

REPORT OF THE EXECUTIVE OFFICER
State Allocation Board Meeting, November 3, 2010

STATE ALLOCATION BOARD AUDIT SUB-COMMITTEE

PURPOSE OF REPORT

To present the recommendations from the Audit Sub-Committee to the Board for discussion and adoption.

DESCRIPTION

The attached report is a result of meetings by the Audit Sub-Committee.

BOARD ACTION

In considering this Item, the State Allocation Board approved the "Audit Sub-Committee Recommendations to the State Allocation Board" except number V.a., and asked staff to present an interim report on implementing the Recommendations at the December 15, 2010 SAB meeting.

REPORT OF THE
STATE ALLOCATION BOARD'S
AUDIT SUB-COMMITTEE

BACKGROUND

The Audit Sub-Committee was established by the State Allocation Board (SAB) at the February 25, 2009 meeting. The Sub-Committee was tasked with studying the scope of the Office of Public School Construction (OPSC) auditing authority and bringing recommendations to the Board defining that authority. To accomplish this task the Board established an Audit Working Group (AWG) made up of State agencies and school district audit experts. The AWG consisted of a representative from the California Association School Business Officials, California County Superintendents Education Services Association, California Department of Education, County Schools Facility Consortium, Fiscal Crisis & Management Assistant Team, OPSC, State Controller's Office, the State Treasurer's Office, a school facility expert and an independent school auditor expert.

The charge of the AWG was to review current and existing junctures of accountability at the State and local level, including at various stages within the State Facilities Program (SFP) in order to avoid potential redundancies and limit inefficiencies within the SFP Expenditure Audit Program.

In this regard the objective of the AWG was to provide recommendations to the Audit Sub-Committee that define the scope of the OPSC audit authority while achieving an appropriate balance between bond accountability and the best use of state and local resources.

Further, the AWG was charged with drafting recommendations for establishing an audit appeals process that ensures a transparent, consistent and equitable appeals process for Board consideration.

The specific issues that were addressed by the AWG as requested by the Audit Sub-Committee included, but were not limited to:

- Process: law, regulation, policy and procedures
- Scope and types of audits being done and recommended
- Content of audits
- Transition issues
- Addressing redundancies
- Promoting best practices
- Communication with school districts

Invitations for AWG participation were also extended to the Office of Statewide Audits and Evaluations, Department of Finance, the Office of the State Auditor and the Office of the Inspector General. These offices declined participation.

The AWG met four times before presenting recommendations to the Audit Sub-Committee on September 1, 2010. Thereafter, the AWG met once more to clarify recommendations and answer questions the Audit Sub-Committee had and presented their final recommendations to the subcommittee on October 14, 2010.

The Audit Sub-Committee has completed its work and has prepared recommendations for the Board's consideration and adoption.

(Continued on Page Two)

AUTHORITY

The Board is the governing body of the bond programs created by the 1998 passage of the Leroy Greene School Facilities Act (SB 50). Education Code §170710.10 *et seq* provides the statutory authority for distributing State school bond funds, and §17076.10(a), specifically prescribes that schools that receive State funds, are required to annually submit a summary of the expenditures until all funds are expended. The statute also indicates “[t]he Board may require an audit of those reports...to ensure that all funds received...are expended in accordance with program requirements.” .

Government Codes §15490 establishes the existence of the Board, and states that the Department of General Services (DGS), shall “provide assistance to the Board as the Board requires” [Gov Code § 15490(c)]. Within this structure, the OPSC is defined in regulations as “the State office within the Department of General Services that assists the Board as necessary and administers the Act on behalf of the Director.”

Education Code §17070.35 prescribes the powers and duties of the Board, specifically stating in §17070.35 (a)(1) that the Board shall, “adopt rules and regulations, pursuant to the rulemaking provisions of the Administrative Procedure Act (APA), Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code, for the administration of this chapter... .”

Education Code §17070.20 indicates that DGS shall administer the chapter in referring to the SFP.

