



# Dave Yost • Auditor of State

## OHIO COMPLIANCE SUPPLEMENT

### Preface

This is the latest revision to the Ohio Compliance Supplement, superseding the September 2010 version. This revision incorporates significant new or revised legal and regulatory requirements as well as comments we have received from auditors and our clients. The following page, titled Implementation Instructions, explains how you can identify updates.

In accordance with *Government Auditing Standards*, financial statement audits include reporting on compliance with provisions of laws, regulations, contracts, and grant agreements that have a material effect on the financial statements (*Government Auditing Standards*, 2.07).

Management of the audited entity is responsible for . . . complying with applicable laws and regulations (including identifying the requirements with which the entity and the official are responsible for compliance). (*Government Auditing Standards* Appendix I, A1.08(b)).

Ohio law requires audits of each public office. These audits help determine whether the government's financial statements are fairly presented and whether management has complied with significant laws and regulations.

The Ohio Compliance Supplement contains certain laws and regulations which are of considerable public interest, or are of the type auditors generally consider direct and material. Though the Ohio Compliance Supplement is not a comprehensive listing of applicable laws and regulations, it is designed to help auditors and public offices identify and familiarize themselves with certain laws and regulations which generally apply to a variety of local governments and colleges and universities.

In order to reduce costs, the Ohio Compliance Supplement is available only in electronic format via the Auditor of State's website at [www.auditor.state.oh.us](http://www.auditor.state.oh.us). However, if you are unable to access the website or have difficulty accessing these files, please contact the Center for Audit Excellence at 1-800-282-0370.

As in the past, we plan to regularly update the Ohio Compliance Supplement. Comments we receive from our staff and others are an important source of revisions and improvements. We appreciate your input as we continue to improve the Ohio Compliance Supplement.

**Dave Yost**  
Auditor of State

June 2012

## Implementation Instructions

This **September 2012 Ohio Compliance Supplement** (OCS) replaces the September 2010 version. The OCS is available at [www.ohioauditor.gov](http://www.ohioauditor.gov), under *Publications*, in both Word and Portable Document Format. (Auditor of State staff can also use the 2012 OCS procedures built into TeamMate.) Due to the wide availability of internet access, we no longer provide the OCS in paper or disc formats.

The seven chapters and appendices D, G, and H are available in MS Word format so auditors can document work or cross reference to other audit documentation in those seven documents. The Introduction and other appendices are only available in Portable Document Format, since we do not expect that auditors would document their work in these sections.

The Table of Contents follows these Implementation Instructions. A table for each chapter is also located in the front of each chapter. The table of contents identifies legislative requirements. The table identifies new or revised requirements via shading. The table also identifies superseded legal requirements using strikeout font. We have not deleted these sections since they may still apply to portions of incomplete audits. For example, Step 2-13 testing was removed and it appears in the table of contents as follows:

~~2-13 ORC 3318: School Building Assistance Limited Fund for the Big 8 school districts~~

In addition, we have included a box at the top left hand corner within each modified step indicating if the section is a revised or new legislative requirement. In both cases, the effective date also appears to enable you to easily determine if the revision applies to the audit period. Below is an example appearing in the OCS:

**Revised: HB 153, 129<sup>th</sup> GA**  
**Effective: 9/29/11**

In addition to the box described above, the OCS uses double underlining to indicate new or revised legislative requirements.

The OCS uses waved underlining to highlight:

- Pre-existing laws we have now determined auditors should test (i.e. requirements not appearing in former OCS editions).
- New or amended guidance. Most of these changes represent information we believe will enhance understanding compliance auditing or reporting.

The OCS uses strike out font to indicate replaced or omitted legislative requirements. We have not deleted these sections since they may still apply to part of an audit period. Also, retaining this information will help users better understand the changes.

**Auditors with engagements in process prior to the issuance of the 2012 Supplement need not discard work performed using the 2010 OCS. However, they must compare the 2012 changes to their work from the 2010 OCS and assure they have tested the legal provisions applicable to their audit period. More than one legal requirement could apply if a legislative change was effective during the audit period.**

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## LEGAL COMPLIANCE AUDITING IN OHIO

### Introduction

Citizens and public officials want and need to know whether governments are handling their funds properly and complying with laws and regulations. Public officials entrusted with public resources are responsible for complying with those laws and regulations.

Ohio Administrative Code Section 117-2-05(A) requires independent auditors of Ohio public to follow the Comptroller General of the United States' generally accepted *Government Auditing Standards* (GAGAS).

~~Under both the AICPA standards and GAGAS, auditors should design the audit to provide reasonable assurance of detecting material misstatements resulting from illegal acts<sup>1</sup> that could have a direct and material effect on the financial statements. If specific information comes to the auditors' attention that provides evidence concerning the existence of possible illegal acts that could have a material indirect effect on the financial statements, the auditors should apply audit procedures specifically directed to ascertaining whether an illegal act has occurred. When an illegal act has or is likely to have occurred, auditors should determine the effect on the financial statements as well as the implications for other aspects of the audit."~~

2011 GAGAS 4.06 requires auditors to follow the AICPA's standards regarding fraud and noncompliance with laws and regulations. 4.06 extends the AICPA's requirements to apply to contracts and grant agreements.

This *Supplement* provides auditors with Ohio laws and regulations (and some laws and regulations from other sources) the Auditor of State has identified as potentially significant in an Ohio government audit. As such, it is designed to help auditors fulfill their responsibility. However, auditors should not consider this as a comprehensive list of compliance requirements for all governments.

The *Ohio Compliance Supplement*'s first six chapters include laws and regulations the AOS normally considers "direct and material." However, ***it is the auditor's responsibility to determine which, if any, compliance requirements are material to the government.***<sup>2</sup>

<sup>1</sup> A footnote to GAGAS 4.28 states, "Illegal acts are violations of laws or government regulations that have a direct and material effect on the determination of financial statement amounts. For example, applicable laws and regulations may affect the amount of revenue accrued under government contracts. However, the auditor considers such laws or regulations from the perspective of their known relation to audit objectives derived from financial statement assertions rather than from the perspective of legality per se."

<sup>2</sup> Some Ohio Administrative Code Sections, such as OAC 117-2-02, include requirements for governments to establish internal controls and report financial information properly. However, we would not automatically deem a few accounting errors as reportable noncompliance under these OAC Sections. While these items may represent a significant deficiency, they may not rise to the level of material noncompliance. Conversely for example, the lack of a cash journal might be noncompliance with OAC 117-2-02(D)(1) as well as a control deficiency. This is a matter of professional auditor's judgment. We should consider the pervasiveness of the noncompliance matter in relation

In addition to the laws and regulations the OCS includes, auditors must also consider other laws and regulations applicable to the government, such as charters, ordinances, resolutions, contracts, grant agreements, debt covenants and leases. If any of these requirements could directly and materially affect the determination of financial statement amounts, the auditor should design tests for them. Regarding laws and regulations this *Supplement* does not include, auditing standards recognize management's year-round involvement with operations should provide them with knowledge of these requirements. It is therefore reasonable to expect *management* to identify and convey these requirements to their auditor. The AICPA's Audit and Accounting Guide, *State and Local Governments*, 4.82 states:

“An entity's *management* is responsible for ensuring compliance with the laws, regulations, and provisions of grants and contracts applicable to its activities. That **responsibility encompasses identifying applicable compliance requirements** and establishing internal control designed to provide reasonable assurance that the entity complies with them.”<sup>3</sup>

To the extent that a public office does not fall within the classes of public offices the *Ohio Compliance Supplement* includes, and also in part to (1) corroborate the completeness of the compliance requirements management identifies, and (2) to identify their potential material effect, 4.86 of the AICPA's *State and Local Governments* Guide suggests:

The auditor may consider performing the following procedures to assess management's identification of compliance requirements that could have a direct and material effect on the determination of financial statement amounts:

- Consider knowledge about compliance requirements obtained during prior-period audits.
- Interview the entity's chief financial officer, legal counsel, or grant administrators about compliance requirements.
- Identify sources of revenue, review any related agreements (for example, loan, grant, and contribution agreements), and ask about legal provisions that relate to using and accounting for the revenue.
- Obtain and review federal and state publications pertaining to compliance requirements, such as Department of the Treasury and Internal Revenue Service regulations (concerning the calculation and reporting of arbitrage rebates and refunds and employment taxes) and OMB's cost principles and administrative requirements circulars and *OMB Circular A-133 Compliance Supplement*, the *Catalog of Federal Domestic Assistance*,<sup>4</sup> and similar state program publications (concerning grants and appropriations).
- Obtain and review sections of the state constitution, statutes, and regulations that pertain to the entity, in particular the sections that concern financial reporting, investment, debt, taxation, budget, appropriation, and procurement matters.

