

AUDITOR OF STATE BULLETIN 97-010

June 20, 1997

TO: ALL COUNTY AUDITORS
ALL COUNTY COMMISSIONERS
ALL CITY COUNCIL MEMBERS
ALL CITY AUDITORS, FINANCE DIRECTORS & TREASURERS
ALL VILLAGE COUNCIL MEMBERS
ALL VILLAGE FISCAL OFFICERS
ALL SCHOOL DISTRICT BOARD OF EDUCATION MEMBERS
ALL EDUCATIONAL SERVICE CENTER BOARD MEMBERS
ALL SCHOOL DISTRICT TREASURERS
ALL EDUCATIONAL SERVICE CENTER TREASURERS
ALL COMMUNITY COLLEGE BOARD MEMBERS
ALL COMMUNITY COLLEGE TREASURERS
ALL TECHNICAL COLLEGE DISTRICT BOARD MEMBERS
ALL TECHNICAL COLLEGE DISTRICT TREASURERS
ALL DETENTION HOME DISTRICT TREASURERS
ALL TOWNSHIP TRUSTEES
ALL TOWNSHIP CLERKS
ALL JOINT FIRE DISTRICT BOARDS OF TRUSTEES
ALL JOINT FIRE DISTRICT FISCAL OFFICERS
ALL JOINT RECREATION DISTRICT BOARDS OF TRUSTEES
ALL JOINT RECREATION DISTRICT FISCAL OFFICERS
ALL JOINT ADAMH BOARDS OF TRUSTEES
ALL JOINT ADAMH FISCAL OFFICERS
ALL JOINT AMBULANCE DISTRICT BOARDS OF TRUSTEES
ALL JOINT AMBULANCE DISTRICT FISCAL OFFICERS
ALL JOINT AMBULANCE AND FIRE DISTRICT BOARDS OF TRUSTEES
ALL JOINT AMBULANCE AND FIRE DISTRICT FISCAL OFFICERS
ALL UNION CEMETERY DISTRICT FISCAL OFFICERS
ALL DRAINAGE IMPROVEMENT DISTRICT FISCAL OFFICERS
ALL JOINT EMERGENCY MEDICAL DISTRICT FISCAL OFFICERS
ALL TOWNSHIP POLICE DISTRICT FISCAL OFFICERS
ALL TOWNSHIP FIRE DISTRICT FISCAL OFFICERS
ALL TOWNSHIP ROAD DISTRICT FISCAL OFFICERS
ALL TOWNSHIP WASTE DISPOSAL DISTRICT FISCAL OFFICERS
ALL INDEPENDENT PUBLIC ACCOUNTANTS

SUBJECT: MISCELLANEOUS BUDGETARY ISSUES

The budgetary presentation required for governmental financial statements reflects a combination of both accounting and legal guidelines. This bulletin will respond to some of the more frequently asked questions and address issues that have been treated inconsistently in Ohio regarding the application of these guidelines.

Legal Level of Control

Normally, there are a number of levels of detail in an appropriated budget. Consider, for example, the following possible levels of detail:

| | |
|------------|---------------------------------------|
| Fund | General fund |
| Function | Public safety |
| Department | Fire |
| Activity | Fire prevention |
| Object | Personal services--salaries and wages |
| Subject | Regular employees |

Although budgets normally are prepared at all of these levels of detail, management frequently retains some latitude in the use of appropriated moneys. For example, management may not legally be able to move resources from one department to another, but may be able to reassign resources from one activity to another within a single department. The lowest level at which a government's management may *not* reassign resources without legislative approval is known as the "legal level of control."

The legal level of control can vary greatly from one government to the next. For some governments, the legal level of control is as high as the fund or function level. For others, the legal level of control may be as low as the object level, or even lower. The legal level of control is the level at which governments must present individual budgetary financial statements in a CAFR, and is also the level at which budgetary violations must be disclosed in the notes to the financial statements.

In Ohio, the legal level of control is the level at which the appropriation measure is passed by the legislative authority of a local government. The legislative authority of a municipality may establish the legal level of control pursuant to charter or ordinance, while other local governments should follow the level, if any, that is set forth in the Ohio Administrative Code. The Auditor of State's Office is currently in the process of amending the Ohio Administrative Code to reflect the practicalities of a local government's ability to set its own level of detail in an appropriation measure.

