STATE OF NEW MEXICO
LEGISLATIVE EDUCATION STUDY COMMITTEE

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http://www.nmlegis.gov/lcs/lesc/lescdefault.aspx

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July 25, 2011

MEMORANDUM

TO: Legislative Education Study Committee

FR: Eilani Gerstner

RE: STAFF REPORT: 2010 LESC SCHOOL FINANCE WORK GROUP OUTCOMES: RESPONSES TO JANUARY 2011 LETTERS FROM THE LESC TO PED AND OTHER ENTITIES

During the 2010 legislative session the Legislative Education Study Committee (LESC) endorsed SJM 24, *Study School District Finances & Operations*, requesting that the Office of Education Accountability, in collaboration with the Public Education Department (PED) and in consultation with the Office of the State Auditor (OSA), form a work group to examine public school finance issues.

Although the joint memorial did not pass, in keeping with the LESC's focus on public school finances during the 2010 interim, the LESC requested that an LESC work group be formed and that updates on the progress of the work group be provided at each interim meeting, with final recommendations to the LESC in December 2010.

Included in the recommendations of the work group and approved by the LESC were requests sent on January 17, 2011 to PED, the OSA, and the New Mexico Association of School Business Officials (NMASBO). This staff report includes a summary of those requests and the responses received to date from each agency.

Requests to PED

The LESC sent two letters to PED requesting that:

(1) the department change rules relating to school board member and charter school governing body member training to require 10 hours of mandatory training, five of which shall be focused on the financial and audit responsibilities of boards and governing bodies; and

(2) PED include confirmation on the school budget questionnaire that school districts and charter schools have established SBO succession planning as part of the internal control process.

Regarding the first request, the Secretary-designate of Public Education sent a letter to the Chairman of the LESC on May 24, 2011 (see Attachment 1) indicating the department needed to be "thoughtful and consider all the implications regarding such a rule change," and that PED would conclude the school budget process "before undertaking rule changes related to preparing school board members for critical oversight." The Chairman's response is included as Attachment 2 to this report and notes that the letter from PED "does not indicate whether or when the department intends to implement the requested rule change."

While a review of the 2011-2012 school budget questionnaire indicates that the second request was met, as of the publication of this staff report the LESC has not received a formal response from PED regarding that request.

Request to the OSA

The LESC also requested that the OSA investigate:

- whether the state audit rule could be amended to allow certain school districts to submit their financial audits on December 15, rather than on November 15; and

- the feasibility of allowing locally and state-chartered charter schools to have a separate audit from their authorizers.

The OSA's response to the LESC's request is included in this report as Attachment 3.

Request to NMASBO

Finally, the LESC requested that NMASBO develop courses that count toward required annual Certified Public Accountant (CPA) training. NMASBO's response, included as Attachment 4, describes the availability of courses offered by the organization that satisfy CPA training.

ATTACHMENT 1

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MAY 27 2011
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HANNA SKANDERA
SECRETARY OF EDUCATION

SUSANA MARTINEZ
GOVERNOR

May 24, 2011

The Honorable Rick Miera
Chair, Legislative Education Study Committee
325 Don Gaspar, Suite 200
Santa Fe, NM 87501

Dear Chairman Miera:

As with our last letter to Sen. Nava on February 28, 2011, the Public Education Department (PED) has under advisement the January 17, 2011 request from the Legislative Education Study Committee (LESC) to revise department rules to increase from five to 10 hours the mandatory training for school board members and charter school governing authority members, with the additional five hours to be dedicated to their financial and audit responsibilities.

While we recognize the significant work of the LESC School Finance Work Group during the 2010 interim to evaluate the adequacy and effectiveness of New Mexico's laws and regulations relating to public school finance, we need to be thoughtful and consider all the implications regarding such a rule change.

Of utmost importance is whether school board members are being trained and equipped in the best way possible. The school budget process is providing new knowledge this year. We need to conclude that process before undertaking rule changes related to preparing school board members for critical oversight.

Warm regards,

Hanna Skandera
Secretary of Education

HS/rmw

cc: The Honorable Cynthia Nava, Vice Chair, Legislative Education Study Committee
Frances Maestas, Executive Director, Legislative Education Study Committee
Paul Aguilar, Deputy Secretary, Public Education Department
Willie Brown, General Counsel, Public Education Department

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June 27, 2011

Ms. Hanna Skandera
Secretary-designate of Public Education
300 Don Gaspar Avenue, Room 109
Jerry Apodaca Education Building
Santa Fe, New Mexico 87501-2786

Dear Ms. Skandera:

This is in response to your letter dated May 24, 2011 regarding a request from the Legislative Education Study Committee (LESC) to revise Public Education Department (PED) rule to increase mandatory training for members of school boards and charter school governing boards.