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to the compliance requirement and the effect or potential effect on financial statements and financial reporting process as a whole.

<sup>3</sup> 2011 Government Auditing Standards Appendix I, A1.08(b) has a similar requirement.

<sup>4</sup> Auditors can also use the Federal Award Compliance Control Records (FACCR's) included on the AOS website as a reference.

- Review the minutes of meetings of the entity's governing board for the enactment of relevant laws and regulations and information about relevant contracts and grant agreements.
- Ask federal, state, or local auditors or other appropriate audit oversight organizations about applicable compliance requirements, including statutes and uniform reporting requirements.
- Ask the audit, finance, or program administrators of other entities from which the entity receives grants, contributions, and appropriations about the restrictions, limitations, terms, and conditions under which the amounts were provided.
- Review the discussions of compliance requirements applicable to specific industries, as found in this guide and other relevant AICPA Audit and Accounting Guides.
- Review accounting and auditing materials available from other professional organizations, such as state societies of certified public accountants and governmental associations.
- Obtain written management representation regarding the completeness of management's identification of compliance requirements.

The procedures listed in the “direct and material” chapters of the *Supplement* generally: assess the compliance control environment, document applicable compliance controls, test and evaluate the controls (if applicable), and substantively test compliance.

The auditor should apply the above for “direct and material” laws, regulations, and provisions of contracts or grant agreements, etc. annually for the assertions relevant to these compliance requirements. The auditor should, at a minimum, document controls and determine whether they have been implemented (placed in operation). If controls are not likely to be effective, or if the auditor deems it more efficient not to test controls’ operating effectiveness, then the auditor should document those considerations and apply more extensive substantive compliance tests.

If a compliance requirement listed in Chapters One through Six applies but the auditor deems it not direct and material to the entity, then the auditor generally should use the less-extensive documentation and testing procedures Chapter Seven describes. Similarly, if the auditor deems an item in Chapter Seven to be direct and material to the entity, she or he generally should use the more extensive procedures similar to those Chapters One through Six describe. For direct and material compliance requirements not included in the *Supplement* at all (for example, municipal income tax provisions), then the auditor should document and test it similar to procedures found in Chapters One through Six.

Appendix F lists the applicability of certain requirements included in the *Ohio Compliance Supplement* to certain additional classes of public offices.

## Direct and Material Laws and Regulations

The AICPA Audit and Accounting Guide *State and Local Governments*, sections 4.82 through 4.87, discusses legal requirements which might directly and materially affect determining financial statement amounts for a governmental entity. These include:

- *GAAP Requirements.* Governments often are subject to legal or contractual provisions that require them to prepare their financial statements in conformity with GAAP.
- *Federal and State Taxes.* Governments are subject to various federal tax requirements, including those relating to employment taxes, employee benefits, and tax-exempt debt (such as arbitrage rebate requirements). State-level tax requirements also may apply.
- *Legal Authority for Transactions.* Governments often should have legal authority to execute transactions. That is, governments, especially local governments, often cannot exercise powers or conduct activities unless authorized by law. For example, a local government may not be able to levy property taxes unless specifically authorized to do so under state law and taxes levied without proper authority may be subject to refund.
- *Establishment of Funds.* Legal and contractual provisions may require governments to establish individual funds to account for and report on particular activities. (For example, Ohio Rev. Code Section 5705.09 establishes the basic funds required for political subdivisions in the State of Ohio, and Ohio Rev. Code Section 5705.10 establishes basic legal requirements for allocating receipts to funds. Failure to comply with these statutory requirements may materially affect financial statement presentation.)
- *Time and Other Eligibility Requirements and Purpose Restrictions on Nonexchange Transactions.* Time and other eligibility requirements and purpose restrictions affect the recognition and reporting of nonexchange transactions. A government's failure to comply with a provider's eligibility requirements and purpose restrictions may cause the provider to withdraw the intended support or request a refund of amounts previously paid. For example, certain costs are not allowable costs for federal programs under OMB Circular No. A-87<sup>5</sup>, *Cost Principles for State and Local Governments*, but they may have been inappropriately charged to those programs. Similarly, legal provisions may restrict a government's use of its tax revenues (such as a constitutional requirement that the proceeds of a state gasoline tax be expended only for the maintenance of highways).
- *Other Legal- and Contract-Based Compliance Requirements.* Besides the eligibility requirements and purpose restrictions that affect the recognition and reporting of nonexchange transactions, providers of such resources may impose other compliance requirements on recipients. For example, federal financial assistance programs often require recipients to adhere to specific procurement and cash management policies. There also may be contractual compliance requirements relating to exchange transactions, such as those discussed below for debt issuances.

<sup>5</sup> The Federal government codified OMB Circular A-87 as 2 CFR Subtitle A, Chapter II Part 225.

- *Budgets.* Budgets often establish the particular funds that can finance particular costs and the nature and amount of interfund activity.
- *Tax and Debt Limitations.* Governments often are subject to legal provisions that limit taxing authority, impose ceilings and other issuance requirements on debt, or limit the use of debt proceeds to particular purposes. For example, state law may impose a millage cap on property taxes or require tax refunds if an entity's annual revenue growth exceeds a set percentage or amount. Also, debt often is issued subject to contractual provisions that require certain reserve fund and revenue coverage amounts.
- *Cash and Investments.* Governments often have legally-limited choices for depositing and investing available cash resources. For example, investments in derivative instruments, hedge funds, and debt instruments with long maturities might be prohibited.
- *Expenditure and Contracting Limitations.* Governments might be prohibited from purchasing certain products or services without open competitive bidding or following other purchasing procedures established by laws and regulations.

SLG 4.87 and GASB Cod. 2300.106(h) requires **financial statement note disclosure** of significant violations of “finance-related legal or contractual provisions” **and actions taken to address such violations.** The GASB Codification does not define “finance-related legal or contractual provisions.” However, the sources below identify the following requirements as being finance-related legal or contractual provisions:

a. The accounting system must include all funds required by law or regulation to help assure restrictions on expenditures are met.	NCGA 1, par. 8 Cod. 1200.106
b. 1. Any excesses of expenditures over appropriations in the general or major special revenue funds included in RSI budgetary schedules. (Disclose in footnotes to RSI if presented as RSI.)  2. Disclose significant excesses of expenditure over appropriations for other funds.	GASB 37, par. 19, <del>Cod 2200.180</del>  GASB Comprehensive Implementation Guide 7.93.1
c. Violations of debt covenants or contracts.	Cod 2300.903, Illustrations 4, 5, 6
d. Significant violations during the period of legal or contractual provisions for deposits and investments	GASB Cod. I 50.125
e. <i>Governmental Accounting, Auditing and Financial Reporting</i> (GAAFR) suggests the following constitute “finance-related legal and contractual requirements.” a. Budgetary b. Grant requirements c. Bond covenants d. Deposits and investments	GAAFR 224

## Immaterial Laws and Regulations

The Auditor of State has audited public offices’ compliance with legal requirements since 1902. Audits of Ohio public offices have been subject to Ohio Rev. Code Chapter 117, or its predecessor, since that time. Section 117.11 (A) states in part that when auditing Ohio public offices:

... [i]nquiry shall . . . be made into . . . whether the laws, ordinances, and orders pertaining to the office have been observed, and whether the requirements and rules of the auditor of state have been complied with.

Although a literal interpretation of Ohio Rev. Code Section 117.11 (A) would require testing *all* applicable legal requirements during an audit, the Auditor of State has determined that it is appropriate to limit the compliance requirements included in an audit of a given public office to:

- Compliance requirements for which noncompliance may materially affect the financial statements of the entity (i.e. the *GAGAS* requirement); and
- Compliance requirements which, although possibly not material to the financial statements, the Auditor of State deems to be of significant public concern regarding public policy, public stewardship, or public accountability. Chapter Seven generally includes these requirements.

