

## CHAPTER 2 INDIRECT LAWS & STATUTORILY MANDATED TESTS

**AU-C 250.A13** Many laws and regulations relating principally to the operating aspects of the entity do not directly affect the financial statements (their financial statement effect is indirect) and are not captured by the entity's information systems relevant to financial reporting. Their indirect effect may result from the need to disclose a contingent liability because of the allegation or determination of identified or suspected noncompliance.

**AU-C 250.06 b** also requires testing other laws that do not have a direct effect. These other “indirect” laws are defined as laws which may be:

- i. fundamental to the operating aspects of the business,
- ii. fundamental to an entity's ability to continue its business, or
- iii. necessary for the entity to avoid material penalties

Chapter 2 includes “indirect” laws. Chapter 2 also includes laws that statutes mandate auditors to test during an audit.

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**BUDGETARY REQUIREMENTS**

**2-1 Compliance Requirement:** Ohio Rev. Code §5705.39 - Appropriations limited by estimated resources.

**Note:** Auditors should not cite entities in Fiscal Emergency for violating Ohio Rev. Code § 5705.10, 5705.36, 5705.39 or 5705.41 (A), (B) or (C) for funds that were already in a deficit at the time a Fiscal Emergency was declared.

Auditors should continue to cite entities for healthy funds (those with positive cash balances at the time of declaration) that experience a deficit after declaration<sup>1</sup>. Therefore, auditors should compare fund deficits during the audit period to the funds that were in deficit at the point when the Fiscal Emergency was originally declared to determine whether any new funds have incurred a deficit balance.

**IMPORTANT:** In order to determine which funds were in a deficit at the time of the declaration auditors should review the declaration of Fiscal Emergency available on the Auditor of State website audit search. The Financial Supervisor (LGS) can assist auditors determining which funds were originally part of the Fiscal Emergency deficit declaration, if needed.

**Summary of Requirements:** Ohio Rev. Code § 5705.39 provides in part that total appropriations from each fund shall not exceed the total estimated resources. No appropriation measure is effective until the county auditor files a certificate that the total appropriations from each fund do not exceed the total official estimate or amended official estimate.

Note: If a government fails to receive the county auditor's certifications that appropriations do not exceed estimated resources, governments may present the appropriations passed by the legislative authority on the financial statements. No citation should be made if the government requested the county auditor's certificate and the county auditor failed to respond. However, a noncompliance citation is still appropriate if appropriations exceed estimated resources by a material amount.

As discussed in Auditor of State Bulletin 1997- 012, if a local government is participating in a grant or loan program whereby proceeds will be received after the expenditures are incurred, it is possible that if properly budgeted, appropriations for one fiscal year will exceed the available amount on the certificate of estimated resources. Ohio Rev. Code §5705.42 makes formal legislative appropriation for certain grants and loans unnecessary. As such, we believe it is equally unnecessary to require a subdivision to seek certification of the amended appropriation measure for purposes of Ohio Rev. Code §5705.39. However, the fiscal officer should record the appropriation amount in the accounting system and include the appropriated amounts on the (amended) certificate to properly monitor budget versus actual activity. An advance should be used to prevent a negative fund balance. (*School districts are permitted to incur deficit fund balances in their special funds under certain circumstances. Refer to OCS section 1-4 for additional guidance.*)

**Project-Length Budgeting**

As described in AOS Bulletin 1997-012, once a grant is awarded or a loan is approved by the Federal or State government, the fiscal officer must obtain an Official Certificate of Estimated Resources or an Amended Certificate of Estimated Resources for all or part of the grant or loan, based on what is to be

<sup>1</sup> In rare instances, complying with the recovery plan can cause violations of Chapter 5705. In these instances, auditors should not cite violations of 5705 if they were necessary in order to comply with the recovery plan.

received in the fiscal year. Any money expected to be received in the next year should be reflected on the next year’s certificate. However, if the local government, with the exception of a school district, has budgeted on a project-length basis pursuant to Ohio Rev. Code § 9.34(B), the fiscal officer must obtain an Official Certificate of Estimated Resources for the entire project-length fiscal period.

The fiscal officer shall record the appropriations in accordance with the terms and conditions of the grant or loan agreement. In addition, prior to recording the appropriations, the legislative authority must pass a resolution amending its appropriation measure (Ohio Rev. Code § 5705.40). If the grant or loan will be expended over a period longer than the current fiscal year, only the amount estimated to be obligated during the current fiscal year should be recorded as appropriated. The remainder of the project should be appropriated in the subsequent year(s).

In situations where the grant or loan proceeds will be received after the expenditures are incurred (i.e., on a reimbursement basis), it is possible that the local government will have appropriated an amount for one fiscal year that is in excess of the amount reflected as available on the Amended Certificate of Estimated Resources. This situation will NOT constitute a noncompliance citation during an audit.

**5705.28(B)(2) Requirements for entities that do not levy taxes (See the Legal Matrices in Exhibit 5 of the OCS Implementation Guide for applicable entities)**

If an entity levies taxes, the sections above apply. However, some entities with taxing authority do not levy taxes. When they do not levy taxes, Ohio Rev. Code §5705.28 (B)(2) permits a comparable, but somewhat streamlined budget process. Ohio Rev. Code §5705.28(B)(2) requires entities to follow §5705.36. While Ohio Rev. Code §5705.39 does not apply, §5705.28(B)(2)(c) prohibits appropriations from exceeding estimated revenue (i.e. receipts + beginning unencumbered cash).

**Suggested Audit Procedures:**

Compare the final year end appropriation measures for selected funds (normally the general fund and major funds are sufficient) and determine that the appropriations do not exceed the official or amended estimate of resources (estimated revenues plus unencumbered fund balances) as of the fiscal year end. (It should not be necessary to schedule out all of the appropriation amendments throughout the year.)

Except: if the government is in fiscal emergency, and you are testing a fund with a beginning unencumbered deficit, compare appropriations to estimated receipts instead of to estimated resources.

For grants or loans awarded by the Federal or State government, determine whether the entity implemented project-length budgeting pursuant to Ohio Rev. Code § 9.34(B). If so, determine whether the fiscal officer obtained an Official Certificate of Estimated Resources for the entire project-length fiscal period and that only the amount estimated to be obligated during the current fiscal year was recorded as appropriated for advance-funded grants and loans. If the local government appropriated amounts beyond fiscal year end, determine whether the exception above was met (i.e. reimbursable grants or loans).

**Audit implications (the indirect and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):**

**2-2 Compliance Requirements:** Ohio Rev. Code §§ 5705.41 (A) and (B); and 5705.42 Restrictions on appropriating and expending money.

**Note:** Auditors should not cite entities in Fiscal Emergency for violating Ohio Rev. Code § 5705.10, 5705.36, 5705.39 or 5705.41 (A), (B) or (C) for funds that were already in a deficit at the time a Fiscal Emergency was declared.

Auditors should continue to cite entities for healthy funds (those with positive cash balances at the time of declaration) that experience a deficit after declaration<sup>2</sup>. Therefore, auditors should compare fund deficits during the audit period to the funds that were in deficit at the point when the Fiscal Emergency was originally declared to determine whether any new funds have incurred a deficit balance.

**IMPORTANT:** In order to determine which funds were in a deficit at the time of the declaration auditors should review the declaration of Fiscal Emergency available on the Auditor of State website audit search. The Financial Supervisor (LGS) can assist auditors determining which funds were originally part of the Fiscal Emergency deficit declaration, if needed.

### Summary of Requirements:

The authorization of a bond issue is *deemed an appropriation*<sup>3</sup> of the proceeds of the bond issue for the purpose for which such bonds were issued. No expenditure shall be made from any bond fund until first authorized by the taxing authority. [§ 5705.41(A)].

Similarly, Federal and State grants or loans are “*deemed appropriated*” for such purpose by the taxing authority” as provided by law and shall be recorded as such by the fiscal officer of the subdivision, and is deemed in process of collection [§5705.42].

No subdivision or taxing unit is to expend money unless it has been appropriated. [§ 5705.41(B)].

<sup>2</sup> In rare instances, complying with the recovery plan can cause violations of Chapter 5705. In these instances, auditors should not cite violations of 5705 if they were necessary in order to comply with the recovery plan.

<sup>3</sup> “Deemed an appropriation” under this section means the Federal or State government has already appropriated and established the purpose(s) for which a government can spend monies received from Federal or State grants and loans. The taxing authority cannot deviate from this purpose; the taxing authority can only resolve to spend the money for a purpose already prescribed in a contract, grant agreement, loan agreement, etc. Therefore, Federal and State grants and loans received under Ohio Rev. Code § 5705.42 *do not* require formal appropriation by the legislative body. In other words, Ohio Rev. Code § 5705.42 effectively eliminates an unnecessary appropriation action by the taxing authority. However, Ohio Rev. Code § 5705.42 directs the fiscal officer to *record* the appropriation amount in the accounting system. The fiscal officer should also include the appropriated amounts on the (amended) certificate to properly monitor budget versus actual activity. Note: Amounts “deemed appropriated” are subject to inclusion in GAAP budgetary presentations (GASB Cod. 2400.102). The government has no legal authority to spend these resources unless they were either appropriated by the legislative authority or deemed appropriated by the Federal or State government. (GASB Comprehensive Implementation Guide Q&A 7.91.14.).

**5705.28(B)(2) Requirements for entities that do not levy taxes (See the Legal Matrices in Exhibit 5 of the OCS Implementation Guide for applicable entities)**

If an entity levies taxes, the sections above apply. However, some entities with taxing authority do not levy taxes. When they do not levy taxes, Ohio Rev. Code §5705.28 (B)(2) permits a comparable, but somewhat streamlined budget process. Ohio Rev. Code §5705.28(B)(2) requires these entities to follow §5705.41(B) and so they cannot disburse more than appropriated.

**Suggested Audit Procedures:**

For selected funds (normally the general fund and major funds are sufficient) compare total expenditures plus contract commitments (including outstanding encumbrances) from each fund versus appropriations and determine if the expenditures and commitments are within the appropriations for the tested funds at year end.

**Audit implications (the indirect and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):**

**CONTRACTS AND EXPENDITURES  
COMMUNITY SCHOOLS**

**2-3 Compliance Requirement:** Ohio Rev. Code § 3314.24(A) **Internet- or computer-based community school** cannot contract with a nonpublic school for instructional facility space.

Notes:

(1) Violations require ODE to withhold foundation payments for any students using nonpublic school facilities.

(2) Ohio Rev. Code § 3314.02(A)(7) defines Internet- or computer-based community schools as those in which the enrolled students work primarily from their residences on assignments in nonclassroom-based learning opportunities provided via an internet- or other computer-based instructional method that does not rely on regular classroom instruction or via comprehensive instructional methods including internet-based, other computer-based, and noncomputer-based learning opportunities.

**Suggested Audit Procedures - Compliance (Substantive) Tests:**

Read internet schools' contracts for instructional space. Determine if contracts for instructional space were with nonpublic schools.

**Audit implications (the indirect and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):**

**ACCOUNTING AND REPORTING  
VARIOUS ENTITY TYPES**

**2-4 Compliance Requirements:** Ohio Admin. Code § 117-2-02(D) and (E) 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; and
    - v. Information, by employee, regarding leave balances and usage;
  - 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. Capital 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. Capital assets are tangible assets that normally do not change form with use and should be distinguished from repair parts and supply items.

Ohio Admin. Code § 117-2-02(E) states that 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 asset (fixed asset) record requirements apply to GAAP and non-GAAP mandated public offices. All public offices should have records of significant capital assets.

### Suggested Audit Procedures - Compliance (Substantive) Tests:

Ohio Admin. Code § 117-2-02 requires governments to establish internal controls and report financial information properly. Auditors may include this citation in a finding to emphasize its importance (which results in classifying the finding as noncompliance as well as a control deficiency.) However, we would not automatically deem one misclassification as reportable noncompliance under this Ohio Admin. Code Section.

Based on our systems documentation, results of inquiries and other audit procedures, assess whether the accounting system generally complies with the aforementioned requirements.<sup>4</sup>

<sup>4</sup> Note: Per AU-C 265, "A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance."

Noncompliance with these Ohio Administrative Code requirements normally also suggest control deficiencies. We would not automatically deem minor misclassifications or other lesser-significant errors as reportable noncompliance under this Ohio Admin. Code Section. While a significant deficiency may exist, it is possible that the deficiency may not necessarily rise to the level of material noncompliance. This is a matter of professional auditor's judgment. We should consider the pervasiveness of the noncompliance matter in relation to the compliance requirement and the financial statements as whole. Conversely, a failure to maintain any utility billing records (for example) would not only be a material weakness, but would be reportable noncompliance with Ohio Admin. Code § 117-2-02(D).

**Audit implications (the indirect and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):**

## COMMUNITY SCHOOL ADDITIONAL REPORTING

**2-5 Compliance Requirements: Per Ohio Rev. Code § 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.). Ohio Rev. Code §3314.03(A)(8) discusses the requirements of community schools to have financial audits by the Auditor of State. The contract between the sponsor and the governing authority shall require financial records of the school to be maintained in the same manner as are financial records of school districts, pursuant to rules of the Auditor of State, and the audits shall be conducted in accordance with § 117.10 of the Revised Code. This includes 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.

Material misstatement or omission of the community school financial statement footnote should be reported as GAGAS level, material noncompliance with Ohio Rev. Code § 3314.024. However, because GAAP does not require this disclosure, do not modify the opinion.

Note: This step updates guidance originally presented in Auditor of State Bulletin 2004-009.

### 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 Accountants' (AICPA) audit and accounting guide, *Not-for-Profit Organizations*, sections 14.12 through 14.1411—and ~~14.12~~—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 management company'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.

Note: The guidance below assumes the school's auditor has sufficient evidence to support an opinion on the school's statements, and is using the AUP solely for the management company footnote.

A school's auditor must judge whether deficiencies in an AUP report affect the management company disclosure sufficiently to require a GAGAS noncompliance finding. For example, completely omitting the note would require a GAGAS noncompliance finding, citing Ohio Rev. Code § 3314.024.

### Agreed Upon Procedures Guidelines

#### Bulletin 2004-009 Agreed Upon Procedures Guidelines, Revised 2010

AOS Bulletin 2004-009 included this sentence in the *Auditing the Footnote* section:

“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.”

Based on our experience since issuing this Bulletin, we are revising this sentence as follows:

“If a management company's audited financial statements do not present combining or consolidating columns for each of its schools, or if the auditor does not provide opinion-level assurance on the combining or consolidating columns presenting each school, the Auditor of State will accept an agreed-upon procedures (AUP) report per AICPA Attestation Standards Section 201. See Bulletin 2004-009 Appendix B for procedures to which the AOS would agree.”

The following is **Appendix B, as revised**:

1. The engagement should follow AICPA Attestation Standards, Section AT 201.
2. Per AT 201.11, the AOS will be a specified party permitted to rely on the report.
3. Per AT 201.07, “To satisfy the requirements that the practitioner and the specified parties agree upon the procedures performed or to be performed and that the specified parties take responsibility for the sufficiency of the agreed-upon procedures for their purposes, ordinarily the practitioner should communicate directly with and obtain affirmative acknowledgment from each of the specified parties.” AT 201.07 also states “The practitioner should not report on an engagement when specified parties do not agree upon the procedures performed or to be performed and do not take responsibility for the sufficiency of the procedures for their purposes.”

**Therefore, you the management company's practitioner auditor should e-mail a letter of arrangement and the draft (i.e. example) procedures to the schools and to AOS Center for Audit Excellence ([SSAE16@ohioauditor.gov](mailto:SSAE16@ohioauditor.gov)). AOS staff will electronically sign the letter of**

**arrangement attesting to the sufficiency of the procedures on behalf of the AOS, prior to the practitioner (“auditor”) commencing the procedures.**

**The letter of arrangement should list the schools to which the agreed-upon procedures will apply.**

**Example required procedures are 11 through 13 below.**

**Each AUP report should specify the schools to which the procedures apply.**

4. As a specified party, AOS requires the following, applicable to each Ohio school the company manages:
  - a. The accountant may issue one AUP report covering all the company’s Ohio schools.
  - b. The report must explain that the accountant performed 10. below to test the compilation of the footnotes separately for each school.
  - c. Regarding the individual expenditure tests below (steps 11. through 13.), the accountant may select one sample from the population of all costs charged to the company’s Ohio schools for each year ending June 30.
5. Ohio community schools’ fiscal years end each June 30. If the management company is on a different fiscal year, the management company must compile the footnote for each Ohio school’s June 30 fiscal year.

For example, if the management company’s fiscal year ended December 31, 2009, each Ohio school’s June 30, 2009 footnote would report expenses the management company incurred on a school’s behalf for the first six months of calendar 2009 plus the last six months of calendar 2008.

6. The accountant performing the AUP should describe the Ohio schools to which the AUP relate and should attach each of the community schools’ footnotes to the AUP report.
7. As stated in AT 201.25, auditors should report all exceptions, such as costs charged to a school where documentation does not support it directly benefited the school, or for which insufficient documentation exists.
8. Because the procedures relate to each school’s footnote, the accountant performing the AUP should apply the procedures to footnotes compiled from the management company’s accounting system, separately summarizing the expenses for each Ohio community school. This requires that the management company’s accounting system include accounts summarizing direct expenses the company incurs for each school. It is permissible to charge / assign indirect costs to these schools, *if the notes disclose the method for charging those costs, and if the note separately identifies indirect costs.*

**If the management company’s accounting system does not include separate accounts for direct expenses for each school, it is unlikely the management company can meet the requirements of Ohio Rev. Code § 3314.024. In this case, the management company or the firm completing the AUP should consult with the Auditor of State.**

9. Federal OMB Circular A-133 §\_\_\_\_.310(b) also requires each school expending more than \$500,000 of federal awards in its fiscal year to prepare a federal awards expenditure schedule. For audit periods **beginning** on or after December 26, 2014, the threshold raises to \$750,000 per the Supercircular.

**If the management company accounts for an Ohio school's federal awards, we believe it is reasonable to expect the management company to compile this schedule for each school, and for the AUP to include a procedure testing this compilation. (Also note that the Ohio Department of Education requires schools to present receipts for each program / CFDA number.)**

**Note that this requires that the management company's accounting system be capable of segregating receipts, disbursements and cash balances for each federal award program of each school.**

**Step 10.b below applies if a school expended more than \$500,000 of federal awards during its fiscal year.**

10. The AUP report should list the following procedures and the results relating to **each** Ohio school's footnote:
- Trace the management company direct expenses from each footnote by object / accounting code to the community school's accounts in the management company's accounting system.
  - Trace each school's federal award receipts and disbursements from its federal awards expenditure schedule to the community school's accounts in the management company's accounting system.
11. Haphazardly or randomly select 100 direct nonpayroll expense transactions (checks, EFTs, etc.) the management company charged to its Ohio community schools. (One sample selected from all the management company's Ohio schools will suffice. If the management company accounts for only one Ohio school, you may reduce the sample size to 60.)

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

- Is a direct expense benefiting the school
  - Is recorded for the proper amount for the proper period in the accounting system
  - Is charged to a proper object / accounting code
12. Haphazardly or randomly select 100 direct payroll expense transactions, including salaries and benefits the management company charged to its Ohio community schools. (One sample selected from all the management company's Ohio schools will suffice. If the management company accounts for only one Ohio school, you may reduce the sample size to 60.)

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

- Is a direct expense paid to an employee for services provided solely to the school
- Is recorded for the proper amount for the proper period in the accounting system

- c. The amount paid agreed to the salary schedule and/or to amounts withheld
  - d. Is charged to a proper object / accounting code
13. Haphazardly or randomly select 100 expense transactions (e.g checks) assigned to any indirect cost pool that include Ohio schools. (One sample from the pool(s) for Ohio schools will suffice. If the management company accounts for only one Ohio school, you may reduce the sample size to 60.)
- a. 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.
  - b. Determine the transaction is recorded for the proper amount for the proper period in the accounting system.
  - c. 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.
  - d. Compare the results from steps a through c 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.

Note: Occasionally, these notes report more expenses than amounts the school paid to its management company. When this occurs, the management company is subsidizing (or loaning money to) the school. We believe the basic statements should report material amounts as revenue (Contributions from management company), and additional related expenses under GASB Statement No. 24.

While some may view recording this entry as “merely” grossing up revenue and expense, we believe the school’s true expenses are understated without this entry. Presenting the management company’s willingness to subsidize operations in the statements is also important information for readers. Also, we are aware that some contracts specify these amounts are repayable loans from the management company, which would require crediting “loans payable to management company” in the statement of net assets rather than “subsidy from management company” in the statement of revenues and expenses.

