

CHARTER SCHOOL AUDITS: CHARTER SCHOOLS AS COMPONENT UNITS

Office of the State Auditor Presentation to the LESC 2014 Interim Charter Schools Subcommittee Farmington, NM - July 16, 2014

1. State Statutory and Regulatory Provisions

- a. Audit Act: Section 12-6-3(A) NMSA 1978 requires audits of government agencies “be conducted in accordance with generally accepted auditing standards and rules issued by the state auditor.” These audits are conducted by the Office of the State Auditor (OSA) or independent auditors approved by the State Auditor.
- b. Charter Schools Act: Section 22-8B-4(C)(1) requires charter schools be subject to audits pursuant to the Audit Act.
- c. A financial audit covers the entire financial reporting entity, including the primary government and any “component units” of the primary government. According to the Governmental Accounting Standards Board (GASB), “component units” are legally separate organizations for which the elected officials of the primary government are financially accountable.
- d. Audit Rule: The school district, the PED, the charter school and the charter school’s independent public accountant (IPA) must evaluate whether GASB Statements require a charter school be presented as a “component unit” of its chartering entity (2.2.2.12(C)(5)(b) NMAC).
- e. Agencies that meet the criteria under GASB to be a component unit of the primary government must be included with the audited financial statements of the primary government.

2. Professional Standards and Reporting Standards

- a. AICPA Professional Standards (U.S. Auditing Standards): Applies to IPAs that conduct audits.
- b. Government Auditing Standards “Yellow Book”: Applies to governmental audits.
- c. Statements issued by the GASB: Accounting for governmental financial activities and must be used by management for financial reporting and IPAs for auditing of the financial statements

3. GASB Statements Applicable to Potential Component Units

- a. GASB 14 and 61 – The Financial Reporting Entity
 - The financial reporting entity consists of (a) the primary government; (b) organizations for which the primary government is financially accountable; and (c) other organizations for which the nature and significance of their

relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

- To determine whether a charter school is a component unit under GASB 14 and 61, an analysis must be conducted on a case-by-case basis by key personnel such as the Finance Director/CFO of the primary government, the charter school and appropriate legal counsel. The determination should be well documented and supported and provided to the IPA to audit and provide an opinion. The OSA does not make these determinations.
- Key concepts/factors outlined under GASB 14 and 61 in determining if a charter school is a potential component unit (PCU):
 1. Financial Accountability
 - a. Legally separate status of the entity from the primary government (primary government does not appoint a voting majority of the PCU's governing body);
 - b. Primary government's ability to impose its will on the PCU; and
 - c. The PCU has potential to provide specific financial benefits or impose specific burdens on the primary government.
 2. Fiscal Dependency
 - a. Ability to budget without the primary government's authority to approve or modify the budget;
 - b. Ability to levy taxes or set rates/changes without approval by the primary government; and
 - c. Ability to issue debt without the approval of the primary government.
 3. Misleading to Exclude
 - a. Management's professional judgment may determine that the inclusion of an organization that does not meet the financial accountability criteria is necessary in order to prevent the reporting entity's financial statements from being misleading.

b. GASB 39 - Determining Whether Certain Organizations Are Component Units

- Applies to non-profit supporting organization (foundations, etc.)

4. Other Factors in the Analysis: State Laws and Regulations

- a. Section 22-8B-4(N) NMSA 1978 - Within constitutional and statutory limits, a charter school may acquire and dispose of property; provided that, upon termination of the charter, all assets of the locally chartered charter school shall revert to the local school board and all assets of the state-chartered charter school shall revert to the state, except that, if all or any portion of a state-chartered charter

school facility is financed with the proceeds of general obligation bonds issued by a local school board, the facility shall revert to the local school board.

- b. 2.2.2.12(C)(5)NMAC – A charter school is considered a public school, accredited by the state board of public education and accountable to the school district's local school board, or to the PED, for ensuring compliance with applicable laws, rules and charter provisions.