Given the statutory grant of authority, the Board adopted SFP Regulations. (Cal. Code Regs., Title 2, §1859 *et. seq.*). SFP Regulation 1859.106 authorizes the OPSC to conduct an audit of a district’s expenditures under the Act, including compliance with site acquisition guidelines.

BACKGROUND INFORMATION

The final Audit Sub-Committee recommendations for Board consideration and approval are contained in Attachment A.

RECOMMENDATIONS

1. Adopt the Audit Sub-Committee’s recommendations listed on Attachment A.
2. Instruct Staff to develop regulations to implement the recommendations and bring the draft regulations to the January 2011 Board meeting.

ATTACHMENT A
Audit Sub-Committee
Recommendations to the State Allocation Board

I. SCOPE AND TYPE OF AUDITS

ISSUE	AUDIT SUB-COMMITTEE RECOMMENDATION
a. Scope of the audit needs to be defined: the School Facility Program (SFP) was intended to be a “Grant and Go” program.	Define the scope of the audit as a compliance audit. Local educational agencies (LEA) are audited to ensure they are in compliance with laws and regulations of the SFP program. Audit Guide to be revised and updated annually.
b. The audits performed should be consistent with audits that are performed by other state agencies.	Audits should be performed in accordance with Governmental Auditing Standards. Audits should commence within established time periods.
c. Ensure objectivity and independence of the audit; audits should not be conducted by the same entity that issued the apportionments.	Audits should be conducted by an independent entity outside of the OPSC. Examples: State Controller’s Office or Independent Auditors. Existing OPSC audit staff and/or resources would be transferred to the responsible entity.
d. Program requirements at the time of application change over the time that an LEA submits their initial application and the time the project is audited.	LEAs should be audited subject to the Audit Guide and the regulations effective at the time the application is deemed complete and accepted by the OPSC. A complete application checklist will be included in the SFP Handbook. A notification will be given to the LEAs upon acceptance of their application detailing which regulations and Audit Guide the project will be subject to at the time of Audit. The OPSC shall post electronically an archive of all previous and current regulations and Audit Guides for the district and the public to access. An interim process is needed to clarify applicable laws, regulations and the Audit Guides until a formal process is developed.

e. The LEA should know the requirements for the audit at the time of application and ensure they are keeping the appropriate documentation to qualify	SFP Handbook and the Audit Guide should complement each other and incorporate the compliance requirements in the handbook that LEAs will be audited on and allow the audits to be audited to the Audit Guide requirements.
f. There is a concern that once an audit is closed out that OPSC has the authority to reopen the audit at any time and re-look at the expenditures.	Audits should not be re-opened. Additional audits may be conducted if there has been a legal finding of fraud, misappropriation of funds or other illegal acts.

II. PROCEDURES ON THE PUBLISHING AND FINDINGS OF THE AUDITS

ISSUE	AUDIT SUB-COMMITTEE RECOMMENDATION
a. In accordance with the Governor's Executive Order, audits are posted to the Accountability website.	Audits should only be published after the audit report is final and the LEA has provided a written report. Draft review of audit should be given to the LEA 30 days prior to publishing and the LEA should have 30 days to respond. Responses should be published in their entirety. Audit findings that are on appeal should also be noted with any published audit information.

III. PROCESS FOR YEARLY UPDATE AND COMMUNICATION TO DISTRICTS REGARDING CHANGES WITH AUDIT PROCESS

ISSUE	AUDIT SUB-COMMITTEE RECOMMENDATION
a. Changes to the audit requirements are not effectively communicated to LEAs. A transparent process to revise the Audit Guide should be established that is relevant to the time of the audit.	Create a standing audit committee that will do an annual review of the Audit Guide and create a process to address needed changes. The Audit Sub-Committee should be comprised of California Department of Education (CDE), State Controller's Office, facility and fiscal LEA staff, independent auditor, OPSC staff or other appropriate staff.