Auditors should obtain evidence supporting whether these amounts are subsidies or loans from the management company. Usually the contract with the management company will explain whether the school must repay the management company. We suggest representation letters include these amounts, and represent whether these amounts are contributions or repayable loans.

If these are repayable loans, the balance sheet should reflect them as such, and consider whether the opening equity is overstated based on prior year unrecorded loans.

**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, significant deficiencies/material weaknesses, and management letter comments):**

**Revised: SB 287, 130<sup>th</sup> GA**  
**Effective: 9/04/14**

**DEPOSITS AND INVESTMENTS  
VARIOUS ENTITY TYPES  
(FOR COUNTY DEPOSIT AND INVESTMENTS SEE SECTION 2-10)**

**2-6 Compliance Requirement:** Ohio Rev. Code §135.14, §135.144 and §133.03(A)(1), 12 CFR 370 – Eligible investments for **interim** monies; section 135.13: **inactive** deposits and maturities.

**Summary of Requirements:**

- Investments must mature within 5 years from the settlement date, unless the investment is matched to a specific obligation or debt of the subdivision, or unless other provisions apply. [Ohio Rev. Code §135.14(D)]
- The following classifications of obligations are eligible for such investment or deposit:
  - United States obligations or any other obligation guaranteed as to principal and interest by the United States.<sup>5</sup> This law prohibits investing in stripped principal or interest obligations. [Ohio Rev. Code §135.14(B)(1)]
  - Bonds, notes, debentures, or any other obligations or securities issued by any federal government agency or instrumentality. All federal agency securities must be direct<sup>6</sup> issuances of federal government agencies or instrumentalities. [Ohio Rev. Code §135.14(B)(2)]
  - Interim deposits in the eligible institutions applying for interim monies as provided in Ohio Rev. Code §135.08. [Ohio Rev. Code §135.14(B)(3)]
    - Per 135.13, *Interim deposits* are certificates of deposit<sup>7</sup> or savings or deposit accounts, including passbook accounts.

<sup>5</sup> See appendix E-1 of the OCS Implementation Guide for a list of agencies the Federal government guarantees.

<sup>6</sup> An example of an *indirect* issuance would be a FNMA CMO (collateralized mortgage obligation), where FNMA pools mortgages it guarantees. However, the mortgages are not a direct issuance of FNMA.

<sup>7</sup> It is the position of the Auditor of State that Ohio Rev. Code §135.03 & §135.32 prohibit purchasing certificates of deposit (negotiable\* or otherwise) from a bank unless the CD is subject to inspection by the Ohio Superintendent of Financial Institutions. Ohio is part of a nationwide cooperative agreement for examining multi-state banks in which these states agreed to recognize each other's supervisory authority for banks headquartered in another state but doing business in theirs. Therefore, it is reasonable to conclude that a multi-state bank in a state subject to this agreement is subject to inspection by Ohio's Superintendent of Financial Institutions. Multi-state banks are eligible to become a public depository for Ohio's governmental entities, subject to sections 135.01 to 135.21 of the Ohio Rev. Code. The bank should be registered with the Ohio Secretary of State to be an eligible public depository in Ohio. A government cannot purchase negotiable/brokered or nonnegotiable CDs unless the governing body has designated the bank as eligible to hold interim or inactive deposits. See ADAM 2002-005.

\*Another term for "negotiable" CDs is "brokered" CDs

- Ohio Rev. Code §135.144 also permits governments to use the Certificate of Deposit Account Registry Services (CDARS) or similar programs (one example is Star Plus) meeting Ohio Rev. Code §135.144 requirements for interim deposits. If a government purchases CDs for more than the FDIC limit (\$250,000) with a bank participating in CDARS or similar program such as Star Plus, the bank or program “redeposits” the excess amounts with other institutions. Each bank accepts less than \$250,000 so that all deposits have FDIC coverage. Ohio Rev. Code §135.144 requires a government to place its deposits with an eligible depository per Ohio Rev. Code §135.03. However, the institutions the government’s depository places excess deposits with are not subject to Ohio Rev. Code §135.03. For example, while the deposit must be initiated at an Ohio depository branch, the Ohio depository can purchase CDs from depositories outside of Ohio for the excess. Because all CDARS, Star Plus, etc. deposits have FDIC coverage, the collateral requirements of Ohio Rev. Code §135.18 and §135.181 do not apply. (That is, these are *insured* deposits for GASB 40 purposes, Appendix E-2 of the OCS Implementation Guide.) Refer to AOS Bulletin 2007-007 for additional information regarding CDARS.<sup>8</sup>
- Any CD’s purchased by a broker must be held in the name of the government. Also, the broker cannot be in possession of cash at any time. If we believe a broker has held cash for any length of time, AOS auditors should refer the matter to the Center for Audit Excellence and AOS Legal division for further evaluation. A way to verify compliance is to request monthly statements provided by the public depository located in Ohio. Ohio Rev. Code §135.144(A)(5) requires the initial public depository to provide public offices with a monthly account statement that includes the amount of its funds deposited and held at each bank, savings bank, or savings and loan association for which the public depository acts as a custodian pursuant to Ohio Rev. Code §135.144. If a public office does not have these statements, it may indicate that the money is being held by a broker-dealer in violation of Ohio Rev. Code §135.144.
- Bonds or other obligations of the State of Ohio, or the political subdivisions of this state, provided that, with respect to bonds or other obligations of political subdivisions, all of the following apply:
  - The bonds or other obligations are payable from general revenues of the political subdivision and backed by the full faith and credit of the political subdivision.
  - The bonds or other obligations are rated at the time of purchase in the three highest classifications established by at least one nationally recognized standard rating service and purchased through a registered securities broker or dealer.
  - The aggregate value of the bonds or other obligation does not exceed twenty per cent of interim moneys available for investment at the time of purchase.
  - The treasurer or governing board is not the sole purchaser of the bonds or other obligations at original issuance.

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<sup>8</sup> It is conceivable programs similar to CDARS may be established. We believe these programs would be legal if they meet all Ohio Rev. Code §135.144 requirements (an example is Star Plus). As another example, we are aware that credit unions have established a similar program to insure deposits exceeding the limits covered by the National Credit Union Share Insurance Fund. However, Ohio Rev. Code §135.144 would not permit governments to use this program because Ohio Rev. Code §135.03 (via Ohio Rev. Code §1151.01) excludes credit unions from eligible depositories. However, Ohio Rev. Code § 135.03 permits any savings association or savings bank located in Ohio, which is doing business under the authority of another state, to become an eligible public depository. Therefore, if they establish programs complying with all § 135.144 requirements, those programs would have similar legal status to the CDARS program (one example is Star Plus).

No investment shall be made under Ohio Rev. Code §135.14(B)(4) unless the treasurer or governing board has completed additional training for making the investments authorized by this section. The type and amount of additional training shall be approved by the treasurer of state and may be conducted by or provided under the supervision of the treasurer of state. [Ohio Rev. Code §135.14(B)(4)]

- No-load money market mutual funds consisting exclusively of obligations described in (B)(1) or (2) of Ohio Rev. Code §135.14 (i.e. the investments listed in the first two bullets above), and repurchase agreements secured by such obligations, provided the government purchases the money market mutual fund **only** through eligible institutions mentioned in Ohio Rev. Code §135.03 (which are, generally, Ohio banks and national banks authorized to do business in Ohio). [135.14(B)(5)] Also, per Ohio Rev. Code § 135.01(O)(2), these funds must have the highest letter or numerical rating provided by at least one nationally recognized standard rating service.
- The Ohio Subdivisions Fund (STAR Ohio) as provided in Ohio Rev. Code §135.45. [Ohio Rev. Code §135.14(B)(6)]
- Chapter 133 securities (generally debt instruments Ohio State & local governments have issued) [Ohio Rev. Code §133.03].

➤ Per Ohio Rev. Code § 135.14(E), the treasurer or governing board may also enter into a repurchase agreement with any *eligible institution* mentioned in Ohio Rev. Code §135.03 or any *eligible dealer* pursuant to Ohio Rev. Code §135.14(M). (*Eligible institutions* per Ohio Rev. Code § 135.03 include any national bank, any bank doing business under authority granted by the superintendent of financial institutions, or any bank doing business under authority granted by the regulatory authority of another state of the United States, located in this state.) *Eligible dealers* per Ohio Rev. Code § 135.14(M) are ~~national association of securities dealers members (NASD)~~ financial industry regulatory authority (FINRA), banks, savings bank, or savings and loan associations regulated by the superintendent of financial institutions, or institutions regulated by the comptroller of the currency, federal deposit insurance corporation, or board of governors of the federal reserve system.) In these agreements, the treasurer or governing board purchases, and such institution or dealer agrees unconditionally to repurchase any of the securities listed in division (B)(1) to (5) of §135.18,<sup>9</sup> except letters of credit described in division (B)(2) are not permitted for repurchase agreements.

- The market value of securities subject to an overnight repurchase agreement must exceed the cash invested subject to the repurchase agreement by 2%.<sup>10</sup> A term repurchase agreement may not exceed 30 days and must be marked to market daily.<sup>11</sup>
- All securities purchased pursuant to a repurchase agreement are to be delivered into the custody of the treasurer or governing board or an agent designated by the treasurer or governing board.<sup>12</sup>

<sup>9</sup> Ohio Rev. Code §135.18(B) (1) – (10) are summarized in Ohio Compliance Supplement Step 2-9.

<sup>10</sup> Many states do not require minimum market values of securities for repurchase agreements. Therefore, the risk of noncompliance increases when banks merge with out-of-state banks. Ohio governments are still bound by Ohio laws even if a bank's depository agreement indicates the bank follows another state's laws for the market value of securities.

<sup>11</sup> The dealer would be responsible for marking the securities, not the government.

- Repurchase agreements must be in writing. They must require that, for each transaction, the participating institution provide:
  - a) the par value of the securities;
  - b) the type, rate, and maturity date of the securities;
  - c) a numerical identifier (e.g., a CUSIP number) generally accepted in the industry that designates the securities.
- Agreements by which the treasurer or governing board agrees to sell securities owned by the subdivision to a purchaser and agrees with that purchaser to unconditionally repurchase those securities (i.e., Reverse Repos) are prohibited. [Ohio Rev. Code §135.14(E)]
- Derivative investments are prohibited. *Derivative*<sup>13</sup> means a financial instrument or contract or obligation whose value or return is based upon or linked to another asset or index, or both, separate from the financial instrument, contract, or obligation itself. Any security, obligation, trust account, or other instrument that is created from an issue of the United States Treasury or is created from an obligation of a federal agency or instrumentality or is created from both is considered a derivative.
  - An eligible investment described in Ohio Rev. Code §135.14 with a variable interest rate payment or single interest payment, based upon a single index comprised of other eligible investments provided for in division (B)(1) or (2) of §135.14 (see above), is **not** a derivative, if the variable rate investment has a maximum maturity of 2 years. [Ohio Rev. Code §135.14(C)] (Therefore, an investment with a variable interest rate indexed to Federal securities would be legal. However, an investment indexed to the London Interbank Offered Rate (LIBOR) or to a bank's prime rate would not be legal.)
    - 1999 Op. Atty. Gen. No. 99-026 deemed collateralized mortgage obligations to be illegal derivatives.
    - A treasury inflation-protected security (TIPS) is permissible for counties only, per Ohio Rev. Code §135.35 (B).
- Article VIII, Sections 4 and 6 of the Ohio Constitution prohibit public bodies from becoming a "stockholder in any joint stock company, corporation or association."
  - However, Article VIII, Section 6 of the Constitution provides an exemption which allows public bodies to purchase insurance from mutual insurance companies (Note that insured parties of mutual insurance companies become stockholders.).
  - The AOS also does not believe Ohio Rev. Code § Chapter 135 (or 1715.52(E)(3)) prohibits a government from **holding** stock **donated** to it. (However, considering the volatility of many equity securities, our management letter should recommend liquidating stock, if liquidation does not violate a trust or other agreement.)

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<sup>12</sup> Counterparties (e.g. banks) accomplish this by maintaining a separate "customer" account at the Federal Reserve designated as a customer account. (For purposes of GASB 40, we currently believe securities held in a customer account would not be exposed to custodial risk.)

<sup>13</sup> Note: The Ohio Rev. Code still uses the derivative definition from GASB Technical bulletin 94-1. GASB Statement No. 53, effective for periods beginning after June 15, 2009, defines derivatives differently than does the Revised Code. So, for legal compliance purposes, governments must follow the Ohio Rev. Code derivative definition. For financial reporting, governments must follow the GASB definition. For example, interest rate swaps and energy futures contracts (which are allowable under Ohio Rev. Code § 9.835 to mitigate price fluctuations, and are not intended as investments) meet the GASB 53 derivative definition, and would be subject to GASB Statement No. 53 derivative measurement and disclosure requirements, but are **not** illegal.

- Per Ohio Rev. Code § 135.14(F), a government cannot purchase an investment unless it reasonably expects to hold it until maturity. **NOTE:** We believe the intention of this section is to reduce the likelihood a government would suffer losses on early redemptions required due to inadequate cash flow planning. See the description of audit procedures for more information.
- Per Ohio Rev. Code § 135.14(G), subdivisions may not invest interim moneys in an investment pool except:
  - The Ohio Subdivision's Fund (STAR Ohio) pursuant to Ohio Rev. Code §135.14(B)(6).
  - A fund created solely to acquire, construct, own, lease, or operate municipal utilities pursuant to Ohio Rev. Code §715.02 or Ohio Const. Art XVIII, §4.
- Leveraging (a government using its current investment assets as collateral for purchasing other investments) is prohibited. [Ohio Rev. Code §135.14(H)]
- Issuing taxable notes for arbitrage is prohibited. [Ohio Rev. Code §135.14(H)]
- Governments cannot contract to sell securities not yet acquired (short sales), for the purpose of purchasing such securities on the speculation that their price will decline. [Ohio Rev. Code §135.14(H)]
- Payment for securities may be made only upon delivery of the securities to the treasurer, governing board, or qualified trustees, or, if not represented by a certificate, only upon receipt of confirmation of transfer from the custodian. [Ohio Rev. Code §135.14(M)(2)]
- Proceeds from refunding securities must be held in the debt service fund or in escrow, and shall be invested in direct obligations of or obligations guaranteed as to payment by the United States that mature or are subject to redemption by and at the option of the holder not later than the date or dates when the moneys, together with interest or other investment income accrued on those moneys, will be required to refund the debt. [Ohio Rev. Code §133.34(D)].
- Ohio Rev. Code §135.13 requires depositing *inactive* funds in certificates of deposit maturing not later than the end of the depository designation period or by savings or deposit accounts, including, but not limited to, passbook accounts.
  - Investments must mature within 5 years from the date of settlement unless the investment matches a specific obligation or debt, and the investment advisory committee specifically approves it.
    - A county may hold investments purchased between 3/22/12 and 9/10/12 until their maturity of up to 10 years due to a temporary change in the law.

**Suggested Audit Procedures – Compliance (Substantive) Tests:**

Note: Some of the steps below require the same documentation / evidence auditors also use to support the *existence, valuation and classification* of investments. You can gain efficiency by combining the steps below with the substantive steps related to the aforementioned assertions.

Select a representative number<sup>14</sup> of investments and:

1. Read investment dealer confirmations\* to determine if the investment is of a type authorized.

\* Note: Dealer confirmations are suitable evidence supporting the details (e.g. valuation, occurrence) of an investment at the time of purchase. However, it provides no evidence the government still owned the investment as of its fiscal year end (the *existence* assertion). Auditors should obtain other evidence to support existence at year end. The audit program should include suitable existence steps.

2. For investments in bonds or other obligations of the State of Ohio, or the political subdivisions of this state, inspect documentation and determine whether the additional training was received. [Ohio Rev. Code §135.14(B)(4)]

3. Determine that the investments mature within the prescribed limits (generally no later than 5 years, or *other* periods for repurchase agreements, bankers' acceptances and commercial paper.)

4. Inspect documentation supporting repurchase agreements and determine that:

- a. The market values of securities exceed the principal values of securities subject to the overnight repurchase agreement by 2%. (Note: The risk of non-compliance increases when banks merge.)

- b. A term repurchase agreement did not exceed 30 days and the values of the securities were marked to market daily.

- c. Repurchase agreements were in writing, including the par value of the securities; the type, rate, and maturity date of the securities; and a numerical identifier.

5. Read the prospectus for money market mutual funds with which the government has significant investment. Determine whether the prospectus limits investments to those authorized under Ohio Rev. Code §135.14(B)(1) & (B)(2). §(B)(1) & (B)(2) describe Federally issued or insured securities. §(B)(1) & (B)(2) would not include, for example, reverse repos consisting of Federal securities or securities other states issue.

6. Determine whether money market mutual funds have the highest credit rating issued by one national ratings agency (such as that S&P, Moody's or Fitch issues).

7. Regarding Ohio Rev. Code §135.14(F), scan investment records to determine whether the government is selling securities prior to maturity. If a significant number or amount of premature sales occurred because the government had an emergency need for cash, review the CFO's cash flow forecasts supporting that the government had reasonable support, at the time of purchase, that it could hold the

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<sup>14</sup> When judging "a representative number," consider focusing on investments held at year end, but also consider testing other purchases and sales during the audit period. In judging how many purchases to test, consider the volume of purchases, the control environment, the adequacy of policies, and the results of prior audits.

security to maturity. *If there is inadequate cash flow planning*,<sup>15</sup> cite this section. The noncompliance finding should also recommend the government improve its cash flow forecasting. The finding should also describe any losses the government suffered from these sales.

7. If the government hires an investment manager for all or a portion of its investments, obtain copies of investment summary reports the manager prepares.

- a. Read the agreement between the manager and the government. Determine if the agreement (or the investment policy Step 2-7 describes) requires the manager to comply with all applicable Ohio Rev. Code Chapter 135 requirements. Maintain a copy or summary of the agreement in the permanent file.
- b. Test selected investments from the reports for compliance with steps 1 – 5 above.
- c. Scan purchases and sales to determine whether the manager sells securities prior to their maturity for other than an urgent need for cash.
- d. (Note that for financial audit purposes, an investment manager may constitute a service organization under SSAE 16 and AU-C 402)

Note: The steps above should normally be sufficient for most governments. Because we believe the risk of governments engaging in certain prohibited activities such as leveraging, short sales or arbitrage violations is low, there are no steps included to test these requirements. You should scan the other requirements in this step, and based on your knowledge of the government’s investing activities, investigate them if evidence suggests the government may have materially violated these requirements.

**Audit implications (the indirect and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):**

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<sup>15</sup> “Emergency” premature sales can result in losses. If inadequate cash flow planning contributed to the need to sell early, we should cite them. In other circumstances, a government may choose to redeem a security early at a loss in order to re-invest at a greater overall rate of return. We would not deem this latter circumstance to violate the intent of Ohio Rev. Code §135.14(F).

**2-7 Compliance Requirement:** Ohio Rev. Code §135.14 – Other Requirements. **(FOR COUNTY DEPOSIT AND INVESTMENTS SEE SECTION 2-10)****Summary of Requirements:**

- Per Ohio Rev. Code §135.14(O)(1), Investments or deposits under §135.14 cannot be made unless a written investment policy approved by the treasurer or governing board is on file with the Auditor of State, with the following two exceptions:
  - Per Ohio Rev. Code §135.14(O)(2), If a written investment policy is not filed with the Auditor of State, the treasurer or governing board can invest only in interim deposits, STAR Ohio, or no-load money market mutual funds.
  - Per Ohio Rev. Code §135.14(O)(3), A subdivision whose average annual investment portfolio is \$100,000 or less need not file an investment policy, provided that the treasurer or governing board certifies to the Auditor of State that the treasurer or governing board will comply and is in compliance with the provisions of §135.01 to §135.21.
- Per Ohio Rev. Code §135.14(O)(1), The investment policy must be signed by:
  - All entities conducting investment business with the treasurer or governing board (except the Treasurer of State);
  - All brokers, dealers, and financial institutions, described in §135.14(M)(1), initiating transactions with the treasurer or governing board by giving advice or making investment recommendations;
  - All brokers, dealers, and financial institutions, described in §135.14(M)(1), executing transactions initiated by the treasurer or governing board.
- If any securities or certificates of deposit purchased are issuable to a designated payee or to the order of designated payee, the designated party is to be the treasurer and the treasurer's office<sup>16</sup>.
- If the securities are registerable either as to principal and/or interest, then the securities are to be registered in the treasurer's name.
- The treasurer is responsible for safekeeping all the documents evidencing a deposit or investment. Any securities may be deposited for safekeeping with a qualified trustee as provided in Ohio Rev. Code §135.18.
- Except for investments in securities described in Ohio Rev. Code §135.14(B)(5) and (6) (no-load money funds, certain repos and STAR Ohio) and for investments by a municipal corporation in the issues of that municipal corporation, all investments must be made through:
  - members of the National Association of Securities Dealers, Inc. (NASD); or
  - institutions regulated by the Superintendent of Banks, Superintendent of Savings and Loan Associations, Comptroller of Currency, Federal Deposit Insurance Corporation, or Board of Governors of the Federal Reserve System.

