Your Annual Audit: Don’t Be Afraid, Be Prepared!

23rd Annual California Charter Schools Conference
Today’s Presenting Team

Panel

- **Brenda Hunt**
  - Squar Milner LLP: Audit Senior Manager
  - Extensive audit experience working with a variety of organizations, including charter schools

- **James Rotherham**
  - Squar Milner LLP: Partner
  - 25+ Years in accounting and finance; last eight Years as auditor of charter schools
  - Hosaka, Rotherham & Company audits 100+ of the 1,230+ operating charter schools in California

Facilitator

- **Cheryl Leong & Kelly Hoppe**
  - EdTec: Client Managers
  - Work as outsourced CFO role for California charter schools throughout California
Goal for Today: De-mystify the Audit!

- When you leave our session in 75 minutes, you will know:
  - What an audit is and what it is not
  - What all audit firms universally need for the audit
  - What a good audit look like from the preparation to actual process to final report
  - What the timeline is for the audit and the different timeframes
  - What some of the common and emerging trouble spots are for charter schools during the audit process

- Whether a first timer or a veteran, a good audit comes down to knowing what to expect, the preparation put in months in advance, and the follow through during and afterwards
Today’s Discussion

- What is an audit and why do you need it?
- How do you engage an audit firm?
- What does the audit timeline look like?
- What should you expect prior to the audit?
- What should you expect during the audit?
- You’ve been audited. Now what?
- Do’s & Don’ts of Audits
- Q&A
What is an audit and why get one?

- Required by law: CA Ed. Code 47605(b)(5)(l) and by your charter
- Official, independent review of your charter school’s financial statements by an approved CPA
  - Are they fairly presented?
- Review done through testing and sampling, not a review of every transaction
- Other programmatic compliance testing
  - LCAP, ASES, A-133, PCSGP, Title I
What isn’t an audit?

- Not an endorsement of spending practices or programs
- Not definitive proof that there may be financial concerns or gaps in financial and internal controls
- Not just a formality
- Not just some “accounting thing”
- Not meant to be a “gotcha” exercise
- Not something that you prepare for at year-end
# The Audit Cycle

<table>
<thead>
<tr>
<th>What?</th>
<th>When?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditor Solicitation</td>
<td>No later than February; as early as September for new or first year charter schools</td>
</tr>
<tr>
<td>Auditor Engagement</td>
<td>No later than April 1st</td>
</tr>
<tr>
<td>Pre-Audit</td>
<td>April, May, June</td>
</tr>
<tr>
<td>Main Audit</td>
<td>August, September, October, November</td>
</tr>
<tr>
<td>Audit Report Review, Discussion, &amp; Response</td>
<td>November, December</td>
</tr>
<tr>
<td>Audit Submission</td>
<td>December 15th</td>
</tr>
<tr>
<td>Post-Audit</td>
<td>Ongoing</td>
</tr>
</tbody>
</table>
Engaging an audit firm

- All operating charter schools must contract with an audit firm no later than April 1 for the current fiscal year
  - E.g., you need to select an audit firm for FY 2016 (ending June 30, 2016) by April 1, 2016
- Many districts and county offices of education require some sort of notification of the selected audit firm, along with cost information and certification that the firm is authorized to conduct school audits
  - Several require notification earlier than April 1, for example Alameda County Office of Education & Los Angeles County Office of Education
- Must contract with an approved CPA firm: http://cpads.sco.ca.gov/CPAList.aspx
Lots of sample requests for proposals for audit services publically available

Simple letter with the following information to an audit firm is usually enough to get an audit proposal:

- Legal name of charter school, school contact person and address
- Whether the school is in its first year or has been operational; if in the first year, if the school has had any sort of audit since its inception/approval
- Status of 501(c)3 application
- Fiscal year to be reviewed, as well as enrollment and ADA for fiscal year to be reviewed
- Is the school independent study or site-based?
- Will federal expenditures exceed $500K for the fiscal year in question?
- Will the school want tax filing services as well?

A board member or the school leader should solicit the proposals, with best practices saying you should obtain at least 3 proposals

Bring to the board; have the audit committee review the proposals and/or conduct interviews

Select the audit firm at a publically noticed board meeting
Charter Schools in their First Year of Operations or Not Operational

- While all operating charter schools need to engage an audit firm no later than April 1, charter schools in their first year or not yet opened may need to engage one earlier than April 1 to file the 990.