The local government's legislative authority has the ability to establish its legal level of control at the beginning of each fiscal year coinciding with the adoption of its annual budget. Once established, the legal level of control should be the same throughout the fiscal year. Auditors are

required to determine the legal level of control and assure that the entity's financial statements and schedules properly report budgetary accountability at that level. Auditors are required to test budgetary compliance throughout the year as well as at the end of the year. In determining the legal level of control, auditors shall use the level of detail set forth in the entity's appropriation measure beginning fiscal year 1999 for school districts and calendar year 1998 for all other local governments.

Delegation of Authority to Set Appropriations

The legislative body of a local government may *not* delegate its authority to establish appropriations. The appropriation process is a function of the legislative authority that must be performed by those specific individuals elected to fulfill that responsibility. However, other officials of the local government may be given the authority to allocate or re-allocate funds within a legally adopted appropriation.

Actual Revenues and Expenditures

It is common for revenues, expenditures and other financing sources and uses to be reclassified from one account on the budgetary statements to a different account on the GAAP operating statements to reflect differences in accounting treatment. For example, a transfer-in on the budgetary statement may become an addition to contributed capital on the GAAP statement. Reclassifications also occur when an error in classification is detected on the budgetary statements. For example, the government may have recorded the receipt of homestead and rollback reimbursements as property taxes rather than as intergovernmental revenue. Another example would be a common pleas court expenditure that should have been classified by the county as judicial, but instead was recorded as public works.

Reclassifications due to errors should not be made just to the GAAP statements but should also be applied to the budgetary statements. Significant misclassifications on the budgetary statements may be misleading and serve as the basis for a qualified opinion. Reclassifications to actual amounts may be accompanied by reclassifications to the budgeted amounts if the budgeted amount was also classified in error.

Note Rollovers

When short-term notes mature, many local governments issue new notes for the same or a slightly smaller amount than the old one. The local government is required to budget for the payment of the principal of the old note and should budget for the receipt of the proceeds of the new note.

Fiscal Officer's Certification of Available Funds

Ohio Rev. Code § 5705.41(D)(1) requires the fiscal officer of each subdivision or district authority to certify that adequate revenues are available to pay every contract or order involving the expenditure of money. It is important to remember that this certification must be received by the fiscal officer of the local government for *every* contract or order involving an expenditure of money. Most local governments include certification language as part of their purchase order.

Certification by the fiscal officer that funds are available can be accomplished in three manners: (1) prior certification; (2) then and now certifications; and (3) blanket certifications.

Prior Certification

Prior to the local government incurring an obligation or entering into a contract involving the expenditure of the entity's money, a certification should be obtained from the fiscal officer stating: "It is hereby certified that the amount of \$_____ required to pay this contract has been lawfully appropriated and is in the treasury or in the process of collection to the credit of the _____ Fund, free from any obligation or certification now outstanding." This language usually appears on purchase orders issued by the local government's fiscal officer upon a request by the official, department or employee for the expenditure of money. This certification is valid only for the specific expenditure supported by a purchase order showing the vendor, quantity, and price for the purchase being made.

Then and Now Certification

Ohio Rev. Code 5705.41(D)(1) provides that if prior certification of funds by the fiscal officer was not obtained before the contract or order involving the expenditure of money was made, as described above, then the fiscal officer may instead certify

[T]hat there was at the time of the making of such contract or order and at the time of the execution of such certificate a sufficient sum appropriated for the purpose of such contract and in the treasury or in process of collection to the credit of an appropriate fund free from any previous encumbrances.

Thus, the fiscal officer is certifying that there were appropriations available and funds in the treasury or in the process of collection at the time the contract or order was made (then), and there are still sufficient appropriations and funds in the treasury or in the process of collection at the time the certificate is being issued (now).

Because the timing of when the fiscal officer is certifying the availability of funds is different when using a then and now certificate, the certification language used by the fiscal officer should also reflect this difference in timing. Sample language for a then and now certificate would state:

It is hereby certified that both at the time of the making of this contract or order and at the date of the execution of this certificate, the amount of \$_____ required to pay this contract or order has been appropriated for the purpose of this contract or order and is in the treasury or in the process of collection to the credit of the _____ Fund free from any previous encumbrance.

When the fiscal officer is using a then and now certificate and the amount certified for counties exceeds \$100 and for all other entities exceeds \$1,000, the fiscal officer must obtain the legislative authority's approval by resolution or ordinance. This approval must be obtained within 30 days of the legislative authority's receipt of the certificate.

It is important to note that if legislative authority approval by resolution or ordinance is needed because the purchase exceeds the threshold dollar amount of \$100 for counties or \$1,000 for other subdivisions, the resolution or ordinance is in *addition to* any resolution by the legislative authority approving the expenditure of the funds to a particular creditor. However, if the dollar amount expended does not exceed the threshold amount, no legislative authority action approving the then and now certificate is necessary.