Since Chapter Seven contains laws and regulations that are probably not, in most circumstances, “direct and material,” the auditor should inquire of management and perform certain other limited substantive tests. If existing controls or substantive compliance tests already satisfy these objectives, the auditor should cross-reference such work to these sections.

The beginning of Chapter Seven includes more guidance and an example of appropriate testing related to Chapter Seven.

## Compliance Risk and Controls

Generally accepted auditing standards indicate that the auditor is responsible for planning and auditing to reasonably assure whether the financial statements are free of material misstatement, whether caused by error or fraud. For direct and material *illegal acts*, the auditor’s detection responsibility for these misstatements is the same as that for errors.

Taking a control’s reliance approach to a compliance audit of Ohio laws and regulations involves documenting each of the five components of internal controls -- the control environment, risk assessment, control activities, information and communication, and monitoring -- that the auditor considers relevant to preventing or detecting noncompliance with such laws and regulations, and assessing control risk that noncompliance could occur and not be detected timely.

Factors to consider in relying on compliance controls are similar to the judgments we use for financial statement accounts. **For example**, a compliance controls approach is often more efficient and effective if the volume of transactions subject to the compliance requirement is large or the compliance requirement is complex. Conversely:

- Relying on investment purchasing controls is normally inefficient for small entities with few investment purchases / sales during the year
  - They might not need / have formal controls anyway – the CFO’s use of an up-to-date ORC 135.13-14 listing of allowable investments may be sufficient *basis* for a “control” for small entities.
- Relying on controls over the legality of interfund transfers may be inappropriate because the complexity of the transfer requirements is not easily subject to a “routine” set of controls.

- That is, even if the entity has controls to help assure interfund transfers are legal, the complexity of the statutes likely still requires auditors to “re-perform” the control, which is really a substantive test / evaluation of the transfer’s legality.

In assessing the compliance control environment, the auditor might consider:

- Management's attitudes toward compliance with laws and regulations;
- Legal actions brought against the government, and/or its elected and appointed officials;
- Involvement of the governing authority and management in the control structure to assure compliance.

Appendix D to the Ohio compliance Supplement lists control environment areas for assessment and related points of focus. Auditors should complete the Supplement as part of each audit. (AOS staff should document these control environment factors in the AOS' ACE.)

Note: We intend the following as general guidance / suggestions for auditors when considering and documenting the five internal control components; while you must document each internal control component, we do not intend that auditors must address each of the matters below in every audit. For example, the list of risks are useful examples auditors should address if they become aware of them. However, we do not expect auditors to design steps to obtain evidence to support the existence or nonexistence of each of these risks for every audit.

In addition to a suitable control environment, an effective internal control structure should also monitor compliance and determine whether controls related to compliance are operating effectively. Therefore, the control structure should also include *a monitoring system, and the auditor should consider whether responsibility for compliance is assigned to appropriate individual(s). For example, auditors should consider (given the size and complexity of the government's operations) whether responsibility is assigned for the following compliance issues:*

- Bond (i.e. debt) compliance
- Budgetary compliance
- Contract compliance
- Grant compliance (including those over federal awards subject to OMB Circular A-133)
- Procurement compliance
- Investment purchases
- Tax reporting (i.e., state & federal requirements)
- Legal authority for transactions
- Taxing and debt limitations
- Establishing funds
- Restriction on disbursements
- Lease compliance

As part of this assessment, auditors should also consider and document the existence of the following risk factors related to internal control over compliance:

- Policies and procedures that are incomplete, inadequate, or outdated for the activities subject to a type of compliance requirement.
- A history of material noncompliance with a particular compliance requirement as evidenced by Schedules of Findings from previous audit reports.
- Changes in the nature or type activity subject to compliance requirements, or changes in the management personnel responsible for monitoring the compliance requirement, since the prior audit. For example, a Village that invested only in certificates of deposit and STAR Ohio in the prior audit that is also investing in government-backed securities or that had a new Village Fiscal Officer in place during the current audit period has a greater risk of noncompliance with investing requirements.
- Inadequate segregation of duties over a type of compliance requirement. For example, a school district with a separate EMIS Coordinator that tracks and enters average daily membership (ADM) information into the EMIS system is a stronger control than a school district where the Treasurer is solely responsible for tracking, entering, and monitoring EMIS data.
- Controls over complex compliance requirements. Depending upon the nature of the local government's activity, OCS Chapters 3, 5, and 6 contain some complex types of compliance requirements related to debt issuance, investments, and other specialized areas.
- IT controls relating to the activity subject to the type of compliance requirement. For example, courts with automated software vendors that update fine and fee schedules due to legislative changes in statutory amounts may be more likely to update fines/fees in a timely manner and therefore be more likely to charge the appropriate fines and fees than courts with manual systems.
  - Paragraph 4.30 in the AICPA's *Government Auditing Standards and Circular A-133 Audits* requires auditors to report noncompliance findings that also relate to control deficiencies in both (1) the internal control and (2) the compliance sections of the GAGAS report. Several Revised Code sections mandate governments to implement internal controls, such as budgeting (Chapter 5705), purchasing / contracting controls (see Ohio Compliance Supplement Chapter 2) and investing policies (Ohio Rev. Code 135.14). **However**, unless noncompliance with these mandated controls contributes to misstatements or potential misstatements, auditors should not report them under SAS 115. For additional guidance, see Section three in AOS Advisory Memo 2007-07 and also AOS Advisory Memo 2010-02.

The following are often at least significant deficiencies. However, as described immediately above, the deficiency must relate to financial misstatements before an auditor would report it under SAS 115:

- Lack of operating policies and procedures for the activities subject to a type of compliance requirement
  - i. However, the auditor should consider that some Ohio Rev. Code sections often are a *policy*, and the need for written *procedures* varies directly with the complexity of the law, the decentralization of agencies within the auditee subject to the law, and perhaps other factors.

- Ineffective oversight of a direct and material compliance requirement by management or those charged with governance. For example, the lack of adequate review of budget versus actual reports.
- Identification by the auditor of material noncompliance for the period under audit that was not initially identified by the entity's internal control.
- Identification of fraud of any magnitude on the part of senior management or those charged with governance. For purposes of evaluating and communicating deficiencies in internal control, the auditor should evaluate fraud of any magnitude—including fraud resulting in immaterial noncompliance—on the part of senior management or those charged with governance, of which he or she is aware.
- Failure by management or those charged with governance to assess the effect of material noncompliance, a significant deficiency, or material weakness related to a direct and material compliance requirement previously communicated to them and either correct it or conclude that it will not be corrected.
- An ineffective control environment. Control deficiencies in various other components of internal control could lead the auditor to conclude that a significant deficiency or material weakness exists in the control environment over compliance with direct and material compliance requirements.

If adequate control procedures exist to reduce the risk that direct and material noncompliance could occur and not be detected on a timely basis, the auditor may be able to test the operating effectiveness of those controls and **significantly reduce substantive testing** of those compliance items. However, auditing standards require some level of substantive evidence. To use a controls reliance approach (an assessment that control risk is less than maximum or low), the auditor must:

1. Identify controls relevant to preventing or detecting material or significant non-compliance with the identified laws and regulations;
2. Test controls to obtain sufficient evidence of the controls' operating effectiveness throughout the audit period;
3. Document the tests of controls.
4. The Auditor of State permits relying on evidence from prior audits' tests of compliance controls' operating effectiveness (i.e. "rotating controls") similar to the guidance in ~~AU-318.40 – 45 AU-C 330.14(b) and 330.A40 – 42~~. When controls are effective, this rotation can enhance efficiency. However, when using this approach, auditors must carefully consider the guidance in ~~AU-318.40 – 45 AU-C 330.14(b) and 330.A40 – 42~~. Since some level of substantive evidence is required, rotating control tests without any substantive tests is insufficient. However, auditors can assess risk of noncompliance and test accordingly. For example, if we recomputed interest allocation the year before and found no misstatement, we might limit current year testing to comparison of amounts per fund to the prior year amounts (*assuming there were no significant changes such as new funds that required an interest allocation*). Among other requirements, auditors should:

- a. Obtain evidence about changes to controls since the prior tests of operating effectiveness.
- b. Obtain evidence that controls were still implemented during the current audit period.
- c. Test operating effectiveness at least every third year (not every third two-year audit).