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<sup>16</sup> For example, an acceptable method of complying with this requirement is for the financial institution to make the securities or certificates of deposit payable to "ABC Township, Joe Jones, Treasurer."

**Suggested Audit Procedures – Compliance (Substantive) Tests:**

Read the government's investment policy for the period.

If there is no written investment policy filed with the Auditor of State, scan the government's investment portfolio for the period to determine that it is composed solely of interim deposits, STAR Ohio, or no-load money market mutual funds, or that its average annual size is \$100,000 or less. Additionally, inspect the certificate to the Auditor of State asserting<sup>17</sup> that the treasurer or governing board will comply and is in compliance with the provisions of Ohio Rev. Code §135.01 to §135.21.

If applicable, inspect documentation that the policy was approved by the treasurer or governing board and is on file with the Auditor of State (For AOS employees the policies and exemptions are available at S:/Final Audit PDF/Region Folder/County Folder/Client Folder/Investment Policy Folder). (We need not repeat this step every audit. Keep a copy in the permanent file, and inquire whether the government has amended the policy since the prior audit.)

Inspect the policy for the requisite signatures:

- All entities conducting investment business with the treasurer or governing board (except the Treasurer of State);
- All brokers, dealers, and financial institutions initiating transactions with the treasurer or governing board by giving advice or making investment recommendations;
- All brokers, dealers, and financial institutions executing transactions initiated by the treasurer or governing board.
- Select a representative number of investments made by the entity and determine whether the investments are in accordance with the entity's investment policy as adopted by the entity's legislative body.

Determine if the policy requires financial institutions, brokers and dealers to comply with Ohio Rev. Code Chapter 135. (There is no legal requirement to include this, but if the policy does not include this requirement, we should recommend the government amend their policy to require compliance.)

Select a representative number<sup>18</sup> or amount of investments:

- Inspect purchase documents and determine that investments were made only through members of NASD, or institutions regulated by the Superintendent of Banks, Superintendent of Savings and Loan Associations, Comptroller of Currency, Federal Deposit Insurance Corporation, or Board of Governors of the Federal Reserve System.
- For certificates of deposit, inspect documentation that any designated payee is the treasurer or treasurer's office; and that the CDs are in the treasurer's name.

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<sup>17</sup> Not required if the portfolio for the period is composed solely of interim deposits, STAR Ohio, or no-load money market mutual funds.

<sup>18</sup> When judging "a representative number," consider focusing on investments held at year end, but also consider testing other purchases and sales during the audit period. In judging how many purchases to test, consider the volume of purchases, the control environment, the adequacy of policies, and the results of prior audits.

**Audit implications (the indirect and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):**

**Revised: SB 287, 130<sup>th</sup> GA**  
**Effective: 9/04/14**

**2-8 Compliance Requirements:** Ohio Rev. Code §135.142 (school districts), §135.14(B)(7) (other subdivisions) – Additional investments allowable for subdivisions other than counties.

**Summary of Requirements:** Ohio Compliance Supplement Step 2-6 identifies certain investments that are eligible for **interim** monies. In addition to those investments, subdivisions can invest interim monies as follows:

➤ Up to ~~twenty five~~ forty per cent of interim moneys available for investment in either of the following [Ohio Rev. Code §135.142(A) for school districts; §135.14(B)(7) for other subdivisions]:

**Commercial paper** notes issued by an entity defined in Ohio Rev. Code §1705.01(D) (see definition below) and that has assets exceeding five hundred million dollars, to which all the following apply:

- The notes are rated at the time of purchase in the highest classification established by at least two nationally recognized standard rating services.
- The aggregate value of the notes does not exceed ten per cent of the aggregate value of the outstanding commercial paper of the issuing corporation.
- The notes mature not later than ~~one hundred eighty~~ 270 days after purchase.
- The investment in commercial paper notes of a single issuer shall not exceed in the aggregate five per cent of interim moneys available for investment at the time of purchase.

**Bankers' acceptances** of banks insured by the FDIC and to which both of the following apply:

- The obligations are eligible for purchase by the Federal Reserve System.
  - The obligations mature not later than one hundred eighty days after purchase.
- Boards of education must authorize the treasurer to invest in commercial paper or bankers' acceptances by a 2/3 majority vote. [Ohio Rev. Code §135.142(A)] (Once authorized, the authorization remains effective unless the policy changes. Therefore, we need not test this every audit. We should maintain documentation of the approval in the permanent file.) ~~Additionally, the treasurer or governing board must complete additional training. The type and amount of additional training shall be approved by the treasurer of state and may be conducted by or provided under the supervision of the treasurer of state. [Ohio Rev. Code §135.14(B)(7)]~~
- "Entity" means any of the following [Ohio Rev. Code §1705.01(D)]:
- A for profit corporation existing under the laws of this state or any other state;
  - Any of the following organizations existing under the laws of this state, the United States, or any other state:
    - A business trust or association;
    - A real estate investment trust;
    - A common law trust;

- An unincorporated business or for profit organization, including a general or limited partnership;
- A limited liability company.

Note: Some of the steps below require the same documentation / evidence auditors also use to support the *existence, valuation and classification* of investments. You can gain efficiency by combining the steps below with the substantive financial audit steps related to the aforementioned assertions.

### Suggested Audit Procedures – Compliance (Substantive) Tests:

1. Inspect a representative number<sup>19</sup> of dealer confirmations of the commercial paper notes purchased and determine that the entity has maintained related documentation that the: [Ohio Rev. Code §135.14(B)(7)(a)]
  - Commercial paper was rated in the highest classification by two standard rating services.
  - The commercial paper matures not later than ~~180~~270 days after purchase.
  - The investment in commercial paper notes of a single issuer does not exceed the aggregate five per cent of interim moneys available at the time of purchase.
2. Inspect dealer confirmations of the bankers' acceptances purchased and determine that the entity has maintained related documentation that the: [Ohio Rev. Code §135.14(B)(7)(b)]
  - Banks are insured by the Federal Deposit Insurance Corporation.
  - ~~Dealer confirmations should indicate if bankers' acceptances were **NOT** eligible for purchase by the Federal Reserve System. Read the confirmation to determine whether the banker's acceptance was **ineligible**. (A statement of ineligibility would indicate an **ineligible** investment, per **Ohio Rev. Code §135.142(A) for school districts or §135.14(B)(7) for other non county entities.**~~
  - The acceptances mature not later than 180 days after purchase.
3. For investments in Bankers' Acceptances and Commercial Paper Notes, inspect documentation and determine whether the additional training was received.
4. For school districts, assure the permanent file documents the resolution authorizing the treasurer to invest in commercial paper and / or bankers' acceptances.

**Audit implications (the indirect and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):**

<sup>19</sup> When judging "a representative number," consider focusing on investments held at year end, but also consider testing other purchases and sales during the audit period. In judging how many purchases to test, consider the volume of purchases, the control environment, the adequacy of policies, and the results of prior audits.

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**2-9 Compliance Requirements:** Ohio Rev. Code §135.18 (specific collateral) and §135.181 (pooled collateral) – Security for repaying public deposits; Ohio Rev. Code §135.37 – Security for repaying county (and county hospital) public deposits; 12 CFR 330.

**Summary of Requirements:** The treasurer of a political subdivision must require the depository to provide security equal to the funds on deposit at all times. Security may consist of federal deposit insurance, surety company bonds, or pledged securities. [Ohio Rev. Code §135.18].

Depository security requirements for county (and county hospital) monies parallel the requirements of other governmental entities pursuant to Ohio Rev. Code §135.18. Ohio Rev. Code §135.37(F) expressly permits counties to follow the pool collateral requirements of Ohio Rev. Code §135.181.

### *FDIC Insurance Coverage*

On July 21, 2010, President Barack Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 into law, which, in part, *permanently* raised the current standard maximum FDIC deposit insurance amount to \$250,000, retroactive to January 1, 2008.

~~All funds in a “noninterest bearing transaction account” are insured in full by the Federal Deposit Insurance Corporation from December 31, 2010, through December 31, 2012. This temporary unlimited coverage is in addition to, and separate from, the coverage of at for at least \$250,000 available to depositors under the FDIC’s general deposit insurance rules (12 CFR 330.16).~~

~~A “noninterest bearing transaction account” means: (1) a deposit or account maintained at an insured depository institution; (i) in which interest is neither accrued nor paid; (ii) in which the depositor or account holder is permitted to make withdrawals, telephone or electronic or other media transfers, or other similar items for the purpose of making payments or transfers to third parties or others; (iii) on which the insured depository institution does not reserve the right to require advance notice of an intended withdrawal<sup>20</sup>. A noninterest bearing transaction account also includes a trust account established by an attorney or law firm commonly known as an Interest on Lawyers Trust Accounts (“IOLTAs”) or its functional equivalent as determined by the corporation.<sup>21</sup>~~

*Depositories may pledge the following securities under the subsections of Ohio Rev. Code §135.18(B) listed below:*

(1) Bonds, notes, or other obligations of the United States; or bonds, notes, or other obligations guaranteed as to principal and interest by the United States or those for which the full faith of the United States is pledged for the payment of principal and interest thereon, by language appearing in the instrument specifically providing such guarantee or pledge and not merely by interpretation or otherwise;

(2) Bonds, notes, debentures, letters of credit, or other obligations or securities issued by any federal government agency, or instrumentality, or the export-import bank of Washington; bonds, notes, or other

<sup>20</sup> See 12 C.F.R. §330.1(r)

<sup>21</sup> ~~The definition of noninterest bearing transaction account cannot include any interest bearing accounts, NOW accounts, or money market deposit accounts except as expressly provided in 12 C.F.R. §330.16(b) with respect to certain swept funds. The exception for swept funds is applicable only in situations where funds are swept from a noninterest bearing transaction account to a noninterest bearing savings account, notably a money market deposit account (MMDA). Pursuant to 12 C.F.R. § 330.16(b), such noninterest bearing savings accounts into which funds are swept would be considered noninterest bearing transaction accounts. Apart from this exception for “reserve sweeps,” MMDAs and noninterest bearing savings accounts do not qualify as noninterest bearing transaction accounts.~~

obligations guaranteed as to principal and interest by the United States or those for which the full faith of the United States is pledged for the payment of principal and interest thereon, by interpretation or otherwise and not by language appearing in the instrument specifically providing such guarantee or pledge;

(3) Obligations of or fully insured or fully guaranteed by the United States or any federal government agency or instrumentality;

(4) Obligations partially insured or partially guaranteed by any federal agency or instrumentality;

(5) Obligations of or fully guaranteed by the Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, Federal Farm Credit Bank, or Student Loan Marketing Association;

(6) Bonds and other obligations of this state and any county, municipal corporation, or other legally constituted taxing subdivision of another state, or an instrumentality of such public entities, if:

- The full faith and credit of the issue is pledged and,
- At the time of purchase, the security is rated in one of the two highest categories by at least one nationally recognized standard rating service

(7) Bonds and other obligations of any county, township, school district, municipal corporation, or other legally constituted taxing subdivision of this state, which is not at the time of such deposit, in default in the payment of principal or interest on any of its bonds or other obligations, for which the full faith and credit of the issuing subdivision is pledged.

(8) Bonds of other states of the United States which have not during the ten years immediately preceding the time of such deposit defaulted in payments of either interest or principal on any of their bonds;

(9) Shares of no-load money market mutual funds consisting exclusively of obligations described in division (B)(1) or (2) of Ohio Rev. Code §135.18 [these sections are (1) & (2), above] and repurchase agreements secured by such obligations.

(10) A surety bond issued by a corporate surety licensed by the state and authorized to issue surety bonds in this state pursuant to Ohio Rev. Code Chapter 3929 and qualified to provide surety bonds to the federal government pursuant to 96 Stat. 1047 (1982), 31 U.S.C.A. 9304.

By written notice to the treasurer, an institution designated as a public depository may designate a qualified trustee<sup>22</sup> and deposit the eligible securities required by this section with the trustee for safekeeping for the account of the treasurer (and the institution). In this case, the treasurer accepts the trustee's written receipt describing the securities which have been deposited with the trustee by the public depository. All such securities so deposited with the trustee are deemed to be pledged and deposited with the treasurer. [Ohio Rev. Code §135.18(D)].

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<sup>22</sup> All securities eligible as collateral are book-entry only and held at the Federal Reserve. The Federal Reserve Bank acts as the government's agent and holds the collateral securities in the government's name. Deposits secured by collateral held in these accounts are not subject to custodial credit risk disclosures if the government can provide evidence that pledge accounts held in the government's name are in existence at the Federal Reserve.

Any federal reserve bank<sup>23</sup> or branch located in this state or Federal Home Loan Bank is qualified to act as trustee for the safekeeping of securities.

Any institution mentioned in Ohio Rev. Code §135.03 is qualified to act as trustee for the safekeeping of securities, other than those belonging to itself, under this section.

### **Ohio Rev. Code §135.181**

In lieu of the specific pledging requirements of Ohio Rev. Code § 135.18, a public depository at its option may pledge a single pool of eligible securities to secure the repayment of all its public deposits not otherwise secured, provided that at all times the total market value of the securities so pledged is at least equal to one hundred five per cent of its uninsured public deposits to be secured by the pooled securities.

The securities described in division (B) of Ohio Rev. Code §135.18 (described above), shall be eligible as collateral, provided no such securities pledged as collateral are at any time in default as to either principal or interest.

A public depository must designate a qualified trustee (i.e., the Federal Reserve) and deposit the eligible pledged securities with that trustee for safekeeping. The depository must give written notice of the qualified trustee to any treasurer depositing public monies for which such securities are pledged. The treasurer shall accept the written receipt of the trustee describing the pool of securities so deposited by the depository. [Ohio Rev. Code §135.181(E)].

Upon request of a treasurer up to 4 times per year, a *public depository* must report: the amount of public monies deposited by the treasurer and secured and the total value based on the valuations described above, of the pool of securities pledged to secure public monies held by the depository, including those deposited by the treasurer [Ohio Rev. Code §135.181(L)].

Upon request of a treasurer up to 4 times per year, a *qualified trustee* must report the total value of the securities pool deposited with it by the depository and provide an itemized list of pooled securities. The trustee must make these reports as of the date the treasurer specifies.

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<sup>23</sup> The Federal Reserve Bank of Cleveland sometimes uses the Boston Federal Reserve Bank for safekeeping. We do not deem this arrangement to violate this provision.

**Suggested Audit Procedures – Compliance (Substantive) Tests:**

Compare depository balances to the amount of pledged securities and other depository collateral during the audit period, noting maximum amounts on deposit at any time. Calculate (or inspect, if available, the government's calculations) if legal security equaled or exceeded depository balances. Focus audit procedures on the most recent fiscal year end, but based on your assessment of the control environment, the nature of collateral<sup>24</sup> and other risks also consider whether you should evaluate the adequacy of collateral as of other dates during the audit when deposit or investment balances may have been materially higher, such as immediately after the receipt of tax settlements.

Inspect the financial institution's listing of pledged securities. Select a few securities and determine if the institution pledged only eligible securities. (When determining the extent of testing, auditors should consider that we do not require a high level of assurance, so a "few" items should be sufficient. Auditors can reduce or eliminate this testing based on the assessed level of control risk\* and past experience with the financial institution. Therefore, if the government documents its review of collateral eligibility, or we have not noted eligibility problems in prior audits, we can reduce or eliminate this test.)

\* "Control risk" in this context refers to the *government's* controls, if any, over reviewing their financial institutions' collateral lists. The AOS has no basis for assessing a financial institution's control risk.

**Audit implications (the indirect and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):**

<sup>24</sup> For example, there is generally less risk that a financial institution using a collateral pool will have insufficient collateral vs. a financial institution pledging specific securities.

**Revised: SB 287, 130<sup>th</sup> GA**  
**Effective: 9/04/14**

**\*COUNTY (AND COUNTY HOSPITAL) REQUIREMENTS**

The provisions of Ohio Rev. Code Chapter 135 relating to counties (and county hospitals) are in separate sections from the provisions relating to all other subdivisions. However, in most cases the requirements are very similar.

**2-10 Compliance Requirements:** Ohio Rev. Code §135.35 and 12 CFR 370 - Eligible Investments for inactive county money (county hospitals may invest in these same securities, per Ohio Rev. Code §339.06).

**Summary of Requirements:**

- Investments must mature within 5 years from the date of settlement unless the investment matches a specific obligation or debt, and the investment advisory committee specifically approves it.
  - A county may hold investments purchased between 3/22/12 and 9/10/12 until their maturity of up to 10 years due to a temporary change in this law.
  
- The following classifications of securities and obligations are eligible for deposit or investment:
  - United States obligations or any other obligation guaranteed as to principal or interest by the United States, or any book entry, zero-coupon United States treasury security that is a direct obligation of the United States. [Ohio Rev. Code §135.35(A)(1)]
  - Stripped principal or interest obligations are not permitted. Except, Federally-issued or Federally-guaranteed stripped principal or interest obligations are permitted. [Ohio Rev. Code §135.35(A)(1)]
  - Bonds, notes, debentures, or any other obligations or securities issued by any federal government agency or instrumentality. All federal agency securities must be direct issuances of federal government agencies or instrumentalities. [Ohio Rev. Code §135.35(A)(2)]
  - Time certificates of deposit<sup>25</sup> or savings or deposit accounts, including passbook accounts, in any eligible institution mentioned in Ohio Rev. Code §135.35(A)(3).