Blanket Certificates

A blanket certificate is best described as a certification for the expenditure of funds for which either the vendor, price or quantity is open-ended on the purchase order. Blanket certificates may be issued for all subdivisions if the dollar amount is not in excess of \$5,000, does not exceed three months in duration, and does not extend beyond the end of the fiscal year.

In addition, counties have the ability to issue blanket certificates for expenditures in excess of \$5,000 for the purposes set forth in Ohio Rev. Code § 5705.41(D)(3). While this certification may extend longer than three months in duration, it must not extend beyond either the end of the fiscal year or end of the quarter for which the county has adopted a quarterly spending plan.

If adequate unencumbered appropriations are not available, the legislative authority must amend or supplement the appropriation so that the certification can be made. State statute does not provide a method for the legislative body to amend the appropriations after the fact. In addition, purchase orders and contracts without certification are void and may not be paid. If the fiscal officer is unable to execute a certificate at the time the obligation was incurred or a then and now certificate, state courts have been willing to recognize an equitable solution by accepting the legislative authority's acknowledgment of a moral obligation to pay the vendor.

Budgeted Revenues and Expenditures

THE REMAINDER OF THIS BULLETIN, WHICH PERTAINS TO THE ISSUE OF BUDGETING REVENUES AND EXPENDITURES, IS APPLICABLE ONLY TO COUNTIES, MUNICIPALITIES AND SCHOOL DISTRICTS. ALL OTHER LOCAL GOVERNMENTS SHOULD DISREGARD THIS SECTION.

Three primary reasons exist under Ohio law for a local government to request of the county auditor issuance of a certificate of estimated resources. Ohio Rev. Code § 5705.36. First, a local government must obtain an official certificate of estimated resources on or about the first day of the fiscal year. This certificate must be obtained prior to the local government’s passage of its original appropriation measure. Secondly, an amended certificate of estimated resources should be obtained prior to passing additional appropriations when the local government experiences an increase in revenue. Also, if a local government experiences a shortfall in estimated resources, the fiscal officer should request from the county auditor a reduced amended certificate. In addition to these three reasons, many counties and school districts request a final amended certificate of estimated resources prior to the fiscal year-end.

Ohio Rev. Code § 5705.36 provides, in part, that upon the determination by a municipal fiscal officer, school district treasurer or by a county auditor that the revenue to be collected by the municipality, school district or county, respectively, will be greater or less than the amount included in the current official certificate, the fiscal officer shall

[In the case of a school district] certify the amount of the deficiency or excess to the commission, and the commission shall certify an amended official certificate reflecting the deficiency or excess.

....

[In the case of a county or municipal corporation] certify the amount of the deficiency or excess to the [budget] commission, and if the commission determines that the [fiscal officer’s] certification is reasonable, the commission shall certify an amended official certificate reflecting the deficiency or excess.

....

The total appropriations made during the fiscal year from any fund shall not exceed the amount set forth as available for expenditure from such fund in the official certificate of estimated resources, or any amendment thereof, certified prior to the making of the appropriation or supplemental appropriation.

Prior to enactment of these provisions, municipal and school district treasurers had the authority to obtain certifications of increases in available resources when their estimate of revenue to be collected increased. County auditors were authorized to obtain such “increase” certificates whenever actual collections exceeded estimates or whenever revenue could be estimated for a previously unbudgeted source. However, these officers were not authorized to obtain certifications of reductions in available resources when they projected a reduction in estimated revenue. As a result, subdivisions frequently made appropriations and expenditures or incurred obligations on the basis of inaccurate estimates, in excess of actual resources.

The intent of this statutory requirement is to require the fiscal officer to obtain such a “reduction” certificate when it appears that budgetary resources will fall short of earlier estimates, reducing the possibility that deficit spending will occur.

Ohio Rev. Code § 5705.36 does not require that municipal fiscal officers, school district treasurers and county auditors certify changes to the budget commission so as to obtain an amended certificate of estimated resources which matches actual resources for the year to the penny (a “zero variance”). Citations for noncompliance with this provision will not be issued by the Auditor of State’s Office on the basis of a variance between amounts in the most recent amended certificate of estimated resources and the amount of actual resources, unless it appears that the fiscal officer knowingly disregarded a significant variance and that, had a “reduction” certificate been obtained, the effect would have been to prevent the making of expenditures or the incurrence of obligations in excess of actual resources.

The following examples illustrate circumstances under which a variance between the amended certificate of estimated resources and the actual resources is not indicative of a deleterious budgetary effect.

