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California State Controller

November 3, 2017

To: K-12 Local Education Agencies (School Districts, County Offices of Education, and Charter Schools), Joint Powers Entities, and Certified Public Accountants Performing Audits of California K-12 Local Education Agencies

SUBJECT: Annual Audits for Fiscal Year 2016-17

This advisory provides information to assist independent auditors in performing the Fiscal Year (FY) 2016-17 audits of Local Education Agencies (LEA) and joint powers entities.

This audit advisory and general guidelines for audits of K-12 LEAs are available on the State Controller's website at www.sco.ca.gov/aud_k12_lea.html.

2016-17 GUIDE FOR ANNUAL AUDITS OF K-12 LOCAL EDUCATION AGENCIES AND STATE COMPLIANCE REPORTING

The audit guide is published by the Education Audit Appeals Panel (EAAP) pursuant to rulemaking procedures and incorporated by reference in Title 5, *California Code of Regulations*, section 19810; the guide is available at www.eaap.ca.gov. The 2016-17 audit guide should be referenced as the *2016-17 Guide for Annual Audits of K-12 Local Education Agencies and State Compliance Reporting* (2016-17 K-12 Audit Guide). Ensure that the applicable fiscal year is included in the title.

The number of procedures is no longer required to accompany the list of state compliance requirements.

PROCEDURAL

1. FY 2016-17 audit reports must be filed with the State Controller's Office (SCO), California Department of Education (CDE), local County Superintendent of Schools, and, if applicable, the chartering entity, by December 15, 2017. Independent auditors must submit to SCO one copy of the audit report by U.S. Postal Service or private carrier, or via File Transfer Protocol. Report submission instructions are posted on the SCO K-12 LEA website at www.sco.ca.gov/aud_k12_lea.html under the Submissions category.

Name the electronic report file according to the entity name, the document type, and fiscal year end. For example, for XYZ Unified School District, the following file names would be used:

- Report = XYZUnifiedRpt17.pdf
- Revisions = XYZUnifiedRevision17.pdf
- Revised Report = XYZUnifiedRevisedRpt17.pdf
- Management Letter Report = XYZUnifiedMgtLtr17.pdf
- Corrective Action Plan = XYZUnifiedCAP17.pdf

The electronic audit report files should be in **unsecured** PDF file format. Electronic files submitted in this format facilitate efficient processing of the annual audit reports.

2. The County Office of Education (COE) must submit its approved extension requests for submitting audit reports to SCO and CDE before December 15, 2017. The extension request must come from the COE and not the LEA or the certified public accountant (CPA). SCO will consent to the extension request only in extraordinary circumstances.

SCO does not grant extensions for charter school audits. An extension must be obtained through the chartering entity, and the chartering entity should notify SCO and CDE of the extension.

3. Charter school audit reports must contain on the cover the official name of the charter school according to the charter school agreement and the name in the CDE school directory. If the charter school has another name, both names should appear on the cover to facilitate SCO's processing of the audit report receipt. The SCO desk review process may be significantly delayed if the charter school audit reports are not properly identified.
4. The auditor rotation requirements specified in California Education Code section 41020(f)(2) apply to auditors who conduct LEA audits. This section of the Education Code makes it unlawful for a public accounting firm to provide audit services to the LEA if the lead audit partner, or coordinating audit partner responsible for the audit or for reviewing the audit, has performed audit services for the LEA in each of the six previous fiscal years. Consequently, a different audit firm and/or audit partners must be used in the seventh year, unless a waiver is obtained from the EAAP.
5. CPAs or public accountants planning to conduct LEA audits must be included to the SCO-published Certified Public Accountants Directory. To be included in the directory, the CPA or public accountant must submit a written request to SCO prior to conducting the audits. Instructions for submitting the request can be found at SCO's website at <http://cpads.sco.ca.gov/>.

In addition, if the auditor is performing an audit under Uniform Guidance, the LEA must request a copy of the audit organization's peer review report, which the auditor is required to provide under *Government Auditing Standards* (Uniform Guidance Subpart F—Audit Requirements §200.509).

