



# Office of the New Mexico State Auditor

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## Charter Schools as Component Units

*Presentation to the Legislative Education Study Committee  
Charter Schools Subcommittee  
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*Evan Blackstone, Esq., Chief of Staff  
Melissa Spangler, CPA, CGFM, CFE, Financial Audit Director*



# Overview of Presentation

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- Financial Audit Requirements for New Mexico's Charter Schools
  - Professional Standards Applicable to Government Agency Audits
  - What is a Component Unit?
  - Component Unit Determination Under GASB
- Survey of Other States: Examples of Charter School Oversight and Financial Reporting
- Survey of Other States: Takeaways
- Moving Forward: Weighing Options



# Financial Audit Requirements for New Mexico's Charter Schools

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- New Mexico Audit Act: Requires government agencies receive financial audits on an annual basis.
- New Mexico Charter Schools Act: Requires charter schools be subject to audits pursuant to the Audit Act.
- Annual financial audits of government agencies are conducted by the Office of the State Auditor (OSA) or independent auditors approved by the State Auditor.
- The Audit Act specifically requires these financial audits “be conducted in accordance with *generally accepted auditing standards* and rules issued by the state auditor.”



# Professional Standards Applicable to Government Agency Audits

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- A range of professional standards and reporting standards apply when conducting financial audits of government agencies:
  - AICPA Professional Standards (U.S. Auditing Standards): Applies to independent audit firms that conduct audits.
  - Government Auditing Standards “Yellow Book”: Applies to governmental audits.
  - Statements issued by the Governmental Accounting Standards Board (GASB): Accounting for governmental financial activities and must be used by management for financial reporting and audit firms for auditing of the financial statements.
- The OSA, audit firms and government agencies must adhere to these standards.
- It is critical to understand this framework in order to assess the “component unit” question.



# What is a Component Unit?

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- GASB has established certain standards for financial reporting for a governmental “financial reporting entity.” A financial audit covers the entire financial reporting entity.
- The financial reporting entity includes the “primary government” (e.g., a school district) and organizations for which the primary government is financially accountable. These organizations are called “component units.”
- GASB bases its definition of the financial reporting entity on the notion of financial accountability, which is used to describe the kind of relationship warranting the inclusion of a legally separate organization in the reporting entity of another government.



# GASB Statements 14 and 61 Component Unit Determination

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- Key concepts/factors outlined under GASB 14 and 61 in determining if a charter school is a component unit:
  - Financial Accountability;
  - Fiscal Dependency; and
  - Misleading to Exclude.
- To determine whether a charter school is a component unit under GASB:
  - Analysis must be conducted on a case-by-case basis by key personnel of the primary government, the charter school the independent auditor.
  - The determination should be well documented and supported and provided to the independent auditor to audit and provide an opinion.
  - The OSA does not make these determinations.



# Survey of Other States: Examples of Charter School Oversight and Financial Reporting

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With the assistance of NASACT, the OSA asked other states a series of questions regarding charter school oversight and component unit reporting:

- 1) How are charter schools in your state authorized?
- 2) What is the governance structure of charter schools in your state?
- 3) Do the charter schools meet the criteria to be reported either as a component unit of a local school district or the state board/department of education?
- 4) Do the charter schools typically issue stand-alone financial statements? Does your state law require that charter schools issue stand-alone financial statements?
- 5) Do the authorizing authorities/agencies of the charter schools have any responsibilities under state law to monitor the charter schools' annual financial audit reports? Are there any mechanisms or penalties for charter schools that receive poor opinions or audit findings?



# Survey of Other States: Arizona

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- Authorizers – State Board of Education, State Board for Charter Schools, state universities, community colleges, and local school boards.
- Governing Board – Governing boards are separate from the authorizer, unless the authorizer is also the operator.
- CU – Charter schools do not meet the criteria to be considered component units of their authorizer, but may meet the criteria to be a component unit of its governmental operator (which could be the same as its authorizer).



## Survey of Other States: Arizona (cont.)

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- FS – Every charter school is required to have an annual audit; however, stand-alone financial statements are not required.
- Oversight – The Auditor General’s Office monitors the annual reports. All authorizers may revoke a school’s charter for various reasons, including poor audit opinions and audit findings. The State Board of Education may withhold funding for noncompliance.



# Survey of Other States: Hawaii

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- Authorizers – State Public Charter School Commission is the statewide authorizer.
- Governing Board – Each charter school has a governing board, whose members are elected by the school community.
- CU – Reported as a component unit of the state Department of Education.
- FS – Audited financial statements are required.



## Survey of Other States: Hawaii (cont.)

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- Oversight – If the commission finds deficiencies in a school's performance or legal compliance, the Commission will follow an intervention protocol (outlined in the charter contract). If the school does not satisfactorily fix its deficiencies, the Commission will issue a warning notice before initiating revocation proceedings in accordance with state law, and applicable administrative rules.



# Survey of Other States: Michigan

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- Authorizers – A local K-12 school district, an intermediate school district, community college, or a state public university.
- Governing Board – Each charter school must have a board, the members of which may either be appointed or elected.
- CU – Not reported as a component unit of the authorizer or the State due to the nature of the contract between the authorizer and charter school board.