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<sup>25</sup> It is the position of the Auditor of State that Ohio Rev. Code §135.03 & §135.32 prohibit purchasing certificates of deposit (negotiable/brokered or otherwise) from a bank unless the CD is subject to inspection by the Ohio Superintendent of Financial Institutions. Ohio is part of a nationwide cooperative agreement for examining multi-state banks in which these states agreed to recognize each other's supervisory authority for banks headquartered in another state but doing business in theirs. Therefore, it is reasonable to conclude that a multi-state bank in a state subject to this agreement is subject to inspection by Ohio's Superintendent of Financial Institutions. Multi-state banks are eligible to become a public depository for Ohio's governmental entities, subject to § 135.01 to 135.21 of the Ohio Rev. Code. The bank should be registered with the Ohio Secretary of State to be an eligible public depository in Ohio. A government cannot purchase negotiable/brokered or nonnegotiable CDs unless the governing body has designated the bank as eligible to hold interim or inactive deposits. See ADAM 2002-005

- Ohio Rev. Code §135.353 also permits counties to use the Certificate of Deposit Account Registry Services (CDARS) or similar programs (one example is Star Plus) meeting Ohio Rev. Code §135.353 requirements. If a county purchases CDs for more than the FDIC limit (\$250,000). *See OCS step 2-6* with a bank participating in CDARS, Star Plus, etc, the bank or program “redeposits” the excess amounts with other institutions. Each bank accepts less than \$250,000 so that all deposits have FDIC coverage. Ohio Rev. Code §135.353 requires a county to place its deposits with an eligible depository per Ohio Rev. Code §135.32. However, institutions the county’s depository places excess deposits with are not subject to Ohio Rev. Code §135.32. For example, while the deposit must be initiated at an Ohio depository branch, the Ohio depository can purchase CDs from depositories outside of Ohio for the excess. Because all CDARS, Star Plus, etc. deposits have FDIC coverage, the collateral requirements of Ohio Rev. Code §135.18 and §135.181 do not apply. (That is, these are *insured* deposits for GASB 40 purposes, Appendix E-2 of the OCS Implementation Guide.)
  - Any CD’s purchased by a broker must be held in the name of the government. Also, the broker cannot be in possession of cash at any time. If we believe a broker has held cash for any length of time, AOS auditors should refer the matter to the Center for Audit Excellence and AOS Legal division for further evaluation. A way to verify compliance is to request monthly statements provided by the public depository located in Ohio. Ohio Rev. Code §135.144(A)(5) requires the initial public depository to provide public offices with a monthly account statement that includes the amount of its funds deposited and held at each bank, savings bank, or savings and loan association for which the public depository acts as a custodian pursuant to Ohio Rev. Code §135.144. If a public office does not have these statements, it may indicate that the money is being held by a broker-dealer in violation of Ohio Rev. Code §135.144.
- Bonds and other obligations of this state or the political subdivisions of this state ~~provided that such political subdivisions are located wholly or partly within the same county as the investing authority.~~ [Ohio Rev. Code §135.35(A)(4)]
- Ohio Rev. Code § 135.35 (C) allows the purchase of municipal debt of the State of Ohio or **any** political subdivision of the State.
- No-load money market mutual funds rated in the highest category at the time of purchase by at least one nationally recognized standard rating service or consisting exclusively of obligations described in Ohio Rev. Code §135.35143(A)(1), or (2) or (6) and (see above), or repurchase agreements secured by such obligations, if purchased from eligible institutions mentioned in Ohio Rev. Code §135.32 (generally, Ohio banks and national banks authorized to do business in Ohio. [Ohio Rev. Code §135.35(A)(5)]
- United States treasury bills, notes, bonds, or any other obligations or securities issued by the United States treasury or any other obligation guaranteed as to principal and interest by the United States, Bonds, notes, debentures, or any other obligations or securities issued by any federal government agency or instrumentality or ~~corporate~~ commercial paper rated in the highest category by two standard ratings ~~agencies~~services (i.e. securities Ohio Rev. Code §135.143(A)(1), (2) or (6) permits);
- Bonds, notes, debentures, or any other obligations or securities issued by any federal government agency or instrumentality [~~Ohio Rev. Code §135.35(A)(2)~~]; ~~Commercial paper issued by any~~

~~corporation incorporated under the laws of the United States or a state, which notes are rated at the time of purchase in the two highest categories by two nationally recognized rating agencies [Ohio Rev. Code §135.35(A)(10)]\*~~

~~\* Note: Ohio Rev. Code §135.35(A)(5) and (A)(10) are similar. Ohio Rev. Code § (A)(5) permits buying money market mutual funds which invest in repurchase agreements, but does not authorize commercial paper, and requires purchasing the fund through a bank. Ohio Rev. Code § (A)(10) permits buying money market mutual funds which invest in commercial paper but does not authorize repurchase agreements. Ohio Rev. Code § (A)(10) also permits purchasing a mutual fund through a bank or through a broker dealer. A county can follow either or both sections.~~

- The Ohio Subdivision's Fund (STAR Ohio) as provided in Ohio Rev. Code §135.45. [Ohio Rev. Code §135.35(A)(6)]
- Securities lending agreements with any eligible institution mentioned in Ohio Rev. Code §135.32 that is a member of the Federal Reserve System or Federal Home Loan Bank, or with any recognized U.S. government securities dealer,<sup>26</sup> under the terms of which agreements in the investing authority lends securities and the eligible institution agrees to simultaneously exchange similar securities described in Section 135.35(A)(1) or (2) or cash or both securities and cash, equal value for equal value. [Ohio Rev. Code §135.35(A)(7)]
- Up to twenty-five per cent of the county's total average portfolio in either of the following [Ohio Rev. Code §135.35(A)(8)]:

**Commercial paper** issued by an "entity" that is defined in division (D) of Ohio Rev. Code §1705.01 (see definition below) and that has assets exceeding five hundred million dollars, to which notes all of the following apply:

- The aggregate value of the notes does not exceed ten per cent of the aggregate value of the outstanding commercial paper of the issuing corporation.
- The notes are rated at the time of purchase in the highest classification established by at least two nationally recognized standard rating services.
- The notes mature not later than 270 days after purchase.

**Bankers' acceptances** of banks that are insured by the federal deposit insurance corporation and to which both of the following apply:

- The obligations are eligible for purchase by the Federal Reserve System.
- The obligations mature not later than one hundred eighty days after purchase.

No investment shall be made in commercial paper or bankers' acceptances unless the treasurer or governing board has completed additional training for making those investments. The type and amount of

<sup>26</sup> Ohio Rev. Code §135.35(J)(I) defines these security dealers as being "members of the ~~national association of securities dealers (NASD)~~ financial industry regulatory authority (FINRA), through a bank, savings bank, or savings and loan association regulated by the superintendent of financial institutions, or through an institution regulated by the comptroller of the currency, federal deposit insurance corporation (FDIC), or board of governors of the federal reserve system."

additional training shall be approved by the auditor of state and may be conducted by or provided under the supervision of the auditor of state.

“Entity” means any of the following [Ohio Rev. Code §1705.01(D)]:

- A for profit corporation existing under the laws of this state or any other state;
  - Any of the following organizations existing under the laws of this state, the United States, or any other state:
    - i. A business trust or association;
    - ii. A real estate investment trust;
    - iii. A common law trust;
    - iv. An unincorporated business or for profit organization, including a general or limited partnership;
    - v. A limited liability company.
- Per Ohio Rev. Code §135.35(A)(9), up to fifteen per cent of the county’s total average portfolio in notes issued by corporations incorporated under U.S. law and that operate within the United States, or by depository institutions doing business under U.S. authority or any state’s authority, and that operate within the United States, provided both of the following apply:
- The notes are rated in one of the two highest categories by at least two nationally recognized standard rating services at the time of purchase;
  - The notes mature not later than two years after purchase.
- Per Ohio Rev. Code §135.35(A)(~~4+10~~) up to 1% of its portfolio in the debt of foreign nations, if:
- Rated at the time of purchase in the three highest categories by two nationally recognized standard rating services
  - The U.S. government recognizes it diplomatically.<sup>27</sup>
  - All interest and principal shall be denominated and payable in United States funds.
  - The foreign government guarantees the debt.
  - Investments must mature within 5 years from the date of settlement ~~unless the investment matches a specific obligation or debt, and the investment advisory committee specifically approves it.~~

Note: A county may hold investments purchased between 3/22/12 and 9/10/12 until their maturity of up to 10 years (this is because in 2012 HB 225 was enacted and then repealed months later).

➤ The investing authority may also enter into a written repurchase agreement with any eligible institution mentioned in Ohio Rev. Code §135.32 or any eligible dealer pursuant to Ohio Rev. Code §135.35(J), under the terms of which agreement the investing authority purchases, and the eligible institution or dealer agrees unconditionally to repurchase any of the securities listed in divisions (B)(1) to (5) of §135.35, except letters of credit described in division §135.18(B)(2) are not permitted for repurchase agreements.<sup>28</sup> The market value of securities subject to an overnight repurchase agreement must exceed the principal value of securities subject to a repurchase agreement by 2%. A written repurchase agreement shall not exceed 30 days and the value of the securities must exceed the principal value by at least 2% and be marked to market daily. [Ohio Rev. Code §135.35(D)]

<sup>27</sup> As best as we can determine, the United States does not recognize the following nations: Cuba, Bhutan, Iran, North Korea, Sudan, Somalia, and the Republic of China (Taiwan).

<sup>28</sup> Ohio Compliance Supplement Step 2-9 summarizes Ohio Rev. Code §135.18(B)(1) to (10).

- All securities purchased pursuant to a repurchase agreement are to be delivered into the custody of the investing authority or the qualified custodian of the investing authority or an agent designated by the investing authority<sup>29</sup>. [Ohio Rev. Code §135.35(D)]
  - Repurchase agreements with an eligible securities dealer must be transacted on a delivery versus payment basis.
  - Repurchase agreements must be in writing. For each transaction, the participating institution must provide:
    1. the par value of the securities;
    2. the type, rate, and maturity date of the securities;
    3. a numerical identifier (e.g., a CUSIP number), generally accepted in the industry, designating the securities.
  - Securities which are the subject of a repurchase agreement may be delivered to the treasurer or held in trust by the participating institution if it is a designated depository of the subdivision for the current period of designation. [Ohio Rev. Code §135.35(I)].
- Agreements by which the investing authority agrees to sell securities owned by the county to a purchaser and agrees with that purchaser to unconditionally repurchase those securities (*Reverse Repos*) are prohibited.
- Investment in derivatives is prohibited. A *derivative*<sup>30</sup> is a financial instrument or contract or obligation whose value or return is based upon or linked to another asset or index, or both, separate from the financial instrument, contract, or obligation itself. Any security, obligation, trust account, or other instrument that is created from an issue of the United States Treasury or is created from an obligation of a federal agency or instrumentality or is created from both is considered a derivative.
- An eligible investment described in Ohio Rev. Code §135.14 with a variable interest rate payment or single interest payment, based upon a single index comprised of other eligible investments provided for in division (A)(1) or (2) of Section 135.35, is **not** a derivative, if the variable rate investment has a maximum maturity of 2 years. [Ohio Rev. Code §135.14(C)]
- 1999 Op. Atty. Gen. No. 1999-026 deemed collateralized mortgage obligations to be derivatives.
- A treasury inflation-protected security (TIPS) shall not be considered a derivative for counties, provided the security matures not later than five years after purchase (Ohio Rev. Code §135.35(B)). HB 225, effective 3/22/12 and then repealed 9/10/12, temporarily increased this to ten years (Ohio Rev. Code § 135.35(C)).

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<sup>29</sup> Counterparties (e.g. banks) accomplish this by maintaining a separate “customer” account at the Federal Reserve designated as a customer account. (For purposes of GASB 40, we currently believe securities held in a customer account would not be exposed to custodial risk.)

<sup>30</sup> Note: The Ohio Rev. Code still uses the definition of a derivative taken from GASB Technical Bulletin 94-1. GASB Statement No. 53, effective for periods beginning after June 15, 2009, includes swaps as derivatives. So, for legal compliance purposes, governments must follow the Ohio Rev. Code definition. For financial reporting governments must follow the GASB definition. For example, an interest rate swap and energy futures contracts (which are allowable under Ohio Rev. Code § 9.835 to mitigate price fluctuations, and are not intended as investments) would be subject to GASB Statement No. 53 derivative measurement and disclosure requirements, but are **not** illegal.

- Per Ohio Rev. Code §135.35(E): No investing authority can invest under §135.35, unless the investment authority reasonably expects that the investment can be held until its maturity. The investing authority's written investment policy should specify the conditions under which an investment may be redeemed or sold prior to maturity.
- Per Ohio Rev. Code §135.35(F), no investing authority may pay a county's inactive moneys, or moneys of a county library and local government support fund (also known as: "county public library funds"), into an investment pool *other than*:
  - the Ohio Subdivision's Fund (STAR Ohio) pursuant to Ohio Rev. Code §135.35(A)(6)
  - a fund created solely for the purpose of acquiring, constructing, owning, leasing, or operating municipal utilities pursuant to Ohio Rev. Code §715.02 or Ohio Const. Art XVIII, Section 4.
- A county may not leverage its investments. (That is, a county cannot use its current investments as collateral to purchase other investments.) [Ohio Rev. Code §135.35(G)]
- A county cannot issue taxable notes for arbitrage purposes. [Ohio Rev. Code §135.35(G)] (That is, a county cannot invest the proceeds of taxable notes hoping to earn a higher return on the proceeds than the interest rate on the TAN.)
- A county cannot contract to sell securities it does not own. (These are called short sales, where a county purchases the rights to a security solely on the speculation that its price will decline.) [Ohio Rev. Code §135.35(G)]
- Payment for investments shall be made only upon the delivery of securities representing such investments to the treasurer, investing authority, or qualified trustee. If the securities transferred are not represented by a certificate, payment shall be made only upon receipt of confirmation of transfer from the custodian by the treasurer, governing board, or qualified trustee. [Ohio Rev. Code §135.35(J)(2)]

### **Suggested Audit Procedures – Compliance (Substantive) Tests:**

Note: Some of the steps below require the same documentation / evidence auditors also use to support the *existence, valuation and classification* of investments. You can gain efficiency by combining the steps below with the substantive steps related to the aforementioned assertions.

Select a representative number<sup>31</sup> of investments and:

1. Read investment dealer confirmations\* to determine if the investment is of a type authorized.

\* Note: Dealer confirmations are suitable evidence supporting the details (e.g. part of the valuation [cost] and occurrence assertions) of an investment at the time of purchase. However, it provides no evidence the county still owned the investment as of its fiscal year end. Auditors should obtain other evidence to support existence at year end. The audit program should include suitable existence steps.

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<sup>31</sup> When judging "a representative number," consider focusing on investments held at year end, but also consider testing other purchases and sales during the audit period. In judging how many purchases to test, consider the volume of purchases, the control environment, the adequacy of policies, and the results of prior audits.

2. Determine that the investments mature within the prescribed limits (generally no later than 5 years, or *other* periods for repurchase agreements [30 days], bankers' acceptances and commercial paper [180 or 270 days, respectively, from the purchase date], or securities matched to debt maturities, etc.)
3. Inspect documentation supporting repurchase agreements and determine that:
  - a. The market values of securities exceed the principal values of securities subject to the overnight repurchase agreement by 2%. (Note: The risk of non-compliance increases when banks merge.)
  - b. A term repurchase agreement did not exceed 30 days and the values of the securities were marked to market daily.
  - c. Repurchase agreements were in writing, including the par value of the securities; the type, rate, and maturity date of the securities; and a numerical identifier.
4. For investments in Bankers' Acceptances and Commercial Paper Notes, inspect documentation and determine whether the additional training was received.
5. Read the prospectus for money market mutual funds with which the government has significant investments. Determine whether the prospectus limits investments to those authorized under Ohio Rev. Code §135.35(A)(1) & (A)(2) or 135.143(A)(1), (2) or (6).
6. Determine whether mutual funds, commercial paper, and any notes of U.S. corporations have the necessary credit rating issued by national ratings agencies (such as that S&P, Moody's or Fitch issues).
7. Inspect dealer confirmations of the bankers' acceptances purchased and determine that the county has maintained related documentation that the:
  - a. Banks are insured by the Federal Deposit Insurance Corporation
  - b. Dealer confirmations should indicate if banker's acceptances were **NOT** eligible for purchase by the Federal Reserve System. Read the confirmation to determine whether the banker's acceptance was **ineligible**. (A statement of ineligibility would indicate an **ineligible** investment, per Ohio Rev. Code §135.35(A)(8)(b)(i).)
8. Scan the county's computation of the composition of its investments. Determine if the portfolio contains ≤:
  - a. 1% foreign national securities
  - b. 15% debt of U.S. corporations
  - c. 25% commercial paper + bankers' acceptances
9. Scan investment records to determine whether the county is selling securities prior to maturity. If a significant number or amount of premature sales occurred:
  - a. Determine whether the premature sales complied with the county's policy regarding early redemption. (We believe the policy should generally require sufficient cash flow planning to support

that the county had sufficient cash at the time or purchase so that a premature sale would not be needed to meet emergency cash flow needs. Forced premature sales often result in losses.)

b. Review the county’s cash flow forecasts supporting that the county had reasonable support at the time or purchase that it could hold the security to maturity. If there is inadequate cash flow planning necessitating premature sales, cite this section and recommend the government improve its cash flow forecasting. The finding should also describe any losses the government suffered from these sales.

Note: The steps above should normally be sufficient for most counties. Because we believe the risk of counties engaging in certain prohibited activities such as leveraging, short sales or arbitrage violations is low, there are no steps included to test these requirements. You should scan the other requirements in this step, and based on your knowledge of the county’s investing activities, investigate them if evidence suggests the county may have materially violated these requirements.

**Audit implications (the indirect and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):**

<p><b><u>Revised: SB 287, 130<sup>th</sup> GA</u></b> <b><u>Effective: 9/04/14</u></b></p>
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**2-11 Compliance Requirements:** Ohio Rev. Code §135.35 – Other County and County Hospital [Ohio Rev. Code §339.06] Requirements.

**Summary of Requirements:**

- Investments or deposits under Ohio Rev. Code §135.35 cannot be made unless a written investment policy approved by the investing authority (for hospitals, the authority is the county hospital board, per Ohio Rev. Code §339.06) is on file with the Auditor of State. If a written investment policy is not filed with the Auditor of State, the investing authority may invest only in certificates of deposit, savings or deposit accounts, STAR Ohio, or no-load money market mutual funds. [Ohio Rev. Code §135.35(K)(1)&(2)]
- The investment policy must be signed by:
  - All entities conducting investment business with the investing authority (except the Treasurer of State);
  - All brokers, dealers, and financial institutions, described in Ohio Rev. Code §135.35(J)(1), initiating transactions with the investment authority by giving advice or making investment recommendations;
  - All brokers, dealers, and financial institutions, described in Section 135.35(J)(1), executing transactions initiated by the investing authority.
- The investing authority is required to inventory all obligations and securities. The inventory includes a description of each obligation or security, including type, cost, par value, maturity date, settlement, date, and any coupon rate. [Ohio Rev. Code §135.35(L)(1)]
- The investing authority is required to keep a complete record of all purchases and sales of the obligations and securities. [Ohio Rev. Code §135.35(L)(2)]
- The investing authority is required to keep a monthly portfolio report and issue a copy of the monthly report describing its investments to the county investment advisory committee. This report indicates: [Ohio Rev. Code §135.35(L)(3)]
  - the current inventory of all obligations and securities,
  - all transactions during the month that affected the inventory,
  - any income received from the obligations and securities, and
  - any investment expenses paid.
  - The names of any persons executing transactions on behalf of the investing authority.

- The inventory and the monthly portfolio report are public records and must be filed with the board of county commissioners and the Treasurer of the State of Ohio. [Ohio Rev. Code §135.35(L)(5)]
- Any securities, certificates of deposit, deposit accounts, or any other documents evidencing deposits or investments must be issued in the name of the county with the county treasurer or investing authority as the designated payee. [Ohio Rev. Code §135.35(H)].
- If any such deposits or investments are registerable as to principal and/or interest, they must be registered in the name of the treasurer. [Ohio Rev. Code §135.35(H)].
- The investing authority is responsible for safekeeping documents evidencing a deposit or investment. Securities and documents confirming the purchase of securities under any repurchase agreement may be deposited with a qualified trustee. [Ohio Rev. Code §135.35(I)].
- Where securities, including securities which are the subject of a repurchase agreement, have been delivered to a qualified trustee for safekeeping, the qualified trustee must report on request to the treasurer, governing board, Auditor of State, or authorized IPA as to the identity, market value, and location of the document evidencing each security.
- All investments in securities except investments described in division (A) (5), (6) and (4211) [no load money market mutual funds and certain repos] are required to be made through
  - members of the ~~National Association of Securities Dealers, Inc.~~ Financial Industry Regulatory Authority (FINRA), or
  - institutions regulated by the Superintendent of Banks, Superintendent of Savings and Loan Associations, Comptroller of the Currency, Federal Deposit Insurance Corporation, or Board of Governors of the Federal Reserve System. [Ohio Rev. Code §135.35(J)(1)].
- Payment for ~~securities investments~~ may be made only upon delivery of the securities to the treasurer, investing authority, or qualified trustee, or, if in book-entry form, only upon confirmation of delivery to such parties. [Ohio Rev. Code §135.35 (J)(2)]

#### **Suggested Audit Procedures – Compliance (Substantive) Tests:**

Read the county's investment policy for the period. (Investment policies have been scanned and are posted on S:\Final Audit PDF. Click on the Region/County/Entity name.)

Inspect documentation that it was filed with the Auditor of State (if posted in the above directory, the policy was filed with AOS).

Inspect the policy for the requisite signatures:

- All entities conducting investment business with the county (except the Treasurer of State);
- All brokers, dealers, and financial institutions initiating transactions with the county by giving advice or making investment recommendations;

- All brokers, dealers, and financial institutions executing transactions initiated by the county.
- Select a representative number of investments made by the entity and determine whether the investments are in accordance with the county's investment policy as adopted by the county's legislative body.

Determine if the policy requires financial institutions, brokers and dealers to comply with Ohio Rev. Code Chapter 135. (There is no legal requirement to include this, but if the policy does not include this requirement, we should recommend the government amend their policy to require compliance.)

If there is no written investment policy filed with the Auditor of State, scan the county's investment portfolio for the period to determine that it is composed solely of certificates of deposit, savings or deposit accounts, STAR Ohio, or no-load money market mutual funds.

Select a representative number<sup>32</sup> or amount of investments and:

- Inspect documentation that any designated payee is the treasurer or treasurer's office; and that registerable securities are registered in the treasurer's name.
- Inspect purchase documents and determine that investments were made through appropriate parties: members of the National Association of Securities Dealers, Inc., or institutions regulated by the Superintendent of Banks, Superintendent of Savings and Loan Associations, Comptroller of the Currency, Federal Deposit Insurance Corporation, or Board of Governors of the Federal Reserve System. Compare purchase dates and payments and determine that payment for securities was made upon delivery of the securities or upon receipt of confirmation of transfer from the custodian. Any CD's purchased by a broker must be held in the name of the government. Also, the broker cannot be in possession of cash at any time. If we believe a broker has held cash for any length of time, AOS auditors should refer the matter to the Center for Audit Excellence and AOS Legal division for further evaluation. A way to verify compliance is to request monthly statements provided by the public depository located in Ohio. Ohio Rev. Code §135.144(A)(5) requires the initial public depository to provide public offices with a monthly account statement that includes the amount of its funds deposited and held at each bank, savings bank, or savings and loan association for which the public depository acts as a custodian pursuant to Ohio Rev. Code §135.144. If a public office does not have these statements, it may indicate that the money is being held by a broker-dealer in violation of Ohio Rev. Code §135.144.
- Inspect copies of the investing authority's (i.e. treasurer's) inventory documents: scan the documents and determine if it appears the inventory includes a description of each obligation or security, including type, cost, par value, maturity date, settlement, date, and any coupon rate; the inventory reflects a complete record of all purchases and sales of the obligations and securities; and that the county is keeping a monthly portfolio report and is issuing a quarterly investment report describing its investments to the county investment advisory committee.

