



Use of Annual Audits: Overview and Trends

ASBCS BOARD MEETING

MAY 13, 2019

Audit Background



Charter Audits

- A.R.S. §§ 15-183(E)(6) and 15-914
- Charter Audits Must Be Conducted by Independent Certified Public Accountant (CPA)
- Charter Audits Must Be Conducted Annually



Generally Accepted Accounting Principles

- Adherence to GAAP Required by Charter Contract
- What Is GAAP?
 - Uniform minimum standards for financial accounting and reporting that govern the form and content of an entity's financial statements
 - Principles encompass conventions, rules and procedures necessary to define accepted accounting practices at a particular time
 - Primary authoritative body on GAAP's application for most charter holders is the nationally-recognized Financial Accounting Standards Board (FASB)



Auditing Standards

GENERALLY ACCEPTED AUDITING STANDARDS

- ❖ Guidelines for how financial audits are to be conducted
- ❖ Audit conducted under GAAS includes auditor's opinion on whether entity's financial statements are presented in accordance with GAAP
- ❖ American Institute of Certified Public Accountants' Auditing Standards Board is primary authoritative body on GAAS

GOVERNMENT AUDITING STANDARDS

- ❖ A.R.S. §15-914 requires charter audits be conducted under GAS
- ❖ GAS adds additional considerations to GAAS
- ❖ Standards pertain to auditors' professional qualifications, quality of audit effort, and reporting requirements, including compliance with certain provisions of laws, regulations, contracts and grant agreements
- ❖ GAS issued by the Comptroller General of the United States



Board's Audit Guidelines

- Rule Requires Release by July 1 of Each Year
- Provide Various Information Related to Audit Requirements, Including:
 - Audit submission deadline
 - Engagement letter and audit components and review processes
 - Mandatory audit firm qualifications



Board's Audit Process



BOARD'S AUDIT PROCESS OVERVIEW

	Description	Timing	Additional Information
Engagement Letter	The Board is required to approve the audit contract and uses the engagement letter to meet this requirement. Generally, the engagement letter describes the audit firm's and charter holder's audit-related responsibilities.	Between January (fiscal year to be audited) and November. Most are received between May and July, or around the time the Board releases the audit guidelines/documents.	A.A.C. R7-5-504(B) Board's audit guidelines
Completeness Determination	Through this process, Board staff ensures each audit reporting package ("audit") includes all the required components. Charter holders that submit incomplete audits may be placed on a Board agenda for possible disciplinary action.	Between August and March for timely submitted audits. Most are received between the last week of October and the November 15 th deadline.	A.A.C. R7-5-504(C)-(E) Board's audit guidelines
Review of Complete Audit	For each audit, Board staff determines the charter holder's financial performance, reviews and enters any issues identified in the audit, and sends a letter to the charter representative(s) with the review results. It is at this time that the charter holder's financial dashboard is made available to the charter representative and the public and the operational dashboard is updated.	Between late September and April for timely submitted audits. Most are reviewed between November and February. Generally, audits are reviewed in the order of date received. Since financial and compliance information from the audits is considered in various Board processes (e.g., renewal, interval reviews, amendments), the audits for charter holders in one of these processes are reviewed first regardless of date received.	A.A.C. R7-5-504(F)-(I) Financial framework Audit & Compliance Questionnaire Follow-up Matrix Operational framework Board's audit guidelines
Corrective Action Plan (CAP)	Appendix B of the operational framework identifies the issues that require a charter holder to submit an audit CAP. Generally, charter holders are given 30 calendar days to submit the initial CAP, except for fingerprinting issues where 10 business days are given. Most CAPs are completed after the initial submission, or, at most, one subsequent submission.	Between November and September/October. Certain CAPs (e.g., those involving payroll taxes) are not completed until after the end of the current fiscal year. September/October usually only comes into play with charter holders that have repeat CAP issues or that submit late audits.	A.A.C. R7-5-504(G) A.A.C. R7-5-510 Operational framework



Phase 1: Engagement Letters



Audit Engagement Letters

- Laws 1999, 1st S.S., Ch.4, sec. 15 Requires Sponsor to Approve Audit Contract before Audit Begins
- Engagement Letter Used to Meet This Requirement
- Engagement Letter Describes Audit Firm's and Charter's Audit-Related Responsibilities