While we appreciate your response, your letter does not indicate whether or when the department intends to implement the requested rule change.

On behalf of the committee, I look forward to receiving your explanation.

Sincerely,

Representative Rick Miera, Chair

State of New Mexico
OFFICE OF THE STATE AUDITOR

Hector H. Balderas
State Auditor

Carla C. Martinez
Deputy State Auditor

May 19, 2011

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MAY 20 2011

VIA FACSIMILE AND U.S. MAIL

Representative Rick Miera, Chair
Senator Cynthia Nava, Vice Chair
Legislative Education Study Committee
State Capitol North
325 Don Gaspar, Suite 200
Santa Fe, New Mexico 87501

Dear Chairman Miera and Vice Chairwoman Nava:

Thank you for your letter dated January 17, 2011 requesting that the Office of the State Auditor (OSA) provide a written response regarding two issues relating to audit due dates and charter school audits. We appreciate the opportunity to assist the Legislative Education Study Committee (LESC) in addressing critical financial reporting issues that impact New Mexico's public schools. What follows is the OSA's response to your request.

FIRST ISSUE:

With regard to the first issue, the LESC requested "an estimate of the feasibility and the impact of a change to the state audit rule that would allow certain school districts to submit financial audits on December 15 or some other later date, rather than November 15."

At the time our office received your letter, the OSA was in the final stages of promulgating the 2011 Audit Rule (2.2.2 NMAC), which was published on February 28, 2011. Unfortunately, due to the timing of the LESC's request, the OSA was unable to consider any change to the audit due date for school districts. However, our office did make a revision to the 2011 Audit Rule that we hope will facilitate the submission of timely audits by all government agencies. The Audit Act (Sections 12-6-1 through 12-6-14 NMSA 1978) and the Audit Rule require that the State Auditor approve all recommendations for auditors chosen by government agencies before the execution of contracts for audit services. Historically, the due date for the submission of auditor recommendations was June 2 for all government agencies, regardless of when the audit reports were due. The past practice of having one uniform due date for auditor recommendations potentially placed government agencies with audit report due dates earlier than December 15 at a disadvantage because those agencies had less time to procure an auditor before their audits were due. Therefore, the 2011 Audit Rule requires school districts' to submit their auditor

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recommendations by May 1, 2011, which gives school districts the opportunity to procure their auditors sooner. Consequently, we hope this change will help school districts complete their audits in a more timely fashion.

What is more, this year the OSA also made adjustments to its contracting process that should reduce the time in which school districts are able to obtain fully executed audit contracts. Specifically, the OSA streamlined its contracting process to allow agencies to submit their audit contracts with their auditor recommendations. Agencies previously could only submit their auditor recommendations and then wait until our office approved the recommendations before we mailed the agencies the audit contracts for signature. This process extended the time before audit work could actually begin on an agency's audit. By streamlining this administrative process, it should also help school districts complete their audits in a timelier manner.

While we remain optimistic about the impacts of our revision to the auditor recommendation deadline and the contracting process, we will study a change in the audit report due date for possible inclusion in the 2012 Audit Rule. A later due date would provide school districts and charter schools additional time to complete their audits; however, I should note a few significant issues that arise in contemplating this type of change.

First, this issue will require extensive analysis regarding how a change in audit due dates would impact the OSA's daily operations. For example, the Audit Rule currently requires that all executive and legislative state agencies, district courts and district attorney offices' (state agencies) submit their audit reports by December 15. Because of the size of some state agencies and because of the OSA's legislatively-mandated performance measure to review audit reports within 10 days of receipt, our office is required to review some very large and complex audit reports in a very short timeframe. Additionally, with the impact of budget cuts to the OSA in the past legislative session and prior sessions, it has become increasingly difficult for OSA staff to review these audit reports by the required deadlines. Moving school districts to the same audit report due date as state agencies could further exacerbate the situation and place considerable stress on staff resources.

Furthermore, moving school districts' audit report due dates beyond December 15 raises a host of concerns that deserve careful consideration. Staff availability becomes a problem if audit reports were due much later than December 15, since the holidays would interfere with the OSA's performance measure to review the reports within 10 days. Legislators also rely on the audit reports to make fiscal assessments and decisions before and during the legislative session, and a later due date may hinder this decision-making process.

An additional consideration is the impact a due date change may have on audit firms. Some audit firms conduct both school and state agency audits. If both types of audits are due at the same time, this may make it difficult for an audit firm to complete both types of audits within the same timeframe and may cause the audit firm to make a choice. It could potentially force the school district to seek a new audit firm, which sometimes is not a simple task for the school district. This consideration would have to be taken into account when determining the feasibility of a change to the audit due date for school districts and charter schools.