5. While the auditor's assessment of inherent and control risk *may* substantially reduce the required nature and / or extent of substantive compliance testing, *some* substantive evidence / testing is necessary for compliance requirements directly and materially affecting the determination of financial statement amounts (similar to AU 318.51 AU-C 330.18 and 330 A45 --- .50) such as those compliance requirements included in OCS Chapters 1 through 6.

## Organization of The Ohio Compliance Supplement

The *Ohio Compliance Supplement* includes, for each compliance requirement:

- A reference to the underlying legal authority, including statutory provisions, administrative rules, court decisions, and opinions of the Attorney General;
- A summary of the requirement; and
- For potentially **direct and material** laws and regulations, “points of (control) focus” and recommended audit procedures; or,
- For **other** laws and regulations, suggested questions for management.

In addition, for both types of law or regulation, there are sections provided to document persons interviewed, tests performed (including, if appropriate, cross-references to audit documentation supporting tests of controls and substantive tests of legal compliance) and conclusions and tentative recommendations.

While the auditor may exercise professional judgment in determining specific compliance requirements to test in a given audit, the AOS requires:

- Testing compliance requirements material to the financial statement in each audit (generally Chapters One through Six);
- Testing compliance requirements not material to the financial statements listed in *Ohio Compliance Supplement* Chapter Seven every other audit, as follows:
  - Auditors generally can limit testing these items to every other audit, such as once every two years if we audit the government annually, or once every four years if we audit the government biennially.

Auditors should divide the steps subject to cycling approximately in half, and budget a

similar amount for cyclic tests each audit to avoid audit cost fluctuations every other audit.

Auditors should test new (i.e., “double underlined” requirements) Chapter 7 requirements in the first audit to which they apply.

Although the *Ohio Compliance Supplement* sets forth recommended audit procedures for each compliance requirement, ***determining the specific audit procedures to be applied, both as to material and non-material compliance requirements, requires professional judgment.***

## Home Rule Powers

### ***Definition***

Villages and cities are municipal corporations. They are defined and regulated in Article XVIII of the Ohio Constitution and in Ohio Rev. Code Title 7.

### ***Classification***

Municipal corporations with a population of less than 5,000 are villages. The village may be incorporated by the procedures set forth in Ohio Rev. Code Chapter 707, requiring a petition to the county commissioners (Ohio Rev. Code §703.01 and Chapter 707).

### ***Plans of Government***

Article XVIII of the Ohio Constitution provides for the formation of municipal corporations. Section 3 confers upon the municipal corporations all powers of local self-government and Section 7 authorizes the municipal corporations to adopt charters setting up their own plans of government. Those ~~villages~~municipalities which do not have charters may adopt one of the plans of government set forth by the legislature in Ohio Rev. Code Chapter 705 or may operate under the general provisions of Ohio Rev. Code Title 7.

### ***Home Rule***

“Home Rule” is a term used to describe those powers granted to municipal corporations under Article XVIII, Section 3 of the Ohio Constitution, which provides, “municipalities shall have authority to exercise all powers of local self-government and to adopt and enforce within their limits such local police, sanitary, and other similar regulations as are not in conflict with general laws”. These powers were granted in an effort to provide more local control over certain governmental activities, but not to allow complete independence from State government. Because this grant of power is derived from the Ohio Constitution, it is superior to laws enacted by the legislature, except where a constitutional limitation is provided allowing the legislature to regulate municipalities.

### ***Charter vs. Non-Charter***

All municipal corporations have Home Rule powers, but the extent of these powers differ depending upon whether a charter has been adopted. By adopting a charter, the municipal corporation may set up a system of government which differs from the statutory plans. It may provide for the officers and procedures for all governmental functions. Non-charter municipal corporations must comply with all State laws concerning matters of procedural local self-

government. Matters of substantive local self-government are not controlled by State laws, regardless of whether or not the municipal corporation has adopted a charter.

### ***Local Self-Government Powers vs. Police Regulations***

As previously mentioned, charter governments are basically free from regulation by the legislature in matters of local self-government, but the exercise of police powers cannot conflict with general laws enacted by the legislature.

#### ***Local Self-Government Powers***

Procedural Local Self-Government Powers are powers which concern the organization of municipal government as well as the procedures under which the municipal corporation must function. Charter governments may deviate from State laws regulating matters of procedural local self-government only by adopting a charter. Examples of these powers are as follows:

1. Structure of government - This pertains to the officers and their functions. Without a charter, municipalities and villages must comply with State laws regulating them;
2. Competitive bidding requirements - State laws determine when competitive bidding is necessary and what procedures must be followed. Only charter governments may set up their own bidding requirements;
3. Initiative and referendum;
4. Appointment and duties of police officers;
5. Election procedures; and
6. Annexation proceedings.

#### ***Substantive Local Self-Government Powers***

Substantive Local Self-Government Powers are powers which concern the decision making authority of the municipal corporation as well as regulate the conduct of individuals within the municipal corporation. With a few constitutional exceptions, these powers cannot be superseded by State laws. Examples of these powers are as follows:

1. Power to contract - The State cannot, by law, restrict the government's general power to contract;
2. Taxation - There are explicit constitutional limitations provided in Article XVIII, Section 13 and Article XIII, Section 6 of the Ohio Constitution, as it is necessary to provide for coordination of State and local taxation. Otherwise, State laws cannot restrict the government's power to tax;
3. Assessments - This power is limited by Article XIII, Section 6 of the Ohio Constitution;
4. Incurring debt - Laws may be passed by the General Assembly limiting this power; (Article XVIII, Section 13 of the Ohio Constitution);
5. Power to purchase, appropriate, or dispose of property - The decision to purchase, appropriate, or dispose of property is a power of substantive local self-government. However, the procedures used to purchase, appropriate, or dispose of property are matters of procedural local self-government and are regulated by State laws, unless the municipal corporation has adopted a charter;
6. Compensation of employees and officers - This area is purely a matter of substantive local self-government. Statutes regulating many matters of compensation can be overridden by local ordinance;
7. Power to establish, locate, and vacate streets; and
8. Power to restrict the weight of vehicles using the charter government's streets.

***Police Regulations***

Police regulations are laws enacted to protect the health, safety, and welfare of persons and property. They are aimed at matters of private conduct rather than matters of government. Unlike matters of local self-government, police regulations can never conflict with general laws.

***Public Utilities***

The power to operate public utilities has a separate and distinct source from the general home rule powers of Article XVIII, Section 3. Article XVIII, Sections 4 and 5 of the Ohio Constitution state that municipal corporations may provide public utility service for their residents directly or by contracting with others within specified limits.

***Compliance Testing***

Auditors must consider whether municipal governments have home rule powers enacted under the statutes above. If so, auditors will need to tailor compliance testing accordingly to reflect the applicable home rules and powers afforded those governments. Auditors should review charter legislation, resolutions, and ordinances for charter municipal corporations and tailor their testing procedures accordingly.

## Reporting

~~2007 2011~~ *Government Auditing Standards (GAGAS)* describes the auditor's compliance reporting obligations:

**5.15** Under AICPA standards and GAGAS, auditors have responsibilities for detecting fraud and illegal acts that have a material effect on the financial statements and determining whether those charged with governance are adequately informed about fraud and illegal acts. GAGAS include additional reporting standards. When auditors conclude, based on sufficient, appropriate evidence, that any of the following either has occurred or is likely to have occurred, they should include in their audit report [i.e. GAGAS report on compliance] the relevant information about:

- a.** ~~fraud and illegal acts that have an effect on the financial statements that is more than inconsequential,~~
- b.** ~~violations of provisions of contracts or grant agreements that have a material effect on the determination of financial statement amounts or other financial data significant to the audit, and~~
- c.** ~~abuse that is material, either quantitatively or qualitatively. (See GAGAS paragraphs 4.12 and 4.13 for a discussion of abuse.)~~

**5.16** When auditors detect violations of provisions of contracts or grant agreements or abuse that has an effect on the financial statements that is less than material but more than inconsequential, they should communicate those findings in writing to officials of the audited entity. Determining whether and how to communicate to officials of the audited entity fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse that is inconsequential is a matter of professional judgment. Auditors should document such communications.