IV. STREAMLINING ACTIONS WITHIN AUDIT PROCESS

ISSUE	AUDIT SUB-COMMITTEE RECOMMENDATION
<p>a. Program requirements can change from the time a district submits an application to the time the project is audited.</p>	<p>Draft an incremental program compliance verification and separate audit process. OPSC Program staff will verify program compliance within 1 year at 2 distinct phases: at the time of SAB action on an Application for Funding and from the Date of Fund Release. The verifications made by OPSC Program staff will be limited to a number of items per project and should be selected based on a program-wide random sample. After the verification has been performed by OPSC Program staff or the one year expires, the project at both phases is deemed in compliance with the applicable certifications and those phases are no longer auditable. The review of the expenditure audits should remain a function of the project audit.</p>
<p>b. OPSC staff does not have a good understanding of the entire cash management process within an LEA.</p>	<p>Provide training to OPSC staff on internal controls, cash management and multi-fund accounting. This training is not to prepare OPSC to take an advisory role but to allow for a better working knowledge of administering the program.</p>
<p>c. Audit requirements related to financial accounting are not coordinated with the requirements of the California School Accounting Manual (CSAM) that affects all LEAs.</p>	<p>OPSC staff to coordinate with CDE staff that maintains the CSAM to assure that financial documentation for audits is an integrated part of the CSAM and does not impose additional accounting burdens on LEAs.</p>

V. AUDIT APPEALS PROCESS

ISSUE	AUDIT SUB-COMMITTEE RECOMMENDATION
<p>a. Currently, LEAs can appeal issues through the SAB. A process is needed to address audit discrepancies that have a fiscal impact on the district and the State.</p>	<p>The audit appeal would be the responsibility of the Assistant Executive Officer in consultation with the Office of Public School Construction and/or a future audit group to process the appeal and present the item to the Board.</p>

REORDER INDEX OF OPSC AUDIT GUIDE

ISSUE	RECOMMENDATION
<p>Audit Guide summarizes the audit requirements for each local educational agency.</p>	<p>The Audit Guide and the School Facility Program Handbook should both be coordinated and re-organized to provide clear guidelines to all LEAs. The Audit Guide should be updated annually. The coordination of the Audit Guide and the School Facility Program Handbook should be vetted through the SAB Implementation Committee.</p>

REPORT OF THE EXECUTIVE OFFICER
State Allocation Board Meeting, December 15, 2010

STATE ALLOCATION BOARD AUDIT SUB-COMMITTEE

PURPOSE OF REPORT

To present the recommendations from the Audit Sub-Committee to the Board for discussion and adoption.

DESCRIPTION

The attached report is a result of meetings by the Audit Sub-Committee.

REPORT OF THE
STATE ALLOCATION BOARD'S
AUDIT SUB-COMMITTEE

PURPOSE OF REPORT

To present the plan for implementing the audit recommendations adopted by the State Allocation Board (Board) at the November 3, 2010 Board meeting.

DESCRIPTION

At the November 3, 2010 Board meeting the recommendations presented by the Subcommittee on Audits, minus one (1) provision were adopted by the Board. The Board directed the Assistant Executive Officer to work with various individuals and report back a plan to implement the adopted recommendations.

On November 18, 2010 a group of individuals from school districts, County Offices of Education, the Office of Public School Construction (OPSC), Department of Finance (DOF), California Department of Education (CDE), and the Assistant Executive Officer to the Board met to discuss the implementation plan for each adopted recommendation.

Attached is the implementation plan discussed at the November 18th meeting for each of the recommendations adopted by the Board.

RECOMMENDATION

- 1) Acknowledge report.
- 2) Give direction on moving forward with the plan for implementing the adopted audit recommendations.

BOARD ACTION

The State Allocation Board accepted the report and directed the OPSC, in conjunction with or in consultation with the Assistant Executive Officer, to implement the plan for Adopted Audit Policy and Procedures, and to return to the Board if there is a question of whether legislation is necessary.