Engagement Letter Review

- A.A.C. R7-5-504(B) and Audit Guidelines
- Approval of Engagement Letter Contingent Upon:
 - Disclosure of certain information specified in the audit guidelines (e.g., completion of compliance questionnaire, retention and availability of audit documentation)
 - Audit firm and supervising CPA meeting certain qualifications



Mandatory Audit Firm Qualifications

- ❖ Auditors must be properly licensed CPAs or persons working for a licensed certified public accounting firm according to GAS.
- ❖ As required by GAS, audit firm must have external peer review performed at least every 3 years and must not have received an opinion of “fail” during most recent review.
- ❖ Each auditor responsible for planning, directing, conducting or reporting on GAS audits must meet the continuing education requirements of GAS.
- ❖ Audit firm and auditors must meet independence requirements of GAS.
- ❖ Audit firm and supervising CPA must not be subject to a current or pending disciplinary action or a regulatory action requiring the audit firm or CPA to complete conditions specified by an accounting industry regulatory body.
- ❖ Audit firm must not have violated or failed to meet GAAS or GAS as identified by an accounting industry regulatory body.
- ❖ Persons employed by audit firm must not have been convicted under federal or state law of a crime indicating lack of business integrity or honesty.

Audit Firm Qualifications Review

- Staff Reviews Most Recent Peer Review Report
- Staff Reviews Accountancy Board's Website
 - <https://www.azaccountancy.gov/CPADirectory/CPASearch.aspx>
- Staff Monitors Agendas of Accountancy Board and Its Committees and May Listen to Recordings
- Firm Affirms It Meets Guidelines' Mandatory Qualifications in Each Engagement Letter



Phase 2: Completeness Determinations



Audit Completeness

- A.A.C. R7-5-504(C)-(E) and Audit Guidelines
- Staff Ensures Each Audit Submitted Is Complete and Includes all the Required Components
- Charters that Submit Incomplete Audits May Be Placed on Agenda for Possible Disciplinary Action



Audit Reporting Package

FINANCIAL STATEMENT AUDIT

- ❖ Financial statements, including the auditor's opinion and notes
- ❖ Government Auditing Standards report on internal control and compliance
- ❖ Applicable compliance questionnaire
- ❖ Management letter, if applicable
- ❖ Submission deadline is November 15
- ❖ Between 75% and 80% of audits received

SINGLE AUDIT

- ❖ Items included in financial statement audit reporting package (see information to left)
- ❖ Schedule of Expenditures of Federal Awards
- ❖ Schedule of findings and questioned costs
- ❖ Submission deadline is March 31
- ❖ Between 20% and 25% of audits received



Phase 3: Review of Complete Audits



Components of Audit Review Process

- Determine Charter's Financial Performance and Make Financial Dashboard Publicly Available
- Update Charter's Operational Dashboard
- Send Letter to Charter Representative(s) with Financial and Operational Audit Review Results



Resources Used in Audit Review Process

- A.A.C. R7-5-504(F)-(I)
- Audit & Compliance Questionnaire Follow-up Matrix (Audit Matrix)
- Financial Framework and Operational Framework
- Audit Guidelines



Audit Matrix

➤ Adopted in 2003

- Guides staff's review of audits and staff's follow-up with charter holders on issues identified through audits
- Classifies issues into three categories – minimal impact, medium impact and serious impact findings

➤ Amended in 2008

- Addresses consequences for “second time” or “third time” an issue is identified through audit that the first time required a corrective action plan
 - Expansion request amendment hold implemented



Financial vs. Operational Framework

FINANCIAL FRAMEWORK

- ❖ Gauges charter holders' financial health and sustainability
- ❖ Focuses on charters' financial viability
 - ❖ Uses certain dollar amounts and informational disclosures from audit
 - ❖ Since the number of students drives funding, the new framework also considers changes in charters' ADM

OPERATIONAL FRAMEWORK

- ❖ Identifies charter holders' compliance with state and federal law, charter contract, and administrative rule
- ❖ Focuses on charters' compliance
 - ❖ Uses information collected through various sources (e.g., audits, site visits, complaints)
 - ❖ As it pertains to the audits, includes, for example, failure to properly fingerprint staff, poor internal controls, noncompliance with Classroom Site Fund requirements



