

AUDITOR OF STATE BULLETIN 2001-003
February 15, 2001

TO: COMMUNITY IMPROVEMENT CORPORATIONS
COMMUNITY DEVELOPMENT CORPORATIONS
INDEPENDENT PUBLIC ACCOUNTANTS

SUBJECT: ANNUAL REPORTING AND AUDITS

Executive Summary

1. Senate Bill 265 of the 123rd General Assembly (SB 265) revises Community Improvement Corporations' and Community Development Corporations' (collectively, "Corporations") reporting and auditing requirements. Corporations will now submit annual financial statement reports and required audit reports to the Auditor of State rather than to the Ohio Department of Development. SB 265 also amends Corporations' annual reporting deadlines.
2. The Ohio Department of Development previously required Corporations with over \$300,000 in assets, revenues or expenditures to obtain an annual audit. SB 265 subjects all Corporations to biennial* audit by the Auditor of State, or by independent public accountants contracted through the Auditor of State.
3. SB 265 requires Corporations to prepare their annual financial statement reports and audited statements in accordance with generally accepted accounting principles (GAAP). This will require some Corporations to change their accounting basis.
4. SB 265 is effective March 12, 2001. Corporations should file annual financial statement reports due on or after March 12, 2001 with the Auditor of State. Any Corporation audit reports not completed by March 12, 2001 will also be subject to biennial audit by the Auditor of State. (See details of this Bulletin regarding existing audit contracts with independent public accountants.)

*Except: Any corporation expending over \$300,000 in Federal assistance during a year must have an audit for that year following Federal Office of Management and Budget Circular A-133.

SB 265 amends Ohio Rev. Code Chapters 1724 (Community Improvement Corporations) and 1726 (Community Development Corporations). This Bulletin overviews: (1) Activities in which Corporations may legally engage; (2) Tax issues; (3) New audit and annual reporting requirements and (4) Generally accepted accounting principles.

BACKGROUND

Community Improvement Corporations

There are currently nearly 300 Community Improvement Corporations which will now file annual financial statement reports with the Auditor of State. Community Improvement Corporations exist to advance, encourage and promote industrial, economic, commercial and civic development of a community or area. Ohio Rev. Code Section 1724.02 provides relatively broad powers to Community Improvement Corporations.

Community Improvement Corporations are permitted to:

1. Borrow money.
2. Lend money to persons or entities. (This power is limited to making loans to persons or entities that have been rejected for credit by other financial institutions.)
3. Acquire real or personal property, including leased property, goodwill, stock or other assets of persons or entities.
4. Assume the liabilities of a person or entity.
5. Acquire real property for business or industrial development.
6. Serve as the agent of one or more political subdivisions.

Community Development Corporations

Fewer than 10 Community Development Corporations have been filing annual reports with the Department of Development. Section 1726.04, Ohio Rev. Code, permits, but does not limit, Community Development Corporations to promoting, aiding, developing and advancing industry, business and agriculture; to stimulating and expanding business ventures and to working with small, federally-licensed business investment companies and the U.S. Small Business Administration.

Community Development Corporations must be capitalized with at least \$5,000 of stock with a par value of \$100 per share.

The powers of Community Development Corporations are virtually identical to those listed for Community Improvement Corporations above, except Community Development Corporations are not authorized to act as an agent of a political subdivision(s). There are also limitations on the amounts of loans Community Development Corporations can have outstanding as a percentage of outstanding stock.

NOT-FOR-PROFIT CORPORATION TAX ISSUES

A full discussion of not-for-profit corporation tax issues is beyond the scope of this Bulletin. Corporations and their auditors should assure that Corporations are receiving guidance from qualified professionals. Items of general interest follow.

