
Betty Montgomery Auditor of State

Bulletin 2003-006

**TO: School District and ESC Treasurers
County Auditors
City Auditors
Finance Directors
Independent Public Accountants**

Date Issued: November 13, 2003

SUBJECT: Auditor of State's Position on GAAP Reporting

GENERALLY:

As you are aware, Ohio law (ORC Section 117.38) requires that local public offices file their annual financial reports with the Auditor of State's Office. The Ohio Administrative Code requires that all **counties, cities and school districts, including educational service centers and community schools**, file their annual financial reports pursuant to generally accepted accounting principles (OAC 117-2-03 (B)). This rule requirement has existed for many years.^{1,2} Since January 2003, as promised, the Auditor of State's Office has been reviewing the rule and its implications for the affected governments. After both formal and informal discussions with many of you, **the Auditor of State's Office has decided not to modify this rule and will continue to enforce this requirement in the audits of these entities.**³

All *other* local public offices which are not required to prepare their annual reports using generally accepted accounting principles must file their annual financial reports on the forms provided by the Auditor of State's Office. If the Auditor of State's Office has not prescribed an annual financial reporting format for a type of local public office, those public offices must file financial statements annually with the Auditor of State's Office, using the format used by the local public office (OAC 117-2-03 (D)).

CONSEQUENCES OF A NON GAAP FILING:

The Auditor of State's Office has reviewed current audit standards that address the type of audit opinion that must be issued when a local government required to prepare

¹ Cities and Counties: December 31, 1992; School Districts & ESCs: June 30, 1994.

² Am. Sub. H.B. 95, effective June 26, 2003, specifies that failing to file school district annual reports in accordance with GAAP is not a factor in determining whether or not a fiscal caution should be declared. This bill did not change requirements that a school district must prepare and file statements in accordance with GAAP.

³ Please note: Independent Public Accountants, are still subject to AICPA Ethics section 501-5 [ET 501.06].

financial statements in accordance with GAAP fails to do so. Please note that unless a set of financial statements conforms with a “comprehensive basis of accounting other than generally accepted accounting principles”, generally accepted auditing standards require the Auditor of State’s Office and independent public accountants to “...use the standard form of report...modified as appropriate because of departures from generally accepted accounting principles.”⁴ Further, the AICPA *Audit and Accounting Guide Audits of State and Local Governments (GASB 34 edition)* requires the auditor of such reports to note significant departures from GAAP. Given these requirements, **any significant departure from GAAP financial reporting will require the Auditor of State’s Office give appropriately qualified audit opinions, up to and including adverse opinions, in the circumstances described in the AICPA’s *Audit and Accounting Guide Audits of State and Local Governments (GASB 34 edition)*.**

If a “non GAAP filing local government uses an “Other Comprehensive Basis of Accounting” [OCBOA] financial statement *substantially conforming with* the requirements of GASB 34, the Auditor of State’s Office will issue an **Emphasis of a Matter Paragraph** indicating the departures from the required GAAP reporting, as well as any other opinion modifications required in the circumstances. Please note, however, that if a cash-basis submission does *not* conform substantially to the requirements of GASB 34, it is not acceptable under current professional accounting and auditing standards for general-use financial statements. Substituting any OCBOA statements not conforming substantially with GASB 34 requirements when GAAP is required will require the Auditor of State’s Office to issue an **adverse opinion**.

DEADLINES FOR COMPLIANCE:

The Auditor of State’s Office is sensitive to the issues confronting political subdivisions during this budget crisis. In light of this, the Office will allow GAAP-mandated entities currently preparing cash basis statements that do not substantially conform with GASB 34 requirements **one additional year** to adopt GAAP reporting. The effective date of this additional year is for the first entity fiscal year beginning on or after July 1, 2003. The relevant dates include:

- Cities and counties that prepared cash statements as of December 31, 2002 may do so for Calendar Years 2003 and 2004.
- Cities and counties whose Calendar Year 2002 statements were prepared in accordance with GAAP but choose to prepare Calendar Year 2003 statements on a cash basis will be subject to this Bulletin.
- Schools, community schools and ESCs that prepared cash statements as of June 30, 2003 may do so for the fiscal year ended June 30, 2004.
- Schools, community schools and ESCs whose June 30, 2003 statements were prepared in accordance with GAAP but choose to prepare Fiscal Year 2004 statements on a cash basis will be subject to this Bulletin.