Information Used for Financial Dashboard

- ❖ Audited Statement of Financial Position
 - Also referred to as the balance sheet
 - Shows charter's assets and liabilities
- ❖ Audited Statement of Activities
 - Also referred to as the income statement
 - Shows charter's revenues and expenses and whether charter operated at a surplus or a loss
- ❖ Audited Statement of Cash Flows
 - Shows charter's sources and uses of cash
 - Identifies cash flows from operating activities, investing activities and financing activities
- ❖ Notes to the Audited Financial Statements
 - Also referred to as disclosure notes
 - May include information about leases, loans, compliance with loan terms, cash restrictions
- ❖ Independent Auditor's Report
 - States the auditor's opinion on the financial statements and may include other disclosures
- ❖ Applicable Compliance Questionnaire
 - Used to help determine restricted cash
- ❖ ADM Data Reported to ADE (New Framework)



Audit Review & Follow-up

- All Audits Reviewed Pursuant to Rule and Matrix
 - Charter holder receives a letter after audit has been reviewed
 - Depending on “impact” of issues identified, the letter may:
 - Indicate the charter holder should work towards correcting the issues and that staff will monitor for repeated issues in the next audit (“minimal impact findings”);
 - Indicate the audit included repeated issues that had not been addressed from prior year’s audit (“repeated minimal impact findings”);
 - Require submission of a corrective action plan or CAP (“medium impact findings”); and/or
 - State the charter holder will be placed on an upcoming Board agenda for possible disciplinary action (“serious impact findings”).
- Letter identifies charter’s financial performance and any audit matters that have been reflected on operational dashboard



Phase 4: Audit Corrective Action Plans (CAPs)



Resources Used in Audit CAP Process

- A.A.C. R7-5-504(G)-(H)
- A.A.C. R7-5-510
- Audit Matrix
- Operational Framework
 - Appendix B identifies issues that require charter to submit audit CAP



Portfolio Trends



Audit CAP Data (FY08 – FY18)

	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18
# of Audits Reviewed	337	349	366	364	379	385	394	404	410	415	410
# of CAP Issues	118	110	79	71	107	57	55	47	60	47	36
# of Charters Holders w/CAP Requirement	91	76	63	59	67	33	34	36	53	40	32
% of Charter Holders w/CAP Requirement	27%	21.8%	17.2%	16.2%	17.7%	8.6%	8.6%	8.9%	12.9%	9.6%	7.8%
# of Charter Holders with 3+ CAP Issues [% of Total CAP Issues]	6 [18.6%]	8 [23.6%]	4 [19%]	3 [12.7%]	8 [34.6%]	8 [50.9%]	7 [45.5%]	3 [23.4%]	1 [6.7%]	1 [6.4%]	0 [0%]
# of “No CAP” Issues	13	12	33	32	36	33	14	11	15	18	9