State Allocation Board

Implementation Plan for Adopted Audit Policy & Procedures

Short-Term (0-3 months)

ADOPTED AUDIT POLICY	IMPLEMENTATION PLAN	NOTES
Audits should be performed in accordance with Governmental Auditing Standards (GAS).	<p><u>Immediate Implementation:</u> This is a simple process of the Office of Public School Construction (OPSC) implementing and following GAS which is consistent with SB 1473 (2010) that required GAS to be implemented at the local level.</p> <p>Include policy in the new Audit Guide and provide training to staff.</p>	To implement the OPSC shall send a memo to auditors instructing them to follow GAS and provide appropriate training.
Audits should commence within established time periods.	<p><u>Immediate Implementation:</u> The OPSC shall follow the current timelines for Audits already outlined in regulation.</p> <p>Include policy in the new Audit Guide and provide training to staff.</p>	The OPSC shall provide staff appropriate training on the regulations and a process for tracking timelines.
<p>Local Educational Agencies (LEAs) should be audited subject to the Audit Guide and the regulations effective at the time the application is deemed complete and accepted by the OPSC.</p> <p>A notification will be given to the LEAs upon acceptance of their application detailing which regulations and Audit Guide the project will be subject to at the time of Audit.</p>	<p><u>Immediate Implementation:</u> The OPSC shall include in a letter to the LEA when their application is deemed complete and accepted informing them that that they will be subject to a specific edition/or year of the SFP Handbook, Audit Guide and regulations.</p> <p>Insert policy in the new Audit Guide and provide training to staff.</p>	<p>The OPSC shall draft a form letter to implement new policy.</p> <p>Unclear whether this policy is needed in Regulation.</p>

State Allocation Board

Implementation Plan for Adopted Audit Policy & Procedures

Short-Term (0-3 months) *continued*

ADOPTED AUDIT POLICY	IMPLEMENTATION PLAN	NOTES
<p>Audits should not be re-opened. Additional audits may be conducted if there has been a legal finding of fraud, misappropriation of funds or other illegal acts.</p>	<p><u>Immediate Implementation</u>: This can be accomplished by ensuring that the current timelines established in regulation are abided by. Direct the OPSC to implement adopted audit policy immediately.</p> <p>Insert policy and establish a process for re-opening audits in the new Audit Guide and provide training to staff.</p> <p>Define when audits can be re-opened in regulation. (<i>Intermediate implementation</i>).</p>	<p>Current regulation allows the OPSC to contact an LEA within 2 years of completing a project to initiate an audit and allows them 6 months to complete the process.</p> <p>Direct the OPSC staff that audits may not be re-opened for ‘further savings’.</p> <p>Direct the OPSC to close all re-opened audits. Additional audits may be conducted if there has been a legal finding of fraud or other illegal acts.</p>
<p>The OPSC shall post electronically an archive of all previous and current Audit-Guides and regulations for the LEAs and the public to access.</p>	<p>All current and previous Audit-Guides and regulations shall be posted to the OPSC website.</p> <p>The OPSC shall create a tab on the OPSC website and upload all prior Audit Guides and regulations to external website for public to access within 90 days.</p> <p>Draft regulations to ensure this practice continues.</p>	<p>An example of the way the OPSC should post these to the website can be found at: www.eaap.ca.gov under Audit Guides.</p>

