State Department of Education shall either consult with the school district to resolve the exception or require the county superintendent of schools to follow up with the school district.” Therefore, the Commission found these activities constitute a reimbursable

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<sup>7</sup> *County of Los Angeles v. Commission on State Mandates* (1995) 32 Cal.App.4<sup>th</sup> 805, review denied.

state-mandate only when the SDE specifically requires a COE to perform these duties on their behalf.

- *Pursuant to Education Code section 41020.2, claimants contended that when a school district has not filed a timely audit report, the COE must consult with the SCO, the district governing board, and the independent auditors to determine the method to be used in obtaining the audited financial statements.*

In instances where audited financial statements have not been prepared for a school district, this section specifies that “the Controller’s office shall determine the most advantageous method of obtaining the required audited financial statements.” The statute allows, but does not require, the county superintendent to initiate certain actions prior to SCO intervention. The only activity required of COEs is to consult with the SCO upon request. Thus, the Commission found any costs resulting from this consultation would be state-reimbursable. However, any other activities initiated by COEs are not state mandated and would not be reimbursable.

- *Pursuant to Education Code sections 1040 and 41020.3, claimants contended that by January 31 of each year, school districts and COEs must place a review of the annual audit on the agenda of a public meeting of their governing boards including discussion **of** any audit exceptions identified, the recommendations or findings of any management letter issued by the auditor, and plans of correction **of** audit exceptions or management letter issues.*

Prior law did not require the placement of the audit report on governing board agendas, accordingly the Commission found this requirement constitutes a new state mandated activity and any costs relating directly to this requirement would be reimbursable, to the extent this activity is not otherwise eligible for reimbursement under Open Meetings Act Parameters and Guidelines.

**Commission findings on remaining contended provisions:**

- *Pursuant to Education Code sections 14501, 14502 and 14503, claimants contended that school districts and COEs must maintain financial records and report financial conditions pursuant to the SCO’s guide Standards and Procedures for Audits of California K- 12 Local Education Agencies.*

Under prior law, school districts and COEs were required to have annual audits and the:

“Department of Finance with the cooperation of the Department of Education shall prescribe the statements and other information to be included in the audit reports filed with the state. The Department of Finance may make such audits, surveys and reports, and may develop suggested procedures for carrying out the purposes of this section, as in the judgment of the department will serve the best interests of the state.”

Claimants asserted that prior to 1975 no “formal” audit guide was presented or mandated and that Statutes of 1977, Chapter 936, for the first time prescribed the legal mandate that the audit manual contain the reporting requirements and audit standards for the district. The

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<sup>8</sup> Education Code section 41020, as reenacted by Statutes of 1976, Chapter 1010.



Commission found that prior law gave the authority for state agencies to set forth specific audit standards and procedures.

In accordance with prior law the DOF Audits Division published two audit guides in April 1970, Content of Reports on Audit Examinations of California School Districts or Funds Under the Control of County Superintendents of Schools (Content of Reports), and Selected List of Audit Procedures Applicable to Examinations of California School Districts or Funds Under the Control of County Superintendents of Schools (Selected List of Procedures). These guides were designed to assist auditors in “adapting generally accepted auditing procedures to the special conditions affecting examination of school districts, ”<sup>9</sup> by including a comprehensive list of suggested financial and compliance audit procedures. According to the introduction in Content of Reports, the two manuals were meant to be used in conjunction with each other. Content of Reports lists the “minimum content required in reports filed with the State” and Selected List of Procedures guides the auditor in applying generally accepted auditing procedures to the special funds, accounts and programs of schools. The guides were consolidated by DOF in 1979, into Standards and Procedures for Audits of California Local Educational Agencies.

Statutes of 1984, Chapter 268, gave the SCO the authority to promulgate the minimum content for audits. In 1985 , the SCO modeled their audit guide after the earlier DOF manual, now titled Standards and Procedures for Audits of California K- 12 Local Educational Agencies. The current audit guide provides a list of compliance requirements and explicitly states that each “is accompanied by suggested audit procedures that can be utilized as determined by the auditor’s professional judgment. ” Thus, the audit guide still leaves much to the discretion of the independent auditor so long as the audit meets the long-standing requirement that it “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 school district. ” The guide specifies the funds and accounts requiring an annual audit.