1. Additional revenue is estimated by the entity, but the entity does not obtain an amended official certificate of estimated resources as it does not anticipate appropriating the resources or incurring any obligations until the next fiscal year. For example, if an auditee determines six weeks before fiscal year end that it will receive an additional \$50,000 in a state grant fund, but it does not anticipate that this money will be appropriated, expended, or obligated until the next fiscal year and, therefore, does not obtain an amended official certificate of estimated resources, a variance between the amount of the most recent amended official certificate of estimated resources and a higher amount of actual resources attributable to this increase would not warrant a citation in the audit report.
2. Additional revenue is estimated by the entity, which obtains an amended official certificate of estimated resources, appropriates the additional revenue, and incurs obligations. The entity elects, however, to defer receipt of the additional revenue until the next fiscal year, when the related cash disbursements will be made. For example, a school district may obtain a new certificate due to an anticipated state loan and appropriate and obligate the resources in question. As payment will not, however, be due until the next fiscal year, it defers actual receipt of the loan proceeds. The result is a variance between the amount of the most recent amended official certificate of estimated resources and the lower amount of actual resources. A citation would not, however, be appropriate.
3. Actual revenue falls below the amount of the amended official certificate of estimated resources, but is sufficient to cover actual expenditures and encumbrances for the fiscal year. For example, an entity may have an

amended official certificate of estimated resources in the amount of \$100,000, actual revenues of \$90,000, and expenditures and encumbrances of \$85,000. Under such circumstances, the failure to obtain an amended certification reflecting the lowered revenue level would not be required.

4. Actual revenue falls below the amount of the amended official certificate of estimated resources, but appropriations and expenditures plus obligations incurred prior to the point at which a revised estimate could have been made exceed the amended estimate. For example, an entity may have an amended certificate of estimated resources in the amount of \$100,000, in reliance upon which it adopts appropriations of \$95,000 and incur obligations of \$95,000. When it thereafter estimates that actual resources will be \$90,000, should it obtain an amended official certificate of estimated resources? And, if so, in what amount? Where expenditures are made or obligations incurred within the limits of an existing certificate and an amended certificate is subsequently obtained pursuant to Ohio Rev. Code § 5705.36 in an amount below the amount of expenditures and outstanding obligations, Ohio Rev. Code § 5705.36 prohibits the reduction of appropriations below that amount necessary to cover "obligations certified from or against the obligation." Thus, appropriations and expenditures and obligations incurred may exceed the year-end amount of the amended official certificate of estimated resources although no statutory violation has occurred. Under the circumstances set forth above, a reduced certificate in the amount of \$95,000, the lowest lawful amount to which appropriations can be reduced, should be obtained. This satisfies the control objective of the statute by preventing unlawful expenditures and obligations in excess of the estimated amount, but recognizes the legal prohibition upon any further reduction in appropriations.
5. The determination of compliance should be made on the basis of the currently estimable legal resources. For example, a subdivision has estimated proceeds of \$100,000, appropriates and expends or obligates \$100,000, but determines that actual resources for the fiscal year will be only \$80,000. It may, however, by transfer or borrowing, obtain the extra \$20,000. In determining whether a "reduction" certificate should have been obtained, look to what actions have been formally taken by the taxing authority of the subdivision. If no action was taken to transfer or borrow the \$20,000, a citation may be appropriate. If the money was transferred or borrowed so as to increase total actual resources to \$100,000, no citation would be necessary.

If a municipal corporation, school district or county, however, desires the issuance of a final amended certificate of estimated resources by the budget commission, the amounts included in a budget should only be amended as of the date the municipal corporation, school district or county requests the issuance of an amended certificate. The date of the amended certificate request should be evidenced by a notation in the minutes of or a resolution by the legislative authority. The Auditor of State's Office will, therefore, use the amounts listed on the last amended certificate of estimated resources requested during the fiscal year as the basis for testing compliance, beginning with audits of fiscal year 1998.

Budgeted expenditures coincide with either the final appropriations passed by the legislative body prior to fiscal year-end or the sum of those final appropriations plus encumbrances carried forward from the prior year. The statutory budget process simply codifies what are or should be good management practices. These processes are intended to provide a framework that management and legislators can use to reasonably control spending activities

This bulletin summarizes some of the budgetary matters about which our Office receives numerous questions. Please be aware that the summary of statutory requirements regarding these budgetary matters is not intended to be used as a substitute for the actual Code provisions.

If you should have any questions, please contact the Senior Deputy Auditor for your Regional Auditor of State's Office.