⁴ AU § 623.06.

Penalties under ORC 117.38 will continue to be assessed to these entities during the above described “grace” period. During this extended implementation period, the entity must file its financial reports on a cash-basis of reporting prescribed by the Auditor of State’s Office. Auditors will audit these statements in accordance with the required financial statement format. Please note that nothing in this bulletin affects implementation dates established by the Government Accounting Standards Board(GASB) for Statement 34.

TYPES OF AUDIT OPINIONS:

As a reminder, there are three types of audit opinions that an auditor may issue: unqualified, qualified or adverse.

- An *unqualified* opinion means the auditor believes the financial statements present fairly, in all material respects, an entity’s financial position, results of operations and cash flows in accordance with generally accepted accounting principles. This opinion does not indicate the financial health of an entity, only that the amounts, footnotes and presentation formats conform with generally accepted accounting principles and are not materially misleading to readers.
- A *qualified* opinion means the auditor believes there is a material departure from generally accepted accounting principles. However, while the departure may significantly affect one or more accounts, disclosures or presentations, it is not severe enough to render the financial statement presentation, taken as a whole, misleading.
- An *adverse* opinion means the auditor believes the effects of departures from generally accepted accounting principles are of such magnitude that readers cannot rely on the amounts, footnotes or presentations in the financial statement presentation.

In certain circumstances an auditor may choose to *disclaim* an opinion on the financial statements. This means that the auditor has insufficient evidence (missing records or irreconcilable accounts would be examples) to support an opinion on the amounts and footnotes in the financial statements, taken as a whole.

The Auditor of State’s Office has spent a great deal of time listening to you all and we greatly appreciate your cooperation and your concern. Should you have any questions or need clarification regarding this bulletin, please direct your inquiries to Accounting & Auditing Support, 1-800-282-0370.

Sincerely,



Betty Montgomery
Ohio Auditor of State

**APPENDIX: AICPA Audit and Accounting Guide Audits
of State and Local Governments (GASB 34 edition)**

14.10 ...certain egregious situations will result in the auditor expressing an adverse opinion or disclaimer of opinion on the financial statements taken as a whole:

- The auditor should express an adverse opinion on the financial statements taken as a whole when the required government-wide or fund financial statements are not presented.
- The auditor should express an adverse opinion on the financial statements taken as a whole when adverse opinions are appropriate for both the governmental activities and business-type activities opinion units (or for only the governmental activities opinion unit if that is the only required presentation for the primary government in the reporting entity's government-wide financial statements).
- The auditor should express a disclaimer of opinion on the financial statements taken as a whole when disclaimers of opinion are appropriate for both the governmental activities and business-type activities opinion units (or for only the governmental activities opinion unit if that is the only required presentation for the primary government in the reporting entity's government-wide financial statements).

Other situations occur in which adverse opinions or disclaimers of opinion on one or more opinion units are appropriate. In those situations, the auditor should use professional judgment to evaluate the facts and circumstances of those opinion modifications to determine whether the financial statement presentations on which he or she is considering issuing a modified report are of such a nature that the financial statements, taken as a whole, are not presented fairly in conformity with GAAP or if it is appropriate to disclaim an opinion on the financial statements taken as a whole.

...

15.01 Many governments, especially smaller governments, prepare financial statements in conformity with a comprehensive basis of accounting other than generally accepted accounting principles (GAAP). Financial statements prepared in this manner are referred to as OCBOA financial statements. (OCBOA is an acronym for other comprehensive basis of accounting.) Statement on Auditing Standards (SAS) No. 62, Special Reports (AICPA, Professional Standards, vol. 1, AU sec. 623.04), identifies comprehensive bases of accounting other than GAAP. The bases that are applicable to governmental financial statements are (a) a basis of accounting that the reporting entity uses to comply with the requirements or financial reporting provisions of a governmental regulatory agency to whose jurisdiction the entity is subject, (b) the cash receipts and disbursements basis of accounting, and modifications of the cash basis having substantial support, such as recording depreciation on fixed assets, and (c) a definite set of criteria having substantial support that is applied to all material items appearing in financial statements, such as the price-level basis of accounting.