**Audit implications (the indirect and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):**

<sup>32</sup> When judging "a representative number," consider focusing on investments held at year end, but also consider testing other purchases and sales during the audit period. In judging how many purchases to test, consider the volume of purchases, the control environment, the adequacy of policies, and the results of prior audits.



**COMMUNITY SCHOOLS**

**2-12 Compliance Requirements:** Pursuant to Ohio Rev. Code §3314.04, Ohio Rev. Code Chapter 135 does not apply to community schools. However, other entities may impose restrictions on investments, collateral, etc. Such entities could be grantors, creditors, the sponsor, board policy, etc. Auditors should identify and list any applicable requirements below:

*[Insert applicable depository and investment requirements.]*

**Suggested Audit Procedures – Compliance (Substantive) Tests**

*[Insert applicable audit procedures. See other OCS Sections for example audit procedures.]*

**Audit implications (the indirect and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):**

**OTHER LAWS AND REGULATION  
COMMUNITY SCHOOLS**

**2-13 Compliance Requirement:** Ohio Rev. Code §3314.02, §3314.023, §3314.03, §3314.07, §3314.072, §3314.073 Sponsor monitoring of community schools

**Summary of Requirement:**

- The sponsor may contract with the school to receive 3% or less of the amount *the State pays to a school annually*, solely for the costs of its oversight and monitoring activities.<sup>33</sup> In other words, the total amount of such payments for oversight and monitoring of the school shall not exceed 3% of the total amount of payments for *operating expenses that the school receives from the State*<sup>34</sup>. [§3314.03(C)]
- The contract between the sponsor and the school must require the sponsor to monitor the following [§3314.03(D)]:
  - Compliance with laws the contract specifies
  - At least annually, monitor and evaluate the academic and fiscal performance and the organization and operation of the community school
  - Report the results of the preceding evaluation to ODE and to the students' parents.
  - Provide technical assistance to the school in complying with applicable laws and terms of the contract;
  - Intervene in the school's operation to correct problems in the school's overall performance,
  - Declare the school to be on probationary status pursuant to §3314.073 of the Revised Code,
  - Suspend the operation of the school pursuant to §3314.072 of the Revised Code,
  - Terminate the contract of the school pursuant to §3314.07 of the Revised Code,
  - Have in place a plan of action to be undertaken in the event the community school experiences financial difficulties or closes prior to the end of a school year.
- Ohio Rev. Code § 3314.023 requires that in order to provide monitoring and technical assistance, a representative of the sponsor of a community school shall meet with the governing authority or treasurer of the school and shall review the financial and enrollment records of the school at least once every month.

**Suggested Audit Procedures - Compliance (Substantive) Tests:**

Examine the contract between the school and the sponsor. Determine if it provides payment to the sponsor for monitoring activities.

- Trace actual payments to the sponsor to the accounting records to determine whether they were ≤ 3% of the school's State assistance (or met the terms of the contract of the sponsor provides additional services).

<sup>33</sup> A sponsor can earn more than 3% if it provides additional services beyond sponsorship. A contract should specify these additional services, and should differentiate them from the services required of a sponsor. Effective 3/30/06, community schools cannot sponsor other community schools [Ohio Rev. Code §3314.02(C)(1)(f)].

<sup>34</sup> AOS has determined that these monies would include Full-Time Equivalency (FTE is explained in step 1-27), State grant, and Federal grant monies. *Grant monies that are restricted from general operations (such as capital grants or grants for limited operation programs like special education) should be excluded from calculations as these monies cannot be used for general operating expenses.*

Inquire regarding the nature and extent of the sponsor’s monitoring activities.

- Examine minutes, correspondence, reports or other evidence supporting that the sponsor fulfilled its monitoring duties described above.
- Read the sponsor’s annual report to ODE. Based on other audit procedures, judge whether that report suggests the sponsor is diligent in its monitoring and is frank in its reporting to ODE.<sup>35</sup>

If based on other audit procedures, the school is experiencing financial or performance problems, judge whether the sponsor is taking the actions the Ohio Rev. Code prescribes above (e.g., declaring the school in probationary status, preparing an action plan to address financial difficulties.)

Assess whether the sponsor’s overall monitoring generally fulfills the requirements above. Report significant noncompliance as necessary.

<p><b>Audit implications (the indirect and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):</b></p>
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<sup>35</sup> Staff should not spend significant time reviewing this report. We are not opining or providing any assurance on it. Consider tracing a “handful” of key financial amounts to current or prior audited statements or to accounting records we used in the audits. Read key passages to determine whether they are generally consistent with your understanding. If we find material misrepresentations in the report to ODE, we can report this as noncompliance by the sponsor. Our noncompliance finding should avoid imprecise statements such as “The sponsor’s report was inaccurate.” Instead, quote statements or amounts from the sponsor’s report compared to quotes or amounts we obtained from other sources. List our source in the finding.

**COURTS**

**2-14 Compliance Requirement:** Ohio Rev. Code §2335.25 - Cashbook of County costs; Ohio Rev. Code §1901.31 – Municipal court records; Ohio Rev. Code §1905.21 – Disposition of fines and other moneys for mayor’s court

**Summary of Requirement:** Each clerk of courts must maintain a journal, cashbook, listing of all receipts and disbursements, or account for all fines, forfeitures, fees, and costs collected.

**POSSIBLE NONCOMPLIANCE RISK FACTORS:**

**Note:** Due to the large volume of over the counter cash receipts and the complexity of statutory fines and fees, the risk of noncompliance in courts is inherently higher. In assessing the risk of noncompliance, auditors should consider whether courts have historically demonstrated effective internal controls and compliance with applicable requirements. Additionally, adequate training of court personnel, segregation of duties, and supervisory monitoring controls can help mitigate the risk of noncompliance with court requirements.

**Suggested Audit Procedures - Compliance (Substantive) Tests:**

1. Determine if a cashbook or similar listing of cash receipts and disbursements is maintained. (Note: We will normally know this from performing financially-related audit procedures.)

**Audit implications (the indirect and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):**

**MUNICIPAL****MOVED TO CHAPTER 1****2-15 Compliance Requirement:** Ohio Rev. Code § 5727**Summary of Requirement: Kilowatt-hour tax (kWh tax)**

~~Municipal (Government) electric systems must assess a monthly kilowatt hour (kWh) tax on end users. This tax is assessed at a variable rate that decreases as kilowatt hour usage increases on the meters of end users (the last meter used to measure the kWh distributed). [Ohio Rev. Code §5727.81(A)]~~

~~Ohio Rev. Code §5727.82(A)(3) permits municipal electric communities to retain in their general fund the taxes collected from customers served inside their city or village limits (including taxes self-assessing customers pay, per §5727.81(C)(2)).~~

~~Note: This legislation did not change the constitutional rule\* that municipal electric systems can sell no more than one-third of electricity outside city or village limits.~~

~~Municipal electric systems must file a monthly report and remit to the Tax Commissioner,<sup>36</sup> by the 20<sup>th</sup> of the next month, taxes collected from any distribution customers served outside their city or village limits. Even if a municipal electric system has no sales outside of its community limits, a monthly report must be filed. [Ohio Rev. Code §5727.82(A)(1) & (A)(3)]~~

~~A self-assessing option exists for large users consuming more than 45 million kWh annually. This self-assessing customer must annually register with the Department of Taxation and pay an annual fee to the State. A self-assessing customer located inside a municipal electric community's limits must remit any kWh tax directly to the community. [Ohio Rev. Code §5727.81(C)(2)]~~

~~Every electric system liable for the kWh tax must keep complete and accurate records of all electric distributions and other records as required by the Tax Commissioner. The records must be preserved for four years after the return for the taxes for which the records pertain is due or filed, whichever is later, and be available for inspection. [Ohio Rev. Code §5727.92]~~

~~Note: AOS Bulletin 2001-011 explains these requirements in more detail. Auditors should familiarize themselves with this Bulletin before testing this requirement.~~

~~\* Per Ohio Constitution, Article 18, §6: "Any municipality, owning or operating a public utility for the purpose of supplying the service or product thereof to the municipality or its inhabitants, may also sell and deliver to others any transportation service of such utility and the surplus product of any other utility in an amount not exceeding in either case fifty per cent of the total service or product supplied by such utility within the municipality, provided that such fifty per cent limitation shall not apply to the sale of water or sewage services." (Note: 50% of the total supplied within the municipality = 1/3 of the total supply.)~~

**Suggested Audit Procedures – Compliance (Substantive) Tests:**

- ~~1. Inquire with management if they are aware of and comply with this law.~~
- ~~2. Inquire with management if they have received any correspondence from an oversight agency~~

<sup>36</sup> Governments must pay the tax to the Tax Commissioner, unless required to remit the taxes via electronic funds transfer to the Treasurer of State per Ohio Rev. Code §5727.83.

regarding compliance or noncompliance with this law. If so, obtain and review correspondence to determine if a material penalty exists.

~~Audit implications (the indirect and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):~~

**CONTRACTS AND EXPENDITURES  
STATUTORY MUNICIPALITIES**

**2-1516 Compliance Requirement:** Ohio Rev. Code § 117.16 (A); 723.52 – Force accounts – [Certain] Municipal Corporations [Cities\Villages]. *This statute does not apply to a charter city or charter village pursuant to Ohio Rev. Code § 723.53.*

**Summary of Requirements:****AOS Force Account Project Assessment Form (See note below for Ohio Department of Transportation Projects)**

A director of public service in a city, or the legislative authority of a village, is required to estimate the costs of any “contract” for the construction, reconstruction, widening, resurfacing, or repair of a street or other public way using the Auditor of State’s force account project assessment form. *Note: the use of this form is required for contracted work pursuant to Ohio Rev Code § 723.52 and for force account projects pursuant to Ohio Rev. Code § 117.16 (A).*

The Auditor of State’s prescribed form [required by Ohio Rev. Code § 117.16(A)] for this purpose can be found on our website at the following link:

<https://ohioauditor.gov/references/development/ElectronicForceAccountProjectAssessmentForm.xls>

Auditor of State Bulletin 2003-003 states an entity may use certain “safe harbor” percentages in computing its estimated costs; if the entity used these safe harbors, auditor of state auditors may accept them without further analysis. The entity may develop its own percentages for the add-ons for labor fringes and overhead costs, and materials overhead costs; the entity should present documentation to the auditor to justify these self-computed percentage add-ons.

**Joint Projects(See note below for Ohio Department of Transportation Projects)**

Joint projects undertaken by 2 or more of the affected entities require that the higher force account limits of the participating parties be applied [Ohio Rev. Code §117.161]. Participating entities shall not aggregate their respective limits, and the share of each entity shall not exceed its respective force account limit. Calculating the proper project force account limits and the share thereof to each participating party should be memorialized in the contracts or other agreements between the parties. One of the participating entities shall complete the force account project form prior to proceeding by force account. An entity shall not proceed with a joint force account project if any one of them is subject to reduced force account limits under Ohio Rev. Code § 117.16(C) or (D).

**Bid Specifications(See note below for Ohio Department of Transportation Projects)**

If the city or village has an engineer or someone performing the duties and functions of an engineer, then that person may develop the estimates.

When the estimated cost of the total project, including labor, exceeds \$30,000, the city or village must invite and receive competitive bids from private contractors for completing the work. However, force accounts **may** be used if the city or village rejects all bids. The force account work must be performed in compliance with the plans and specifications upon which the private contractor bids were based.<sup>37</sup>

<sup>37</sup> Occasionally, change orders may be necessary for force account projects. Change orders may be made for overruns in actual construction as long as: (1) the original estimate was made in good faith and (2) the change order request was for a legitimate unforeseen issue. Change orders to force account projects may constitute noncompliance if, however, estimates were intentionally low-balled to arrive under the bidding limits (e.g., not

The terms “construction, reconstruction, widening, resurfacing, or repair of a street or other public way” are not defined in this Ohio Rev. Code section. The city or village’s legal counsel or engineer should define these terms for the city or village. The Auditor of State will accept those definitions unless they are palpably and manifestly arbitrary or incorrect. *If the entity’s legal counsel, and/or engineer, as appropriate, did not define the indicated terms for the entity, indicate the same in your draft report. Consult with CFAE and the AOS’s Legal department concerning any issues involving a potential finding or citation.*

*Note: The following clarifies how all entity types subject to force account limits should measure these limits for fractions of miles, excerpted from Auditor of State Audit Bulletin 2007-001:*

“A city must bid a project involving construction or reconstruction of a road if it exceeds \$30,000 per mile. However, it is unclear whether the limit for a 1.5 mile project would be \$45,000 (\$30,000 for the first mile, \$15,000 for the partial second mile), or \$60,000 (\$30,000 for each mile – full or partial – of the project). We determined that it was appropriate to consider the legislative intent separately for projects under one mile and for projects exceeding one mile.

**For projects exceeding one mile**, we determined that the intent of these statutes was to apply the limits proportionally for partial miles. In other words, for the example of the city cited above, the applicable force account limit would be \$45,000.

**For projects less than a mile**, the interpretation above would cause problems. In the example of a city commencing a small road repair project of one-tenth of a mile, a proportional limit would require the county to bid the project if it exceeded \$3,000 (one tenth of the \$30,000 per mile limit). We did not believe that this was the result intended by the legislature, so for projects of less than a mile, the entire per mile limit (in the case of the county in our example, \$30,000) will apply. In other words, any project that is less than a mile (regardless of distance) is to be treated as if it were a mile and subjected to the entity’s corresponding monetary limit.”

*Note: The following applies to Ohio Department Of Transportation Projects*

**Force Account Limits (Ohio Rev. Code § 5517.02)**

The legislative changes in House Bill 51 increased the statutory limits for ODOT force account projects to \$30,000 per mile of highway and \$60,000 for any traffic control signal or any other single project. The changes also require the ODOT Director to increase these limits on the first day of July of every odd-numbered year beginning in 2015 by an amount to not exceed the lesser of three per cent or the percentage increase in ODOT’s construction cost index, as annualized and totaled for the two prior calendar years. The Director shall publish the applicable amounts on ODOT’s website.

**Work Exempt from Competitive Bidding/Force Account Requirements (Ohio Rev. Code § 5517.021)**

Certain work that may be undertaken by ODOT that does not require competitive bidding:

- Replace any single span bridge in its substantial entirety or widen any single span bridge.

estimating the cost of labor or evidence that the entity knew from previous experience that a minimum amount of material would be required to complete a project but was not included in the original force account project estimate or was included at clearly insufficient amounts). Auditors should use professional skepticism when auditing force account project change orders and consult with AOS Legal Division or CFAE as needed.

including necessary modifications to accommodate widening the existing substructure and wing walls. The deck area of the new or widened bridge may not exceed 700 square feet as measured around the outside perimeter of the deck.

- Replace the bearing, beams, and deck of any bridge on that bridge's existing foundation if the deck area of the rehabilitated structure does not exceed 800 square feet.
- Construct or replace any single cell or multi-cell culvert whose total waterway opening does not exceed 52 square feet.
- Pave or patch an asphalt surface if the operation does not exceed 120 tons of asphalt per lane-mile of roadway length. The department may not perform a continuous resurfacing operation under this section if the cost of work exceeds the amounts established in R.C. Section 5517.02.
- Approach roadway work, extending not more than 150 feet as measured from the back side of the bridge abutment wall or outside the edge of the culvert, as applicable. The length of the approach guardrail shall be in accordance with ODOT's design requirements and shall not be included in the approach work size limitation.

These projects are not subject to the force account requirements of Ohio Rev. Code § 117.16, do not require an estimate, and are exempt from audit for force account purposes except to determine compliance with applicable size or tonnage restrictions.

#### **Force Account Assessment Forms (Ohio Rev. Code § 117.16)**

Ohio Rev. Code § 117.16 requires that, before undertaking a project by force account, a public entity must estimate the cost of the project using a form approved by the Auditor of State. With projects constructed by or in conjunction with ODOT, an estimate may be prepared using the Department's automated system (currently the Enterprise Information Management System (EIMS), which replaced the Transportation Management System (TMS), effective June 16, 2014) or other internal standardized forms. Such estimates are acceptable in lieu of the Auditor of State's force account project assessment form provided all the necessary elements of an estimate, as required by Ohio Rev. Code § 117.16, are included. However, whether prepared using the AOS form, the electronic ODOT system, or another standard ODOT form, an estimate is required to be completed and documentation supporting the estimate should be retained for ALL projects, unless specifically exempted by R.C.. If the total estimated cost exceeds the statutory limits defined in R.C., the project must be competitively bid.

**Ohio Attorney General Opinion 2008-007**<sup>38</sup> briefly states:

- Completing the Auditor of State's force account project assessment form estimating the cost of the work constitutes commencement of the project for purposes of determining which force account limit is in effect and applicable to the project;
- The Auditor of State is authorized to require the use of a "safe harbor rate" for the cost of overhead or the justification of a different rate in estimating the cost of road, bridge and culvert work;
- A public office may acquire material and equipment pursuant to contract, and may subcontract part of the work undertaken by force account, so long as the contracts for material and equipment and the subcontracts are let in compliance with the appropriate competitive bidding requirements;

<sup>38</sup> Although the opinion was issued in response to a County's inquiry, the Auditor of State will apply this guidance to each public office undertaking force account projects pursuant to AOS Bulletin 2008-004.

- The estimate of the cost of road, bridge or culvert work must include the cost of materials and equipment that would be acquired by contract, and the cost of work that would be performed pursuant to a subcontract, if the project were undertaken by force account. If the total exceeds the applicable force account limit, the whole project must be competitively bid;
- Failure to comply with competitive bidding requirements when contracting for materials or equipment as part of a force account project, or when subcontracting work performed on a force account project, constitutes a violation of the force account limits as well as the applicable competitive bidding law.

Refer to AOS Bulletin 2008-004 for further information regarding 2008 Op. Atty. Gen. No. 2008-007 and the matters mentioned above.

### **Noncompliance**

Note: These laws require the Auditor of State to track all published [GAGAS-level] citations and any notifications sent to affected entities. Auditor of State staff should document on the Audit Executive Summaries, force account citations in the GAGAS report or if you have recommended that the Auditor of State send the entity [or the State Tax Commissioner] the communication required by these changes notifying the entities of the increased force account limits. Certified Public Accountants auditing force accounts should follow the guidance in Ohio Rev. Code § 117.12.

### **Suggested Audit Procedures - Compliance (Substantive) Tests:**

Note: For ODOT projects, ODOT forms may be used in place of an Auditor of State form. You should test whichever form is appropriate for your project.

Read the minutes, inquire of management, and scan expenditures to reasonably determine if any capital construction or maintenance activity relating to a street or other public way took place during the audit period. Determine if such projects were undertaken using force accounts.

If such projects were undertaken, inspect a representative number of the entity's completed Auditor of State Uniform Force Account Project Assessment or ODOT forms. Trace wage rates, etc. to entity supporting documentation on a test basis.

Inspect the Auditor of State's project assessment or ODOT forms prepared by the entity and determine that work undertaken by force account for construction, reconstruction, widening, resurfacing, or repair of a street or other public way was documented to have an estimated cost of \$30,000/per mile or less.

Determine if the entity used the "safe harbor" percentages described in Bulletin 2003-003. Recompute items on the form or scan the form for reasonableness. If the entity used its own labor fringes or overhead rates, or materials overhead rates, obtain supporting documentation and review for reasonableness.

Compare the actual projects' costs with the project assessment form estimates. Inquire of management for reasons for any change orders or apparent excessive costs compared with the project estimates. Evaluate for reasonableness of the estimates. Be alert for indications of "bid-splitting" or deliberate attempts to evade bid limitations, such as successive estimations just under the bid amount.

Whether such projects have been undertaken or not, consider adding language to the audit management representation letter affirming or disaffirming the existence of projects subject to the applicable force account provisions.

Note: with “force account” provisions, it is possible to have non-compliance with the preparation of the Auditor of State form; with the bidding limits; or with both.