**4.25** When performing a GAGAS financial audit, and auditors conclude, based on sufficient, appropriate evidence, that any of the following either has occurred or is likely to have occurred, they should include in their report on internal control and compliance the relevant information about:

- a.** ~~fraud and noncompliance with provisions of laws or regulations that have a material effect on the financial statements or other financial data significant to the audit objectives and any other instances that warrant the attention of those charged with governance;~~
- b.** ~~noncompliance with provisions of contracts or grant agreements that has a material effect on the determination of financial statement amounts or other financial data significant to the audit objectives; or~~
- c.** ~~abuse that is material, either quantitatively or qualitatively.~~

**4.26** When auditors detect instances of noncompliance with provisions of contracts or grant agreements or abuse that have an effect on the financial statements or other financial data significant to the audit objectives that are less than material but warrant the attention of those charged with governance, they should communicate those findings in writing to audited entity officials. When auditors detect any instances of fraud, noncompliance with provisions of laws, regulations, contracts or grant agreements, or abuse that do not warrant the attention of those charged with governance, the auditors' determination of whether and how to communicate such instances to audited entity officials is a matter of professional judgment.

GAGAS 5.09 4.26 requires auditors to communicate immaterial violations of lesser significance warranting management's attention in writing (such as via a management letter). 2011 GAGAS allows auditors to judge whether and how to communicate matters of lesser importance. When the auditor reports these matters in a management letter, GAGAS 5.09 still requires the GAGAS report to refer to the management letter. However, per 5.16 above, written communication other than a management letter is also acceptable. Auditor of State staff should report such items in a management letter (unless they are inconsequential).

The auditor should refer to the AICPA's accounting and auditing guide, *Government Auditing Standards and Circular A-133 Audits*, for reporting examples. (AOS staff can access these examples in the Audit Briefcase.)

## Audit Findings

An audit **finding** is a conclusion of fact an auditor *finds* as part of the audit process. Findings of legal noncompliance in Ohio fall into three categories<sup>6</sup>:

- Noncompliance citations,
- Findings for adjustment, and
- Findings for recovery.

### Noncompliance Citations

Noncompliance citations should cite the appropriate legal authority (i.e. the **criteria** GAGAS 4.115 requires in written noncompliance findings). Legal authorities auditors can cite include the Federal and State constitutions, the United States Code and rules, the Ohio Revised Code and rules, local ordinances, Federal and State court decisions, Federal and State regulations, and opinions of the Ohio Ethics Commission. Auditors may refer to opinions of the Attorney General, AOS Technical Bulletins, and other advisory materials within the text of a finding as additional guidance, but AG opinions, AOS Technical Bulletins, and advisory materials are not legally binding **criteria**.<sup>7</sup>

<sup>6</sup> *Questioned costs* normally apply only when opining on compliance under SAS 117, such as A-133 audits of Federal programs. This discussion does not pertain directly to questioned costs.

<sup>7</sup> Ohio Rev. Code § 117.20(C) states that the Auditor of State may prepare and disseminate to public offices and other interested parties advisory bulletins, directives and instructions relating to accounting and financial reporting

For example, AOS Bulletin 2002-004 states the AOS' position that local governments should record and budget Ohio Public Works Commission infrastructure project (Issue II money) receipts and disbursements even when the local government does not directly receive or disburse this money. When a government fails to record or budget this money, the citation would be to the sections within Ohio Rev. Code Chapter 5705 requiring budgeting and recording this money, not Bulletin 2002-004. However, it is desirable for the finding to *suggest* the local government officials to review and follow the accounting and budgeting guidance from AOS Bulletin 2002-004.

Also, as described in *Government Auditing Standards*, auditors should report material noncompliance with provisions of contracts or grant agreements.

**Appendix A** to the *Ohio Compliance Supplement* sets forth guidelines for the appropriate form for citing legal authority.

*GAGAS* defines the elements of a finding to include:

**4.115 Criteria:** The laws, regulations, contracts, grant agreements, standards, measures, expected performance, defined business practices, and benchmarks against which performance is compared or evaluated. Criteria identify the required or desired state or expectation with respect to the program or operation. Criteria provide a context for evaluating evidence and understanding the findings.

**4.126 Condition:** Condition is a situation that exists. The condition is determined and documented during the audit.

**4.137 Cause:** The cause identifies the reason or explanation for the condition or the factor or factors responsible for the difference between the situation that exists (condition) and the required or desired state (criteria), which may also serve as a basis for recommendations for corrective actions. Common factors include poorly designed policies, procedures, or criteria; inconsistent, incomplete, or incorrect implementation; or factors beyond the control of program management. Auditors may assess whether the evidence provides a reasonable and convincing argument for why the stated cause is the key factor or factors contributing to the difference between the condition and the criteria.

**4.148 Effect or potential effect:** The effect is a clear, logical link to establish the impact or potential impact of the difference between the situation that exists (condition) and the required or desired state (criteria). The effect or potential effect identifies the outcomes or consequences of the condition. When the audit objectives include identifying the actual or potential consequences of a condition that varies (either positively or negatively) from the criteria identified in the audit, "effect" is a measure of those consequences. Effect or potential effect may be used to demonstrate the need for corrective action in response to identified problems or relevant risks.

**5.21 4.28** . . . If auditors sufficiently develop the elements of a finding, they may provide recommendations for corrective action.

### Auditee Responses to Findings

GAGAS 5.32 – 5.38 4.33 – 4.39 establish requirements for obtaining and reporting the auditee's responses to findings. GAGAS 5.324.33 states, “. . . auditors should obtain and report the views of responsible officials of the audited entity concerning the findings, conclusions, and recommendations, as well as any planned corrective actions.” GAGAS 4.35 states, “When auditors receive written comments from the responsible officials, they should include in their report a copy of the officials' written comments, or a summary of the comments received.”

Therefore, if an auditee responds to a finding, we should refer to their response in the applicable report (i.e., GAGAS or A-133 report).

If an auditee responds verbally to a finding (for example, at the post audit conference) we should ask if they wish to include their response in the report.

We should recognize that the tone of these responses will vary. Some officials will prepare thoughtful responses, perhaps even acknowledging responsibility for the error. Conversely, other officials will feel we have been unfair, that we do not understand the *criteria* (e.g. laws) we are citing or draft a response impugning our abilities or motives. Regardless, we should carefully consider these responses. If there is significant disagreement regarding a finding, we should attempt to resolve the disagreement, if practical. For example, if there is disagreement regarding a grant requirement, we might contact the grantor and obtain the grantor's interpretation of the requirement.

GAGAS 5.374.38 states that when we believe the responses lack validity or when planned corrective action does not adequately address the issue, we should state our reasons for disagreeing with the client's response or corrective action the audited entity's comments are inconsistent or in conflict with the findings, conclusions, or recommendations in the draft report, or when planned corrective actions do not adequately address the auditors' recommendations, the auditors should evaluate the validity of the audited entity's comments. If the auditors disagree with the comments, they should explain in the report their reasons for disagreement. However, we should always attempt to resolve disagreements before issuing the final report. If we can resolve the differences, the report should not include the client's original response. (We can include an updated response.) The report would not refer to a disagreement, since the disagreement no longer exists.

If we cannot agree with the client, we should summarize the client's substantive reasons for disagreeing and our reasons, per GAGAS 5.374.38. Responses indicating significant disagreement require review by the Center for Audit Excellence Group. (This review requirement does not apply to IPA audits.)

**Important:** In some instances, we should include most of the text of the client's response, if the issue is complex or if there is substantial disagreement. However, often we need not include the complete text of the client's response in our reports. For brevity, we prefer a summary within the body of the finding in question, indicating their general agreement or disagreement and

planned corrective action. Deciding whether to summarize versus including the complete text requires auditor judgment. When we summarize the response, we must allow the client to read the draft finding, our summary of their response, and our rebuttal to their response if we disagree with it. We should include their signature on a draft of the finding in the audit documentation indicating they have read the final draft, including their response (and our rebuttal, if there is one).