Repeat CAP Issue Trends

➤ Board's Audit Matrix

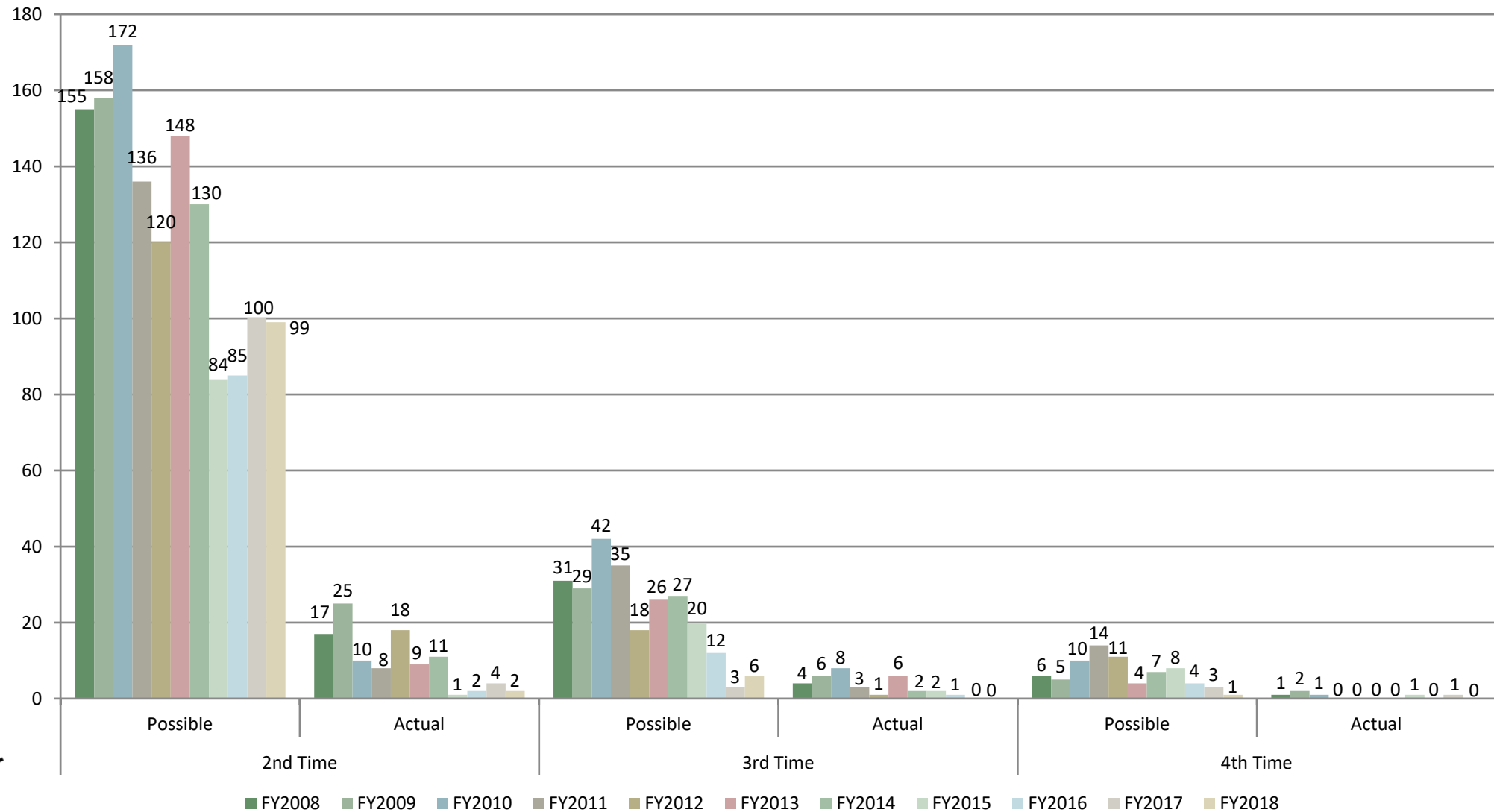
- After CAP issue is identified in audit, charter holder must have two “clean” audits to avoid having issue classified as “second time” or “third time”.

➤ Chart Included on Next Slide

- Reflects # of CAP issues identified, not # of charter holders
- Puts actual number of 2nd time, 3rd time and 4th time issues identified through audits in context by comparing it to possible number
- Shows Board's policy and charter holders' efforts have generally been effective in addressing CAP issues and avoiding subsequent violations



Possible vs. Actual Repeat CAP Issues



Top 5 Audit CAP Compliance Issues

FISCAL YEAR 2018 (36 CAP ISSUES TOTAL)

1. Fiscal Matters (8)
2. Classroom Site Fund (7)
3. Fingerprinting (7)
4. Internal Controls (6)
5. Student Attendance Matters (3)

FISCAL YEAR 2009 (110 CAP ISSUES TOTAL)

