Chapter 4

ACCOUNTING AND REPORTING

The Auditor of State prescribes and requires by rules, that certain public offices prepare and file annual financial reports in accordance with generally accepted accounting principles. Certain public offices may also be required by statute, rule, or agreement to prepare and file performance or other special purpose reports.[1]

Compliance Requirements **Page**
Chapter 4 - Accounting and Reporting

* **IMPORTANT!** ORC 117.11(A) **mandates** the AOS to inquire regarding these security controls. We interpret this requirement to also apply to IPAs contracting to audit counties.

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1 The Auditor of State also requires by rules, that certain public offices follow a prescribed uniform chart of accounts and/or establish a fund accounting system to demonstrate legal compliance, financial accountability and to provide management with information for decision making. These rules are in Chapter 117 of the Ohio Administrative Code. As a matter of accountability and internal control, each public office should account for financial activities using an accounting system which demonstrates legal compliance and follows a documented chart of accounts appropriate for its particular activities; and is supported by appropriate subsidiary ledgers/journals. When a public office fails to maintain such an accounting system, auditors should consider whether the failure constitutes a reportable internal control condition or reportable noncompliance. Also see Step 4-5.

While the law did not change, AOS Bulletin 2005-02 amended auditors' opinions due to an interpretation the AICPA issued.

4-1 Compliance Requirements: Ohio Admin. Code Section 117-2-03 (B) GAAP financial reporting.

Summary of Requirement: All counties, cities, school districts, educational service centers, and community schools must report (but not necessarily account) on a GAAP basis.

In determining how the government ensures compliance, consider the following:	**What control procedures address the compliance requirement?**	**W/P Ref.**
• Policies and Procedures Manuals • Knowledge and Training of personnel • Presence of an Effective Accounting System • Legislative and Management Monitoring • Management's identification of changes in laws and regulations • Management's communication of changes in laws and regulations to employees		

Suggested Audit Procedures - Compliance (Substantive) Tests

Inquire if the government files its financial reports with the Auditor of State on a GAAP basis. Inspect a copy of the filed report. If a GAAP-mandated government does not follow GAAP, issue an adverse opinion on the financial statements, as well as a noncompliance finding. See Bulletin 2005-002.	

Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):

4-2 Compliance Requirements: GAAP and annual financial reporting for community improvement corporations (CICs)[2] and development corporations (DCs).[3]

Summary of Requirements: Annual Reporting (Ohio Rev. Code §1724.05– CICs and §1726.11– DCs)

- Corporations must submit (unaudited) annual GAAP financial reports to the Auditor of State. The corporation must file the annual report within 120 days of fiscal year end. The Ohio Rev. Code does not prescribe a fiscal year end for these corporations.

Failure to Report/Present Auditable Records (Ohio Rev. Code §1724.06- CICs and §1726.12- DCs)

- Additionally, the Auditor of State must certify corporations to the Secretary of State in the following two circumstances:
  - If a Corporation files its annual report more than 90 days delinquent (i.e., does not file its annual GAAP financial statement report within 210 days of its fiscal year end).
  - If a Corporation does not present auditable records within 90 days of a determination by the Auditor of State that a corporation is unauditable.
- Upon certification, the Secretary of State is to cancel the Corporation's articles of incorporation until the deficiency is remedied.

►For more information, see AOS Bulletin 2001-003.

NOTE: Revisions to audit requirements in RC 9.234 per the 2005 budget bill (HB 66) do **not** alter the AOS' statutory requirement to audit CICs or DCs.

In determining how the government ensures compliance, consider the following:	**What control procedures address the compliance requirement?**	**W/P Ref.**
• Policies and Procedures Manuals • Knowledge and Training of personnel • Presence of an Effective Accounting System • Legislative and Management Monitoring		

[2] Being non-profit under chapter 1702 is not enough to be a CIC. To be a CIC requiring an AOS audit, the entity must be incorporated under both 1702 & 1724. (A Development Corp. would only be incorporated under chapter 1726.) Read the articles and see if they refer to chapters 1724 or 1726. Merely entitling an entity an improvement or development corporation is not sufficient. The articles of incorporation must support that the entity falls under 1724 or 1726.

[3] We are aware of only four DC, and at least two of them are inactive. Development corporations organized under ORC 1726 are stock-issuing entities.

• Management's identification of changes in laws and regulations • Management's communication of changes in laws and regulations to employees		

Suggested Audit Procedures - Compliance (Substantive) Tests

Read the corporation's annual report. Determine if it complies with GAAP in material respects. Determine if the corporation filed its report with the AOS within 120 days of fiscal year end.

