

**LEGISLATIVE EDUCATION STUDY COMMITTEE  
BILL ANALYSIS**

**Bill Number:** SB 257a

**52nd Legislature, 1st Session, 2015**

**Tracking Number:** .198738.1

**Short Title:** Charter Schools & Public Audit Changes

**Sponsor(s):** Senator Daniel A. Ivey-Soto and Representative Jimmie C. Hall

**Analyst:** David Craig

**Date:** February 18, 2015

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**AS AMENDED**

**The Senate Education Committee amendment adds a requirement that the primary government entity's auditor shall accept the audit performed by the component unit's auditor.**

**Original Bill Summary:**

SB 257 amends the *Audit Act* to:

- include charter schools in the definition of agency;
- allow a component unit of a primary government entity to be audited separately from the primary government entity, at the component unit's discretion; and
- require the component unit to be included in the primary government's audit.

According to Section 3, if enacted, SB 257 would apply to the financial affairs of an agency in FY 16 and all subsequent fiscal years.

**Fiscal Impact:**

SB 257 does not carry an appropriation.

**Substantive Issues:**

Provisions of the *Audit Act*, and the section of New Mexico Administrative Code (NMAC) pertaining to the Audit of Governmental Entities (commonly referred to as the Audit Rule<sup>1</sup>) (see "Background," below), help determine how:

- a component unit's Independent Public Auditors (IPAs) are selected;
- charter authorizers (the local school district or the Public Education Department (PED) and generally classified as "primary government entities") present charter schools in their financial affairs (generally as "component units");
- locally chartered charter schools classified as component units are to be audited by the same audit firm that audits the school district as a primary government;

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<sup>1</sup> The Audit Rule also references Generally Accepted Audit Principles (GAAP) developed by the Governmental Accounting Standards Board (GASB).

- state-chartered charter schools classified as component units are to be audited by the same audit firm that audits PED as a primary government; and
- a process, initiated upon written request, by which a charter school, school district, or PED, can request a separate auditor for component units from the State Auditor’s Office (SAO), subject to certain requirements.

Provisions in SB 257 would allow component units to select their own auditors and would place the requirement for the component unit to be included in the primary government’s audit in statute.

As it relates to state-chartered charter schools, SB 257 does not amend provisions of the *Audit Act* related to a state-chartered charter school receiving PED approval prior to submitting a recommendation for an IPA of its choice.

**Background:**

***Legislative Education Study Committee (LESC) Charter Schools Subcommittee***

During the July 2014 LESC Charter Schools Subcommittee interim meeting, members heard testimony from SAO staff that:

- pursuant to several statutory, regulatory, and administrative provisions, all charter schools are subject to an annual audit;
- the Audit Rule requires an IPA to evaluate whether a charter school is to be presented as a component unit – that is, a separate, financially accountable legal entity – of its chartering authority;
- the Governmental Accounting Standards Board (GASB) requires that this determination be made on a case-by-case basis, using criteria related to financial accountability and fiscal dependency;
- GASB standards require that a financial audit cover the entire “financial reporting entity,” which includes:
  - the “primary government” (such as a school district or PED); and
  - “component units,” or organizations for which the primary government is financially accountable (such as a charter school); and
- charter schools classified as component units must be included with the audited financial statements of their authorizers.

During the October LESC subcommittee meeting, staff from the SAO provided additional testimony from a survey of other states, conducted to find examples of charter school oversight and component unit reporting.<sup>2</sup> The survey revealed considerable variety in the practices of other states with regard to charter schools being classified as component units in audits, depending upon such factors such as:

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<sup>2</sup> The SAO posed a number of questions to the following states: Arizona, Hawaii, Michigan, Missouri, Nevada, Ohio, Oklahoma, Oregon, and Utah.

- the type of charter school;
- the statutory provisions for oversight; and
- elements of the charter school contract.

The SAO advised the subcommittee to regard the following factors when considering whether to require stand-alone audit reports for charter schools:

- the availability of funding and other resources; and
- provisions for oversight of charter school compliance.

Although SB 257 does not carry an LESC endorsement, a bill to amend the *Audit Act* to include charter schools in the definition of “agency” was a recommendation of the LESC during the 2014 interim.

### ***Provisions in Current Law***

As they relate to charter school audits, provisions in current law require charter schools to:

- have an annual audit as required by the *Audit Act*;
- comply with due dates for annual audits specified by the Audit Rule;
- be subject to the progressive sanctions for failure to submit a timely audit report; and
- include a description of the manner in which the annual audit of the charter school is to be conducted in the charter school application.

Additional provisions in the *Audit Act* require the SAO to notify:

- the Legislative Finance Committee (LFC) and PED if:
  - a charter school has failed to submit a required audit report within 90 days of the due date; and
  - the SAO has investigated the matter and attempted to negotiate with the charter school but the charter school has not made satisfactory progress toward compliance with the *Audit Act*; and
- each agency designated for audit by an independent auditor that the agency must enter into a contract with an IPA of its choice, provided, however, that a state-chartered charter school subject to oversight by PED shall receive approval prior to submitting a recommendation.

### ***Provisions of the Audit Rule***

As they relate to charter school audits and designation of component units, selected provisions of the Audit Rule:

- encourage the inclusion of members of a component unit (including charter schools) in the IPA selection process;
- require component units to be reported within the financial statements of the primary government, if the primary government is financially accountable for the entity or if the nature and significance of the entity to the primary government warrants inclusion;

- require the primary government, in conjunction with its auditors, to determine whether an agency that is a separate legal entity from the primary government is a component unit of the primary government as defined by certain GASB standards;
- require all agencies that meet the criteria to be a component unit of the primary government to be included with the audited financial statements of the primary government by discrete presentation unless an exemption for blended presentation is requested and approved by the SAO; and
- require component units to be audited by the same audit firm that audits the primary government with requests for exemption from this requirement to be submitted in writing by the agency to the state auditor and meet the following requirements:
  - the primary auditor must agree to use the information from the work of the component unit auditor;
  - the component unit auditor selected must appear on the office of the state auditor list of eligible IPAs;
  - the bid and auditor selection processes must comply with specific requirements of the Audit Rule;
  - the SAO's standard contract form must be used;
  - all component unit findings must be disclosed in the primary government's audit report; and
  - any separately issued component unit audit report must be submitted to the SAO for a review process.

In addition, the Audit Rule:

- specifies that, pertaining to charter schools:
  - certain GASB standards are to be applied to determine whether a charter school is a component unit of the chartering entity; and
  - the school district, PED, charter school, and IPAs are required to evaluate whether the charter school must be presented as a component unit; and
- requires charter schools that are determined to be component units pursuant to the GASB standards<sup>3</sup> must be included in the financial statements of their sponsoring school district or PED.

**Committee Referrals:**

SEC/SPAC

**Related Bills:**

- SB 8a *Charter School Education Tech Equipment*
- SB 128 *Public School Capital Outlay Building Needs*
- SB 130a *Public School Lease Purchase Act Definitions*
- SB 148 *Charter School Responsibilities*

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<sup>3</sup> Certain GASB standards define component units as legally separate organizations for which elected officials of the primary government are financially accountable.

*SB 236 Charter School Lease Approval*  
*SB 273 Charter School Governance*  
*CS/HB 19 Charter School Educational Tech Equipment*  
*HB 166 Charter School Transportation Agreements*  
*HB 253a Charter School Facility 4 Year Plans*