Thus, the Commission found that DOF did, in fact, present a formal “audit guide” describing mandated audit content and procedures, in the form of the Content of Reports and its companion manual , Selected Lists of Procedures. The Commission also found that the later change of audit authority from DOF to the SCO did not substantially alter the basic duty for districts to file an annual audit report in compliance with state guidelines and minimum requirements.

The long-standing statutory requirement that the audits be performed by CPAs set up additional guidelines as public accountants have their own standards that they must conform with when performing governmental audits. Both DOF’s audit guide and the later SCO version were designed in consultation with school administrators and professional accountants with a goal of making the audit guide conform to standard accounting practices while addressing the special needs of schools. The Commission found there is nothing in the statutory or audit guide language that places a duty on school districts and COEs to maintain their financial books and records in a manner suggested by the language in the audit guide. Alternately, because the audit guide is based on generally accepted governmental accounting standards and principles, as well as on the California School Accounting Manual, the Commission found these code

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<sup>9</sup> Preface, Selected List of Audit Procedures Applicable to Examinations of California School Districts.

sections do not impose any additional duty upon districts for keeping their books in a manner other than that already required for fiscal responsibility.

*z Pursuant to Education Code section 14505, claimants contended that whenever contracting for an independent audit, school districts and COEs must contract for 10-percent fee-withholds pending the SCO 's certification of the audit as conforming to the audit guide; 50-percent fee-withholds for subsequent years if the audit is not certified; and add a new contractual provision to void multi-year contracts if the auditor is found ineligible to perform such audits.*

All parties agreed that this code section clearly imposes a new activity on districts and COEs for a one-time cost to change boilerplate audit contract language, adding a clause to the contract that delineates the payment terms, possible withholds, and the provision to void multi-year contracts. Claimants maintained the statute imposes the “legislated enforcement” of the requirement to comply with the reporting standards of the SCO’s audit guide because if an auditor wants to get full compensation for performing California school audits they must comply with reporting standards. DOF contended that this section does not result in additional responsibilities for auditors, and should not increase the cost of the audits.

Section 14505 provides the state and local educational agencies with a mechanism to compel contracted public accountants to fulfill their contractual duty to provide an adequate audit report. However, the Commission found it is not a new duty, simply a new contractual penalty for failing to meet minimum standards. This provision does not penalize school districts or COEs; rather it serves to potentially penalize contracted auditors. This section provides a process for auditors to appeal any negative decision by the SCO with the State Board of Accountancy, which has authority to order the SCO to reverse its decision and release the fee withhold. Again, prior law required audits to be performed by public accountants, and state agencies were to “prescribe the statements and other information to be included in the audit reports filed with the state.”<sup>10</sup> Therefore the Commission found that the requirements for audits to conform to an audit guide is not a new program or higher level of service. Section 14505 imposes a mandate upon districts and COEs for a one-time cost to change boilerplate audit contract language, however, the Commission noted that the statutory requirement for the change in contract language was enacted by Statutes of 1988, Chapter 1351. The reimbursement period for this test claim begins on July 1, 1994, therefore, the Commission found local educational agencies should have incurred their one-time costs six years prior to the beginning of the claiming period.

Claimants asserted that section 14505 also imposes additional costs for processing multiple payments to the auditor because of mandatory fee withholds. The Commission found that the requirement that local educational agencies withhold 10 percent of the final payment to auditors until the audit is certified by the SCO is a new program, and to the extent that such withholds impose costs for additional paperwork and accounting processes, constitutes an additional reimbursable activity.

*z Pursuant to Education Code section 41020, subdivisions (b), (c) and (d), claimants contended that by April 1 of each fiscal year for school districts, and May 1 of each year for COEs, each entity must have an independent audit zzz all funds and entities*

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<sup>10</sup> Education Code section 41020, as reenacted by Statutes of 1976, Chapter 1010.

