

# Governor Signs State Sarbanes Oxley-Type Reforms for School Districts and Comptroller Audit Requirements for School Districts, Charter Schools and BOCES

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In the wake of the accounting scandals with Enron and MCI WorldCom, Congress enacted the Sarbanes Oxley Act of 2002 ("SOX") to enhance accountability, auditing and financial reporting for publicly traded companies. With the exception of document destruction procedures and whistleblower protections contained in the SOX<sup>1</sup>, the accountability provisions, auditing and financial reporting requirements of the SOX do not apply to entities other than publicly traded companies.

However, since the enactment of SOX, states have engaged in the discussion of SOX-type financial disclosure, auditing and accounting requirements for entities not covered by SOX. In New York, for example, there has been much discussion by the Legislature, Attorney General Spitzer and Comptroller Hevesi about the implementation of these financial oversight reforms for school districts and non-profit organizations.

The Legislature and the Governor recently enacted a series of reforms that will impose financial oversight requirements on school districts and enhanced audit requirements by the State Comptroller for school districts, charter schools and BOCES. (See, Chapters 263 and 267 of the Laws of 2005 (legislative bills, S.5050-A and S.890-B). (For bill text, visit our [Government Legal Resources section](#), click on New York State Senate and insert the Senate bill numbers (S.5050-A and S.890-B)). Should the Legislature seek to impose SOX-type requirements on non-profits as proposed in bill A.10239/S.4836, this action provides important insight into what provisions of SOX the Legislature and the Governor consider important.

In Chapter 263 (S.5050-A), the law increases the accountability of school district financial practices. The new law will require districts to appoint an outside claims auditor, train new board members, limit the number of years an outside auditor may be engaged, impose internal audit controls and require the establishment of an audit committee.

## **Outside claims auditor:**

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<sup>1</sup> Section 1107 of SOX (which applies to entities that receive Federal funds) creates criminal liability if an employer fires or otherwise retaliates against an employee who provides law enforcement any truthful information relating to the commission or possible commission of a federal offense. Additionally, Section 802 of SOX creates a new criminal statute that prohibits knowingly altering, destroying or concealing records with the intent to impede, obstruct or influence any matter involving the Federal government. With regard to non-profits and school districts that receive federal funds, these provisions would apply.

Union free and common school districts will be required to establish an office of claims auditor and appoint a claims auditor not connected to the district. The law specifically prohibits the auditor from being either a trustee of the district, clerk or treasurer of the district, the superintendent or other business official of the district or an individual directly involved in the accounting and/or purchasing functions of the school district.

**School board training:**

Every voting member of a board of education, elected after July 1, 2005, must receive, within one year of his or her term, six hours of training in financial oversight, accountability and the fiduciary responsibilities of a school board member. A trustee is only required to go through this training once. New York City must certify to the Commissioner of Education that school board members receive such training so that the requirements of this section do not apply.

The curriculum used for this training must be approved by the Commissioner of Education in consultation with the State Comptroller. The training may be offered by providers approved by the Commissioner of Education. In approving providers, the Commissioner must consider the potential provider's understanding of the educational environment, the roles of the trustees and BOCES and the experience of the provider in delivering such training. To demonstrate compliance each person must file a certificate of completion with the district clerk.

**Request for Proposal (RFP) for external auditor:**

On or after July 1, 2005, except for New York City, school districts must use a competitive RFP process when contracting for an independent annual audit. In addition, all school districts, including New York City, may not engage an auditor for a term longer than five consecutive years. However, a district may, in its discretion, permit an existing auditor/accountant to submit a proposal for such services in response to an RFP or be awarded a contract based on an RFP. School districts will be required to amend their procurement practices to comply with this requirement.

**Internal audit practices:**

Except for small school districts<sup>2</sup>, all school districts by July 1, 2006 for implementation by December 31, 2006, must establish an internal audit function. Such function must include:

- development of a risk assessment of district operations, including a review of financial policies and procedures and testing and evaluation of district internal controls;
- an annual review and update of such risk assessment; and,
- preparation of reports, at least annually, which analyze significant risk assessment findings, recommend changes for strengthening controls and reducing identified risks and specify timeframes for implementation.

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<sup>2</sup> Exempt from these requirements are school districts with fewer than eight teachers, actual general fund expenditures totaling less than \$5 million in the last school year, or enrollment of fewer than 300 students. New York City will certify annually to the Commissioner of Education that its internal audit functions meet or exceed these requirements.

**School district audit committees:** All school districts, except those employing fewer than eight teachers, must establish an audit committee to oversee and report to the district board on the annual audit of the district financial records. The audit committee must be established by January 1, 2006 and may either be: (1) an advisory committee composed entirely of persons other than board members if (in the board's opinion) such membership is advisable to provide accounting and auditing expertise; or, (2) a committee of the whole board. The audit committee must consist of at least three non-district employed members.

The role of the audit committee is advisory only. Such committee will be required to:

- provide recommendations regarding the appointment of the external auditor for the district;
- meet with the external auditor prior to commencement of the audit;
- review and discuss with the external auditor any risk assessment of the district's fiscal operations;
- receive and review the draft annual audit report and, working directly with the auditor, assist the board in understanding such document;
- make a recommendation to the board accepting the report; and,
- review every corrective action plan developed by a school district.

A related law, Chapter 267 (bill number: S.890-B), the Comptroller will be required to complete an audit of each school district, BOCES and charter school by March 31, 2010. Adding \$2.9 million to the Comptroller's budget to accomplish this task, this audit requirement would be in addition to and not in place of, the independent audit already performed by such entities. The Comptroller has performed several audits in the past of school districts and BOCES. (For examples, see <http://www.osc.state.ny.us/localgov/muni/audits/2005/schools/05school.htm>)

Under the new law, the Comptroller would develop a plan for the audit of each school district, BOCES and charter school by March 31, 2010. After that, audits would be conducted based on a "risk assessment" process conducted by the Comptroller. While this process is not defined in the legislation, it may include investigations of alleged improprieties, previous audit findings and recommendations, or other financial performance indicators. Reasonable notice (not defined) must be provided to the entity to be audited prior to commencement of such audit.

In the audit, the Comptroller must include:

- Examination, auditing and evaluation of financial documents and records of the entity;
- An assessment of the current financial practices of the entity to ensure such practices are consistent with established standards; and,
- A determination that the entity provides adequate protections against any fraud, theft or professional misconduct.

The audit report would include any appropriate findings and recommendations of the auditors regarding the fiscal practices that the auditors believe to be in violation of "any state or federal law, rule or regulation, or demonstrate negligence or incompetence." The final report must be made available to the public by the audited entity for a period of at least five years. Such audit is to be posted on the entity's web site, if it has one.

In the event there is a finding of misconduct that may constitute a crime, the Comptroller must report such information to the appropriate officials, including the Commissioner of Education, the charter entity or the U.S. Attorney.

The Comptroller will be required to advise the Governor and the Legislature in December of each year about the audits that were conducted in the previous year.

*The opinions expressed in this bulletin are intended for general guidance only. They are not intended as recommendations for specific situations. As always, readers should consult a qualified attorney for specific legal guidance.*