

CALIFORNIA DEPARTMENT OF EDUCATION

Audit Report

EDUCATION PROTECTION ACCOUNT RECORDED IN THE STATE GENERAL FUND

July 1, 2012, through June 30, 2015



BETTY T. YEE
California State Controller

August 2016



BETTY T. YEE
California State Controller

August 12, 2016

The Honorable Tom Torlakson
Superintendent of Public Instruction
California Department of Education
1430 N Street
Sacramento, CA 95814

Dear Mr. Torlakson:

The State Controller's Office audited the Education Protection Account (EPA) recorded in the State General Fund for the fiscal years ended June 30, 2013, June 30, 2014, and June 30, 2015.

The account, administered by the California Department of Education, was created to receive and disburse revenues derived from the incremental increases in taxes imposed by the California State Constitution, Article XIII, Section 36, subdivision (f), and to provide general purpose funding in accordance with subdivision (e)(3)(A) and (B) to local education agencies (school districts, county offices of education, charter schools) and community college districts.

With the exception of a calculation error made by the California Department of Finance (DOF) that understated a transfer to the EPA by \$59,755,000 as of June 30, 2015, funds recorded in the EPA for the fiscal years ended June 30, 2013, June 30, 2014, and June 30, 2015, accounted for and used the incremental increases in taxes in a manner consistent with the California State Constitution, Article XIII, Section 36.

As required by the California State Constitution, DOF estimated fiscal year (FY) 2012-13 revenues, which were based on assumptions and tax revenues that have not yet been collected from California taxpayers, and provided its adjustment to the original estimate on June 12, 2015, when calculating the FY 2014-15 fourth quarter transfer. In making the adjustment, DOF understated the amount to be transferred to the EPA by \$59,755,000. DOF corrected this error on June 28, 2016, when calculating the FY 2015-16 fourth quarter transfer. This error did not adversely affect the local educational agencies and community college districts, as the monies were otherwise received through state aid because of the mandatory education spending level required by Proposition 98 that was approved by the voters in 1988.

If you have any questions, please contact Jim L. Spano, CPA, Chief, Financial Audits Bureau, at (916) 323-5849.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/ljs

cc: Michelle Zumot
Chief Deputy Superintendent
California Department of Education
Kevin Chan, Director of Audits and Investigations
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Audit Report

Summary

The State Controller's Office (SCO) audited the Education Protection Account (EPA) recorded in the State General Fund for the fiscal years ended June 30, 2013, June 30, 2014, and June 30, 2015.

The account, administered by the California Department of Education (CDE), was created to receive and disburse revenues derived from the incremental increases in taxes imposed by the California State Constitution, Article XIII, Section 36, subdivision (f), and to provide general purpose funding in accordance with subdivision (e)(3)(A) and (B) to local education agencies (LEA) and community college districts (CCD). LEAs consist of school districts, county offices of education, and charter schools.

With the exception of a calculation error made by the California Department of Finance (DOF) that understated a transfer to the EPA by \$59,755,000 as of June 30, 2015, funds recorded in the EPA for the fiscal years ended June 30, 2013, June 30, 2014, and June 30, 2015, accounted for and used the incremental increases in taxes in a manner consistent with the California State Constitution, Article XIII, Section 36.

As required by the California State Constitution, DOF recalculated the estimate made in FY 2012-13, which was based on assumptions and tax revenues that had not yet been collected from California taxpayers, and provided its adjustment to the original estimate on June 12, 2015, when calculating the FY 2014-15 fourth quarter adjustment. In making the adjustment, DOF understated the amount to be transferred to the EPA by \$59,755,000. DOF corrected this error on June 28, 2016, when calculating the FY 2015-16 fourth quarter transfer. This error did not adversely affect the LEAs and CCDs, as the monies were otherwise received through state aid because of the mandatory education spending level required by Proposition 98 that was approved by the California voters in 1988.