*within the jurisdiction, including income and expenditures by source of funds, in compliance with the format prescribed in the SCO's standards and procedures. Each audit shall also include all funds and attendance procedures of the school district or COE and any other-funds under their jurisdiction and the funds of any regional occupation centers and programs, or a joint powers agreement agency.*

The Commission found it clear that COEs and school districts were required under prior law to provide for an annual audit of the books and accounts of their jurisdiction, with identical deadlines to those set forth in the test claim legislation. Prior law did not specify that the audit was to include the income and expenditures by source of funds, but it did require each audit to 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. ”<sup>11</sup> Claimants asserted that the significance of the change in section 4 1020 “lies in the fact that the books, accounts and funds referred to” under prior law “consisted of various sources of income and expenditures. Each book, account and fund can contain hundreds of sources of income and expenditures. ”

The Commission found that there is no change in the law that the audit be conducted by funds and accounts. The Commission recognized the fact that the sources of income and expenditures referenced *may* be greater in number and *may* result in higher costs, but this fact alone does not create a new mandate or higher level of service in respect to the long-standing annual audit requirement. <sup>12</sup>

Statutes of 1980, Chapter 1329, added a line to section 41020, “Each audit shall also include an audit of attendance procedures. ” Claimants assert “the scope of the focus of attendance audits was changed from a numerical audit of the calculations to an audit of attendance procedures which implies an audit of the process of obtaining attendance data.” Under prior law, audits were to include any audit procedures as deemed necessary by DOF. The DOF audit guide *did* include tests of average daily attendance procedures and records and set forth a number of procedures for the auditor to use to determine whether attendance procedures were adequate. Specifically , the DOF guide explained, in part:

“The tests of detailed attendance records in all school districts should be sufficient to satisfy the accountant that the records were maintained with prescribed procedures and that the reports submitted to the State were accurate. In the larger districts particularly, the accountant should take into consideration the internal control and review procedures in effect. . . . Determine that *entries in the basic attendance records are made daily* and that procedures are otherwise adequate to insure that all absences are recorded. *Review the procedures relating to excused absences to determine whether they are adequate.* Test to supporting information. ”<sup>13</sup> (Emphasis added.)

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<sup>11</sup> *Id.*

<sup>12</sup> “A mere increase in the cost of providing a service which is the result of a requirement mandated by the state is not tantamount to a higher level of service. ” *Long Beach Unified School Dist. v. State* (1990) 225 Cal.App.3d 155, 173, review denied.

<sup>13</sup> Selected List of Audit Procedures Applicable to Examinations of California School Districts (1970 -), p. 18.5 - 18.7, DOF Audits Division.

Therefore, based on the language of the DOF audit guide, the Commission found that performing compliance audits of attendance procedures are not new programs or higher levels of service.

Regarding the requirement for auditors to use the format established by SCO in the audit guide, in addition to the long-standing requirement implicit in prior law, the Commission found this requirement also appears to reflect the auditor's own industry standards. The AICPA publishes the "Audits of State and Local Governmental Units" guide. The 1974 edition advises use of guidance manuals such as the one prepared by the SCO, stating that if such a "manual is available, the review of legal provisions and administrative procedures may be *materially expedited*." (Emphasis added.) Accordingly, the Commission found that this activity does not constitute a new program or higher level of service.

Finally, while the specific language requiring audits of joint powers agencies and regional occupational centers and programs was added by Statutes of 1977, Chapter 36, as discussed regarding sections 41020, subdivision (q) and 41023, the Commission found that these entities are exclusively supported by "funds under the control or jurisdiction of the district" and thus were subject to audit pursuant to prior law.