6. If the audit report contains a finding or findings that may be considered apportionment-significant, SCO will send the LEA a certification letter with information on its appeal rights. The LEA has 30 days from the date the U.S. Postal Service delivers the letter to request a summary review of any apportionment-significant audit finding or findings on the grounds of substantial compliance. In addition, the LEA has 60 days from delivery of the letter or 30 days following the conclusion of a summary review, with regard to the findings included in that review, to file a formal appeal of any apportionment-significant finding or findings on any of the grounds set forth in California Education Code section 41344(d). For more information on audit finding appeals, visit the EAAP website at <http://eaap.ca.gov/appeals/>.
7. CDE is only accepting electronic versions of the FY 2016-17 audit reports. For instructions on how to submit the annual audit reports to CDE, see <http://www.cde.ca.gov/fg/au/ag/submitauditrt.asp>.
8. CDE has posted the Calculator for Estimating the Cost of an Audit Finding at <http://www.cde.ca.gov/fg/au/ag/statecomp.asp>. The calculator is designed to assist LEAs and auditors in estimating the costs associated with audit findings for school districts and charter schools for the Local Control Funding Formula (LCFF) unduplicated pupil counts, LCFF K-3 grade-span adjustment, and failure to comply with instructional time requirements.

GOVERNMENTAL ACCOUNTING STANDARDS BOARD UPDATES FOR FISCAL YEAR 2016-17

- The following Governmental Accounting Standards Board (GASB) statements are effective for the FY 2016-17 financial statement audits:
 - *GASB 73, Accounting and Financial Reporting for Pensions and Related Assets That Are not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. The requirements of GASB 73 are effective for fiscal years beginning after June 15, 2015, except those requirements that address accounting and financial reporting by employers and governmental non-employer contributing entities for pensions that are not within the scope of GASB 68. The accounting and reporting requirements are effective for financial statements for fiscal years beginning after June 15, 2016. GASB 73 was amended by GASB 82 for reporting periods beginning after June 15, 2016;

- GASB 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*;
- GASB 77, *Tax Abatement Disclosures*;
- GASB 78, *Pensions Provided Through Certain Multiple-Employer Defined Benefit Pension Plans*;
- GASB 80, *Blending Requirements for Certain Component Units – amendment of GASB Statement No. 14*; and
- GASB 82, *Pension Issues – An Amendment of GASB Statements No. 67, No. 68 and No. 73*. The requirements of this Statement are effective for reporting periods beginning after June 15, 2016, except for the requirements of this Statement for the selection of assumptions in circumstances in which an employer’s pension liability is measured as of a date other than the employer’s most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017.

STATE COMPLIANCE UPDATES FOR FISCAL YEAR 2016-17

1. The following new compliance requirements and audit procedures were added to the 2016-17 K-12 Audit Guide:
 - Mental Health Expenditures
2. The following modifications/amendments in procedures were made to existing compliance requirements in the 2016-17 K-12 Audit Guide:
 - **Educator Effectiveness:** Added to procedure 1 for “2015-16 or 2016-17” for adopting a plan and clarified procedure 2.c. to include Assembly Bill 104, Section 58(b)(1)(c).
 - **California Clean Energy Jobs Act:** Procedure 2, the reference for the total award available for planning, has been updated and the charter school reference has been deleted. Procedures have been updated to include references to a final project completion report and the California Clean Energy Program’s Implementation Guidelines applicable to the audit year.
 - **Unduplicated Local Control Funding Formula Pupil Counts:** Allows the auditor to select another student to sample if the student transferred to another LEA, since it may be difficult to obtain supporting documentation from the LEA to which the student transferred.

- **Immunizations:** Refers to either a current medical exemption or personal beliefs exemption filed prior to January 1, 2016, for measles testing and deletes personal beliefs from Tdap.
- **Charter Schools – Mode of Instruction:** Clarifies if any Average Daily Attendance (ADA) reported as classroom-based instruction was not generated in compliance with classroom-based instruction, but was in full compliance with nonclassroom-based instruction, to state in a finding the number of units of ADA that were misreported as classroom-based instruction but eligible for nonclassroom-based ADA.