Exempt Status

All Corporations must register as not-for-profit Ohio corporations, under Chapter 1702, Ohio Rev. Code. Registration under Chapter 1702 exempts Corporations from Ohio income tax. However, this status does not exempt them from Federal taxation. To receive a Federal tax exemption, corporations must file for an IRS exemption certificate. Corporations can often qualify for exemption under Internal Revenue Code Sections 501(c)(3) or (c)(4). An entity is then exempt from Federal taxation as long as they comply with the conditions of the exemption. If an exempt entity changes its mission (such as by amending its articles of incorporation without approval of the Secretary of State or the Internal Revenue Service, or by actions conflicting with its approved exemption), it may lose its exempt status.

Audited financial statement reports should disclose (1) whether the Corporation is exempt from State taxation; (2) whether it is exempt from Federal taxation; (3) the Internal Revenue Code Section under which it is exempt and (4) any known conditions that may jeopardize its exemptions.

Tax Filing Requirements

Tax-exempt not-for-profit corporations must annually file Form 990 with the IRS, if their gross receipts

exceed \$25,000. Form 990 includes financial statement forms (they need not be audited) and other important disclosures. Should a Corporation not be exempt from Federal taxation, it should annually file Form 1120 (corporate income tax return) with the IRS.

Corporations must also file an annual financial statement with the Ohio Attorney General, if their gross receipts exceed \$5,000 or their gross assets exceed \$15,000. A copy of Form 990 will meet this requirement.

Audit Tax Issues

Auditors must familiarize themselves with tax issues that may affect Corporations. Tax issues can directly and materially affect the determination of financial statement amounts, even for exempt organizations. Such matters may include (but are not limited to):

1. Engaging in prohibited activities, such as those inconsistent with its exemption, or acting for the private benefit or inurement of certain groups or officers.
2. Earning unrelated business income.
3. Lobbying or political campaigning activities.

Any of the above could affect liability measurement or disclosures required in GAAP statements. Auditors should consider tax issues as a source of inherent risk in planning Corporation audits. Auditors should also consider the following in planning and auditing Corporations:

1. Read Chapter 15 of the AICPA *Not-For-Profit Organizations Audit and Accounting Guide* for additional tax issue guidance.
2. Read the Corporation's Form 990 to assure it was filed timely, and also as a source of important information about the entity.
3. Consider whether the Corporation has adequately disclosed the present, known status of its Federal and State exemptions.
4. Consider whether the Corporation has sufficient expertise to identify and report tax issues or seeks assistance from qualified professionals when such issues arise.

NEW AUDITING AND REPORTING REQUIREMENTS

1. SB 265 is effective March 12, 2001. Corporations should file annual financial statement reports due on or after March 12, 2001 with the Auditor of State.
2. Corporations must certify and submit an annual financial statement report to the Auditor of State within 120 days of their fiscal year end. SB 265 does not prescribe a fiscal year end. The annual report filing need not be audited. Corporations should mail their annual reports to:

Auditor of State
P.O. Box 1140

SB 265 authorizes the Auditor of State to grant extensions to the 120 day filing requirement. However, consistent with Auditor of State Bulletin 97-015, we will only grant extensions in the exceptional circumstances described in Bulletin 97-015 (e.g., destruction of records by fire or flood, etc). Auditor of State Bulletins are available at www.auditor.state.oh.us.

3. Annual financial statement reports must conform with generally accepted accounting principles (GAAP), and should include footnote disclosures required by GAAP.
4. The Auditor of State does not prescribe an annual reporting form for Corporations. Any financial statement presentation based on GAAP is acceptable.
5. Any audit report not completed by March 12, 2001 will be subject to audit by the Auditor of State, under Chapter 117, Rev. Code. The Auditor of State will audit (or the Auditor of State may choose to contract with an independent public accountant (IPA) to audit¹) each Corporation at least once every two years, under Section 117.11, Ohio Rev. Code. Biennial audits must cover both years. Corporations expending over \$300,000 of Federal assistance in a fiscal year must be audited for that year, under Federal Office of Management and Budget Circular A-133. Note that it is a Corporation's responsibility to inform the Auditor of State if it has expended over \$300,000 of Federal assistance in a fiscal year.