- z *Pursuant to Education Code section 41020, subdivision (g), claimants contended that the auditors report shall include a statement that the audit was conducted pursuant to standards and procedures developed in accordance with Chapter 3 (commencing with Section 14500) of Part 9 of Division I of Title 1 of the Education Code; a summary of audit exceptions and management improvement recommendations; and a description of the actions that are planned to be taken, or that have been taken, to correct any problem identified by the auditor, all of which is additionally specified in the SCO's audit guide, Standards and Procedures for Audits of California Local Educational Agencies.*

DOF contended that because of the long-standing requirement that the audits shall be made by CPAs or licensed public accountants, school district and COE auditors are required to perform audits in conformance with industry standards, specifically those promulgated by the AICPA, the U.S. GAO, the Governmental Accounting Standards Board, the Single Audit Act, and OMB Circular A-128 (now A-133). It was DOF's position that the reporting requirements listed in the SCO's audit guide largely illustrate the auditor's own general, fieldwork, and reporting standards for audits of governmental units. For these reasons, DOF asserted that the requirement that COE audits meet the criteria in the audit guide does not require a higher level of service than is already required of CPAs, and is not a reimbursable state-mandated cost. Claimants disagreed with DOF contentions, asserting that state compliance requirements are much more specific than federal requirements, because all state requirements applicable to the district or COE, identified in the "State Compliance Requirements" section of the audit guide, must be tested for compliance with state law.

Prior law provided that DOF, in conjunction with the SDE, "shall prescribe the statements and other information" <sup>14</sup> that must be included in the annual audit reports. This provision gave authority for state agencies to set forth specific audit standards and procedures, and DOF did, in fact, present a formal, detailed, audit guide describing mandated audit content.

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<sup>14</sup> Education Code section 41020, as reenacted by Statutes of 1976, Chapter 1010.

The long-standing statutory requirement that CPAs perform the audits set up additional guidelines as public accountants have their own standards that they must conform with when performing governmental audits. Both DOF's audit guide and the later SCO version were designed in consultation with school administrators and professional accountants with a goal of making the audit guide conform to standard accounting practices while addressing the special needs of schools. Therefore the Commission found that the requirement for an auditor to include a statement that the audit was conducted pursuant to standards and procedures developed in accordance with the Education Code is not a new program or higher level of service than what was required either by prior law or federal law.

- *Pursuant to Education Code section 41020, subdivisions (j) and (k), claimants contended that commencing with fiscal year 1993-94, districts must respond to any audit exception reviews related to attendance, inventory of equipment, internal control, and other miscellaneous exceptions conducted by the COE and submit plans of correction requested by the COE and applicable forms to the SPI regarding attendance-related audit exceptions. Claimants contended that pursuant to Education Code section 41020, subdivision (I), the districts must respond to any inquiry from the SDE or the county superintendent of schools as a result of referrals by the independent auditor regarding previous correction or plans of correction for audit exception not resolved by the district.*

DOF contended that audit findings generally result because of a weakness in internal controls, an error in financial statements or reports, or an instance of noncompliance with laws and regulations. Regarding the requirement of an amended attendance report, DOF maintained it is the district's responsibility to ensure that the initial report is correct, and to file an amended report if necessary. DOF asserted that the state should not have to reimburse districts for the cost of filing corrected reports when it is the district's own error/oversight which resulted in the need for the corrected reports. Finally, DOF contended that since districts subject to the Single Audit Act are required by OMB Circular A-128 (now A-1 33) to provide corrective action plans to resolve audit findings, this request is made in accordance with a federal mandate.

Claimants disagreed with DOF's position, asserting that the issue was not the correction of possible errors and non-compliance by districts, but the fact that all audit exceptions must now be reported and dealt with by filing a plan of correction, no matter how minor the incident may have been. Claimants contended that before Statutes of 1977, Chapter 936, auditors measured the effects of their findings based upon materiality, and if a finding was deemed immaterial, it was reported informally to the district and dealt with accordingly, and only material errors were reported in the final audit.