State Allocation Board Implementation Plan for Adopted Audit Policy & Procedures

Short-Term (0-3 months) *continued*

ADOPTED AUDIT POLICY	IMPLEMENTATION PLAN	NOTES
<p>Audits should only be published after the audit report is final and the LEA has provided a written report. (<i>Sentence Clarified</i>) <i>The report shall be provided to the LEA with 30 days to respond before the audit is deemed final.</i> All responses shall be published in their entirety. Audit findings that are on appeal should also be noted with any published audit information.</p> <p>(<i>SAB Adopted Policy</i>) Draft review of audit should be given to the LEA 30 days prior to publishing and the LEA should have 30 days to respond.</p>	<p>Accept audit policy clarification in italics.</p> <p>Insert policy and establish a process in the new Audit Guide and provide training to staff.</p> <p>Draft regulations to memorialize this process.</p> <p>Implement within 90 days.</p>	<p>At the direction of the Board, various parties gathered to discuss the implementation and next steps of the audit policies adopted by the Board. The group determined that clarification was needed on this policy.</p> <p>Was the Governors Executive Order to place audits of the OPSC online or Audits done by the OPSC of the LEA's?</p> <p>How long shall the audit findings stay on the OPSC website?</p> <p>The group also wanted to make the Board aware that in their preparation for the meeting they researched this item and currently only LAUSD's audit findings are listed on the OPSC website and they are very difficult to find.</p>
<p>Provide training to the OPSC staff on internal controls, cash management and multi-fund accounting. This training is not to prepare the OPSC to take an advisory role but to allow for a better working knowledge of administering the program.</p>	<p>The OPSC staff shall work with an LEA or auditor to create a training program to better understand internal controls, cash management and multi-fund accounting.</p> <p>The OPSC to conduct a "walk-thru" similar to Department of Finance's(DOF) within 90 days.</p> <p>Insert policy and establish a process in the new Audit Guide and provide training to staff.</p>	<p>DOF was given a "walk-thru" of an LEA's cash management process and they found the information to be useful in understanding the bigger picture.</p>

State Allocation Board Implementation Plan for Adopted Audit Policy & Procedures

Short-Term (0-3 months) *continued*

ADOPTED AUDIT POLICY	IMPLEMENTATION PLAN	NOTES
The OPSC staff to coordinate with the California Department of Education (CDE) staff that maintains the California School Accounting Manual (CSAM) to assure that financial documentation for audits is an integrated part of the CSAM and does not impose additional accounting burdens on LEAs.	The OPSC shall attend the CDE Standardized Accounting Code Structure (SACS) and the CSAM meetings to insure that the manuals are aligned and the OPSC is current and up-to-date on the CDE SACS and the CSAM process. The OPSC will continually work with the CDE staff to ensure this.	The CDE has very clear accounting manuals which would be a useful tool in creating the handbook and audit guides while ensuring that the OPSC audit is an integrated part of the CSAM and does not impose additional accounting burdens on LEAs.

Short-Term to Intermediate (0-9 months)

ADOPTED AUDIT POLICY	IMPLEMENTATION PLAN	NOTES
A standing audit committee that will do an annual review of the Audit Guide and create a process to address needed changes. The audit committee should be comprised of the CDE, State Controller's Office (SCO), facility and fiscal LEA staff, independent auditor, the OPSC staff or other appropriate staff.	<p>State Allocation Board (Board) action is needed to constitute a standing Audit Committee similar to Implementation Committee. (Within 60 days).</p> <p>To implement the creation of the Audit Committee the Board will need to identify staff to the committee and instruct them to develop a process for which LEA representatives will be determined for committee membership. (30-90 days).</p> <p>Insert policy and charge of the Audit Committee in the new Audit Guide. (30-90 days).</p> <p>Audit Committee to begin meeting and drafting the new Audit Guide to memorialize audit policies adopted by the Board (90-150 days).</p>	This may require regulation and/or Legislation (<i>parties were not in agreement on whether regulation or legislation was needed to constitute audit committee and its charge</i>).

State Allocation Board Implementation Plan for Adopted Audit Policy & Procedures

Short-Term to Intermediate (0-9 months) *continued...*

ADOPTED AUDIT POLICY	IMPLEMENTATION PLAN	NOTES
A complete application checklist will be included in the SFP Handbook.	The Audit Committee will create a checklist which shall be approved by the Board and included in the SFP Handbook. (90-150 days). Insert policy and establish checklist in the new Audit Guide.	This may require regulation.
An interim process is needed to clarify applicable laws, regulations and the Audit Guides until a formal process is developed.	Board action to create the Audit Committee to come up with the interim process. (90-150 days). Insert policy and establish checklist in the new Audit Guide.	Board Action needed to establish Audit Committee to draft the new Audit Guide.