## Findings for Adjustment

Audit procedure results may determine an audited entity has posted receipts to a fund having no authority to receive them, or has disbursed amounts not authorized from one fund but permissible from another.

In these instances, it may be appropriate to make a *finding for adjustment*, that is, a reallocation of receipts or disbursements to the proper funds. Whether the auditor recommends an adjustment, and the manner in which the auditor reports it depends on: (1) the nature of the adjustment, i.e., whether it is material, ~~ineconsequentialtrivial~~<sup>8</sup>, or immaterial; (2) whether the auditee agrees with the adjustment; and (3) whether the misallocation of funds also constitutes a violation of law warranting a noncompliance citation.

Potential *findings for adjustment* fall into one of the following categories:

- 1 Material adjustments with which the auditee agrees, which have been posted to the accounting records and which are reflected in the audited financial statements;
- 2 Material adjustments with which the auditee disagrees and which are neither posted to the accounting records nor reflected in the financial statements;
- 3 Immaterial adjustments which are more than ~~ineconsequentialtrivial~~. See discussion in the following section.
- 4 InconsequentialTrivial

Note: Auditors base materiality on opinion units when forming their opinion.

However, when assessing whether a finding for adjustment is a material noncompliance finding, we believe auditors should normally consider materiality in relation to both affected funds rather than the opinion unit. Considerations include:

- Judging whether measuring materiality against receipts, disbursements or fund cash balance is the most appropriate.
- Auditors may detect a *finding for adjustment* affecting two funds reported in the same opinion unit. This adjustment would have no effect on the financial statements (and the auditor's opinion thereon), but may still represent reportable noncompliance if it is material to either of the two funds.

## Treatment of Findings for Adjustment in Audit Reports

Adjustments in the first category above based on a violation of legal authority will result in a noncompliance citation reported in the GAGAS report. The auditor should neither label the noncompliance as a *Finding for Adjustment* nor use a “finding for adjustment statement” (i.e. “In accordance with the foregoing facts, we hereby issue a finding for adjustment . . .”) but the

<sup>8</sup> Trivial as described in AU 314.42 footnote 71, explains matters that are “trivial” are amounts designated by the auditor below which misstatements need not be accumulated. This amount is set so that any such misstatements, either individually or when aggregated with other such misstatements, would not be material to the financial statements, after the possibility of further undetected misstatements is considered.

finding should cite the legal criterion and briefly state the client has agreed to and posted adjustments which are also reflected in the financial statements. No qualification of the auditor's financial statement opinion is necessary because the adjustment corrected the material misstatement.

Adjustments in the second category and which are based on a violation of legal authority will result both in a noncompliance citation and normally a qualification paragraph in the auditor's financial statement opinion. The noncompliance citation will also include a finding for adjustment statement (i.e. "In accordance with the foregoing facts, we hereby issue a finding for adjustment. . .").

Adjustments in the third category (quantitatively immaterial but more than ~~inconsequential~~~~trivial~~) should be reported in the management letter if the misallocation of funds also constitutes a violation of law which warrants a noncompliance citation. However, auditors should report these adjustments in the GAGAS letter whenever qualitative considerations of materiality outweigh the quantitative materiality amounts.

- If the auditee agrees with the adjustment and has posted it, cite the law violated, but do not use the term *finding for adjustment*; do not include a *finding for adjustment statement*.
- If the auditee disagrees with the adjustment or has not posted it, cite the law violated, label the finding as a *finding for adjustment*, and include a *finding for adjustment statement*.

~~Inconsequential~~ Trivial noncompliance adjustments will simply be noted in the audit working papers.

### Summary of Finding For Adjustment Reporting Treatment

	<i>Material adjustments with which the auditee agrees, which have been posted to the accounting records and which are reflected in the audited financial statements:</i>	<i>Material adjustments with which the auditee disagrees and which are neither posted to the accounting records nor reflected in the financial statements:</i>	<i>Quantitatively Immaterial adjustments which are more than <del>inconsequential</del><del>trivial</del></i>	<i>Adjustments which are <del>inconsequential</del><del>trivial</del></i>
<b>GAGAS Report</b>	If based on a violation of legal authority, report a noncompliance citation in the GAGAS report. Do not classify as a <i>finding for</i>	If based on a violation of legal authority, report a noncompliance citation in the GAGAS report. AOS staff <u>should</u> include a <i>finding for adjustment</i> statement. (IPAs	If based on a violation of legal authority, report a noncompliance citation in the management letter. However, if the matter is qualitatively material, report a noncompliance	Not reported in the GAGAS report.

	<i>Material adjustments with which the auditee agrees, which have been posted to the accounting records and which are reflected in the audited financial statements:</i>	<i>Material adjustments with which the auditee disagrees and which are neither posted to the accounting records nor reflected in the financial statements:</i>	<i>Quantitatively Immaterial adjustments which are more than <del>inconsequential</del> trivial</i>	<i>Adjustments which are <del>inconsequential</del> trivial</i>
	<i>adjustment.</i>	should not include a finding for adjustment statement.)	citation in the GAGAS report.	
<b>Auditor's report (opinion) on the financial statements</b>	No qualification of the auditor's opinion.	Adjustments which are based on a violation of legal authority will result in a qualified (or adverse) opinion on the financial statements.	Adjustments which are qualitatively material and are based on a violation of legal authority <i>may</i> result in a qualified (or adverse) opinion on the financial statements. This requires judgment.	No effect.
<b>Management letter</b>	Not applicable	Not applicable	If the misallocation of funds also constitutes a violation of law which warrants a noncompliance citation, a citation will be reflected in the management letter if the matter is quantitatively and qualitatively immaterial. AOS staff should include a <i>finding for adjustment</i> statement if the auditee does not agree to or post the adjustment. (IPAs should not include a finding for adjustment statement. Reporting the noncompliance citation alone is sufficient.)	Not reported in the management letter. Document in the working papers only.

**Financial Statement Opinion Qualification Paragraph**

During 20XX, Any Local School District expended \$584,000 from the Bond Retirement Fund to pay employees' salaries. Section 5705.10 of the Revised Code restricts the use of the Bond Retirement Fund to debt retirement. Had this amount been properly expended from the General Fund, the effect would have been to decrease disbursements of the Bond Retirement Fund by \$584,000 and increase the fund cash balance to \$631,675 and to increase disbursements of the General Fund by \$584,000 and decrease the fund cash balance to a deficit of \$347,000 as of and for the year ended December 31, 20XX.

In our opinion, except for the matter referred to in the preceding paragraph, the financial statements present fairly . . .

We would only include this paragraph if the effect was material to one or more opinion units (in this case, assume the effect was material to the general and bond retirement fund and that both are major funds). The result will be either a qualified ("except for") or adverse opinion. A government can avoid a qualified or adverse opinion only if they adjust their accounting records. A mere commitment by the public office to adjust is insufficient. That is, the auditee has not agreed to the adjustment until she or he has posted it to the accounting system.

Finally, AU 312.52(c) requires auditors to consider the effect of uncorrected prior audit adjustments on the current audit. Therefore, auditors should consider whether uncorrected prior findings for adjustment affect the current audit's financial statements.

**Findings for Adjustment Procedures for Independent Public Accountants (IPA)**

IPAs should follow the preceding guidance regarding *Findings for Adjustment* with the following modifications.

IPAs should report a noncompliance finding in their GAGAS report for the matters requiring it as listed above. However, IPAs should not label these as *findings for adjustment* and should not include the "finding for adjustment statement" (i.e. "In accordance with the foregoing facts, we hereby issue a finding for adjustment . . .")<sup>9</sup>. When the IPA believes a finding for adjustment condition exists and the client does not agree with and does not make the adjustment, the following procedures apply.

- As soon as the IPA has an indication there could be Findings for Adjustment, the IPA should contact the regional chief auditor.
- The IPA should provide the regional chief auditor with all relevant supporting documentation for the Finding.
- After notifying the Chief Auditor of the Center for Audit Excellence that a finding for adjustment may be issued, the regional chief auditor or his designee will prepare a preliminary Finding, and submit it to the Auditor of State Legal Division for review. Included will be any needed supporting documentation.