In Statutes of 1977, Chapter 936, the Legislature added language to Education Code section 4 1020, providing that

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

It appears that at the time this provision was added the Legislature sought to increase the level of district accountability, and did so by creating more follow-up procedures for findings in the

long-required annual audits. Some of these procedures create more responsibility on the part of the SCO; others place the work upon the districts themselves. Prior law provided that the SPI “shall make any adjustments necessary in future apportionments of all state funds, to correct any discrepancies revealed by such audit reports;” in other words, the remedy for audit exceptions prior to the addition of the claimed code sections was for the districts to lose funding, without a provision for districts to correct errors and possibly ameliorate the problem. In addition, the code now requires performance of specific follow-up actions on the part of the districts that were not previously required. Although many of these provisions appear to follow common sense ideas regarding fiscal responsibility, the Commission found, according to the available evidence, the requirements were not included in prior law and thus constitute a new program or higher level of service.

DOF recommended that if the Commission did find a mandate exists, that it only be found for activities related to non-material audit findings. The Commission found that the new activity imposed by section 41020 subdivisions (j), (k) and (l) is not for the correction of the audit exceptions and discrepancies, but for the paperwork, forms and reporting requirements imposed by the state for the monitoring of such corrections.

DOF also asserted that this requirement is only applicable to districts and COEs that are not subject to the Federal Single Audit Act. The Commission found that OMB Circular A-133, which rescinded and consolidated OMB Circular A-128, effective July 30, 1997, provides that “The auditee is responsible for follow-up and corrective action on all audit findings. ” However, “audit findings” are specifically defined as “deficiencies which the auditor is required by § \_\_.510(a) [*sic*]<sup>15</sup> to report.” In turn, reportable audit findings are defined as those found in “major programs, ” which “means a Federal program, ” according to the definitions in OMB Circular A-133. Therefore, the Commission found the requirements for reviewing and developing plans of correction regarding *non-federal program* audit exceptions are not covered by the Federal Single Audit Act.

The Commission found that section 41020, subdivisions (j), (k), and (l) constitutes a reimbursable state mandate for school district activities undertaken in reviewing their own state program audit exceptions, providing for and filing plans of correction on state program audit exceptions, and responding to requests for follow up of the audit resolution process, as initiated by the SDE.

- *Pursuant to Education Code section 41020, subdivision (n), claimants contended that beginning with audit reports filed for fiscal year 1994-95, COEs must respond to any SCO follow-up of the county superintendent of school’s audit resolution process.*

DOF contended that while this section specifically requires the SCO to select a sampling of COEs; perform a follow-up of the audit resolution process; and report the results of such follow-up to the SPI and the COE, it does not require the COE to provide any response to the Controller, therefore this is not a reimbursable state-mandated activity. Claimants assert that a response is required to complete the audit process; a non-response would indicate the COE accepts the SCO’s conclusions.

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<sup>15</sup> Omission of section number is in original document.

The applicable language in section 41020, subsection (n) is that “the Controller annually shall select a sampling of county superintendents of schools and perform a followup of the audit resolution process of those county superintendents of schools and report the results of that followup to the Superintendent of Public Instruction and the county superintendents of schools that were reviewed.” The Commission found that while these directives are to the SCO, selection by the SCO for audit resolution follow up could result in the COE having to respond or participate in the audit follow-up process. DOF asserted that these activities are in keeping with the claimants’ general fiscal responsibilities, and as such are not new. The Commission found that when a COE is selected by the SCO for the new audit follow up process it may incur reimbursable costs for cooperating in the process. Accordingly, the Commission found any activities directed by the SCO during the follow-up process would be reimbursable; activities a COE undertakes on its own initiative are not.

- *Pursuant to Education Code section 41020, subdivision (o), claimants contended that each COE must adjust future local property tax requirements to correct any audit exceptions relating to school district tax rates and tax revenues.*

DOF contended that the correction of errors affecting school district tax rates and revenues should be part of a COE’s standard duties, requirements and accountability under governmental generally accepted accounting principles, and therefore this section does not impose a reimbursable state mandated activity. Claimants disagreed, stating that the DOF has failed to show how this was a requirement under prior law.