Intermediate to Long Term (4 months to 2 years)

ADOPTED AUDIT POLICY	IMPLEMENTATION PLAN	NOTES
The scope of the audit is defined as a compliance audit. LEAs will be audited to ensure they are in compliance with laws and regulations of the SFP program. Audit Guide to be revised and updated annually.	The Audit Committee will write a new Audit Guide which will be reviewed annually and updated as needed. Draft regulations to memorialize this process.	The group determined that it is unclear if Legislation is needed at this time. <i>Parties were not in agreement on whether legislation was needed to formally constitute the standing Audit Committee and its charge.</i> As a compliance audit, the findings should be limited to compliance with laws and regulations of the SFP. Opinions on internal controls are not a part of the audit except to the extent that the LEA can't provide auditable data thus preventing a determination of compliance.

State Allocation Board

Implementation Plan for Adopted Audit Policy & Procedures

Intermediate to Long Term (4 months to 2 years) *continued...*

ADOPTED AUDIT POLICY	IMPLEMENTATION PLAN	NOTES
SFP Handbook and the new Audit Guide should complement each other and incorporate the compliance requirements in the handbook that LEAs will be audited to the Audit Guide requirements.	<p>The Audit Committee would ensure that the handbook and audit guide complement each other.</p> <p>Train the OPSC staff on compliance audits and the variation of programs which may require different auditing standards (using the handbook and audit guide).</p>	
Audits should be conducted by an independent entity outside of the OPSC. Examples: State Controller’s Office or Independent Auditors. Existing OPSC audit staff and/or resources would be transferred to the responsible entity.	<p>The Board could authorize a specific third party to conduct the audits through a MOU.</p> <p>Discuss implementation of this process in standing audit committee.</p> <p>Establish hiring an outside entity process in regulation.</p> <p>Legislation – is it needed?</p>	<p>The OPSC has currently sent letters to OSAE and SCO requesting a meeting to discuss the possibility if their agency conducting audits. OSAE has responded that they will not meet to discuss conducting independent audits for THE OPSC.</p> <p>Question: Would a third-party handle the oversight of the audit or would they be conducting the audits? Suggestion: Third-party would review a sample of audits conducted by the OPSC to ensure that the new Audit Guide is being followed.</p>
Re-ordering of the Index: The Audit Guide and the School Facility Program Handbook should both be coordinated and re-organized to provide clear guidelines to all LEAs. The Audit Guide should be updated annually. The coordination of the Audit Guide and the School Facility Program Handbook should be vetted through the SAB Implementation Committee.	<p>Implement re-ordering of Audit Guide index at the standing Audit Committee.</p> <p>Establish in regulation the process for annually updating the audit guide and vetting new requirements through the Implementation Committee (mirror the EAAP process).</p>	<p>The group determined that it is unclear if Legislation is needed at this time. <i>Parties were not in agreement on whether legislation was needed to formally establish a process for annually updating the audit guide.</i></p>

State Allocation Board Implementation Plan for Adopted Audit Policy & Procedures

Long Term (10 months to 2 years)

ADOPTED AUDIT POLICY	IMPLEMENTATION PLAN	NOTES
<p>Draft an incremental program compliance verification and separate audit process. The OPSC program staff will verify program compliance within 1 year at 2 distinct phases: at the time of SAB action on an Application for Funding and from the Date of Fund Release.</p> <p>The verifications made by the OPSC program staff will be limited to a number of items per project and should be selected based on a program-wide random sample. After the verification has been performed by the OPSC program staff or the one year expires, the project at both phases is deemed in compliance with the applicable certifications and those phases are no longer auditable.</p> <p>The review of the expenditure audits should remain a function of the project audit.</p>	<p>The Audit Committee will establish the process and include it in the SFP Handbook and Audit Guide.</p> <p>The Board may wish to establish policy and request a review be conducted by the Audit Committee and presented at a Board meeting regarding the implementation of incremental compliance one year after beginning.</p> <p>Establish regulations to implement incremental review of compliance verification vs. separate audit process.</p>	