Background

The EPA was established in April 2013 after California voters approved Proposition 30 in November 2012. Proposition 30 is also known as The Schools and Local Public Safety Protection Act of 2012. The EPA (Fund 3207) is recorded in the General Fund Special Account within the State of California's General Fund. The General Fund is accounted for under the modified accrual basis of accounting.

The EPA was established to ensure that public education is not harmed in the process of providing critical protection to local Public Safety Services as defined in the California State Constitution, Article XIII, Section 36, subdivision (a)(1). This account was created to receive and disburse revenues derived from the incremental increase in taxes and to provide general purpose funding in accordance with the California State Constitution, Article XIII, Section 36, subdivision (e)(3)(A) and (B). California State Constitution, Article XIII, Section 36, subdivision (e)(3), states that all moneys are continuously appropriated for the support of LEAs and CCDs.

The Schools and Local Public Safety Protection Act of 2012 provides for a one-quarter cent sales tax increase that expires in four years and an increase in income taxes for wealthier taxpayers that ends in seven years. The moneys that are appropriated as a result of this Act are allocated quarterly; 89% to the Superintendent of Public Instruction to provide general purpose funding to LEAs and 11% to the Board of Governors of the California Community Colleges to provide general purpose funding to CCDs.

In addition, LEAs and CCDs are required to have annual independent financial and compliance audits. Specific audit procedures are included in both the LEAs' and CCDs' Audit Guides to verify whether funds from the EPA have been properly disbursed and expended.

California Department of Finance's Process to Calculate Proposition 30 Funds Available for Transfer to the Education Protection Account

DOF's Revenue and Taxation section is responsible for estimating the State's major General Fund and special fund tax revenues for the Governor's Budget. DOF monitors and reports on monthly receipts compared to estimates. DOF is responsible for developing the estimate of revenues for the State overall and the amount of funds that will be available for transfer into the EPA as a result of Proposition 30. DOF's revenue estimate is prepared by forecasting expected personal income tax and sales and use tax. The Proposition 30 revenue estimates are derived from the tax increases that were enacted when California voters approved the Schools and Local Public Safety Protection Act of 2012.

DOF calculates its estimate in May. By mid-June, DOF provides a notification letter to the California State Controller of its Proposition 30 revenue estimate, which includes three estimated amounts. DOF's first estimate is the initial estimate of Proposition 30 revenues that will be available for the following fiscal year. The second estimate revises the prior fiscal year's estimate of Proposition 30 revenues based on updated information. The third estimate is the final estimate of Proposition 30 revenues estimated two years prior. The adjustments from the revenue estimate revisions could be positive or negative.

California Department of Education's Process to Account For, Allocate, and Disburse Proposition 30 Funds to County Treasurers

CDE allocates EPA funds to LEAs based on their proportionate share of the statewide revenue limit amount, which includes the allowance for necessary small schools, and charter school general purpose funding. If an LEA's funding from the combined local property taxes and EPA exceeds the LEA's revenue limit or charter school general purpose entitlement, the LEA's EPA entitlement may be reduced, provided it receives the minimum amount of \$200 per unit of average daily attendance.

CDE quarterly performs its allocation and disbursement calculations, factoring in the EPA funding requirement criteria. CDE also quarterly prepares a Notice of Certification of the EPA's Apportionment and includes a payment summary schedule by county of the amount transferred to each county treasurer. In addition, CDE provides a schedule on its website of the EPA amounts that are to be disbursed by the county treasurers to each LEA.

California Community Colleges Chancellor's Office's Process to Account For, Allocate, and Disburse Proposition 30 Funds to County Treasurers

The California Community Colleges Chancellor's Office (CCCCO) allocates EPA funds to CCDs based on their proportionate share of the statewide total computational revenue (TCR). The TCR is the amount CCDs are guaranteed to receive in state aid, which is offset by enrollment fees, local property taxes, and EPA revenues. The CCD's EPA entitlement amount is a minimum of \$100 per full-time equivalent student for those CCDs that receive more than their state entitlement amount from local property taxes and enrollment fees.