DOF brought up prior law in former Education Code section 17206, that “the Superintendent of Public Instruction shall make any adjustments necessary in future apportionments of state funds, to correct any discrepancies.. .” is similar to the provisions in current section 41020 (o). The Commission found that the prior law cited is a directive to the *state* Superintendent of Public Instruction, while the new law makes the tax adjustments the responsibility of the *county* superintendent of schools. Accordingly, the Commission found a reimbursable activity for the process of making the tax rate adjustment, but not for any losses in tax revenue resulting from the required adjustment.

DOF failed to provide evidence that the adjustment of future local tax requirements to correct audit exceptions was previously the responsibility of the COE or another local entity prior to the enactment of the test claim legislation. Therefore, the Commission found the costs for engaging in the activity of adjusting future local property tax requirements constitute a reimbursable state mandate.

### **Test Claim Amendment:**

In the amendment to the test claim, claimants alleged seven new audit-related reimbursable state mandate programs for school districts and/or COEs resulting from the “1997 State Compliance Requirements” as published by the SCO’s May 1997 revision of the Standards and Procedures for Audits of California K-12 Local Education Agencies audit guide. (In quoting from the revised audit guide, additions are represented in bold-face; deletions are represented by a strike-through.)

- *Claimants contend that page 76 **of** the revised audit guide provides that the auditor must now verify that the evaluated work samples **for** student attendance on independent study programs have been retained in the file.*

The Commission found that under “Suggested Audit Procedures” for “Attendance Accounting - Independent Study, ” regarding a sample of students, the language was altered via a strike-through: “Trace each student’s attendance from the attendance records to the teacher’s record, student’s work record, and the corresponding work assignment record ~~and a sample of the work for the attendance period for the attendance period.~~” Then one sentence was added: **“Verify that evaluated student work samples have been retained in the file.”**

The previous language required an examination of a sample of student work for the attendance period. The Commission found the new language does not increase the auditor’s work in any way, because tracing the student’s attendance through a sample of the student work record is, in essence, verifying that the work record is in the file. Thus, the Commission found that this revision does not constitute a new program or higher level of service.

- *Claimants contend that page 86 of the revised audit guide provides that the audit sample was expanded to grades K-12. The prior sample was limited to grades 7-12.*

The Commission found that under “Compliance Requirement” for “Attendance Accounting – COE County Community Schools” the language was changed as follows: “Community school apportionment may be claimed ~~only~~ for those students enrolled in **kindergarten and** grades 7-12.” The “Suggested Audit Procedure” for this requirement was similarly altered: “Select a representative sample of students. Examine the district’s attendance and enrollment records to verify that the attendance claimed for apportionment is limited to those students enrolled in **kindergarten and** grades 3-12.”

The original audit requirement was to verify that schools were not claiming students for community school apportionment, except those in grades 7-12. Since community school apportionment may now be claimed for students in *all* grade levels, despite the “Suggested Audit Procedures” there is actually nothing for the auditor to verify. Thus, the Commission found that this revision does not constitute a new program or higher level of service.

- *Claimants contend that page 97, step 2(b) of the revised audit guide expands the audit procedures to verify whether or not the school is school-based coordinated or has a school-wide program, and if it is not, verify that multi-funded employees times are accounted to the approved school plan.*

The Commission found that under “Suggested Audit Procedures” for “School Improvement Program (SIP) and Economic Impact Aid (EIA)” programs the language was added as noted:

- “ 1. Select a representative sample of non-employee expenditures . . . charged to the SIP and EIA programs. . . .
2. Select a representative sample of employee salaries . . . charged to the SIP and EIA programs and perform the following procedures:
  - a. Verify that the employees (positions) charged to the programs are included in the school site plan.
  - b. For multi-funded employees, **verify that the school is not school based coordinated or have a school wide program, in which case multi-funded employees need only time account to the approved school plan. If the school is neither school base coordinated nor have a school wide program,** determine that the time charged to the SIP and EIA programs is supported by employee time reports. ”



Previously auditors had to verify that employee time reports supported any sampled employee whose time was charged to the SIP/EIA programs. Now, the step is only applicable if the district *does not* operate a school-based coordinated program or a school wide program, which has already been determined in earlier steps. Thus, the Commission found the suggested audit procedure does not need to be performed in an increased manner, and most likely, the change in language serves to diminish audit procedures. Accordingly, the Commission found this revision is not a new program or higher level of service over that which was previously required.