If a corporation does not file its annual GAAP financial statement report within 210 days of fiscal year end, or does not present auditable records within 90 days of the Auditor of State's determination of unauditability:

- The Chief Auditor will consult with the Chief Deputy Auditor. The Chief Deputy Auditor will determine whether to request the Legal Division to issue a subpoena for the accounting records.

- IPA firms should contact the Regional Chief Auditor regarding these matters.

Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):

New section per HB 364, effective 4/08/03

4-3 Compliance Requirements: : **Per ORC 3314.024:** A management company providing services to a community school and charging more than twenty percent of the school's annual gross revenues shall provide a detailed accounting, including the nature and costs of the services it provides to the community school. This information shall be included in the footnotes of the financial statements of the school and be subject to audit during the school's regular financial audit.

Summary of Requirement: This footnote should list management company expenses during the year by object codes (e.g., salaries, supplies, etc.). Pursuant to Ohio Rev. Code § 3314.03(A)(8), community schools must use the Uniform Schools' Accounting System (USAS), which requires classifying costs by function and object codes. ***Also***, This footnote should differentiate between the direct costs and any overhead costs a management company allocates to a community school.

Since AOS deems this information material, failing to provide an adequate level of audit assurance (as described above) will require AOS to qualify a school's statements for omitting a required disclosure, or will require a scope qualification for an inability to audit the footnote. Finally, AOS will report this as material noncompliance with Ohio Rev. Code § 3314.024.

See Auditor of State Bulletin 2004-009 for more information.

In determining how the government ensures compliance, consider the following:	What control procedures address the compliance requirement?	W/P Ref.
• Policies and Procedures Manuals • Knowledge and Training of personnel • Presence of an Effective Accounting System • Legislative and Management Monitoring • Management's identification of changes in laws and regulations • Management's communication of changes in laws and regulations to employees		

Suggested Audit Procedures - Compliance (Substantive) Tests

The management company may elect to have AOS (or contracting IPA's) audit this information at the management company. AOS will examine the books, records, and other supporting documentation prepared and maintained by the management company.

Alternatively, AOS will accept a management company's independently audited financial statements as meeting the requirements of Ohio Rev. Code § 3314.024, provided the audit meets the audit and disclosure requirements set forth in the following paragraph. (IPA's may elect to follow this guidance.).

Where a management company manages more than one community school or has other "lines of business" in addition to managing a community school, AOS will require a statement showing direct and allocated indirect (e.g., overhead) expenses for each school. The companies should present this statement in a combining or consolidating format (i.e., present a column for each school). Additionally, the American Institute of Certified Public Accountant's (AICPA) audit and accounting guide, *Not-for-Profit Organizations*, sections 14.09 and 14.10 permits organizations to present this as supplemental information. Notes to the supplemental information should briefly describe the method used to allocate overhead costs. Since overhead allocations require subjective judgment, their amounts and allocation method should be considered disclosures of higher inherent risk. (An example disclosure is in Appendix A to Bulletin 2004-009.).

Where a management company's sole business is providing services to one community school, the company's audited statements should suffice, if the statements classify expenses in substantial conformance with USAS object codes. (IPA's may elect to follow this guidance.

The community school's audit opinion must extend to the combining or consolidating columns. Auditors of community schools must set their materiality threshold to include assurance the supplemental information for each school is not materially misstated. Opinions that report only on the individual school statement's fair presentation in relation to the management company's basic financial statements do not provide sufficient audit assurance, unless accompanied with an agreed-upon procedures report related to the supplemental information.

Agreed Upon Procedures Guidelines

A management company may decide to issue financial statements for which its independent auditors have only opined on the fair presentation of individual community school expenses by object code in relation to the company's basic statements taken as a whole. As this Bulletin describes, this does not provide AOS with enough assurance to provide an unqualified opinion on a community school's disclosure of management company expenses. However, we can accept this presentation if the auditor provides us an agreed-upon procedures report following these guidelines.

1. The engagement should follow Chapter 2, Agreed-Upon Procedures Engagements, from the AICPA's *Statement on Standards for Attestation Engagements No. 10* (SSAE 10).