15.02 As discussed in Chapters 4, “Planning the Audit,” 13, “Concluding the Audit,” and 14, “Audit Reporting,” auditors should plan, perform, evaluate the results of, and report on audits of a government’s GAAP-basis basic financial statements based on opinion units. The auditor also should apply those requirements concerning opinion units to audits of OCBOA financial statements.

15.03 SAS No. 62 (AU sec. 623.10) requires that when OCBOA financial statements contain items that are the same as or similar to those in financial statements prepared in conformity with GAAP, similar informative disclosures are appropriate. Interpretation No. 14, “Evaluating the Adequacy of Disclosure in Financial Statements Prepared on the Cash, Modified Cash, or Income Tax Basis of Accounting,” of SAS No. 62 (AICPA, Professional Standards, vol. 1, AU sec. 9623.90–95), provides guidance concerning that requirement. The Interpretation (AU sec. 9623.92) states that the financial statements should either provide the relevant disclosure that would be required for those items in a GAAP presentation or provide information that communicates the substance of that disclosure. That may result in substituting qualitative information for some of the quantitative information required for GAAP presentations; the Interpretation provides the example of disclosing the repayment terms of significant long-term borrowings if that sufficiently communicates information about future principal reduction without providing the summary of principal reduction during each of the next five years that would be required for a GAAP presentation.

15.04 Interpretation No. 14 of SAS No. 62 (AICPA, Professional Standards, vol. 1, AU sec. 9623.91) states that if GAAP sets forth requirements that apply to the presentation of financial statements, **then cash basis and modified cash basis statements should either comply with those requirements or provide information that communicates the substance of those requirements.** The Interpretation also states that the substance of GAAP presentation requirements may be communicated using qualitative information and without modifying the financial statement format. Generally, that guidance does not permit OCBOA financial statements to omit required basic financial statements or to substitute substantially similar information for a basic financial statement that is required by GAAP. Instead, it permits the substitution of substantially similar information for required display within those financial statements. For example, GAAP generally require that basic financial statements present government-wide financial statements, columnar presentations based on major funds, and separate identification of special and extraordinary items. **OCBOA financial statements should include similar government-wide financial statements and columnar presentations of major funds.** (In governmental financial statements, major funds are considered separate “reporting units” equivalent to a required basic financial statement rather than a required display element within the basic financial statements.) However, required line item presentations of special and extraordinary items could be disclosed in a note to the financial statements. If required basic financial statements are not presented, or information that would be provided by required display elements is not communicated, the auditor should modify the opinion(s) on the financial statements. Whether the modifications would be qualified, adverse, or disclaimers of opinions depends on materiality of the omitted financial statement or information to the affected opinion units.

15.05 If a government issues financial statements using the cash or modified cash basis of accounting, those financial statements should be accompanied by required supplementary information (RSI) applicable to the presentation and may be accompanied by supplementary information other than RSI, known as SI. The auditor's responsibility for and reporting on that information is the same as for RSI and SI that accompanies financial statements prepared in conformity with GAAP, as discussed in Chapters 4 and 14.

15.06 SAS No. 62 (AU sec. 623.05) lists elements required in an auditor's report on financial statements prepared in conformity with an OCBOA. Notable among those required elements are (a) a paragraph that states the basis of presentation, refers to the note to the financial statements that describes the basis, and states that the basis of presentation is a comprehensive basis of accounting other than GAAP and (b) if the financial statements are prepared in conformity with the requirements or financial reporting provisions of a governmental regulatory agency, a separate paragraph at the end of the report stating that the report is intended solely for the information and use of those within the entity and the regulatory agencies to whose jurisdiction the entity is subject, and is not intended to be and should not be used by anyone other than these specified parties. An example of an unqualified opinion on modified cash basis financial statements is shown in Example 15.1 in paragraph 15.07.