SINGLE AUDITS UNDER UNIFORM GUIDANCE

The following requirements are applicable if the LEA audit is subject to the single audit requirements under Uniform Guidance:

1. Independent Auditor’s Report on the Financial Statements:

If the Schedule of Expenditures of Federal Awards (SEFA) is referenced in the “Other Information” section of the report, the auditor should use the following words: Schedule of Expenditures of Federal Awards, as required by Title 2, *U.S. Code of Federal Regulations*, Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*.

2. Schedule of Expenditures of Federal Awards [(Uniform Guidance Subpart F—Audit Requirements §200.510(b))]:

- Uniform Guidance removes the previous flexibility available in OMB Circular A-133 and now requires the following to be presented on the face of the SEFA:
 - Total amounts provided to subrecipients from each federal program [§200.510(b)(4)]
 - The total federal awards expended for loan or loan guarantee programs [§200.510(b)(5)]
- The schedule must now include a total for each cluster of programs [§200.510(b)(3)].
- The notes to the schedule must include whether or not the auditee elected to use the 10 percent de minimis indirect cost rate [(§200.510(b)(6))].

3. The Report on Compliance and Internal Control Over Compliance Applicable to Each Major Program:

For guidance and examples of reports on compliance with requirements that could have a direct and material effect on each major federal program and on internal control over compliance issued under the audit requirements of Title 2, *U.S. Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for*

Federal Awards (Uniform Guidance), refer to the American Institute of Certified Public Accountants' *Government Auditing Standards and Single Audits* with conforming changes as of March 1, 2017.

4. Schedule of Findings and Questioned Costs:

- Updated terminology and references are incorporated into the Summary of Auditor's Results in accordance with section 200.515(d)(1).
- Findings relating to the financial statements must be reported in accordance with generally accepted government auditing standards (GAGAS).
- Findings and questioned costs for federal awards must include audit findings as defined in section 200.516 (a).
- The following changes were made to findings and to the schedule of findings and questioned costs under Uniform Guidance:
 - The threshold for reporting known questioned costs is \$25,000. Known questioned costs must also be reported when likely questioned costs are greater than \$25,000 for a type of compliance requirement for a major program. Known questioned costs must be identified by applicable Catalog of Federal Domestic Assistance (CFDA) and federal award identification number(s).
 - Both known fraud and likely fraud that affects federal awards must be reported.
 - Audit findings under Uniform Guidance must include significant instances of abuse relating to major programs.
 - Audit findings must include a statement of cause that identifies the reason or explanation for the conditions or the factors responsible for the finding. In addition, identification of whether the audit finding was a repeat finding in the immediately prior year must be included.
 - Audit findings must include the views of responsible officials for all findings, not only those about which there is a disagreement.
 - Audit finding reference numbers must be included. The audit finding references are required to be in a format that meets the requirements of the data collection form submission. The format is 201X-XXX.
 - Audit finding details should include a statement about whether the sampling was a statistically valid sample.

5. Audit Findings Follow-up:

- The corrective action plan and summary schedule of prior audit findings must include findings relating to the financial statements that are required to be reported in accordance with GAGAS (Uniform Guidance §200.511[a]).

- The summary schedule of prior audit findings must report the status of all audit findings included in the prior audit's schedule of findings and questioned costs (Uniform Guidance §200.511[b]).
- At the completion of the audit, the LEA must prepare, in a document separate from the auditor's findings described in section 200.516, a corrective action plan to address each audit finding included in the current-year auditor's report (Uniform Guidance §200.511[c]).

REPORT CERTIFICATION COMPLIANCE REMINDERS

During the annual audit report certification process, SCO spends a significant amount of time corresponding with independent auditors regarding audit report deficiencies. To expedite certification of audit reports for FY 2016-17, SCO requests that auditors address the following requirements when completing their audit reports. Failure to comply with these requirements will result in audit reports being rejected:

1. **LEA Organization Structure Description:** The description must be presented in the Supplementary Information section of the audit report as required in the 2016-17 K-12 Audit Guide (Report Components 4.a.).
2. **Schedule of Average Daily Attendance (ADA):** If there are any ADA adjustments due to audit findings, the schedule must display additional columns for the Second Period and Annual Reports reflecting the final ADA after audit finding adjustments, as required by the 2016-17 K-12 Audit Guide (Report Components 4.b.).