If the “force account” limits have been violated – that is, the municipal corporation did the work by force account even though it should have been bid – then the Auditor of State is required to notify the entity [and possibly the State tax commissioner] of the penalty provisions specified in AOS Bulletin 2003-003. Auditors should indicate in this block of the OCS if the Auditor of State is to notify the entity\State tax commissioner of any of the penalty provisions. Auditor of State auditors should include this in the executive summary. IPAs should notify the Auditor of State Center for Audit Excellence.

<p><b>Conclusion: (effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):</b></p>
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## COUNTIES

**2-1617 Compliance Requirement:** Ohio Rev. Code § 117.16(A); 5543.19 – Force accounts - Counties.

### Summary of Requirements:

#### AOS Force Account Project Assessment Form(See note below for Ohio Department of Transportation Projects)

A county engineer, when authorized by the county commissioners, may utilize county labor and materials when undertaking the construction, reconstruction, improvement, maintenance, or repair of **roads**. Before undertaking force account activity for **construction** or **reconstruction**, including **widening** and **resurfacing**, of **roads**, an estimate of the cost of the road work must be compiled using the Auditor of State's force account project assessment form. When the estimated cost of the total project, including labor,<sup>39</sup> exceeds \$30,000 per mile, the county commissioners must invite and receive competitive bids from private contractors for completing the **road** work.

*Note: § 5543.19 (A) does not explicitly require using the Auditor of State's force account project assessment form for the **maintenance or repair** of roads. However, § 117.16(A) requires using this form for each public office that undertakes force account projects, presumably including, for counties, maintenance and repair of roads.*

The Auditor of State's prescribed form [required by Ohio Rev. Code § 117.16(A)] for this purpose can be found on our website at the following link:

<https://ohioauditor.gov/references/development/ElectronicForceAccountProjectAssessmentForm.xls>

Auditor of State Bulletin 2003-003 states an entity may use certain "safe harbor" percentages in computing its estimated costs; if the entity used these safe harbors, auditor of state auditors may accept them without further analysis. The entity may develop its own percentages for the add-ons for labor fringes and overhead costs, and materials overhead costs; the entity should present documentation to the auditor to justify these self-computed percentage add-ons.

#### Joint Projects(See note below for Ohio Department of Transportation Projects)

Joint projects undertaken by 2 or more of the affected entities require that the higher force account limits of the participating parties be applied [Ohio Rev. Code §117.161]. Participating entities shall not aggregate their respective limits, and the share of each entity shall not exceed its respective force account limit. Calculating the proper project force account limits and the share thereof to each participating party should be memorialized in the contracts or other agreements between the parties. One of the participating entities shall complete the force account project form prior to proceeding by force account. An entity shall not proceed with a joint force account project if any one of them is subject to reduced force account limits under Ohio Rev. Code § 117.16(C) or (D).

#### Bid Specifications(See note below for Ohio Department of Transportation Projects)

Various terms, such as **road maintenance and repair, construction, and reconstruction**, are not defined in the Ohio Rev. Code sections discussed in the individual subsections below. We indicate in each such section that the Auditor of State will accept definitions from the entity's legal counsel, and/or county engineer, as appropriate, unless the definitions are palpably and manifestly arbitrary or incorrect. *If the entity's legal counsel, and/or county engineer, as appropriate, did not define the indicated terms for*

<sup>39</sup> Pursuant to 2008 Op. Atty. Gen. No. 2008-007 discussed in section 2-16, any work subcontracted to private contractors should be included in the total cost of the project to determine if the project should be bid.

the entity, indicate the same in your draft report. Consult with the AOS's Legal department concerning any issues involving a potential finding or citation.

A county engineer, when authorized by the county commissioners, may utilize county labor and materials when undertaking the construction, reconstruction, improvement, maintenance, or repair of **bridges and culverts**. Before undertaking force account activity, an estimate of the cost of the bridge/culvert work must be compiled using the Auditor of State's force account project assessment form. When the estimated cost of the work exceeds \$100,000, the county commissioners must invite and receive competitive bids from private contractors for completing the **bridge/culvert** work.

*Note: The following clarifies how all entity types subject to force account limits should measure these limits for fractions of miles, excerpted from Auditor of State Audit Bulletin 2007-001:*

“A county must bid a project involving construction or reconstruction of a road if it exceeds \$30,000 per mile. However, it is unclear whether the limit for a 1.5 mile project would be \$45,000 (\$30,000 for the first mile, \$15,000 for the partial second mile), or \$60,000 (\$30,000 for each mile – full or partial – of the project). We determined that it was appropriate to consider the legislative intent separately for projects under one mile and for projects exceeding one mile.

**For projects exceeding one mile**, we determined that the intent of these statutes was to apply the limits proportionally for partial miles. In other words, for the example of the county cited above, the applicable force account limit would be \$45,000.

**For projects less than a mile**, the interpretation above would cause problems. In the example of a county commencing a small road repair project of one-tenth of a mile, a proportional limit would require the county to bid the project if it exceeded \$3,000 (one tenth of the \$30,000 per mile limit). We did not believe that this was the result intended by the legislature, so for projects of less than a mile, the entire per mile limit (in the case of the county in our example, \$30,000) will apply. In other words, any project that is less than a mile (regardless of distance) is to be treated as if it were a mile and subjected to the entity's corresponding monetary limit.”

*Note: The following applies to Ohio Department Of Transportation Projects*

**Force Account Limits (Ohio Rev. Code § 5517.02)**

The legislative changes in House Bill 51 increased the statutory limits for ODOT force account projects to \$30,000 per mile of highway and \$60,000 for any traffic control signal or any other single project. The changes also require the ODOT Director to increase these limits on the first day of July of every odd-numbered year beginning in 2015 by an amount to not exceed the lesser of three per cent or the percentage increase in ODOT's construction cost index, as annualized and totaled for the two prior calendar years. The Director shall publish the applicable amounts on ODOT's website.

**Work Exempt from Competitive Bidding/Force Account Requirements (Ohio Rev. Code § 5517.021)**

Certain work that may be undertaken by ODOT that does not require competitive bidding:

- Replace any single span bridge in its substantial entirety or widen any single span bridge, including necessary modifications to accommodate widening the existing substructure and wing walls. The deck area of the new or widened bridge may not exceed 700 square feet as measured around the outside perimeter of the deck.

- Replace the bearing, beams, and deck of any bridge on that bridge's existing foundation if the deck area of the rehabilitated structure does not exceed 800 square feet.
- Construct or replace any single cell or multi-cell culvert whose total waterway opening does not exceed 52 square feet.
- Pave or patch an asphalt surface if the operation does not exceed 120 tons of asphalt per lane-mile of roadway length. The department may not perform a continuous resurfacing operation under this section if the cost of work exceeds the amounts established in R.C. Section 5517.02.
- Approach roadway work, extending not more than 150 feet as measured from the back side of the bridge abutment wall or outside the edge of the culvert, as applicable. The length of the approach guardrail shall be in accordance with ODOT's design requirements and shall not be included in the approach work size limitation.

These projects are not subject to the force account requirements of Ohio Rev. Code § 117.16, do not require an estimate, and are exempt from audit for force account purposes except to determine compliance with applicable size or tonnage restrictions.

#### **Force Account Assessment Forms (Ohio Rev. Code § 117.16)**

Ohio Rev. Code § 117.16 requires that, before undertaking a project by force account, a public entity must estimate the cost of the project using a form approved by the Auditor of State. With projects constructed by or in conjunction with ODOT, an estimate may be prepared using the Department's automated system (currently the Enterprise Information Management System (EIMS), which replaced the Transportation Management System (TMS), effective June 16, 2014) or other internal standardized forms. Such estimates are acceptable in lieu of the Auditor of State's force account project assessment form provided all the necessary elements of an estimate, as required by Ohio Rev. Code § 117.16, are included. However, whether prepared using the AOS form, the electronic ODOT system, or another standard ODOT form, an estimate is required to be completed and documentation supporting the estimate should be retained for ALL projects, unless specifically exempted by R.C.. If the total estimated cost exceeds the statutory limits defined in R.C., the project must be competitively bid.

**Ohio Attorney General Opinion 2008-007** briefly states:

- Completing the Auditor of State's force account project assessment form estimating the cost of the work constitutes commencement of the project for purposes of determining which force account limit is in effect and applicable to the project;
- The Auditor of State is authorized to require the use of a "safe harbor rate" for the cost of overhead or the justification of a different rate in estimating the cost of road, bridge and culvert work;
- A public office may acquire material and equipment pursuant to contract, and may subcontract part of the work undertaken by force account, so long as the contracts for material and equipment and the subcontracts are let in compliance with the appropriate competitive bidding requirements;
- The estimate of the cost of road, bridge or culvert work must include the cost of materials and equipment that would be acquired by contract, and the cost of work that would be performed pursuant to a subcontract, if the project were undertaken by force account. If the total exceeds the applicable force account limit, the whole project must be competitively bid;

- Failure to comply with competitive bidding requirements when contracting for materials or equipment as part of a force account project, or when subcontracting work performed on a force account project, constitutes a violation of the force account limits as well as the applicable competitive bidding law.

Refer to AOS Bulletin 2008-004 for further information regarding 2008 Op. Atty. Gen. No. 2008-007 and the matters mentioned above.

### **Noncompliance**

Note: These laws require the Auditor of State to track all published [GAGAS-level] citations and any notifications sent to affected entities. Auditor of State staff should document on the Audit Executive Summaries, force account citations in the GAGAS report or if you have recommended that the Auditor of State send the entity [or the State Tax Commissioner] the communication required by these changes notifying the entities of the increased force account limits. Certified Public Accountants auditing force accounts should follow the guidance in Ohio Rev. Code § 117.12.

### **Suggested Audit Procedures - Compliance (Substantive) Tests:**

Note: For ODOT projects, ODOT forms may be used in place of an Auditor of State form. You should test whichever form is appropriate for your project.

Read the minutes, inquire of management, and scan expenditures to reasonably determine if any road capital construction or maintenance activity took place during the audit period. Determine if such projects were undertaken using force accounts.

If such projects were undertaken, inspect a representative number of the entity's completed Auditor of State Uniform Force Account Project Assessment or ODOT forms. Trace wage rates, etc. to entity supporting documentation on a test basis.

Inspect the Auditor of State's project assessment or ODOT forms prepared by the county engineer and determine that work undertaken by force account for construction, reconstruction, widening, or resurfacing of roads was documented to have an estimated cost of \$30,000 or less per mile.

Inspect the county engineer's project assessment or ODOT forms, and determine whether they document that work undertaken by force account to construct, reconstruct, improve, maintain, or repair bridges and culverts cost an estimated \$100,000 or less.

Determine if the entity used the "safe harbor" percentages described in Bulletin 2003-003. Recompute items on the form or scan the form for reasonableness. If the entity used its own labor fringes or overhead rates, or materials overhead rates, obtain supporting documentation and review for reasonableness.

Compare the actual projects' costs with the project assessment form estimates. Inquire of management for reasons for any change orders or apparent excessive costs compared with the project estimates. Evaluate for reasonableness of the estimates. Be alert for indications of "bid-splitting" or deliberate attempts to evade bid limitations, such as successive estimations just under the bid amount.

Whether such projects have been undertaken or not, consider adding language to the audit management representation letter affirming or disaffirming the existence of projects subject to the applicable force account provisions.

Note: with “force account” provisions, it is possible to have non-compliance with the preparation of the Auditor of State form; with the bidding limits; or with both.

If the “force account” limits have been violated – that is, the county did the work by force account even though it should have been bid – then the Auditor of State is required to notify the entity [and possibly the State tax commissioner] of the penalty provisions specified in AOS Bulletin 2003-003. Auditors should indicate in this block of the OCS if the Auditor of State is to notify the entity\State tax commissioner of any of the penalty provisions. Auditor of State auditors should include this in the executive summary. IPAs should notify the Auditor of State Center for Audit Excellence.

<p><b>Conclusion: (effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):</b></p>
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**TOWNSHIPS**

**2-1718 Compliance Requirement:** Ohio Rev. Code § 117.16(A); 5575.01 – Force accounts - Townships.

**Summary of Requirements:****AOS Force Account Project Assessment Form (See note below for Ohio Department of Transportation Projects)**

In the **maintenance** and **repair** of **roads** the board of township trustees may use force account labor provided the board has first caused **the county engineer** to complete the Auditor of State’s prescribed force account project assessment form.

The Auditor of State’s prescribed form [required by Ohio Rev. Code § 117.16(A)] for this purpose can be found on our website at the following link:

<https://ohioauditor.gov/references/development/ElectronicForceAccountProjectAssessmentForm.xls>

Auditor of State Bulletin 2003-003 states an entity may use certain “safe harbor” percentages in computing its estimated costs; if the entity used these safe harbors, auditor of state auditors may accept them without further analysis. The entity may develop its own percentages for the add-ons for labor fringes and overhead costs, and materials overhead costs; the entity should present documentation to the auditor to justify these self-computed percentage add-ons.

Before undertaking the **construction** or **reconstruction** of a township road, the board shall obtain from the **county engineer** an estimate of the cost of such work, which estimate shall include labor, material, freight, fuel, hauling, use of machinery and equipment, and all other items of cost. The Auditor of State’s interpretation of Ohio Rev. Code § 5575.01(C), is that the county engineer should use the Auditor of State’s force account project assessment form in estimating these costs. Note: when there is no AOS project assessment form completed, cite 5575.01(C). If neither the form nor any other type of estimate is completed, cite to both 5575.01(B) and (C).

The Auditor of State’s force account project assessment form is **not** required if the **road maintenance or repair** project’s total estimated cost is less than \$15,000 or if the **road construction or reconstruction’s** total estimated cost is less than \$5,000 per mile. The terms **road maintenance and repair, construction, and reconstruction**, are not defined in this Ohio Rev. Code section. The township’s legal counsel, and/or county engineer, along with the board, should define these terms for the township. The Auditor of State will accept those definitions unless they are palpably and manifestly arbitrary or incorrect.

**Joint Projects(See note below for Ohio Department of Transportation Projects)**

Joint projects undertaken by 2 or more of the affected entities require that the higher force account limits of the participating parties be applied [Ohio Rev. Code §117.161]. Participating entities shall not aggregate their respective limits, and the share of each entity shall not exceed its respective force account limit. Calculating the proper project force account limits and the share thereof to each participating party should be memorialized in the contracts or other agreements between the parties. One of the participating entities shall complete the force account project form prior to proceeding by force account. An entity shall not proceed with a joint force account project if any one of them is subject to reduced force account limits under Ohio Rev. Code § 117.16(C) or (D).

**Bid Specifications(See note below for Ohio Department of Transportation Projects)**

Various terms, such as **road maintenance and repair, construction, and reconstruction** are not defined in the Ohio Rev. Code sections discussed in the individual subsections below. We indicate in each such section that the Auditor of State will accept definitions from the entity's legal counsel, and/or county engineer, as appropriate, unless the definitions are palpably and manifestly arbitrary or incorrect. *If the entity's legal counsel, and/or county engineer, as appropriate, did not define the indicated terms for the entity, indicate the same in your draft report. Consult with the AOS's Legal department concerning any issues involving a potential finding or citation.* Certified Public Accountants auditing force accounts should follow the guidance in Ohio Rev. Code § 117.12.

Force accounts **may not** be used and bidding is required when the total estimated cost of the project, including labor, for **maintenance and repair** of roads exceeds \$45,000.

Bids from private contractors should be sought when the total estimated cost of the project, including labor, for **construction or reconstruction** of roads exceeds \$15,000 per mile. However, force accounts **may** be used if the board finds it in the best interest of the public. In this case, private contractor bids must have been received, considered, and rejected, and the force account work must be performed in compliance with the plans and specifications upon which the bids were based.

*Note: The following clarifies how all entity types subject to force account limits should measure these limits for fractions of miles, excerpted from Auditor of State Audit Bulletin 2007-001:*

“A township must bid a project involving construction or reconstruction of a road if it exceeds \$15,000 per mile. However, it is unclear whether the limit for a 1.5 mile project would be \$22,500 (\$15,000 for the first mile, \$7,500 for the partial second mile), or \$30,000 (\$15,000 for each mile – full or partial – of the project). We determined that it was appropriate to consider the legislative intent separately for projects under one mile and for projects exceeding one mile.

**For projects exceeding one mile**, we determined that the intent of these statutes was to apply the limits proportionally for partial miles. In other words, for the example cited above, the applicable force account limit would be \$22,500.

**For projects less than a mile**, the interpretation above would cause problems. In the example of a township commencing a small road repair project of one-tenth of a mile, a proportional limit would require the township to bid the project if it exceeded \$1,500 (one tenth of the \$15,000 per mile limit). We did not believe that this was the result intended by the legislature, so for projects of less than a mile, the entire per mile limit (in the case of our example, \$15,000) will apply. In other words, any project that is less than a mile (regardless of distance) is to be treated as if it were a mile and subjected to the entity's corresponding monetary limit.”

*Note: The following applies to Ohio Department Of Transportation Projects*

**Force Account Limits (Ohio Rev. Code § 5517.02)**

The legislative changes in House Bill 51 increased the statutory limits for ODOT force account projects to \$30,000 per mile of highway and \$60,000 for any traffic control signal or any other single project. The changes also require the ODOT Director to increase these limits on the first day of July of every odd-numbered year beginning in 2015 by an amount to not exceed the lesser of three per cent or the percentage increase in ODOT's construction cost index, as annualized and totaled for the two prior calendar years. The Director shall publish the applicable amounts on ODOT's website.

**Work Exempt from Competitive Bidding/Force Account Requirements (Ohio Rev. Code § 5517.021)**

Certain work that may be undertaken by ODOT that does not require competitive bidding:

- Replace any single span bridge in its substantial entirety or widen any single span bridge, including necessary modifications to accommodate widening the existing substructure and wing walls. The deck area of the new or widened bridge may not exceed 700 square feet as measured around the outside perimeter of the deck.
- Replace the bearing, beams, and deck of any bridge on that bridge's existing foundation if the deck area of the rehabilitated structure does not exceed 800 square feet.
- Construct or replace any single cell or multi-cell culvert whose total waterway opening does not exceed 52 square feet.
- Pave or patch an asphalt surface if the operation does not exceed 120 tons of asphalt per lane-mile of roadway length. The department may not perform a continuous resurfacing operation under this section if the cost of work exceeds the amounts established in R.C. Section 5517.02.
- Approach roadway work, extending not more than 150 feet as measured from the back side of the bridge abutment wall or outside the edge of the culvert, as applicable. The length of the approach guardrail shall be in accordance with ODOT's design requirements and shall not be included in the approach work size limitation.

These projects are not subject to the force account requirements of Ohio Rev. Code § 117.16, do not require an estimate, and are exempt from audit for force account purposes except to determine compliance with applicable size or tonnage restrictions.

#### **Force Account Assessment Forms (Ohio Rev. Code § 117.16)**

Ohio Rev. Code § 117.16 requires that, before undertaking a project by force account, a public entity must estimate the cost of the project using a form approved by the Auditor of State. With projects constructed by or in conjunction with ODOT, an estimate may be prepared using the Department's automated system (currently the Enterprise Information Management System (EIMS), which replaced the Transportation Management System (TMS), effective June 16, 2014) or other internal standardized forms. Such estimates are acceptable in lieu of the Auditor of State's force account project assessment form provided all the necessary elements of an estimate, as required by Ohio Rev. Code § 117.16, are included. However, whether prepared using the AOS form, the electronic ODOT system, or another standard ODOT form, an estimate is required to be completed and documentation supporting the estimate should be retained for **ALL** projects, unless specifically exempted by R.C.. If the total estimated cost exceeds the statutory limits defined in R.C., the project must be competitively bid.

**Ohio Attorney General Opinion 2008-007** briefly states:

- Completing the Auditor of State's force account project assessment form estimating the cost of the work constitutes commencement of the project for purposes of determining which force account limit is in effect and applicable to the project;
- The Auditor of State is authorized to require the use of a "safe harbor rate" for the cost of overhead or the justification of a different rate in estimating the cost of road, bridge and culvert work;
- A public office may acquire material and equipment pursuant to contract, and may subcontract part of the work undertaken by force account, so long as the contracts for material and equipment and the subcontracts are let in compliance with the appropriate competitive bidding requirements;

- The estimate of the cost of road, bridge or culvert work must include the cost of materials and equipment that would be acquired by contract, and the cost of work that would be performed pursuant to a subcontract, if the project were undertaken by force account. If the total exceeds the applicable force account limit, the whole project must be competitively bid;
- Failure to comply with competitive bidding requirements when contracting for materials or equipment as part of a force account project, or when subcontracting work performed on a force account project, constitutes a violation of the force account limits as well as the applicable competitive bidding law.