***The Commission noted that Claimants and State Agencies agreed that the following provisions are new to the SCO audit guide:***

- *Pages 86-88 of the revised audit guide refer to entirely new audit requirements for probation referred (“Type C”) pupils in COE, county community schools.*
- *Pages 101-105 of the revised audit guide require all new audit compliance procedures for Class Size Reduction (CSR) and facilities program operation.*
- *Pages 106-107 of the revised audit guide, regarding Staff Development Funds, now requires new audit compliance procedures for the Teacher Reading Instruction Development Program.*
- *Pages 108-109 of the revised audit guide now require new audit compliance requirements and procedures for schools receiving funding for the School Site Block Grant Program.*

DOF maintained that although it agrees that there are new compliance procedures in the amended audit guide that were not previously required, historically when updating the audit guide there is an effort to balance audit testing requirements by removing some provisions when adding others. DOF states that over several years, it is common for new state programs to be implemented, existing state programs to sunset, or material changes to be made to requirements for ongoing programs, all of which must be reflected in the audit guide. DOF asserted that total state compliance requirements should be evaluated, not by whether the program or procedure is new, but rather if compliance tests, including additions and deletions, result in a higher level of service.

While agreeing that the SCO audit guide constitutes an executive order, and there are additions and deletions made to the guide on at least a biennial basis, the Commission found that the underlying task of auditing funds and programs in accordance with state guidelines is a long-standing requirement of school districts and COEs. In addition, the Commission found the current SCO audit guide is the immediate successor to the DOF audit guide, which was also an executive order mandating audit procedures. Therefore, the Commission found the required use of the audit guide does not, in itself, constitute a new program or higher level of service.

DOF pointed out that when the SCO makes changes to the audit guide, programs are generally removed at the same time others are added, which should result in offsetting savings. For example, in May 1997 four new programs were added to audit new school funding sources, while two major programs were completely deleted from the audit guide: “Categorical Programs Mega Item” and “Attendance Accounting - Concurrent Enrollment in Public Higher Education.” However, the Commission found that when the SCO makes such changes to the

audit guide, school districts and COEs may incur higher costs when contracting for audits, as auditors may have to spend more time preparing for the audit.

DOF asserted that adjusting to changes in the audit guide is part of the claimants' long-standing fiscal responsibilities, and is not state-mandated. DOF further urged that if the Commission disagreed, that the costs should be found to be one-time only, and should be adjusted for cost-savings resulting from deletions to the programs in the audit guide. Government Code section 17556, subdivision (e) provides that the Commission shall not find costs mandated by the state if the executive order provides for offsetting costs to local agencies or school districts resulting in no net costs. The Commission noted that DOF's comments did not identify how the deletions to the programs in the audit guide resulted in cost-savings.

The Commission found that one-time costs of adjusting to changes in the audit guide constitute a reimbursable state mandate. However, the Commission found the on-going costs associated with performing the audit are not a reimbursable mandate because the activity of having an annual audit, performed by a CPA, including all funds under the control or jurisdiction of the district, including state-prescribed information, is a long-standing requirement under prior law.