Failure to Comply

SB 265 requires the Auditor of State to certify Corporations to the Secretary of State 90 days after either of the following events:

1. Failing to file an annual financial statement report with the Auditor of State within 120 days of a Corporation's fiscal year end (i.e., failing to file within 210 days of fiscal year end);
2. Failing to present auditable financial records to the Auditor of State within 90 days of a determination by the Auditor of State that a Corporation is unauditible.

¹ The Auditor of State is aware that some Corporations have pre-existing audit contracts. The Auditor of State will accept audits under contracts signed prior to the effective date of SB 265 (March 12, 2001), under the following conditions: (1) The Corporation will deliver a copy of the audit contract to the Auditor of State's Regional Office; (2) The IPA will comply with generally accepted auditing standards and Chapters 3, 4 and 5 of *Government Auditing Standards*; (3) the IPA will complete and submit to the Auditor of State an *Audit Firm Data Sheet*, and a copy of their most recent peer review report; (4) the IPA will e-mail an electronic copy of the audit report to the Auditor of State following our report submission policies; and (5) the IPA will make its working papers available to the Auditor of State for review upon request. Audit contracts made after March 12, 2001 must be three-party contracts executed by the Corporation, the Auditor of State and IPA, under Ohio Administrative Code Chapter 117-3 and Ohio Rev. Code Section 115.56. Contract extensions that circumvent these requirements are void. Due to the complexity of IPA contracting procedures, Corporations should discuss this with our Regional Office staff.

The Secretary of State is to cancel the articles of incorporation of noncompliant corporations. The Secretary of State may reinstate Corporations upon their subsequent compliance with the annual reporting and auditing requirements.

Audit Coordination

The Auditor of States' Regional Offices will soon contact Corporations to discuss audit arrangements.

ACCOUNTING PRINCIPLES

Determining the applicable GAAP depends upon whether a corporation classifies itself as a governmental or nongovernmental not-for-profit organization.

A governmental non-profit organization?

Section 1.03 of the AICPA *Not-For-Profit Organizations* Audit and Accounting Guide provides criteria for classifying a not-for-profit entity as either governmental or nongovernmental. The Guide defines governments as bodies corporate and politic, and includes public corporations as governmental entities. Public corporations are corporations created to administer public affairs. They are instrumentalities created by the State, formed and owned by the State in the public interest, supported in whole or part by public funds, and governed by managers deriving their authority from the State.

The AICPA Guide also includes organizations as governments if they have one or more of the following characteristics:

1. Popular election of officers or appointment (or approval) of a controlling majority of the not-for-profit's governing body by officials of one or more state or local government;
2. The potential for unilateral dissolution by a government with the net assets reverting to a government;
3. The power to enact and enforce a tax levy.
4. The power to issue tax-exempt debt directly (rather than through a government).

Corporations that meet only criteria 4, may rebut the presumption that they are governmental, if their determination is supported by compelling evidence.

Generally Accepted Accounting Principles for Corporations

Corporations deemed governmental should follow the reporting guidance of Governmental Accounting Statement No. 29. Statement 29 restricts governmental not-for-profit organizations to using (1) the reporting model promulgated for governments, (2) the not-for-profit guidance of Statement of Position 78-10 or (3) the AICPA's *Audits of Voluntary Health and Welfare Organizations* Guide. Statement 29 prohibits governmental not-for-profits from following Financial Accounting Statements Nos. 116, 117, 124 and 136.

Conversely, corporations not meeting the governmental criteria listed above must follow Statements 116, 117, 124, 136 and other standards applicable to not-for-profit organizations. See Chapter 1 of the AICPA *Not-For-Profit Organizations* Audit and Accounting Guide.

Corporations must exercise judgment in determining whether they should follow governmental or nongovernmental, not-for-profit GAAP. The Auditor of State will respect determinations that are not clearly improper.

Governmental Accounting Statement No. 34 will supersede Statement 29. The effective date of Statement 34 for governments with less than \$10 million in annual revenue is fiscal years beginning after June 15, 2003. Governments with more than \$10 million in annual revenue must implement Statement 34 earlier. A discussion of Statement 34 is beyond the scope of this Bulletin. Corporations deemed to be governmental nonprofits should discuss Statements 29 and 34 with their independent auditor or other accounting professional.