Refer to AOS Bulletin 2008-004 for further information regarding 2008 Op. Atty. Gen. No. 2008-007 and the matters mentioned above.

### **Noncompliance**

Note: These laws require the Auditor of State to track all published [GAGAS-level] citations and any notifications sent to affected entities. Auditor of State staff should document on the Audit Executive Summaries, force account citations in the GAGAS report or if you have recommended that the Auditor of State send the entity [or the State Tax Commissioner] the communication required by these changes notifying the entities of the increased force account limits. Certified Public Accountants auditing force accounts should follow the guidance in Ohio Rev. Code § 117.12.

### **Suggested Audit Procedures - Compliance (Substantive) Tests:**

Note: For ODOT projects, ODOT forms may be used in place of an Auditor of State form. You should test whichever form is appropriate for your project.

Read the minutes, inquire of management, and scan expenditures to reasonably determine if any road capital construction or maintenance activity took place during the audit period. Determine if such projects were undertaken using force accounts.

Inspect the estimates prepared by the county engineer and determine that work undertaken by force account was documented as less than \$15,000 for a **road maintenance or repair** project or less than \$5,000 per mile for a **road construction or reconstruction** project. If so, no Auditor of State force account project assessment form would have been required to have been completed.

Inspect the estimates prepared by the county engineer and determine that work undertaken by force account was documented as \$45,000 or less for **maintenance** and **repair** of roads.

Inspect the estimates prepared by the county engineer and determine that work undertaken by force account was documented as less than \$15,000 per mile for **construction or reconstruction** of roads.

If the bids from private contractors were taken for **construction or reconstruction** of roads but the board used the force account anyway, determine that the board documented that the private contractor bids were received, considered, and rejected, and the board's rationale for why using the force account approach was in the best interest of the public. Compare the force account's documented project specifications with the plans and specifications upon which the private contractor bids were based.

If such projects were undertaken, inspect a representative number of the entity's completed Auditor of State Uniform Force Account Project Assessment or ODOT forms. Trace wage rates, etc. to entity supporting documentation on a test basis.

Determine if the entity used the “safe harbor” percentages described in Bulletin 2003-003. Recompute items on the form or scan the form for reasonableness. If the entity used its own labor fringes or overhead rates, or materials overhead rates, obtain supporting documentation and review for reasonableness.

Compare the actual projects’ costs with the project assessment form estimates. Inquire of management for reasons for any change orders or apparent excessive costs compared with the project estimates. Evaluate for reasonableness of the estimates. Be alert for indications of “bid-splitting” or deliberate attempts to evade bid limitations, such as successive estimations just under the bid amount.

Whether such projects have been undertaken or not, consider adding language to the audit management representation letter affirming or disaffirming the existence of projects subject to the applicable force account provisions.

Note: with “force account” provisions, it is possible to have non-compliance with the preparation of the Auditor of State or ODOT form; with the bidding limits; or with both.

If the “force account” limits have been violated – that is, the township did the work by force account even though it should have been bid – then the Auditor of State is required to notify the entity [and possibly the State tax commissioner] of the penalty provisions specified in AOS Bulletin 2003-003. Auditors should indicate in this block of the OCS if the Auditor of State is to notify the entity\State tax commissioner of any of the penalty provisions. Auditor of State auditors should include this in the executive summary. IPAs should notify the Auditor of State Center for Audit Excellence.

<p><b>Conclusion: (effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):</b></p>
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**ACCOUNTING AND REPORTING**  
**Counties' Electronic (i.e., Internet) Transactions**

**2-1819 Compliance Requirement:** Ohio Rev. Code §117.111(A) Security controls over counties' electronic (i.e. internet) transactions

**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 Ohio Rev. Code §304.02 to secure electronic signatures or records relating to county business that is conducted electronically under Chapter 1306 of the Revised Code.<sup>40</sup>

Other statutes relevant to this requirement:

**Per Ohio Rev. Code § 304.01:**

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

(D) "Electronic record" means a record created, generated, sent communicated, received, or stored by electronic means.

(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 business with a county office.

**Ohio Rev. Code § 304.02:** Prior to a county office using electronic records and electronic signatures, under Chapter 1306 of the Revised Code and except as otherwise provided in § 955.013 of the Revised Code, 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.

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

**Ohio Rev. Code § 1306.02(A)** provides that Chapter 1306 of the Revised Code, the Uniform Electronic Transactions Act, generally applies to electronic records and electronic signatures relating to a transaction.

**Ohio Rev. Code § 1306.04(B)** provides that sections 1306.01 to 1306.23 of the Revised Code apply only to transactions between parties each of which has agreed to conduct transactions by electronic means.

**Ohio Rev. Code § 1306.01(P)** defines "transaction" as an action or set of actions occurring between two or more persons relating to the conduct of business, commercial, or governmental affairs.

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<sup>40</sup> Note: Since the legislature has mandated this step, we should deem it to be qualitatively material.

**Ohio Rev. Code § 1306.11:** (A) An electronic record of information generally satisfies record retention laws.

**Suggested Audit Procedures - Compliance (Substantive) Tests:**

1. Determine the electronic records and electronic signatures relating to a county office's electronic (i.e. *internet*) transactions. These include:
  - a. Cash receipts where a county office accepts credit/debit cards electronically (i.e. via the internet).
  - b. Other types of internet transactions.<sup>41</sup>
  
2. Obtain and read the *written* security procedure the county office (or its internet transaction service organization<sup>42</sup>) adopted to safeguard each type of electronic (i.e. internet) transaction. Note: Because the service organization processes most elements of these transactions, it is sufficient if the *service organization* adopts security procedures. If the service organization requires the county office to adopt "user control" security procedures, we should consider whether the county office has implemented these controls. (Often the service organization's contract or response to a county office's RFP will describe the security procedures.)
  - a. Retain a copy or summary of the procedure in the permanent file.
  - b. Update systems' documentation as needed.<sup>43</sup>

Assess the effectiveness of the design of controls and determine that they have been "implemented." (AOS staff can refer to AOSAM 30500.75-.79)
  
3. Determine whether results from the steps above regarding the design and implementation of controls related to securing electronic signatures and electronic records relating to internet transactions result in any management comments, significant deficiencies or material weaknesses. We must also report as a noncompliance finding. Since the statute explicitly refers to a security procedure adopted in writing, we should report the absence of a security procedure adopted in writing.

**Conclusion: (effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):**

<sup>41</sup> As noted on the previous page, Ohio Rev. Code § 955.013 separately addresses electronic / internet sales of dog licenses. Direct deposits do *not* fall under Ohio Rev. Code 117.111 or Ohio Rev. Code 304.02.

<sup>42</sup> Companies providing internet transaction services may be *service organizations*. We should consider service organization implications per AU-C 402 depending upon the materiality of the transactions.

<sup>43</sup> AOS staff should update the RCEC where needed to incorporate electronic (i.e. internet) transactions, including controls and procedures 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 30500.52-.54). Also consider that the nature of electronic transactions and signatures subject to this law may require ISA assistance.

**OTHER LAWS AND REGULATION  
GENERAL**

**2-1920 Compliance Requirement:** Ohio Admin Code § 3745-27-15 through 18 Landfill Financial Responsibility and Certifications

*The following is only a summary. When auditing a government managing a landfill, auditors should obtain and read copies of the applicable Ohio Administrative Code sections.*

Governments owning or managing landfills must annually certify financial information related to their ability to finance closure and postclosure liabilities to the OEPA. These reports are due within 180 days of fiscal year end.

An index to the relevant Ohio Administrative Code requirement follows:

- 3745-27-15: Solid waste facility or scrap tire transporter final closure requirements (Section (L) describes the local government test)
  - 3745-27-16: Solid waste facility or scrap tire transporter final postclosure requirements (Section (L) describes the local government test)
  - 3745-27-17: Wording of financial assurance instruments (Section (H) describes the wording for the letter governments assured under the local government test must submit to OEPA).
  - 3745-27-18: Only applies when OEPA director mandates corrective action, such as to remediate landfill groundwater contamination described in 3745-27-10. (Section (M) describes the local government requirements, if applicable.)
- I. The Federal EPA adopted a regulation (40 CFR 258.74(f)) allowing governmental solid waste landfills (GSWLFs) to avoid acquiring third-party financial instruments (such as letters of credit, insurance or establishing trust funds) to assure current final closure, postclosure and/or corrective measure cost estimates and any other environmental obligations to the extent they meet certain financial tests. The Federal EPA placed the responsibility for monitoring compliance with this rule on the states. In response, the Ohio EPA adopted a regulation that parallels the Federal regulation in most aspects.
  - II. A GSWLF need not obtain third-party instruments for amounts up to 43% of the local government's **total revenue**,<sup>44</sup> *provided* that it meets the tests described in **III** below. A GSWLF must obtain a third-party instrument (e.g., insurance, trust fund, bond) for all current final closure, postclosure and/or corrective measure cost estimates and any other environmental obligations, exceeding 43% of total revenue.
  - III. There are two alternatives to the third-party financial instruments nongovernments must have for (closure + postclosure + mandated corrective care costs). Governments do not need these instruments (for up to 43% of total annual revenue), if:

**Alternative I**

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<sup>44</sup> Terms defined in the *State Support Document for the Local Government Financial Test* are printed in **boldface type** the first time they appear. A copy of this document was sent to each region

- a. The GSWLF issues GAAP financial statements.
- b. The GSWLF has not:
  1. Defaulted on GO bonds, or has not issued GO bonds of less than investment grade per Moody's or S&P.  
  
Local governments issuing bonds secured by collateral or a guarantee (e.g. AMBAC insurance) must meet the minimum rating without that security. (This means consider the *government's* debt rating, not the rating of a particular insured or collateralized *issue*.)
  2. Has not operated at a deficit of greater than or equal to (5% x annual revenue) in either of the past two fiscal years. (The federal rule defines a deficit as total revenue minus **total expenditures**);
  3. Received a qualified opinion.

Also, either condition c. or d. must be met:

- c. All GO bonds must be of investment grade, rated by either Moody's or S&P.

**OR:**

**Alternative II:**

- d. The GSWLF must have:
  1. **(Cash + marketable securities)** / total expenditures  $\geq 5\%$ , AND
  2. **Debt service** / total expenditures  $\leq 20\%$ , AND
  3. **Ratio of long term debt issued & outstanding / capital expenditures** must be  $\leq 2.0$ .

(Based on the federal regulation, we believe that the reference to "outstanding" debt immediately above only refers to debt issued in the current year that is still outstanding at year end.)

IV. Reporting requirements:

- a. The GAAP statements must comply with GASB 18 disclosures (this requirement does not appear in the Ohio Administrative Code, but is included in the Federal regulation.) However, Ohio Admin. Code § 3745-27-15(C)(1)(a) requires the final closure financial assurance instrument for a sanitary landfill facility, solid waste transfer facility, solid waste incinerator, or Class I composting facility to contain an itemized written estimate, in current dollars, of the cost of final closure. The final closure cost estimate shall be based on the final closure costs at the point in the operating life of the facility when the extent and manner of its operation would make the final closure the most expensive, and shall be based on a third party conducting the final closure activities.
- b. The CFO must prepare a letter listing current final closure, postclosure and/or corrective measure cost estimates and any other environmental obligations, and certify whether the government meets III.a.-d. (above), and also certify that the government is assuring a liability  $\leq 43\%$  of annual operating revenues.
- c. Audited financial statements must be kept as part of the "facility's operating record."

- d. Accountants must also issue an agreed-upon procedures report. The procedures must note whether amounts used for the ratios Alternative II above in the CFO's letter agree to the audited GAAP statements.

#### V. Definitions:

To assure that the CFO's letter is appropriate, it is critical that the financial information be consistent with the definitions in the *State Support Document for the Local Government Financial Test* (the Document). For example, the Document explains that "total expenditures" should not include capital project, internal service or fiduciary fund expenditures/expenses. A copy of the *Document* has been sent to each regional office.

The Federal EPA informed us they do not intend to update the Document for GASB 34. Therefore, we believe the amounts for the accounts described above appearing in the CFO's letter (cash and marketable securities, revenues, etc.) should be derived from the governmental and proprietary **fund** financial statements, not from the entity-wide financial statements.

#### VI. Other

1. The Federal regulation gives state directors the option of allowing governments to discount the liability. However, Ohio does not permit discounting. Also, paragraph 42 of GASB 18 prohibits discounting.
2. Both the Federal and State regulations refer to governmental financial statements as *Comprehensive Annual Financial Reports*. However, while the Federal and State rules require GAAP reporting, there appears to be no explicit requirement to prepare a CAFR. In the Auditor of State's opinion, basic financial statements complying with GASB 18 and including segment information (if applicable) for the landfill operation are sufficient.

#### Suggested Audit Procedures - Compliance (Substantive) Tests:

**NOTE: These procedures relate to the local government test. If a government uses other assurance methods, auditors must read the applicable Ohio Admin. Code § 3745-27 requirements and design appropriate tests and reports.**

**For AOS staff: If the reporting differs from the example AUP available to AOS staff in the Briefcase, you must submit your draft report to the Center for Audit Excellence for review.**

Determine whether the estimate of closure, postclosure and other corrective care liabilities has been updated through the most recent balance sheet date. Such estimates may require corroboration by an environmental specialist. (The auditor may need to consider AU-C 620, *Using the Work of a Specialist*.)

Compare the format of the CFO's letter to the EPA with the example included in Ohio Admin. Code §3745-27-17(H).

Prepare the agreed-upon procedures report required by the Federal EPA. An example report is available to AOS staff in the AOS Briefcase/Audit Employees folder under AUP.

If the government cannot meet the government test, or has liabilities exceeding 43% of annual revenue, inquire which method the government has selected to assure these amounts. If the government has (1) established a final closure trust fund; (2) secured a surety bond guaranteeing payment; (3) obtained an irrevocable letter of credit or; (4) obtained commercial insurance to finance these liabilities, then inspect documentation that the required funds, bonds, letter of credit, or insurance have been obtained, and are in force.

GASB 18, paragraph 7(e) requires disclosing the methods /instruments used to finance closure and postclosure care. (AOS omitted this sentence because the local government requirements in Ohio Admin. Code § 3745-27-15, 16, 17, and 18 mandate GAAP financial statements.)

- Read the draft financial statements to determine if they meet the GAAP display and disclosure requirements for these assets/guarantees/commitments, etc.

<p><b>Conclusion: (effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):</b></p>
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<p><b><u>Revised: SB 287, 130<sup>th</sup> GA</u></b> <b><u>Effective: 9/04/14</u></b></p>
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**2-2021 Compliance Requirements:** Ohio Rev. Code §§ 135.14(B)(7), 135.142, 135.22, 135.35, 319.04, 321.46 and 733.27 - Education Requirements

### Summary of Requirements:

#### Subdivision Treasurers<sup>45</sup>

Subdivision treasurers must complete annual continuing education programs provided by the Treasurer of State (TOS). The TOS issues certificates indicating that the treasurer has successfully completed the continuing education program.

The continuing education requirement does not apply to a subdivision treasurer who annually provides a notice of exemption to the Auditor of State, certified by the Treasurer of State (and confirmable through the TOS searchable database weblink below) that the treasurer is not subject to the continuing education requirements because the treasurer invests or deposits public funds in the following investments only (Ohio Rev. Code §135.22):

- (1) Interim deposits pursuant to § 135.14 (B)(3) or section 135.145 (CDAR and similar programs);
- (2) STAR Ohio pursuant to § 135.14(B)(6);
- (3) No-load money market mutual funds pursuant to § 135.14 (B)(5)

Specific requirements apply to the officials listed below:

#### County Treasurers

Newly-elected treasurers must complete education programs (26 hours) approved by the Auditor of State (13 hours) and the Treasurer of State (13 hours) between December 1 and the first Monday in September following that person's election [Ohio Rev. Code §321.46]. For instance, a treasurer elected in November 2011, taking office in 2012, would be required to receive the initial 26 hours of training between December 1, 2011 and September 2012. In this example, the newly-elected treasurer would complete one year in office in September 2013 and would then enter into the biennial cycle for 2014/2015 for continuing education.

After completing one year in office, a county treasurer must take not fewer than 24 hours of continuing education approved by the Auditor of State (12 hours) and the Treasurer of State (12 hours) in each **biennial cycle** commencing the January 1 after the treasurer's first year in office. County treasurers may carry forward up to six hours received from the Auditor of State plus up to six hours received from the Treasurer of State in excess of 24 from the current to the next biennial cycle. [Ohio Rev. Code §321.46] The biennial time periods are:

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<sup>45</sup> A treasurer of an agricultural society must comply with the continuing education requirements of Ohio Rev. Code § 135.22. The treasurer meets the definition of "treasurer" in Ohio Rev. Code § 135.22 (which refers to the definition in Ohio Rev. Code § 135.01) which is as follows: (M) "Treasurer" means, in the case of the state, the treasurer of state and in the case of any subdivision, the treasurer, or officer exercising the functions of a treasurer, of such subdivision. In the case of a board of trustees of the sinking fund of a municipal corporation, the board of commissioners of the sinking fund of a school district, or a board of directors or trustees of any union or joint institution or enterprise of two or more subdivisions not having a treasurer, such term means such board of trustees of the sinking fund, board of commissioners of the sinking fund, or board of directors or trustees.

- January 1, 2012 to December 31, 2013
- January 1, 2014 to December 31, 2015
- January 1, 2016 to December 31, 2017

Auditors should wait until the expiration of the applicable biennial time period to determine whether *existing treasurers* (as opposed to those *newly-elected*) have completed the continuing education requirements.

A treasurer who fails to complete the **initial** education programs required by §321.46 cannot invest and is *subject to removal from office*. Investment authority transfers immediately to the county investment advisory committee.

A treasurer who fails to complete the **continuing** education programs required by §321.46 is restricted to investing in STAR Ohio, no-load money market mutual funds pursuant to §135.14 (B)(5) and § 135.35(A)(5), or in certificates of deposit pursuant to Ohio Rev. Code §135.35(A)(63), or savings or deposit accounts pursuant to Ohio Rev. Code §135.35(A)(-63). A county treasurer who has failed to complete the continuing education programs and invests in other than these investments is subject to removal from office.

### **Village Fiscal Officers**

Must attend annual training programs for new village fiscal officer *and* annual continuing education programs provided by the Auditor of State [Ohio Rev. Code §733.27]. (The Auditor of State interprets this section as requiring a newly-elected fiscal officer to attend the new fiscal officer's training offered by the Auditor of State between December 1 and the following February 15, and any other annual training offered by the Auditor of State. Continuing fiscal officers must attend the annual update sessions only.)

### **All Local Governments**

No investment shall be made in commercial paper or bankers acceptances unless the following have completed additional training for making those investments. The type and amount of additional training shall be approved by the ~~Auditor~~Treasurer of State:

- School treasurer [Ohio Rev. Code §135.142(B)]
- County investing treasurer<sup>46</sup> [Ohio Rev. Code §135.35(A)(8)]
- For other local governments: Treasurer or governing board [Ohio Rev. Code §135.14(B)(7)]

### **TOS CPIM Confirmation and FAQ's**

The Treasurer of State's website includes an online searchable CPIM report database<sup>47</sup> of treasurers receiving TOS-approved certifications and exemptions. The link to this website is: [http://stateofohio-web.ungerboeck.com/ceu/ceu\\_lookup.aspx](http://stateofohio-web.ungerboeck.com/ceu/ceu_lookup.aspx). However, the TOS website does not include CPIM for AOS-approved courses for county treasurers. Auditors should refer to the Continuing Education Hours Report under *County Treasurer's* box on the AOS website at <https://ohioauditor.gov/trainings/ContinuingEducationHoursReport.pdf> to obtain a listing of AOS-

<sup>46</sup> Ohio Rev. Code §135.35(A)(8) applies to the investing authority. However, the treasurer is the investing authority, except in the rare circumstance county commissioners determine a treasurer is not complying with county policies, per Ohio Rev. Code §135.34.

<sup>47</sup> Note: The reliability of the TOS online CPIM search results may be affected by the accuracy of information entered into the database. Therefore, auditors may still need to inquire with local treasurers regarding CPIM certifications if discrepancies are identified using the online database.

approved CPIM received by county treasurers.