CCCCO quarterly performs its allocation and disbursement calculations, factoring in the EPA funding requirement criteria. CCCCCO also quarterly prepares a notification letter for the EPA's apportionment, which includes a payment summary schedule by county of the amount transferred to each county treasurer. In addition, CCCCCO provides a schedule on its website of the EPA amounts that are to be disbursed by the county treasurers to each CCD.

**Objectives, Scope,
and Methodology**

We conducted this performance audit to determine whether funds recorded in the EPA for the fiscal years ended June 30, 2013, June 30, 2014, and June 30, 2015, accounted for and used specified incremental increases in taxes in a manner consistent with the California State Constitution, Article XIII, Section 36, subdivision (e).

The legal authority for us to conduct this audit is set forth in the California State Constitution, Article XIII, Section 36, subdivision (g)(1), which states that the State Controller shall audit the Education Protection Account "to ensure that those funds are used and accounted for in a manner consistent with this Section." We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We limited our review of internal control to gaining an understanding of the process:

- Established by DOF to calculate Proposition 30 funds derived from increases in sales and use tax, and personal income tax to the EPA
- Established by CDE to account for, allocate, and disburse the Proposition 30 funds to the county treasurers
- Established by CCCCCO to account for, allocate, and disburse the Proposition 30 funds to the county treasurers

Our audit scope did not assess the efficiency or effectiveness of program operations. We did not audit the EPA's financial statements.

To achieve our audit objectives, we performed the following procedures:

- Interviewed employees, completed internal control questionnaires, and performed walk-throughs of the processes used by DOF to calculate Proposition 30 funds available for transfer to the EPA
- Interviewed employees, completed internal control questionnaires, and performed walk-throughs of the processes used by CDE and CCCCCO to account for, allocate, and disburse Proposition 30 funds to county treasurers
- Traced DOF's calculations to supporting documentation and verified the validity of its estimates
- Verified the accuracy of the EPA allocations between CDE and CCCCCO in accordance with the California State Constitution
- Verified the accuracy of CDE's allocation to LEAs and disbursement of funds to county treasurers for individual LEAs
- Randomly sampled payments from county treasurers to individual LEAs to verify that correct payments were made and in a timely manner
- Verified the accuracy of CCCCCO's allocation to CCDs and disbursement of funds to county treasurers for individual CCDs
- Randomly sampled payments from county treasurers to individual CCDs to verify that correct payments were made and in a timely manner

Conclusion

Our audit found that, with the exception of a calculation error made by the California Department of Finance that understated a transfer to the Education Protection Account (EPA) by \$59,755,000 as of June 30, 2015, funds recorded in the EPA for the fiscal years ended June 30, 2013, June 30, 2014, and June 30, 2015, accounted for and used specified incremental increases in taxes in a manner consistent with California State Constitution, Article XIII, Section 36. This issue is described more fully in the Finding and Recommendation section.

Views of Responsible Officials

The finding relates to DOF only. In an email dated August 9, 2016, Jay Chamberlain, Chief, Revenue and Taxation Unit, stated that DOF agreed with the audit finding. In separate emails, CDE and CCCCCO indicated that they had no comments related to information presented in the report.