<sup>9</sup> This is to comply with RC 117.12 which states, "IPAs have no authority to make formal findings of illegality, malfeasance, or gross neglect under this division or section 117.23 of the Revised Code."

- The Legal Division will review the proposed Finding and may ask the chief auditor or the IPA for any needed additional information.
- After the Legal Division has approved the Finding, the chief auditor or his designee will send the proposed Finding for Adjustment to all applicable parties. These parties normally have five days to respond. If there is a response, the chief auditor evaluates the response and decides whether the Finding should be withdrawn or modified.
- The regional chief auditor must send a copy of the approved finding to the Chief Auditor, Center for Audit Excellence or his designee for inclusion with the Acceptance Letter. The Chief Auditor, Center for Audit Excellence or his designee certifies the report with the Clerk of the Bureau.
- The Auditor of State will describe material, unadjusted Findings for Adjustment in the Acceptance Letter we include in the front of each report.

## Findings for Recovery

Ohio Rev. Code Section 117.28 authorizes the Auditor of State to report a *finding for recovery* in audit reports when legal action may be appropriate to recover public money or property. It is the policy of the Auditor of State to only issue a finding for recovery in whole dollars. Therefore, all finding for recovery amounts will be rounded down to the nearest whole dollar.

Ohio Rev. Code Section 117.01 (C) defines *public money* as "any money received, collected by, or due a public official under color of office, as well as any money collected by any individual on behalf of a public office or as a purported representative or agent of a public office."

Under Ohio Rev. Code Sections 9.24(H)(3) and 117.28, a finding for recovery may exist when:

- Public money has been illegally expended;
- Public money that has been collected has not been accounted for;
- Public money that is due has not been collected; or when
- Public property has been converted or misappropriated.

Each of these is discussed below.

### 1. Illegal Expenditure

A finding for recovery for an illegal expenditure may be made only where the auditor (after consultation and advice from the Legal Division) has concluded that the public office does not possess the legal authority for the expenditure in question. This generally may occur where the government either has no statutory authority (or the government exceeded the authority statute provides) for the expenditure or there is no *proper public purpose* for the expenditure.

Governmental units other than charter municipal corporations generally possess only the authority expressly granted by statute or necessarily implied to carry out an express statutory function. Thus, a governmental entity such as a school district or township may act only where a statutory grant of authority exists and, if any doubt as to the authority exists, it must be resolved against the expenditure of public monies. If the basis for a finding for recovery is that the governing body exceeded its statutory authority, a citation to a court decision containing a general description of the limited authority of the governmental unit is sufficient.

#### *Proper Public Purpose*

Governmental entities, without regard to their specific nature, may not expend public monies unless they are for a proper (i.e. valid) public purpose.

State ex rel. McClure v. Hagerman, 155 Ohio St. 320, provides that governmental expenditures should serve a public purpose. In McClure, the Ohio Supreme Court offered the following guidelines to determine a public purpose:

1. Whether the expenditure is for or promotes the public health, safety, morals or general welfare;
2. Whether the primary objective is to promote a public purpose, although it may incidentally advance a private interest;
3. If there has been a prospective legislative determination of a proper public purpose.

See AOS Bulletins 2003-005 and 2004-002 for further guidance regarding *proper public purpose*.

The courts will not substitute their judgment for that of the authorities unless the latter's exercise of judgment or discretion is shown to have been unquestionably abused.

In general, if the principal benefit is for the public, an expenditure is not invalid merely because a private party derives an incidental benefit. A public officer's determination that a contemplated expenditure serves a valid public purpose is generally not subject to question unless this determination is "palpably and manifestly arbitrary and incorrect." (However, disbursing public money for alcohol will result in a finding for recovery, per Bulletin 2003-05.<sup>10</sup>)

Before the discretionary determination of the governing body that a given expenditure serves a public purpose may be overruled, the auditor must consult with the Legal Division and cite a specific prohibition against the class of expenditure in question or must have facts to support a conclusion that the local determination was "palpably and manifestly arbitrary and incorrect."

While auditing expenditures, the auditor should scan or perform other analytical procedures looking for unusual or nonrecurring items and determine the reasonableness of designations of public purpose. Any questionable items can be discussed with the appropriate regional chief auditor, who should consult with the Legal Division.

## **2. Collected but Unaccounted For**

A finding for recovery for public money collected but unaccounted for, should be made where the auditor, after consultation with and advice from the Legal Division, concludes that public money, as defined in Ohio Rev. Code Section 117.01, has been received by the public office, but cannot be adequately accounted for by authorized disbursements of public moneys.

A mere unidentified shortage of public moneys is a sufficient basis for a finding for recovery, as public officials are *strictly liable*<sup>11</sup> without fault to account for public funds entrusted to their care.

However, the Auditor of State's office recognizes that even the most honest employees make errors in recording cash. Therefore, the Auditor of State will not issue FFRs for insignificant cash shortages a cashier reports to management as part of their reconciliation process, if the government's management monitors overages and shortages and suitably follows up on patterns

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<sup>10</sup> Note the prohibition on spending public money for alcohol is consistent with the Federal government's prohibition stated in 2 CFR Part 225 (OMB Circular A-87), Appendix B.3.

<sup>11</sup> See the discussion of *strict liability* later in this introduction.

of shortages. Conversely, we may report shortages as FFRs if a government's controls are not in place or are inadequate.<sup>12</sup>

### 3. Due but Not Collected

Public money that is due a public office but which has not yet been collected may also be subject to a finding for recovery. Money may become due the public office by operation of statute, by contract, or by court order. The decision as to whether a particular obligation is sufficiently overdue to justify the issuance of a finding for recovery requires judgment based upon the facts of an individual audit. Auditors should consult with and seek advice from the Legal Division and the Center for Audit Excellence prior to pursuing/working on the finding for recovery. In general, amounts are to be considered overdue and a proper subject for a finding for recovery if they have been outstanding in excess of one year and are not the subject of either a statutory collection process or ongoing collection efforts by the client.

Findings for recovery for public money due but not collected are normally identified in the audit of the public office to which the moneys are due. In some circumstances, however, the information necessary to identify the obligation is available only in the records of the obligor. Where such circumstances exist, a finding for recovery is issued in the audit report of the obligor and in favor of the obligee. For example, if a village is not collecting statutory fees for remittance to the State, a finding for recovery for the amounts in question may be issued against the village and in favor of the State in the village's audit report.

The citation justifying the findings for recovery for public money due but not collected should include not only statutes or regulations, but also the document evidencing the underlying obligation.

### 4. Public Property Converted or Misappropriated

A finding for recovery for public property converted or misappropriated should be issued only if the auditor has substantial evidence that a theft has occurred. This would include the ability to identify the individual responsible for the loss. Before any finding for recovery of this type can be issued, it is essential that the advice of legal counsel be obtained. If such circumstances arise during an audit, direct the matter to the AOS Legal Division for resolution.

In most instances, the auditor can only demonstrate that certain property was acquired by the client, and at the time of the audit it cannot be located. Under such circumstances, a finding for recovery may not be appropriate. A noncompliance citation should be issued instead, citing Ohio Rev. Code Section 117.28, stating the relevant facts, and indicating that the property may have been converted or misappropriated.

**NOTE:** Generally, no contract (including an acquisition subject to Ohio Revised Code competitive bidding requirements) may be awarded to a person or entity against whom a finding for recovery has been made if this finding is unresolved (per Ohio Rev. Code Section 9.24 (A)). Ohio Rev. Code Section 9.24 (D) requires the Auditor of State to maintain a database, accessible

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<sup>12</sup> See *Best Practices in Cash Handling* in the AOS' Fall, 2007 *Best Practice* publication. You can view this article under the Publications link at [www.ohioauditor.gov](http://www.ohioauditor.gov)

to the public, listing persons against whom an unresolved finding for recovery has been issued, and the amount of the money identified in the unresolved finding for recovery. The Auditor of State currently has this database operational and updates the database periodically in accordance with Ohio Rev. Code Section 9.24 (D). AOS Bulletins 2003-009 and 2004-006 provide further guidance regarding this law.