## Survey of Other States: Michigan (cont.)

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- FS – State law requires charter schools to issue stand-alone financial statements.
- Oversight – State law allows the authorizing entity to revoke the contract with the charter school if the authorizing entity determines that the charter school failed to "meet generally accepted public sector accounting principles and demonstrate sound fiscal stewardship."



# Survey of Other States: Missouri

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- Authorizers – School boards; four year public or private colleges or universities; community colleges, two-year private vocational or technical schools; and Charter Public School Commission.
- Governing Board – Separate governing board.
- CU – Charter schools are not reported as a CU. The analysis is that each charter school is a legally separate entity (a nonprofit corporation) with its own governing board.



## Survey of Other States: Missouri (cont.)

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- FS – Each charter school issues stand-alone financial statements.
- Oversight – The Department of Elementary and Secondary Education monitors results and may require increased monitoring through disbursement of funds on a reimbursement rather than advanced basis. The sponsor is responsible for monitoring a school's performance and compliance, including fiscal monitoring at least each renewal period, and may revoke sponsorship if funds are in peril.



# Survey of Other States: Nevada

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- Authorizers – Local school districts, a college or university, and the State Public Charter School Authority.
- Governing Board – Charter schools have separate governing boards.
- CU – The charter schools are not reported as component units of the local school district or the Department of Education.
- FS – State law requires each charter school in the State to issue annual audited financial statements.



## Survey of Other States: Nevada (cont.)

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- Oversight – The State Department of Education is responsible for reviewing each charter school’s annual audit report and evaluating its compliance with statutes and regulations. Within 60 days of receipt of the annual audit, the charter school board must advise the Department of Education of the corrective action taken. If the governing body fails to submit a plan, or the State Department of Education determines the plan is not being complied with, the Department must, through the State Office of the Attorney General, seek a writ from a court of competent jurisdiction to compel compliance.



## Survey of Other States: Ohio

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- Authorizers – Local school districts, Joint Vocational Schools and Educational Service Centers.
- Governing Board – Each school has a governing board that is appointed.
- CU – No. The schools are public nonprofit, nonsectarian schools that operate independently of any school district but under a contract with an authorized sponsoring entity that is established by statute or approved by the State Board of Education.



## Survey of Other States: Ohio (cont.)

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- FS – Required to file annual financial reports prepared in accordance with generally accepted accounting principles.
- Oversight – Authorizers are required to monitor and evaluate the academic and fiscal performance, organization and operation, and the legal compliance of the schools they authorize.



# Survey of Other States: Oklahoma

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- Authorizers – A school district, a technology center school district, a higher education institution, the State Board of Education (only for services to youth in the custody or supervision of the state) or a federally recognized Indian tribe.
- Governing Board – Charter schools have separate governing boards.
- CU – Charter schools are not reported as component units.
- FS – Required to issue stand-alone financial statements.



## Survey of Other States: Oklahoma (cont.)

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- Oversight – The State Department of Education does the following:
  1. Required by statute to withhold state aid for late filing of the audit;
  2. Withhold making federal reimbursements until late audits are received;
  3. Review single audit results and withhold questioned costs in excess of \$600 from subsequent federal reimbursements;
  4. Make demand that any monies illegally disbursed or expended be returned or the unreturned amount will be withheld from subsequent allocations of state funds.



# Survey of Other States: Oregon

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- Authorizers – Charter schools were established by the Oregon State legislature around 1999 as 501(c)(3) nonprofit organizations. A sponsor is required (almost always a local school district, sometimes the State Board of Education).
- Governing Board – Independently elected board of directors.
- CU – Analysis depends on the applicable GASB standards.



## Survey of Other States: Oregon (cont.)

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- FS – Stand-alone financial statement reports are required.
- Oversight – The Department of Education is the responsible authority for charter schools and is required to adopt the rules necessary to carry out those laws.



# Survey of Other States: Utah

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- Authorizers: State Charter School Board, but a few are authorized by a school district (the exception).
- Governing Board: Each school is required to have a school board (volunteer basis).
- CU – Most report as non-profit entities separate from any other reporting entity. Those rare few created by a school district will report as a component unit of that school district, but still issue their own financial statements.



## Survey of Other States: Utah (cont.)

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- FS – Required to issue stand alone financial statements.
- Oversight – The State Charter School Board is required/responsible for monitoring the annual financial reports and findings if applicable. They have set up various criteria that are monitored and if a school fails, the school is put on a corrective action plan. Over time, if the school continues to fail the Board has the authority to close the school.



# Survey of Other States: Takeaways

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- Summary of common points or themes
  - Lessons to learn from other states – not just an issue in New Mexico
  - Component unit determination can depend on several factors – nonprofit charter school; statutory oversight and elements of charter school contract
  - Stand-alone financial statements
  - Some states have robust monitoring of charter school compliance



# Moving Forward: Weighing Options

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- Changes that impact whether a charter school meets the underlying criteria for a component unit
  - These policy changes should be thoroughly and carefully considered
  - Auditors must comply with professional standards
  - Impacts on charter school oversight
- Requiring stand-alone audit reports
- Strengthen monitoring and oversight of charter school compliance
- Funding and resource considerations



**Any Questions?**

Thank  
You