Corporations (especially those whose governing boards are appointed by a government) may also be deemed “component units” of a local government. The criteria for determining component unit classification is included in Governmental Accounting Statement No. 14. Component units must include their audited financial statements within the statements of the primary local government. These Corporations must schedule their audits to meet reporting deadlines of the primary local government. Corporations audited as component units will satisfy Revised Code Chapter 117 and SB 265 audit requirements. However, if those Corporations desire a separate audit report, we will accommodate those requests. (Corporations deemed component units will still be subject to annual financial statement reporting requirements.)

QUESTIONS

Should a Corporation have questions regarding SB 265, audit contracting, scheduling or other matters, contact the Auditor of State regional office serving your county. A list of regional offices and the counties they serve is attached.



Regional Office Directory

Canton	Gerald Holzaphel, Senior Deputy Auditor Nathan Mortimer, Asst. Senior Deputy Auditor	111 2nd St., NW, 4th Fl. Canton, OH 44702 (330) 438-0617 (330) 471-0001 Fax	Ashland, Coshocton, Holmes, Medina, Richland, Stark, Summit, Tuscarawas, Wayne
Cincinnati	Loren Crisp, Senior Deputy Auditor Ruthann Sisk, Asst. Senior Deputy Auditor	250 W Court St., Ste. 150E Cincinnati, OH 45202 (513) 361-8550 (513) 361-8577 Fax	Adams, Brown, Butler, Clermont, Clinton, Fayette, Hamilton, Highland, Preble, Warren
Cleveland	Peter Giesswein, Senior Deputy Auditor Robert Wilhelm, Asst. Senior Deputy Auditor	Lausche Bldg., 12th Fl. 615 Superior Ave., NW Cleveland, OH 44113 (216) 787-3665 (216) 787-3361 Fax	Cuyahoga, Geauga, Lake, Lorain
Columbus	Robert Hinkle, Senior Deputy Auditor Gerald Hamilton, Asst. Senior Deputy Auditor	35 N. Fourth St., 2nd Fl. Columbus, OH 43215 (614) 466-3402 (614) 728-7199 Fax	Crawford, Delaware, Fairfield, Franklin, Knox, Licking, Madison, Marion, Morrow, Pickaway, Ross, Union, Wyandot
Dayton	Richard Wade, Senior Deputy Auditor Mike Botkins, Asst. Senior Deputy Auditor	One First National Plaza 130 W. Second St., Ste. 2040 Dayton, OH 45402 (937) 285-6677 (937) 285-6688 Fax	Allen, Auglaize, Champaign, Clark, Darke, Greene, Hardin, Logan, Mercer, Miami, Montgomery, Shelby, Van Wert
Southeast	Richard Sketel, Senior Deputy Auditor Charles Barga, Asst. Senior Deputy Auditor	743-B E. State St./Athens Mall Athens, OH 45701 (614) 594-3300 (614) 594-2110 Fax	Athens, Belmont, Gallia, Guernsey, Hocking, Jackson, Lawrence, Meigs, Monroe, Morgan, Muskingum, Noble, Perry, Pike, Scioto, Vinton, Washington
Toledo	George Prephan, Senior Deputy Auditor Gary Sartain, Asst. Senior Deputy Auditor	One Government Ctr, Rm 1420 Toledo, OH 43604 (419) 245-2811 (419) 245-2484 Fax	Defiance, Erie, Fulton, Hancock, Henry, Huron, Lucas, Ottawa, Paulding, Putnam, Sandusky, Seneca, Williams, Wood
Youngstown	Rick Kubic, Senior Deputy Auditor Kathy Plichta, Asst. Senior Deputy Auditor	Voinovich Government Center 242 Federal Plaza W., Suite 302 Youngstown, OH 44503 (330) 797-9900 (330) 797-9949 Fax	Ashtabula, Carroll, Columbiana, Harrison, Jefferson, Mahoning, Portage, Trumbull