2. Per SSAE 10, 2.11, AOS will be a specified party permitted to rely on the report.

3. As a specified party, AOS requires the following procedures:

    a. Haphazardly or randomly select 100 direct nonpayroll expense transactions (checks, EFTs, etc.) the management company charged to its community schools.

    b. Compare the amount charged to the school to supporting documentation, including a canceled check (or EFT documentation, etc.) and vendor invoice, supporting that the cost:

        i. Is a direct expense benefiting the school.

        ii. Is recorded for the proper amount for the proper period in the accounting system.

iii. Is charged to a proper object code.

c. Haphazardly or randomly select 100 direct payroll expense transactions, including salaries and benefits the management company charged to its community schools.

d. Compare the amount charged to the school to supporting documentation, including a canceled check and to personnel files supporting that the cost:

i. Is a direct expense paid to an employee for services provided solely to the school

ii. Is the cost recorded for the proper amount for the proper period in the accounting system

iii. Is the cost charged to a proper object code

e. Haphazardly or randomly select 100 expense transactions assigned to any indirect cost pool.

i. Compare the transaction to source documentation, such as vendor invoice, personnel file, etc. supporting the cost indirectly benefits the schools or other activities to which it is allocated.

ii. Determine the transaction is recorded for the proper amount for the proper period in the accounting system.

iii. Obtain an understanding of the method the management company uses to pool and assign indirect costs to individual schools. Recompute selected allocations for conformity with the method.

iv. Compare the results from steps e.(i.) through e.(iii.) with the overhead allocation disclosure in the footnote. Report any material departures from the footnote description in terms of the actual method used and any projected dollar effects of the departure.

4. As stated in SSAE 10, 2.25, auditors should report all instances of noncompliance, such as costs charged to a school where documentation does not support it directly benefited the school, or for which insufficient documentation exists.

5. The community school's auditor must judge whether any deficiencies in the agreed-upon procedures report requires the opinion to be qualified regarding the footnote.

Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):

New section per HB 204, effective 11/05/04

If you are auditing a county, ORC 117.111(A) mandates that we complete this step, if a county implemented significantly updated electronic records or signatures related to commercial (i.e. financial) transactions. This requirement applies to IPAs auditing counties.

4-4 Compliance Requirement: Ohio Rev. Code Section 117.111(A) Security controls over counties' electronic signatures and records.

Summary of Requirement: The AOS (and IPAs contracting to audit counties) **must** inquire into the method, accuracy and effectiveness of any procedure a county office adopts under ORC 304.02 to secure electronic signatures or records.[4]

Other statutes relevant to this requirement:

Per ORC 304.01:
(B) "County office" means any officer, department, board, commission, agency, court, or other instrumentality of a county.

(E) "Electronic signature" means an electronic sound, symbol, or process attached to or logically associated with a record and executed or adopted by a person with the intent to sign the record.

►Note: The signature can be by a county employee **or** a citizen transacting with the county.

ORC 304.02: Prior to a county office using electronic records and electronic signatures, a county office shall adopt, in writing, a security procedure to verify that an electronic signature, record, or performance is that of a specific person or for detecting changes or errors in the information in an electronic record. A security procedure includes, but is not limited to, a procedure requiring algorithms or other codes, identifying words or numbers, encryption, or callback or other acknowledgment procedures.

ORC 955.013 permits paying dog and kennel registration fees by financial transaction devices (e.g. credit cards), including via the internet.

ORC 1306.11: (A) An electronic record of information satisfies record retention laws.

In determining how the government ensures compliance, consider the following:	What control procedures address the compliance requirement?	W/P Ref.
• Accounting system designed to capture the required information • Accounting policies and procedures		

[4] Note: Since the legislature has mandated this step, we should deem qualitative materiality to be significant.

manuals • Knowledge and training of accounting personnel • Legislative and Management Monitoring		

Suggested Audit Procedures - Compliance (Substantive) Tests

1. Determine the records the county processes that use electronic signature or otherwise transacts electronically. These include:

   a. Automated accounting systems;

   b. Payroll and other checks/warrants the county issues with signatures;

   c. Cash receipts where the county accepts credit/debit cards.

   d. Internet transactions, encompassing everything from dog licenses to direct deposit receipts or payments.

2. Obtain and read the *written* security policy the county adopted to safeguard the transaction.

   a. Retain a copy or summary of the policy in the permanent file.

   b. Update systems' documentation as needed.[5]

3. Assess the effectiveness of the design of controls and determine that they have been "placed in operation." (AOS staff can refer to AOSAM 30500.45 -- .46.)

4. If we assess CR at less than the maximum level or low, test monitoring or application controls related to electronic transactions and signatures.

5. Determine whether results from the steps above regarding the design and operation of controls related to securing electronic signatures and transactions result in any management comments, reportable conditions or material weaknesses we must also report as a noncompliance finding. Since the statute explicitly refers to a written security policy, we should report the absence of a written security policy.