### CONCLUSION

Based on the foregoing, the Commission concluded that Education Code sections 1040, 14504, 14505, 41020 subdivisions (i), (j), (k), (l), (n), and (o), 41020.2, 41020.3 and the SCO Audit Guide revisions impose a new program or higher level of service within an existing program upon school districts within the meaning of section 6, article XIII B of the California Constitution, and costs mandated by the state pursuant to Government Code section 17514. Accordingly, the Commission approved this test claim for school district and COE activities necessary to comply with annual audit reports requirements, as follows:

#### COE Activities:

- ⌘ Review school district audit exceptions, follow up on corrective actions taken by school districts, require the school district to submit or resubmit any inadequate response to the COE by March 15, and certify to the SPI that the COE has reviewed all school district audit exceptions and that those exceptions have been corrected. (Ed. Code, § 41020, subd. (i), (j) and (k).)<sup>16</sup>
- ⌘ Contact any district identified by the State Department of Education (SDE) to not have resolved all exceptions in the plan of correction for the preceding fiscal year and obtain resolution of the exception. (Only reimbursable when the SDE requests the COE to perform this activity.) (Ed. Code, § 41020, subd. (l).)<sup>17</sup>
- ⌘ Respond to any SCO directives if selected for a follow-up of the county superintendent of school's audit resolution process for fiscal years 1994-95 and beyond. (Ed. Code, § 41020, subd. (n).)<sup>18</sup>
- ⌘ Adjust future local property tax requirements to correct any audit exceptions relating to school district tax rates and tax revenues. (Ed. Code, § 41020, subd. (o).)<sup>19</sup>

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<sup>16</sup> Statutes of 1994, Chapter 1002.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

- Consult with the SCO, upon the SCO's request, when audited financial statements are not timely completed for a school district in the COE's jurisdiction. (Ed. Code, § 41020.2.)<sup>20</sup>

#### **School District Activities:**

- Submit plans of correction for any state program audit exceptions as requested by its COE by March 15 and file forms to the SPI regarding attendance-related and other audit exceptions as directed. (Ed. Code, § 41020, subd. (j) and (k).)
- Respond to any inquiry from the SDE, COE, or the county superintendent of schools regarding previous corrections or plans of correction for state program audit exceptions not resolved by the district. (Ed. Code, § 4 1020, subd. (1) .)

#### **COE and School District Activities:**

- Change boilerplate audit contract language requiring access to audit working papers. (One-time costs, if costs were incurred within reimbursement period.) (Ed. Code, § 14504 .)<sup>21</sup>
- Provide access to audit working papers. (Only reimbursable when district is not subject to the Federal Single Audit Act.) (Ed. Code, § 14504 .)
- Change boilerplate audit contract language to delineate the payment terms, possible withholds, and the provision to void multi-year contracts. (One-time reimbursement, if costs were incurred within reimbursement period) Provide for the costs of processing multiple payments to the auditor due to mandatory fee-withholds. (On-going costs.) (Ed. Code, § 14505.)<sup>22</sup>
- Place a review of the annual audit on the agenda of a public meeting of governing boards including discussion of any audit exceptions identified, the recommendations or findings of any management letter issued by the auditor, and plans of correction of audit exceptions or management letter issues. (Only if not reimbursable under Open Meetings Act Parameters and Guidelines .) (Ed. Code, § § 1040<sup>23</sup>, 41020.3 .)<sup>24</sup>
- Increased independent audit costs for changes made by the state to audit formats or boilerplate language, and for additional time auditors may require to prepare an audit to conform to the revised audit guide. (One-time costs.) (SCO Audit Guide: May 1997 revisions .)

The Commission denied all remaining test claim issues, code sections, regulations and executive orders because they do not constitute a new program or higher level of service; and they are not costs mandated by the state pursuant to Government Code section 175 14.

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<sup>19</sup> Statutes of 1977, Chapter 936.

<sup>20</sup> Statutes of 1986, Chapter 1150. Non-substantive amendments by Statutes of 1988, Chapter 1462.

<sup>21</sup> Statutes of 1984, Chapter 268; non-substantive amendments by Statutes of 1995, Chapter 476.

<sup>22</sup> Statutes of 1984, Chapter 268; amended by Statutes of 1988, Chapter 1351; non-substantive amendments by Statutes of 1995, Chapter 476.

<sup>23</sup> Statutes of 1976, Chapter 1010; amended by Statutes of 1985, Chapter 741.

<sup>24</sup> Statutes of 1978, Chapter 207; amended by Statutes of 1994, Chapter 1002.