Restricted Use

This report is intended solely for the information and use of CDE, CCCCCO, and DOF; it is not intended to be and should not be used for any other purpose. This restriction is not meant to limit distribution of the report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

August 12, 2016

Schedule—
Education Protection Account
Transfers In, Expenditures, and Changes in Account Balances
for the Fiscal Years Ended June 30, 2013, June 30, 2014, and June 30, 2015

	<u>June 30, 2013</u>	<u>June 30, 2014</u>	<u>June 30, 2015</u>
Transfers In			
<i>For Local Education Agencies:</i>			
Personal Income Tax	\$ 6,076,920,000	\$ 5,071,625,840	\$ 6,424,960,730
Sales and Use Tax	432,540,000	1,212,611,650	1,328,885,700
Subtotal	<u>6,509,460,000</u>	<u>6,284,237,490</u>	<u>7,753,846,430</u>
<i>For Community College Districts:</i>			
Personal Income Tax	751,080,000	626,830,160	794,096,270
Sales and Use Tax	53,460,000	149,873,350	164,244,300
Subtotal	<u>804,540,000</u>	<u>776,703,510</u>	<u>958,340,570</u>
Total Transfers In	7,314,000,000	7,060,941,000	8,712,187,000
Expenditures			
<i>Disbursements to County Treasurers:</i>			
For Local Education Agencies	6,509,460,000	6,283,968,534	7,754,031,627
For Community College Districts	804,540,000	776,703,510	958,340,570
Total Expenditures	<u>7,314,000,000</u>	<u>7,060,672,044</u>	<u>8,712,372,197</u>
Excess (Deficiency) of Transfers In over Expenditures	-	268,956	(185,197)
Beginning Balance	-	-	268,956
Ending Balance ¹	<u>\$ -</u>	<u>\$ 268,956</u>	<u>\$ 83,759</u>

¹ Ending balances resulted from timing adjustments to LEAs payments that were subsequently reallocated to other LEAs.

Finding and Recommendation

FINDING—Misstated Proposition 30 Transfer to the Education Protection Account

DOF understated the transfer to the EPA by \$59,755,000 as of June 30, 2015. DOF corrected the error in June 2016. The error had no impact on total funds received by LEAs and CCDs, as the understated funds were otherwise paid through state aid. Further, the error was not material to transactions recorded in the EPA.

Each fiscal year, DOF estimates the amount of Proposition 30 incremental tax revenues that are available to be transferred into the EPA. Two years subsequent to the estimates, DOF updates its calculation, provides an adjustment to the original estimate, and notifies the California State Controller of the revenue adjustment. The original revenue estimate is updated because the initial calculation is based on assumptions and tax revenues that have not yet been collected from California taxpayers. In gathering documentation supporting its calculation for this audit, DOF discovered that it had understated its June 12, 2015 revenue adjustment related to the FY 2012-13 estimated revenue by \$59,755,000.

DOF's June 12, 2015 notification letter to the California State Controller stated that there was a positive adjustment of \$675,613,000 that was necessary to update (true-up) DOF's prior FY 2012-13 revenue estimate. However, DOF should have reported a positive adjustment amount of \$735,368,000 in this letter. The difference is \$59,755,000. DOF issued a letter on June 28, 2016, identifying the understatement amount that was corrected by including an additional \$59,755,000 in revenues to the EPA in the fourth quarter of FY 2015-16.

The California State Constitution, Article XIII, Section 36, subdivision (e)(2)(C), requires DOF, in the last quarter of each fiscal year from 2012-13 to 2018-19, to calculate the EPA transfer amounts for each fiscal year, and, in each June from 2015 through 2021, to calculate a final true-up for the EPA transfers for the fiscal year that ended two years prior.

DOF correctly calculated individual components for the revenue estimation calculation; however, when compiling the calculation components, DOF used an older version of the personal income tax estimate component.

The error had no impact on funds disbursed to LEAs and CCDs. The amount of Proposition 30 funds that were not identified in the revenue adjustment true-up calculation was still distributed to the recipient agencies in the form of state aid. The lack of any funding shortfall is attributed to the mandatory education spending that is required by Proposition 98, which sets a minimum percentage of the state budget to be spent on education by LEAs and CCDs.

Recommendation

We recommend that DOF management review and consider revising its process for verifying whether the Proposition 30 components to its revenue estimates have been properly calculated and carried forward throughout its calculations.

DOF's Response

DOF agreed with the audit finding.

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