Auditors can also refer to AOS/TOS Frequently Asked Questions (FAQ's) regarding training requirements for county and local subdivision treasurers on our website listed as *Training Requirements for County Treasurers* or as *Training Requirements for Treasurers of Subdivisions*

at: <https://ohioauditor.gov/trainings/CPIMFAQsForCountyTreasurers.doc> or  
<https://ohioauditor.gov/trainings/CPIMFAQsForTreasurersOfSubdivisions.doc>

**Suggested Audit Procedures - Compliance (Substantive) Tests:**

For counties, please show me your certificates of completion for the last biennial period. (*Note: For efficiencies, auditors may be able to obtain these certifications using the weblink above for the Treasurer of State and the Auditor of State*).

For other subdivisions, please show me your annual certificates of completion. (*Note: For efficiencies, auditors may be able to obtain these certifications using the weblink above for the Treasurer of State*).

**Conclusion: (effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):**

**2-2122 Compliance Requirements and Summaries Thereof:**

Ohio Rev. Code §102.03 - Restrictions and prohibitions.

- This section restricts the conduct of public officials and employees with respect to their official positions. Per Ohio Rev. Code §3314.03(A)(11)(e), Ohio Rev. Code §102 applies to community schools. For fiscal year 2007 audits and later, members of a community school's governing authority cannot be employed by the school or, except in specified circumstances, have an interest in any contract awarded by the governing authority.
- Present and former public officials or employees are prohibited during their public employment or for twelve months thereafter from representing any person on any matter in which the public official or employee personally exercised administrative discretion as a public official or employee. (Also known as *the revolving door statute*.) [Ohio Rev. Code §102.03(A)(1)]
- Division (A) of Ohio Rev. Code §102.03 shall not be construed to prohibit performing ministerial functions, including, but not limited to, the filing or amending tax returns, applications for permits and licenses, incorporation papers, and other similar documents. [Ohio Rev. Code §102.03(A)(7)]
- Public officials and employees are prohibited from using or authorizing the use of the authority or influence of office or employment to secure anything of value or to promise or to offer anything of value that is of such a character as to manifest a substantial and improper influence upon the public official or employee with respect to that person's duties. [Ohio Rev. Code §102.03(D)]
- Public officials and employees are prohibited from soliciting or accepting anything of value that is of such character as to manifest a substantial and improper influence upon that public official or employee with respect to that person's duties. [Ohio Rev. Code §102.03E)]

**Ohio Rev. Code sections governing interests in contracts by elected officials**

- **Ohio Rev. Code §305.27** Prohibits county commissioners from having an interest in a county contract.
- **Ohio Rev. Code §511.13** Prohibits any member, officer or employee of a board of township trustees from having an interest in any contract the trustees approve.
- **Ohio Rev. Code §731.02** Prohibits members of a city legislative authority from having an interest in any contract with the city.
- **Ohio Rev. Code §731.12** Prohibits members of a village legislative authority from having an interest in any contract with the village.

**Ohio Rev. Code §3313.33** Prohibits board of education members from having a pecuniary interest in a board contract, or from being employed by the board. However, there are exceptions, per Ohio Rev. Code §3313.33(C). You should refer to the statute for details of the exceptions.

**Ohio Rev. Code §2921.42** - Having an unlawful interest in a public contract.

This section prohibits such interests. Ohio Rev. Code §3314.03(A)(11)(e) requires community schools to comply with Ohio's Ethics Law, which, among other things, requires public officials to disclose conflicts of interest and prohibits them from having an interest in a contract awarded by their public office. Effective March 30, 2006, members of a community school's governing authority cannot be employed by

the community school or, except in specified circumstances, have an interest in *any* contract awarded by the governing authority<sup>48</sup>.

**Ohio Rev. Code §9.833(F)** expressly permits a subdivision's officials or employees to serve on the governing board of the program administrator of a governmental self-insurance program, if his or her government participates in that program.

Ohio Rev. Code §**2921.41**- Theft in office.

Public officials committing theft of public property (or services), or who use their offices in committing such acts, or permit their offices to be so used, are in violation of this Section. §2913.01(K) defines "theft."

Ohio Rev. Code §**2921.421** - Assistants and employees of prosecutors, law directors, and solicitors. This section provides procedures for employing persons associated in the private practice of law in these offices.

Ohio Rev. Code §**3329.10** - Purchases of school textbooks and supplies:

Superintendents, principals, teachers, and supervisors are prohibited from acting as sales agents for textbook companies including companies offering electronic textbooks. These school officials are also prohibited from representing companies selling school apparatus or equipment. (Not applicable to community schools.)

Ohio Rev. Code §**117.103 (B) (1)** – [Effective 5/4/2012] A public office shall provide information about the Ohio fraud-reporting system and the means of reporting fraud to each new employee upon employment with the public office. Each new employee shall confirm receipt of this information within thirty days after beginning employment. The auditor of state shall provide a model form on the auditor of state's web site (<https://ohioauditor.gov/fraud/FraudReportingSystemModelForm.pdf>) to be printed and used by new public employees to sign and verify their receipt of information as required by this section. The auditor of state shall confirm, when conducting an audit under section 117.11 of the Revised Code, that new employees have been provided information as required by this division.

1979 Op. Atty. Gen. No. 1979-111 - Incompatibility of public offices: A public officer or employee may be prohibited from holding another public position.

Note: You may find evidence of possible violations of Ohio Rev. Code § 102.03, 2921.41, 2921.42, and 2921.421 from various audit tests. These sections are criminal violations. Auditor of State staff should consult with the State Auditor's Legal Division whenever you suspect possible violations of these sections. Independent public accountants should consult with their own legal counsel.

### **Suggested Audit Procedures - Compliance (Substantive) Tests:**

1. Determine how the entity identifies possible interests on the part of officials and employees in matters coming before them for official action. For example, are officials and employees required to report the outside businesses and organizations they work for to the entity?

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<sup>48</sup> It is permissible for a public official to have an interest in a public contract if (1) the contract covers necessary services or supplies for the official's public office, (2) the services or supplies cannot be obtained elsewhere for the same or lower cost or are being furnished to the public office as part of an ongoing relationship that started prior to the official's involvement with the office, (3) the treatment given to the public office is either preferential to or the same as the treatment given to other clients, and (4) the public office is aware of the official's interest in the contract and the official does not participate in any deliberations regarding the contract [Ohio Rev. Code §2921.42(C)].

2. Inquire if any correspondence was received from the Ohio Ethics Commission regarding ethical violations.<sup>49</sup> If so, read correspondence regarding ethical violations and document the impact of any violations on the audit.
3. Inquire if any conflicts of interest or unethical transactions occurred during this year.
4. Inquire if the entity is aware of any other illegal acts or frauds. (AU-C 240 requires this step. If you already documented this in the FRAQ, you need not repeat this step here.)
5. If the school district purchased textbooks (including electronic textbooks) or school apparatus or equipment during this year, determine how the school assured that no one on the purchasing committee (superintendents, principals, teachers, and supervisors) acted as sales agents for those companies.
6. Determine if the entity notified employees about the new fraud reporting system. Inquire regarding the entity’s process for obtaining and maintaining confirmations from new hires signing off that they have received notification about the fraud reporting system.
7. Select a small number of newly hired employees (hired after 5/4/2012) and review the employees’ confirmations that they have been notified about the fraud reporting system.

**Conclusion: (effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):**

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<sup>49</sup> Auditors and IPAs should not contact the Ethics Commission. If evidence comes to your attention concerning possible ethics violations, IPAs and AOS staff should follow this guidance from the *Ohio Compliance Supplement Implementation Guide*:

Ethics Commission Referrals

All potential “consequential” ethics law violations are to be submitted to the Auditor of State Legal Division. After review, the Auditor of State Legal Division will make appropriate referrals. The Audit Division should consult with the Legal Division in determining how or if to report this matter. IPA’s should consult with the Center for Audit Excellence.

<p><b>Revised: HB 487, 130<sup>th</sup> GA</b> <b>Effective: 9/17/14</b></p>
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**2-2223 Compliance Requirement:** Ohio Rev. Code §149.43 - Availability of public records<sup>50</sup> [Each type of governmental entity has its own records commission as established in Ohio Rev. Code §149.38 - counties, §149.39 - municipalities, §149.41 – school districts and educational service centers<sup>51</sup>, §149.411 - libraries, §149.412 – special taxing districts, & §149.42 – townships.]

**Summary of Requirement:** Ohio Rev. Code §149.011(G) defines a “record” for the public records law, as any document, device, or item, regardless of physical form or characteristic, created, received by, or coming under the jurisdiction of any public office which document the organization, functions, policies, decisions, procedures, operations, or other activities of the public office.

Ohio Rev. Code §149.43(A)(1) defines “public record” as any record that is kept by any public office, including, but not limited to, state, county, city, village, township, and school district units (including community schools). Exceptions are numerous and highly fact-specific. Questions should be referred to AOS Legal for review. Some examples include, but are not limited to, medical records, records pertaining to adoption, probation, and parole proceedings, trial preparation records, usage information (including names and addresses of specific residential and commercial customers of a municipally owned or operated utility), confidential law enforcement investigatory records, records pertaining to abortions by minors (Ohio Rev. Code §2151.85), “security”<sup>52</sup> or “infrastructure”<sup>53</sup> records defined under Ohio Rev. Code §149.43, and records the release of which is prohibited by state or federal law.

All public records shall be promptly prepared and made available to any member of the general public at all reasonable times during regular business hours for inspection. Upon request, a person responsible for public records shall \*make copies available at cost, within a reasonable period of time. In order to facilitate broader access to public records, public offices shall maintain<sup>54</sup> public records in such a manner that they can be made available for inspection. [Ohio Rev. Code §9.01]

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<sup>50</sup> Ohio Rev. Code § 3314.03(A)(11)(d) requires that each contract entered into between a sponsor and the governing authority of a community school shall specify that the school will comply with Ohio Rev. Code § 149.43. Therefore, AOS interprets the requirements of Ohio Rev. Code § 149.43 described in this OCS step to be applicable to community schools.

<sup>51</sup> This statute applies to each city, local, joint vocational, and exempted village school district as well as each educational service center. However, this statute does not apply to community schools. Community schools do not have a statutory records commission.

<sup>52</sup> “Security” record is defined as any record that contains information directly used for protecting or maintaining the security of a public office against attack, interference or sabotage; or any records assembled, prepared or maintained by a public office or public body to prevent, mitigate or respond to “acts of terrorism” or emergency management plan. [Ohio Rev. Code §149.433(A)(3)]

<sup>53</sup> “Infrastructure” record is defined as any record that discloses the configuration of a public office’s critical systems (e.g., communication, computer, electrical, mechanical, ventilation, water, plumbing, etc.) of the building in which the public office is located. Simple floor plans are not included in this definition. [Ohio Rev. Code §149.433(A)(2)]

<sup>54</sup> Maintaining official records includes recording or copying to reduce storage space by any means which correctly and accurately reproduces, or provides a medium of copying, or reproducing, the original record [Ohio Rev. Code §9.01]. Therefore, scanned documents are considered properly maintained as long as they can be accurately reproduced.

***Public Records Policies and Posters***

Pursuant to Ohio Rev. Code §149.43(E), the Ohio Attorney General shall develop and provide to all public offices a model public records policy for responding to public records requests in compliance with Ohio Rev. Code §149.43 in order to provide guidance to public offices in developing their own public record policies for responding to public records requests in compliance with that section. This model policy is available at:

<http://www.ohioattorneygeneral.gov/files/Publications/Publications-for-Legal/Sunshine-Laws/Model-Public-Records-Policy.aspx>

Pursuant to Ohio Rev. Code § 149.43(B)(2), the entity shall have available a copy of its current records retention schedule at a location readily available to the public. The auditor of state, in the course of an annual or biennial audit of a public office pursuant to Ohio Rev. Code Chapter 117 shall audit the public office for compliance with this section and divisions (E) of Ohio Rev. Code §149.43 [Ohio Rev. Code §109.43(G)] The Auditor of State must ensure compliance with public records policy provisions.

Every public office must have a policy in place for compliance with Public Records Laws. There are three specific items that public offices cannot have in their public records policies. The policy cannot: (1) limit the number of public records it will make available to a single person; (2) limit the number of public records it will make available during a fixed period of time; or (3) establish a fixed period of time before it will respond to a request for inspection/copying of public records unless that period is less than eight hours. However, pursuant to Ohio Rev. Code § 149(B)(7), the policy may limit the number of responses delivered by U.S. Mail to ten per month unless the person certifies to the office in writing that the person does not intend to use or forward the requested records, or the information contained in them, for commercial purposes. For purposes of this division, “commercial” shall be narrowly construed and does not include reporting or gathering news, reporting or gathering information to assist citizen oversight or understanding of the operation or activities of government, or nonprofit educational research. All public offices are required to distribute their Public Records Policy to the employee who is the records custodian/manager of otherwise has custody of the records of that office. Per Bulletin 2007-014, AOS will require written evidence that the records custodian/manager acknowledged receipt of a copy of the policy.

By September 29, 2007, all public offices were required to create a poster describing its public records policy. In addition, the public office is required to post the poster in a conspicuous place in the public office and in all locations where the public office has branch offices. Finally, if the public office has an employee policies and procedures manual or handbook, it is required that the public records policy be included in such manual or handbook. [Ohio Rev. Code §149.43(E)(2)] The AOS will require that: (1) the public office created a poster to describe its Public Records Policy; (2) the poster containing the policy has been posted in required locations; and (3) the policy has been included in the employee manual/handbook.

***Destruction of Public Records***

Any application or schedule for the destruction of records must be sent to the Ohio Historical Society for review to determine whether any of the records are of historical value [Ohio Rev. Code §149.39] Once reviewed by the Ohio Historical Society, the applications are then forwarded to the Ohio Auditor of State’s Office, General Services Department for final approval. [The following governments have separate records commission requirements: Ohio Rev. Code §149.38 - counties, §149.39 - municipalities,

§149.41 – school districts and educational service centers<sup>55</sup>, §149.411 - libraries, §149.412 – special taxing districts, & §149.42 – townships.]

### **Public Records Training**

All state and local elected officials<sup>56</sup>, or their designees<sup>57</sup>, must attend at least 3 hours of training on Ohio's Public Records Laws during each term of office. [Ohio Rev. Code §109.43(B) & §149.43(E)(1)] The training received must be certified by the Ohio Attorney General. Proof that training has been completed must include documentation that either the Attorney General's Office or another entity certified by the Attorney General provided the training to the elected official, or his/her designee. Attendees who successfully complete the training will receive a certificate to serve as proof of training.

Refer to AOS Bulletins 2007-014 and 2011-006 for additional information pertaining to Ohio Public Records Law.

### **Sample Questions and Procedures:**

Unless the prior audit detected noncompliance:

- You can limit steps 1-6 to years in which the auditee adopted or changed its policy.
- Step 7 must be performed every year.
- You can limit steps 8 and 9 to each term of office. The working papers should document whether we tested this in the prior audit.

Ascertain if responsible personnel are aware of the above requirements and have implemented local policies and procedures regarding:

1. What records are made available.
2. Times when records may be reviewed.
3. Costs for copies to be made.
4. Obtain the entity's Public Records Policy and scan it to be sure that the policy does not limit the number of responses that will be made to a particular person, or limit the number of responses during a specified period of time, or establish a fixed period of time before it will respond unless that period is less than eight hours.
5. Ascertain whether the entity's policy for records retention (note: this is not the same policy as the public records policy) includes provisions for the application or schedule for destruction of public records, including transmission to the Ohio Historical Society and approval by the Auditor of State's Office.

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<sup>55</sup> This statute applies to each city, local, joint vocational, and exempted village school district as well as each educational service center. However, this statute does not apply to community schools. Community schools do not have a statutory records commission.

<sup>56</sup> Includes officials elected to local or statewide office, but does not include: justices of the Supreme Court, court of appeals, common pleas, municipal court, county court, or a clerk of any of those courts.

<sup>57</sup> Designees must be employees in the public office and there must be evidence of the designation. If there is more than one elected official in the public office, the designee should be the designee for all of the elected officials within the office.

6. Ascertain whether the entity has a records retention policy readily available to the public.
7. Ascertain whether the entity’s policy was included in policy manuals, and displayed conspicuously in all branches of the public office. As part of this process, determine whether written evidence exists that the Public Records Policy was provided to the records custodian/manager.
8. Determine whether each elected official, or his/her designee, has successfully attended a certified three-hour Public Records Training for each term of office. Obtain copies of their certificates of completion and place them in the permanent file for future reference. For county auditors, confirmation can be obtained by reviewing the County Auditor Continuing Education Status Report available under IPA resources located at: <https://ohioauditor.gov/references/confirmations/hours.html>.
9. If a designee attended the course, determine whether the designee was an employee of the public office and obtained evidence of the designation.

**Conclusion: (effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):**

### SCHOOL AND/OR COMMUNITY SCHOOL

**2-2324 Compliance Requirement:** Ohio Rev. Code §3313.666(A), (B), and (C) and §3314.03(A)(11)(d) Anti-Bullying Provisions

**Summary of Requirements:**

The board of education of each city, local, exempted village, and joint vocational school district and the governing authority of each community (charter) school must adopt an anti-bullying policy in consultation with parents, school employees, school volunteers, students, and community members.

The policy must prohibit the harassment, intimidation, or bullying of any student on school property, on a school bus, or at a school-sponsored activity. It also must define the term "harassment, intimidation, or bullying" in a manner that includes the definition prescribed in Ohio Rev. Code §3313.666(A)(1)-(2). The act defines that term as "an intentional written, verbal, electronic or physical act that a student has exhibited toward another student more than once and the behavior both (1) causes mental or physical harm to the other student, (2) is sufficiently severe, persistent, or pervasive that it creates an intimidating, threatening, or abusive educational environment for the other student and (3) violence within a dating relationship."

Each policy also must include the following additional items (Ohio Rev. Code §3313.666(A), (B), and (C) and §3314.03(A)(11)(d)):

- A procedure for reporting prohibited incidents;
- A requirement that school personnel report prohibited incidents of which they are aware to the school principal or other administrator designated by the principal;
- A requirement that the parents or guardians of a student involved in a prohibited incident be notified and, to the extent permitted by state and federal law governing student privacy, have access to any written reports pertaining to the prohibited incident;
- Procedures for documenting, investigating, and responding to a reported incident;
- A requirement that the district or community school administration provide semiannual written summaries of all reported incidents to the president of the district board of education or community school governing authority, and post them on the district's or school's website (if applicable);
- A strategy for protecting a victim from additional harassment and from retaliation following a report; and
- The disciplinary procedure for a student who is guilty of harassment, intimidation, or bullying.

These items form a framework for districts and community schools to use in developing their policies. The policy must be included in student handbooks and in publications that set forth the standards of conduct for schools and students. Employee training materials must also include information on the policy.

***Auditor of State identification of harassment policy***

***Beginning in fiscal year 2009***, the act **requires** the Auditor of State (or contracting IPAs), when auditing a school district or community school, to identify whether the district or school has adopted an anti-harassment policy. This determination must be recorded in the audit report. The Auditor of State may not prescribe the content or operation of the policy. (Ohio Rev. Code §17.53)

**Suggested Audit Procedures - Compliance (Substantive) Tests:**

Inspect the anti-bullying policy the school adopted pursuant to Ohio Rev. Code §3313.666(A), (B), and

(C) (for school districts) or §3314.03(A)(11)(d) (community schools). To comply with this reporting obligation, the Auditor of State and contracting independent accountants must include an additional agreed-upon procedures report describing the procedures applied and the results, for audits of fiscal year ended June 30, 2009 and in subsequent audits until full compliance is obtained<sup>58</sup> This report should appear immediately after the schedule of findings or schedule of prior year audit findings, if applicable. The table of contents should separately list this report. (Because this report is a statutory requirement, we believe it is inappropriate to include it with a management letter.)

Bulletin 2009-010, *School Anti-harassment Policy*, describes the reporting process AOS and IPA’s should use to satisfy these requirements.

(Note: This procedure need not be repeated for future audits once we determine the school has fully complied with this requirement. However, “Full compliance” includes both compliance with the original anti-bullying laws as described in AOS Bulletin 2009-010 and the revision to Ohio Rev. Code §3313.666(A) which requires the addition of violence in a dating relationship, harassment on a school bus, and by electronic means to school district anti-bullying policies. Therefore, fiscal year 2012, (and later year(s) if a district has not fully complied for FYE 2012), school district audits will need to include an Agreed-Upon Procedures report describing the school district’s compliance with the “violence in dating”, school bus, and electronic means revisions until full compliance is achieved.)

<b>Conclusion: (effects on the audit opinions and/or footnote disclosures, significant deficiencies/material weaknesses, and management letter comments):</b>
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<sup>58</sup> “Full compliance” includes both compliance with the original anti-bullying laws as described in AOS Bulletin 2009-010 and all revisions to Ohio Rev. Code §3313.666(A).