As a final issue, your request identifies a change to the Audit Rule for "certain school districts." We believe it is most prudent to have one uniform audit due date for all school districts and we are happy to engage in a discussion with the LESC regarding the necessities of that approach.

With regard to the OSA's process in revising the Audit Rule, the OSA revises the Audit Rule on an annual basis and the process generally commences in the summer. The OSA requests input from users of the Audit Rule, including audit firms and government agencies. After the OSA receives suggestions for revisions, our staff analyzes the input received and may hold meetings with persons who provided input. We also conduct comprehensive reviews of government auditing standards to ensure that the Audit Rule reflects current standards and any updates to those standards. OSA staff drafts the revisions once decisions have been made regarding what revisions to include, and the revisions subsequently undergo multiple levels of review. Finally, in February the OSA finalizes and publishes the Audit Rule. We look forward to working with the LESC during this lengthy process later this year.

SECOND ISSUE:

With regard to the second issue, the LESC requested "an analysis regarding charter school audits" including "information on the extent to which authorizers are currently responsible for the financial audits of charter schools". The LESC further requested "guidance on how to create an appropriate relationship between authorizers and charter schools in terms of financial accountability." The letter stated that the information provided by the OSA may "address how any changes might impact the Public Education Department, the Public Education Commission, school districts and charter schools, as well as the OSA". The request also asked that the OSA's response include "information relevant to the issue" and answers to six questions listed in you January 17, 2011 letter.

The extent to which authorizers are currently responsible for the financial audits of charter schools is addressed in the OSA's Audit Rule and audit standards. The Audit Rule, specifically Section 2.2.2.12(C)(5)(b) NMAC, provides the following:

> "Certain GASBS 14 criteria must be applied to determine whether a charter school is a component unit of the chartering entity (the district or PED). GASBS 14 was recently amended by GASBS 61. The Financial Reporting Entity: Omnibus -- an amendment of GASB Statement No. 14 and No. 34. The district, the PED, the charter school and the IPA must evaluate whether the amended GASBS 14 criteria requires a charter school to be presented as a component unit of its chartering entity. If a charter school is determined to be a component unit, then the charter school must be included in the financial statements of its sponsoring school district or PED by discrete presentation. Discrete presentation entails reporting component unit financial data in a column(s) separate from the financial data of the primary government."

Additionally, Section 2.2.2.12(C)(5)(c) NMAC provides that "financial statements for charter schools that are determined to be component units pursuant to the amended GASBS 14 criteria should be presented and opined on in the following manner:

(i) All charter schools should be reported as major component units of the school district or PED. All charter schools should be included in the basic financial statements (full accrual basis presentation) in one of the following manners: a separate column for each component unit presented in the government-wide statement; combining statements of component units presented as a basic financial statement after the fund financial statements; or as condensed financial statements in the notes to the basic financial statements (GASBS 34 Paragraphs 124 to 126).

(ii) When separate audited financial statements are not available for a charter school, the fund financial statements for that charter school must be presented in the primary government's financial statements on the modified accrual basis of accounting. If applicable, combining and individual fund financial statements should also be presented for the nonmajor funds. The financial statements should be presented as supplemental information (SI) according to AAG-SLV 3.20 (latest edition).

(iii) The State Auditor requires that individual fund budgetary comparison statements for all of the charter school's funds must be included in the supplemental information section of the financial statements following the fund financial statements and the combining statements for the nonmajor funds to demonstrate compliance with legally adopted budgets. The budgetary comparisons must be audited and included in the auditor's opinion.

Generally speaking, if a determination is made under the Government Accounting Standards Board's Statement (GASBS) number 14, "The Financial Reporting Entity", that a charter school is a component unit of either a school district or PED (the authorizer), then the authorizer's audit report must include the financial information for the charter school. Furthermore, since the Audit Rule provides that "all charter schools should be reported as major component units of the school district or PED" (Section 2.2.2.12(C)(5)(c) NMAC), the failure by the authorizer to include the charter school's financial statements in its audit report could result in a qualified or an adverse audit opinion if the charter school is material to the financial statements (SAS AU 508.35 through .60), or it could result in a finding in the audit report if the charter school is not material to the financial statements (Section 12-6-5 NMSA 1978 and Section 2.2.2.10(I)(1)(b) NMAC). The Audit Rule also requires that "component unit audit findings must be reported in the primary government's financial audit report." Section 2.2.2.10(I)(6) NMAC. Therefore, indirectly, the authorizer is responsible for the financial information and findings of the charter school.