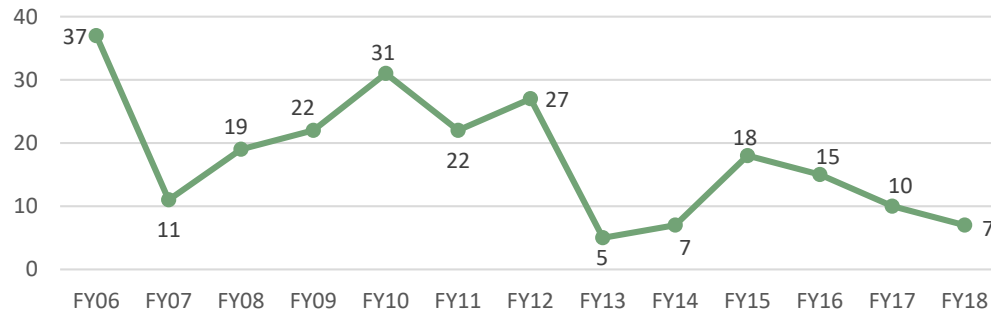
1. Internal Controls (32)
2. Fingerprinting (22)
3. Classroom Site Fund (16)
4. Payroll Taxes (12)
5. Attendance Record Retention (10)
Instructional Hours (10)



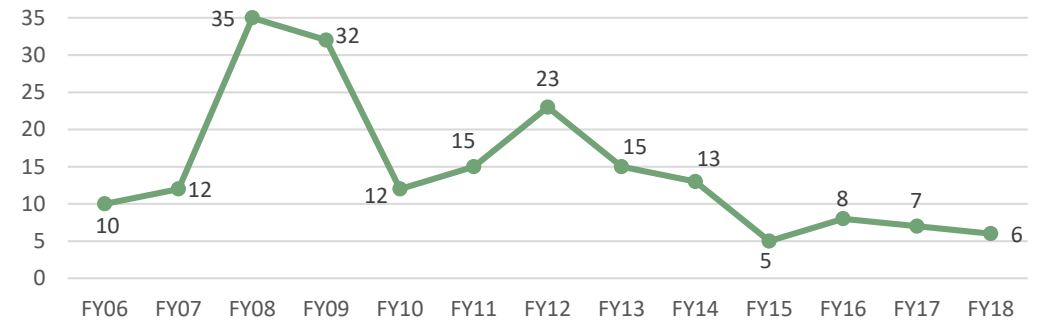
A list of the audit issues that require the submission of a corrective action plan may be found in Appendix B of the Board's *Operational Performance Framework and Guidance*.

Audit CAP Compliance Issue Trends

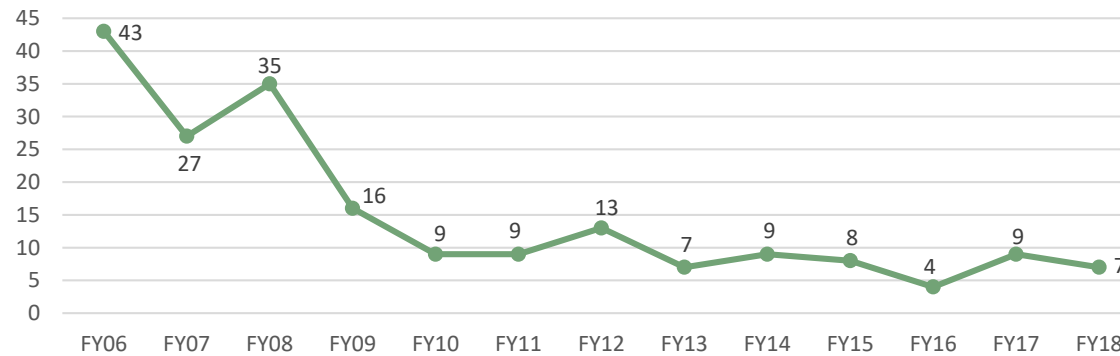
Fingerprinting CAPs [Total=231]



Internal Controls CAPs [Total=193]

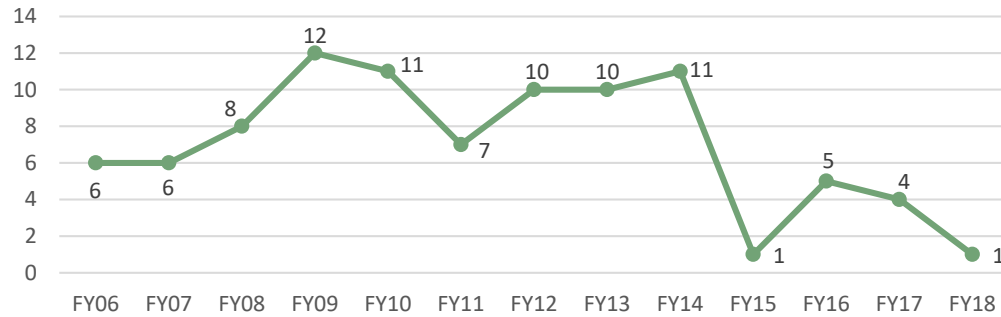


Classroom Site Fund CAPs [Total=196]