Audit Implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):

[5] AOS staff should update the RCEC where needed to incorporate electronic transactions, including controls and policies designed to safeguard electronic transactions. Also, consider the appropriate degree of ISA involvement. AOS audit staff must consult with ISA when a government has a complex IT environment (AOSAM 30500.49). Also consider that the nature of electronic transactions and signatures subject to this law may require ISA assistance.

Section D: Accounting requirements applicable to all public offices

While this OAC section was effective in 2000, auditors should consider citing it to support audit findings related to significant deficiencies in accounting records.

4-5 Compliance Requirement: Ohio Admin. Code Section 117-2-02(D) Accounting records

Summary of Requirement:
All local public offices may maintain accounting records in a manual or computerized format. The records used should be based on the nature of operations and services the public office provides, and should consider the degree of automation and other factors. Such records **should** include the following:

(1) Cash journal, which typically contains the following information: The amount, date, receipt number, check number, account code, purchase order number, and any other information necessary to properly classify the transaction.

(2) Receipts ledger, which typically assembles and classifies receipts into separate accounts for each type of receipt of each fund the public office uses. The amount, date, name of the payor, purpose, receipt number, and other information required for the transactions can be recorded on this ledger.

(3) Appropriation ledger, which may assemble and classify disbursements or expenditure/expenses into separate accounts for, at a minimum, each account listed in the appropriation resolution. The amount, fund, date, check number, purchase order number, encumbrance amount, unencumbered balance, amount of disbursement, and any other information required may be entered in the appropriate columns.

(4) In addition, all local public offices should maintain or provide a report similar to the following accounting records:

a. Payroll records including:

i. W-2's, W-4's and other withholding records and authorizations;

ii. Payroll journal that records, assembles and classifies by pay period the name of employee, social security number, hours worked, wage rates, pay date, withholdings by type, net pay, and other compensation paid to an employee (such as a termination payment), and the fund and account charged for the payments;

iii. Check register that includes, in numerical sequence, the check number, payee, net amount, and the date;

iv. Information regarding nonmonetary benefits such as car usage and life insurance

v. Information, by employee, regarding leave balances and usage

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b. Utilities billing records including:

i. Master file of service address, account numbers, billing address, type of services provided, and billing rates;

ii. Accounts receivable ledger for each service type, including for each customer account, the outstanding balance due as of the end of each billing period (with an aging schedule for past due amounts), current usage and billing amount, delinquent or late fees due, payments received and noncash adjustments, each maintained by date and amount;

iii. Cash receipts records, recording cash received and date received on each account. This information should be used to post payments to individual accounts in the accounts receivable ledger described above

c. Fixed asset records* including such information as the original cost, acquisition date, voucher number, the asset type (land, building, vehicle, etc.), asset description, location, and tag number. Local governments preparing financial statements using generally accepted accounting principles will want to maintain additional data. Fixed assets are tangible assets that normally do not change form with use and should be distinguished from repair parts and supply items.

d. Each local public office should establish a capitalization threshold* so that, at a minimum, eighty per cent of the local public office's non-infrastructure assets are identified, classified, and recorded on the local public office's financial records.

* These capital assets apply to GAAP *and non-GAAP* mandated public offices. All public offices should have record of significant capital assets owned sufficient to manage their operations.

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- Accounting system designed to capture the required information
- Accounting policies and procedures manuals
- Knowledge and training of accounting personnel
- Legislative and Management Monitoring

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<tr><td colspan="3">Suggested Audit Procedures - Compliance (Substantive) Tests</td></tr>
<tr><td colspan="2">Based on our systems documentation, results of inquiries and other audit procedures, assess whether the accounting system generally complies with the aforementioned requirements.[6]</td><td></td></tr>
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[6] Note: We would not deem deficiencies with meeting these requirements as reportable GAGAS noncompliance unless a deficiency is also a material weakness. We would normally deem these matters to be material weaknesses only if the matter (1) caused an opinion qualification (including a

Audit Implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):

scope restriction), (2) contributed significantly to other material noncompliance or fraud, (3) resulted in an unauditable condition, (4) required records reconstruction, or (5) other serious condition. We would also describe the finding as a material weakness in the internal control section of the GAGAS report.

If the deficiency was not as severe as the above circumstances, but nevertheless constituted a "significant deficiency in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the government's ability to record, process, summarize, and report financial data consistent with management's assertions in the financial statements," we would issue a reportable condition without citing this OAC section.