However, GASB recently approved an amendment to Statement 14, Statement No. 61, The Financial Reporting Entity: Omnibus-an amendment of GASB Statement No. 14 and No. 34 (Issued November 2010). This amendment is effective for financial statements for periods after June 15, 2012 with earlier application encouraged. It could potentially impact whether a charter

school is considered a component of the authorizer. The Statement modifies certain requirements for inclusion of component units in the financial reporting entity. For organizations that previously were required to be included as component units by meeting the fiscal dependency criterion, a financial benefit or burden relationship would also need to be present between the primary government (authorizer) and the charter school for the charter school to be included in the reporting entity as a component unit.

Further, for organizations that do not meet the financial accountability criteria for inclusion as component units but are included as component units because it would be misleading to exclude them, this Statement clarifies the manner in which that determination should be made and the types of relationships that generally should be considered in making the determination. (Summary of Statement No. 61). Therefore, charter schools and authorizers would need to closely analyze GASBS 14 and the amendment to make a determination as to whether the charter school would remain a component unit of the authorizer. If the conclusion of the analysis is that the charter school is a component unit of the authorizer, then the preceding paragraphs would apply. If the conclusion of the analysis is that the charter is not a component unit of the authorizer, then the charter school would be required to have a separate audit report completed and submitted to the OSA. If the latter situation applies, the authorizer would not be responsible for the financial information and findings of the charter school. It is our understanding that the PED will be providing guidance on this issue soon.

The analysis above addresses LESC's first of six specific questions regarding whether charter schools are component units of the authorizers and what authority governs the audits of component units and/or charter schools. With regard to the LESC's second and third specific questions, whether a charter school can have an audit and associated findings separate from the authorizer is dependent upon whether the charter school is considered a component unit of the authorizer under GASBS 14. As previously discussed, if a charter school is considered a component unit of the authorizer, then the financial information must be incorporated within the audit report of the authorizer as well as any associated findings.

The analysis above also addresses the LESC's fourth and fifth specific questions regarding how authorizers are responsible for the audits of charter schools. If there is a desire for authorizers to not be responsible for the financial information and findings of the charter schools, then each charter school and authorizer should analyze GASBS 14 and its current arrangement to determine what adjustments, if any, are needed so that the charter school will not be a component unit of the authorizer. Their analysis could lead to suggested changes to state law or the current approved charter application(s) in order to not be considered a component unit. If charter schools are ultimately not considered component units of the authorizers, then each charter school will be required to procure its own auditor and to submit its own audit report to the OSA. I should note that this will significantly increase the OSA's workload because the OSA will be required to administer each contract between the charter school and its selected audit firm. The OSA will also be required to review each individual charter school's audit report.

With regard to the LESC's final specific question, if a charter school is not a component unit of the authorizer then it would not be necessary to include the findings of the charter school in the authorizer's audit report. The charter school would be responsible for resolving its own audit

findings. How this would impact public school financial accountability seems to be a question better answered by the school districts and/or PED.

I hope our responses fully answer the LESC's questions and we look forward to working with the LESC on these issues during the interim. If you have any further questions, please feel free to contact the Deputy State Auditor, Carla Martinez.

Sincerely,

Hector H. Balderas
State Auditor

NMASBO

new mexico association of school business officials

State of New Mexico
Legislative Education Study Committee
State Capitol North
325 Don Gaspar, Suite 200
Santa Fe, NM 87501

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Attention: Senator Cynthia Nava, Chairperson
And
Representative Rick Miera, Vice Chairperson

Dear Senator Nava and Representative Miera:

Thank you for your letter dated January 17, 2011. In your letter, you requested that the New Mexico Association of School Business Officials develop training courses with credits that could count towards the required annual Certificated Public Accountant (CPA) Training. We note that a number of our CPA members have used NMASBO conference coursework for continuing professional education (CPE) credit.

We have researched the sponsor requirements outlined in the New Mexico Public Accountancy Board's (NMPAB) Statement of Standards for Continuing Professional Education (CPE) Programs. These Standards set forth specific criteria and other requirements for CPE programs taken by Certified Public Accountants in New Mexico. Our research has concluded that our organization needs only to make minor programmatic and record keeping requirements in order to offer CPE credit. Accordingly, we will make these changes and formalize a process for the granting of CPE credit beginning with our next conference in September, 2011.

In general, we believe that our courses will, in total or in part, comply with the NMPAB's sponsorship requirements. Additionally, we have noted that Certified Public Accountants are provided with additional credits for the development and presentation of course work. We will maintain documentation in order to offer these credits with the anticipation that more Certified Public Accountants will become trainers to our organization.

NMASBO training conferences provide up to date informational training to membership on meaningful issues of current interest to school business professionals and are well attended by our membership. We would welcome your attendance at our training conferences.

Sincerely,

Tami J. Coleman
President
cc: NMASBO Board
Joey Montano, Executive Director
Bill Moffatt, Training Coordinator
Frances Ramirez-Maestas, Director-LESC

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