- The 990 is the tax return for nonprofit organizations with revenues greater than $50,000 in a given year.
  - If you are a charter school that was approved with substantial time between approval and your first year of operations and you have had at least $50,000 of activity prior that year, you’re likely going to need to file a 990.

- Must be filed no later than four months after the close of the fiscal year.

- Potential tax exempt revocation implications if you’re not in compliance with annual 990 filing requirements.

- California Corporation Reporting.
What makes for a good audit firm?

- Experience working with charter schools, not just on the approved list
- If you’re a first year charter school, experience working with first year charter schools
- Responsive to questions and proposal requests
- Reasonable, fair mentality; any hints an “adversarial” attitude probably not going to be good
- Can provide clear feedback and ongoing support throughout the year for questions throughout the year as they come up
- Audit and tax practices, if separated, not disjointed
- References and recommendations – your colleagues and peers at other charter schools
True or False:

- Any certified public accountant or accounting firm can be selected to audit a charter school
- My charter school needs an audit only if it is mentioned in my charter petition
- A new charter school must contract for an audit no later than the end of its first fiscal year
- An audit will express an opinion as to whether a charter school’s financial statements are fairly presented
- A charter school board should choose an audit firm primarily based on the best deal it can get
**The Audit Cycle**

<table>
<thead>
<tr>
<th>What?</th>
<th>When?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditor Solicitation</td>
<td>No later than February; as early as September for new or first year charter schools</td>
</tr>
<tr>
<td>Auditor engagement</td>
<td>No later than April 1st</td>
</tr>
<tr>
<td>Pre-Audit</td>
<td>April, May, June</td>
</tr>
<tr>
<td>Main Audit</td>
<td>August, September, October, November</td>
</tr>
<tr>
<td>Audit Report Review, Discussion, &amp; Response</td>
<td>November, December</td>
</tr>
<tr>
<td>Audit Submission</td>
<td>December 15th</td>
</tr>
<tr>
<td>Post-Audit</td>
<td>Ongoing</td>
</tr>
</tbody>
</table>
Pre-Audit: Reaching Initial Consensus

- Agree on an audit timeline for the final report
- Leave enough time for a thorough review of the audit report
- Ask questions throughout the process
- Auditor is a resource, not an adversary
  - We want a clean and seamless audit just as much as you do
- Stay organized before and throughout the process
- Be involved
  - This is your audit and your financial statements
Pre-Audit: Planning Ahead for the First Visit

- Discuss significant or complex transactions as they occur
- Have segregation of duties reviewed
- Update internal control policies and procedures
- Compile copies all state compliance records
  - Student records, bell schedules, instructional minutes
  - English Learner, Free/Reduced Lunch Program records
- Retain copies of all significant transactions
  - New leases and new loans
  - Any new/pending legal matters
  - New contracts with different service providers
  - New grant agreements
Pre-Audit: Preparing for the Auditor’s First Visit

- Provide as many requests as possible in electronic format prior to auditors arrival
  - Trial Balances (through a closed accounting period)
  - Check Registers
- Provide information in an organized fashion
- Review current year activity as compared to prior year
- Let the auditors know of any concerns before arrival
- Be responsive and ask questions
- Update the auditors on major developments
  - New school opened during the year?
  - New federal funds received during the year?
  - New loans to the school?
Pre-Audit: Ongoing Communication

- Collaborative process
- Be open to suggestions or improvements to a process
- Transparency is necessary to understand the full picture of a school
- Set aside an hour once the auditors arrive for questions about the processes and general understanding of how the school works
- New accounting standards
- Stay current on requirements and compliance
  - EPA
  - LCAP
  - Teacher effectiveness grant
The Audit Cycle

<table>
<thead>
<tr>
<th>What?</th>
<th>When?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditor Solicitation</td>
<td>No later than February; as early as September for new or 1st year charter schools</td>
</tr>
<tr>
<td>Auditor engagement</td>
<td>No later than April 1st</td>
</tr>
<tr>
<td>Pre-Audit</td>
<td>April, May, June</td>
</tr>
<tr>
<td>Main Audit</td>
<td>August, September, October, November</td>
</tr>
<tr>
<td>Audit Report Review, Discussion, &amp; Response</td>
<td>November, December</td>
</tr>
<tr>
<td>Audit Submission</td>
<td>December 15th</td>
</tr>
<tr>
<td>Post-Audit</td>
<td>Ongoing</td>
</tr>
</tbody>
</table>
Main Audit: What Happens?