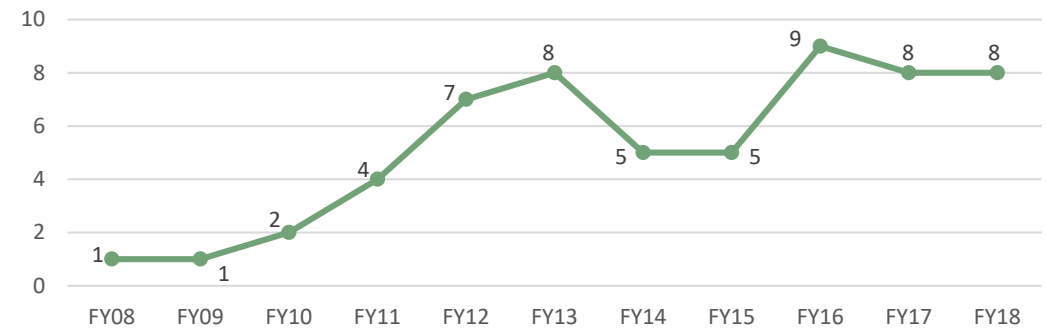


Audit CAP Compliance Issue Trends

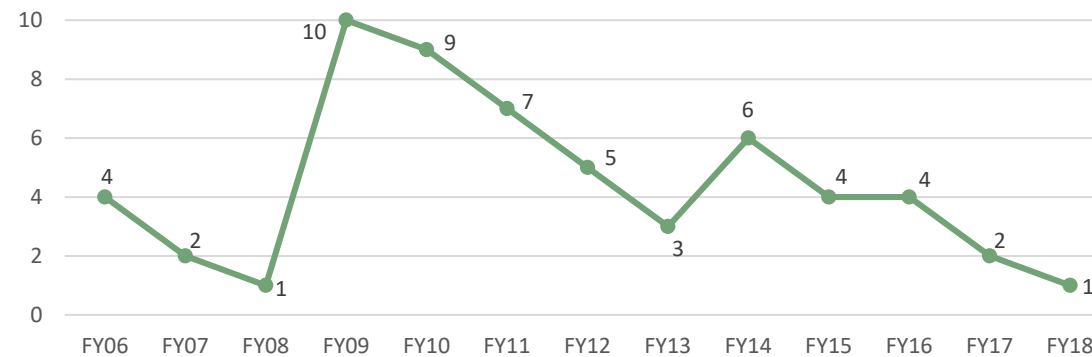
Payroll Tax CAPs [Total=92]



Fiscal Matters CAPs (CAP Added in FY08) [Total=58]