The schedule of ADA for charter schools must display total ADA and ADA that is generated through classroom-based instruction by grade span. For LEAs that include one or more charter schools in their financial statements, total ADA and classroom-based ADA for each charter school must be presented.

3. **Schedule of Instructional Time:** When a charter school is included in the sponsoring entity's audit report, a separate Schedule of Instructional Time for each classroom-based charter school must be included in the supplementary information section of the audit report as required by the 2016-17 K-12 Audit Guide (Report Components 4.c.).

The following changes are also required:

- For charter school reports, include the number of instructional days offered in the schedule of instructional time.
- For school district reports, include a note stating whether the district participated in longer-day incentives and whether the district met or exceeded its Local Control Funding Formula target funding.

In addition, the Education Code section 46201.2(b) provision that reduced the equivalent of up to five days of instruction or the equivalent number of instructional minutes without incurring a penalty has been removed.

4. **State Compliance Findings:** The financial impact of state compliance findings must be quantified. The 2016-17 K-12 Audit Guide includes specific information that must be included in each finding. For example, for attendance findings, the 2016-17 K-12 Audit Guide requires that the audit report include a statement of the number of units of ADA that were inappropriately reported for apportionment and an estimate of their dollar value. If there is no financial impact, the finding must describe the reasons for the auditor's conclusion. The stated criteria should refer to a California state law or regulation that governs the program. It is not appropriate to cite the 2016-17 K-12 Audit Guide as the criterion.
5. **Federal Compliance Findings:** For single audits under Uniform Guidance, Federal award findings must be presented in accordance with Title 2, *U.S. Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, Subpart F—Audit Requirements, section 200.516(a)(b)(c), as follows for the following categories:
 - **Federal program(s) information:** CFDA number and title, identification number and fiscal year, name of the federal agency and pass-through entity;
 - **Criteria or specific requirement:** Statutory, regulatory, or other citation;
 - **Condition:** Facts that support the deficiency in the audit finding;
 - **Cause:** Statement of cause that identifies the reason or explanation for the condition or the factors responsible for the finding;
 - **Effect:** Clear, logical link to establish the impact or potential impact of the difference between the condition and criteria;
 - **Questioned costs:** Identification of questioned costs and how they were computed; known questioned costs must be identified by applicable CFDA number(s) and applicable federal award identification number(s);
 - **Context:** Information to provide proper perspective for judging the prevalence and consequences of the audit findings, such as whether the audit finding represents an isolated instance or a systematic problem. The auditor should report whether the sampling was a statistically valid sample;
 - **Identification as a repeat finding, if applicable:** Identification of whether the audit finding was a repeat of a finding in the immediately prior audit and, if so, the applicable prior-year audit finding number(s);
 - **Recommendation:** Information to prevent future occurrences of the deficiency identified in the audit finding(s);

- **Views of responsible officials:** Views of the auditee and planned corrective actions; and
 - **Reference number(s):** Each audit finding must include a reference number in the format meeting the requirements of the data collection form submission required by section 200.512 Report submission, paragraph (b).
6. **Elements of Audit Findings:** Each audit finding should be presented in the level of detail described in the Findings and Recommendations section of the 2016-17 K-12 Audit Guide, Report Components, 6.a.

OTHER

The SCO's FY 2016-17, LEAs Desk Review Checklist was placed on the State Controller's website (www.sco.ca.gov/aud_k12_lea.html) on November 1, 2017.

If you have any questions or need additional information, please contact Jim L. Spano, CPA, Assistant Division Chief, Division of Audits, by telephone at (916) 324-6442 or send an email to leaaudits@sco.ca.gov.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA, Chief
Division of Audits
State Controller's Office

JVB/kw

cc: Tom Torlakson, State Superintendent of Public Instruction
California Department of Education