- During pre-audit or interim audit, most audit firms try to do as much of the audit work as possible for items not dependent on fiscal year being closed.
- Main fieldwork usually takes place during late Summer or Fall; expect them to be on site for 2-3 days.
- During this time, the audit firm is going to test financial information as of the fiscal year close with specific attention to:
  - How information has or has not changed from unaudited actuals.
  - Financial activity immediately following the close of fiscal year.
  - Review of subsequent events.
Main Audit: How do you Facilitate?

- During pre-audit, you should have discussed the format or manner you would give the audit firm information; stick to that.
- A dedicated physical space for an audit team to work out of is really crucial.
- The audit firm will generate requests for more information as they are conducting testing; it’s important to be responsive to not hold up the process or force them to stay on site longer than they have to.
An Example: Audit of the LCAP

- A school does **not need** to track base, supplemental and concentration grant funds separately, although it is best practice.

- Auditors should begin by selecting an action or service from the LCAP that the LEA has identified as having expenditures.

- The LEA will then be responsible for guiding the auditor as to how they can find those certain expenditures in the general ledger.
Even when fieldwork is completed, there’s a lot of work to be done still on the audit firm’s side

- Following up on outstanding items or testing not done during main fieldwork
- Organizing audit work and documentation
- Preparing a list of audit adjustments if any are required
- Double-checking work
- Peer and partner review of work papers
- Supplemental schedule development

When discussing timeline with the contracted audit firm, it’s important to make sure this timeframe is discussed and included in planning.
Check For Understanding #2

- **True or False:**
  - Auditors don’t want any school materials until the fiscal year is officially closed
  - Creating an electronic share space for my charter school’s financial information and making that available to the audit firm is appropriate
  - If a problem has come up during the year, I should wait for the pre-audit meeting to discuss in greater detail
  - My audit firm is strictly concerned with my financial information, so legal issues should not take any focus
  - If my school contracts with a CPA firm for its audit, I can now ask them financial questions throughout the year
# The Audit Cycle

<table>
<thead>
<tr>
<th>What?</th>
<th>When?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditor Solicitation</td>
<td>No later than February; as early as September for new or 1st year charter schools</td>
</tr>
<tr>
<td>Auditor engagement</td>
<td>No later than April 1st</td>
</tr>
<tr>
<td>Pre-Audit Work</td>
<td>May, June</td>
</tr>
<tr>
<td>Audit Field Work</td>
<td>August, September, October, November</td>
</tr>
<tr>
<td>Audit Report Review, Discussion, &amp; Response</td>
<td>November, December</td>
</tr>
<tr>
<td>Audit Submission</td>
<td>December 15th</td>
</tr>
<tr>
<td>Post-Audit</td>
<td>Ongoing</td>
</tr>
</tbody>
</table>
## The Audit Report – What Does Each Section Tell You?

<table>
<thead>
<tr>
<th>Section</th>
<th>What is in it?</th>
<th>Why is it important?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditor’s Opinion</td>
<td>Whether the audit firm believes your financial statements are fairly presented</td>
<td>Unqualified, Qualified, or Adverse Opinion</td>
</tr>
<tr>
<td>Statement of Financial Position</td>
<td>Balance sheet listing out assets, liabilities, and net assets or equity</td>
<td>Gives reader snapshot of what the charter school owns and owes</td>
</tr>
<tr>
<td>Statement of Activities</td>
<td>Income statement listing out revenues and expenses and impact to net assets</td>
<td>Gives reader snapshot of what took place during the year</td>
</tr>
<tr>
<td>Statement of Cash Flows</td>
<td>Schedule explaining how a charter school’s cash has changed between start and end of year</td>
<td>Charter schools are on accrual basis; helps to reconcile the difference to cash position</td>
</tr>
<tr>
<td>Notes to Financial Statements</td>
<td>Disclosures such as makeup of receivables and debt, future obligations, retirement contributions</td>
<td>Provides context to reader to evaluate financial information within report</td>
</tr>
<tr>
<td>Organizational Information</td>
<td>Organizational history, funding explanation, board members</td>
<td>Who makes up the organization, who governs it, what is operating context, other key factors</td>
</tr>
<tr>
<td>Supplemental Schedules</td>
<td>Average Daily Attendance, Instructional Minutes Tabulation</td>
<td>Drives funding; state compliance</td>
</tr>
</tbody>
</table>
# The Audit Report – What Does Each Section Tell You?