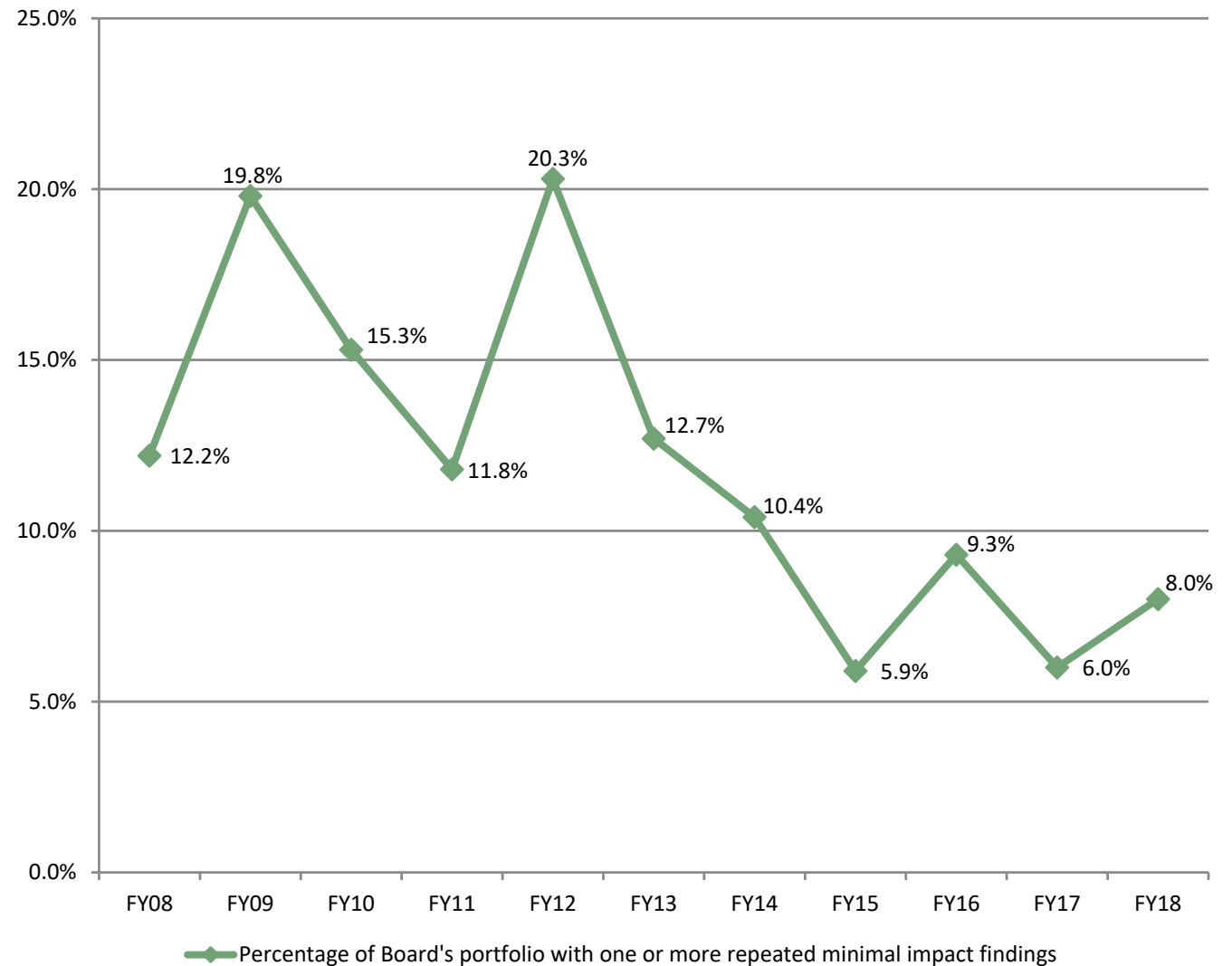


Attendance Record Retention CAPs [Total=58]



Repeated Minimal Impact Findings

- ❖ Chart at right represents the percentage of the Board's portfolio with one or more repeated minimal impact findings for fiscal years 2008 through 2018
- ❖ Number of repeated minimal impact findings range from a low of 34 in fiscal years 2015 and 2017 to a high of 136 in fiscal year 2012
- ❖ 65.3% of repeated minimal impact findings addressed after being identified in 2 consecutive audits
- ❖ 82.4% of repeated minimal impact findings addressed after being identified in 3 consecutive audits



Audit Quality Assurance Considerations

- When an Audit Firm or Auditor Is Identified by the State Board of Accountancy or Similar Regulatory Body as Requiring Disciplinary Action or Failing to Meet Standards, the Board May in the Future Wish to Consider:
 - Suspending that firm's or auditor's ability to conduct charter school audits for up to a specified number of years (e.g., up to 3 years)
 - Whether audits conducted by that firm or auditor should be reissued and, if so, how many years should be reissued (e.g., up to 2 years)
 - The audit firm that takes over auditing responsibilities for impacted charter holders would be responsible for ensuring the accuracy of certain information in the previous year's audit prior to completing a new audit
- Regulatory Body's Findings Would Be Presented to Board When Board Determines Final Decision in Each Case