<table>
<thead>
<tr>
<th>Section</th>
<th>What is in it?</th>
<th>Why is it important?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statement of Functional Expenses</td>
<td>Breakdown of spending by classification – administrative, instructional, fundraising</td>
<td>Gives reader additional context around spending decisions</td>
</tr>
<tr>
<td>Reconciliation to Unaudited Actuals</td>
<td>Schedule explaining difference between report submitted in late summer vs. audit</td>
<td>What’s changed going through audit preparation</td>
</tr>
<tr>
<td>Opinion of Internal Control Over Financial Reporting</td>
<td>Limited opinion on internal control to express opinion on financial statements</td>
<td>Clarifies how the auditor can have an opinion on statements for fairness</td>
</tr>
<tr>
<td>State &amp; Federal Compliance</td>
<td>List of the various state and federal programs a charter school participates in, e.g., Title I, ASES</td>
<td>Conveys whether or not you are in compliance based on testing done</td>
</tr>
<tr>
<td>Audit Year Findings</td>
<td>Issue identified during course of the audit</td>
<td>So it can be fixed</td>
</tr>
<tr>
<td>Prior Audit Year Findings</td>
<td>Issues identified during course of prior year audit</td>
<td>Confirmation that it was fixed</td>
</tr>
<tr>
<td>A-133*</td>
<td>If a charter school expended more than $500,000 in federal funds</td>
<td>Statement on separate testing for programmatic compliance</td>
</tr>
</tbody>
</table>
What is an Audit Finding?

- Issue identified in course of audit that represents a deficiency in internal control over compliance
- Deficiency or deficiencies can combine to not allow management the ability to prevent, detect, or correct issues of noncompliance
- Two types of findings:
  - Material Weakness (most severe)
  - Significant Deficiency (less severe than a material weakness but warrants flagging for management)
- Sometimes, audit firms utilize the management letter or exit interview process to address additional concerns not categorized as findings
The Anatomy of an Audit Finding

- **Condition**: What did the charter school do or not do that was incorrect or improper?
- **Criteria**: What is the generally accepted expectation for what the charter school should have done?
- **Effect**: What was the impact to the financial statements?
- **Recommendation**: What should the charter school do to resolve it?
Common Charter School Audit Findings

- Inadequate resourcing or tagging of restricted fund activity
- Missing documentation, e.g., credit card transactions
- Lack of adherence to purchase or approval policies or thresholds
- Timely deposition of funds
- Improper capitalization of fixed assets
Audit Findings – Management Response

- Understand the findings!
- All audit findings require a response from management that allows the charter school to provide any additional context around actions
- Acknowledge (or contest) auditor recommendations and outline corrective action to be taken
- Responses should be drafted by staff and reviewed by the board prior to submission to auditor
- Responses, depending on nature of the findings, may require consultation with legal counsel
Audit Findings – Corrective Action

- Start with the auditor recommendations
- Policy or process or some combination of both?
- School issue, staff issue, or provider issue?
- Ask for help
Check For Understanding #3

- True or False:
  - My audit report doesn’t contain any findings, so I don’t need to worry about my financial processes or internal controls
  - A material weakness is worse than a significant deficiency
  - A charter school needs an A-133 or Single Audit every year it spends federal revenues
  - Audit firms have discretion on what schedules they need to include in an audit report, so my audit reports can look very different from year to year
  - If a charter school changes its audit firm from one year to the next, it can avoid getting dinged again for an issue that has happened before
# The Audit Cycle

<table>
<thead>
<tr>
<th>What?</th>
<th>When?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditor Solicitation</td>
<td>No later than February; as early as September for new or 1st year charter schools</td>
</tr>
<tr>
<td>Auditor engagement</td>
<td>No later than April 1st</td>
</tr>
<tr>
<td>Pre-Audit Work</td>
<td>May, June</td>
</tr>
<tr>
<td>Audit Field Work</td>
<td>August, September, October, November</td>
</tr>
<tr>
<td>Audit Report Review, Discussion, &amp; Response</td>
<td>November, December</td>
</tr>
<tr>
<td>Audit Submission</td>
<td>December 15th</td>
</tr>
<tr>
<td>Post-Audit</td>
<td>Ongoing</td>
</tr>
</tbody>
</table>
Post-Audit

- Exit interview
- Auditor presentation to board
- Implementing formal and informal recommendations
- Posting adjusting entries!
- Sharing the audit report
- 990 filing if extended
- Beginning preparations for the next fiscal year
Emerging & Existing Audit Trouble Spots

- EPA/LCAP documentation
- One-time Restricted Funding Sources
- Deferred Operating Leases
- Independent Study & Nonclassroom-Based Instruction compliance
- New compliance requirements for 2016
Thank You For Attending!