### **Issuing Findings for Recovery Before and/or After the Audit Period**

Audit engagements are for specified time periods as reflected in the auditor's letter of engagement. The great majority of findings for recovery are therefore based on transactions that have occurred within the period that is currently under audit. Extenuating circumstances may arise which lead auditors to test before and / or after the audit period; however, this is not standard practice.

Determining whether to review transactions and/or issue findings for recovery for transactions that occurred prior to or subsequent to the current audit period requires judgment based on factors such as:

- Suspected or known fraud
- Significant fraud risk factors that are associated with the current finding for recovery
- The magnitude of the finding for recovery
- Judgment as to whether the finding for recovery was an error or deliberate
- Appropriate client requests – careful consideration needs to be given on the type of request, the timing of the request, the purpose of the request, and the documentation given to substantiate the request
- If requested by the AOS Special Audit Task Force to review issues that arise outside the audit period
- The governing authority's involvement in the circumstances surrounding the issue, and its ability to correct the issue on its own
- The impact of information that has come to the auditor's attention involving transactions subsequent to the audit period on the entity's financial condition and whether prudence dictates review of the transactions prior to the next audit.

Since there are numerous variables affecting this determination that will be unique to each finding for recovery, the regional Chief Auditor should consult with the Chief Deputy Auditor or his designee *prior to testing outside of the audit period* to pursue a finding for recovery.

## **Additional Policies for Findings for Recovery for Auditor of State Audits**

If the auditor preliminarily determines to issue a finding for recovery, the auditor should draft the proposed finding and send it, along with all factual information pertinent to the proposed finding, to the Legal Division for review. The Legal Division reviews the proposed finding in the Legal Consultation program folder of the applicable TeamMate project. The Legal Division will approve the Proposed Finding as is, approve with modifications, disapprove, or request more information be submitted by the auditor to evaluate the proposed finding. Once approved by the Deputy Chief Legal Counsel in the Legal Division, the auditor should send draft GAGAS findings to the Center for Audit Excellence for review. The Center for Audit Excellence will also approve the finding's conformance with GAGAS reporting requirements.

If the Legal Division and the Center for Audit Excellence approve the proposed finding, the auditor should immediately prepare and send a *Notice of Proposed Finding for Recovery* to the Legal Division for review (a sample is provided on the second following page). This notice provides the person against whom the finding is contemplated an opportunity to rebut the allegations. The notice must include the language of the finding for recovery from the report and must be factually specific and detailed enough to allow the persons to understand the allegations made against them.

The notice also must state that the individual has five business days in which to respond in writing to the proposed finding. That five-day period may be extended in rare circumstances, but only upon approval of the Auditor of State, the Chief Deputy Auditor, the chief auditor (or equivalent), or the Legal Division. The notice should be sent to the individual sufficiently in advance of any post-audit or exit conference so that he or she has time to respond and so that the Auditor of State's Office has time to withdraw or modify the finding before that conference, if necessary.

If the person against whom the finding is contemplated responds within the time allowed with something other than a general denial of responsibility, the auditor should evaluate the response. If the auditor believes the response has merit, the auditor should submit it to the Legal Division for consideration. If after the evaluation, the decision is made to delete the proposed finding from the draft report, the person should be notified of that decision. If the decision is made to retain the finding, the individual should be notified of the opportunity to attend the exit conference or to schedule a separate meeting to discuss the finding.

### **Post-Audit Conference Procedures**

After the individual's response to the notice is evaluated and a decision is made to delete it, retain or modify the finding, the post-audit conference may be held. Under Ohio Rev. Code § 121.22(D), conferences between auditors and the audited public office are an exception to the "Sunshine Law" requiring meetings of public officials to be in public. In addition, under Ohio Rev. Code § 117.26, reports this Office prepares are not public records until certified copies of them are served upon certain officials of the public office. To comply with those two confidentiality provisions, this Office has traditionally held that the auditors conducting the post-audit conference have some discretion as to who may attend it. For example, auditors would

have discretion not to conduct a post-audit conference if one of the public officials present invited the media to the conference.

If the person against whom the finding is contemplated is a public official or employee who would normally attend a post-audit conference (for example, the public office's chief financial officer, the chief executive officer, or the governing board or commission), the proposed finding may be discussed during the conference. If the person is an official or employee who would not ordinarily be present at a post-audit conference or the person is not an official or an employee of the public body, a separate meeting may be scheduled to discuss the proposed finding. In either situation, the person against whom the finding is contemplated may have legal counsel present. If so, the auditor may request that a lawyer from the Legal Division attend as well. In this meeting, the person against whom the finding is contemplated and/or his legal counsel may inspect (but not copy) the audit documentation related to the finding at issue.

The letter scheduling the post-audit conference should state the public body will have five business days after the conclusion of the conference to respond to the draft report presented. This period may also be extended upon approval of the Auditor of State, the Chief Deputy Auditor, the chief auditor (or equivalent), or the Auditor of State's Legal Division. If the public body's response after the post-audit conference contains any information questioning the validity or the amount of the proposed finding for recovery, the auditor, in consultation with the Legal Division, should evaluate the response and determine whether the finding should be maintained, deleted, or modified.

### **Notice of Finding for Recovery**

Note: Do not send a final *Notice of Finding* if the Finding for Recovery has been repaid; however, a *Notice of Proposed Finding* should still be sent to the appropriate individual(s).

When the Clerk of the Bureau certifies an audit report for release, unless the finding has been repaid, the regional office shall send separate copies of the approved *Notice of Finding* (a sample is provided on the second following page) to each individual named in the Finding for Recovery<sup>13</sup> and the bonding company(ies). In addition, a copy of the *Letter on Findings for Recovery* should be sent to the entity's statutory legal counsel. If the statutory legal counsel is not the county prosecutor, then the *Letter on Findings for Recovery* should also be sent to the county prosecutor.

An example of the *Notice of Finding* and the *Notice of Proposed Finding* follow. Note they are the same, except the title and the language changes to reflect whether the Finding for Recovery is proposed or issued. Also, an example of the *Letter on Findings for Recovery* follows the *Notice of Finding* letter.

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<sup>13</sup> IPAs follow different procedures. See the *Finding for Recovery Procedures for Independent Public Accountants (IPA)* discussion later in the Introduction.

**Sample NOTICE OF (PROPOSED)<sup>14</sup> FINDING**

DATE

To: NAME  
 STREET ADDRESS  
 CITY, Etc.

The Auditor of State [**is auditing**] [has audited] Washington Township, Sandusky County for the period January 1, 200X through December 31, 200X +1.

Ohio Rev. Code 117.28 requires the Auditor of State to issue a finding for recovery when “an audit report sets forth that any public money collected has been illegally expended, or that any public money collected has not been accounted for, or that any public money due has not been collected, or that any public property has been converted or misappropriated...”

A “Finding for Recovery” [**may be**] [**has been**] issued against you. Issuance of a Finding for Recovery constitutes a preliminary determination by the Auditor of State, in accordance with Ohio Revised Code Section 117.28, that you may be liable to a public office for SELECT ONLY THE APPLICABLE CATEGORIES>>> public monies illegally expended; collected but unaccounted for; due but not collected; for public property which has been converted or misappropriated. It does not constitute a final determination that such legal liability exists and is not an accusation of criminal misconduct. The [**proposed**] Finding for Recovery **would** / **will** be issued against you INSERT ANY OTHER RESPONSIBLE PARTIES, SUCH AS>> [and your bonding company and/or NAME OF OTHER RESPONSIBLE PERSON, jointly and severally,] and **would** / **will** be in the amount of \$XXX, and in favor of \_\_\_\_\_.

We are **proposing** / **issuing** this Finding for Recovery for the following reason:

The Township Trustees approved NAME’s salary at \$XX.XX beginning [DATE] (\$XX.XX [PREVIOUS SALARY AND EFFECTIVE DATE]). Overtime pay at time and a half would be \$XX.XX for 200X (\$XX.XX for hours worked during the first pay of 200X at the 200X-1 rate). For the payroll checks issued 1/13/0X, 1/28/0X, 2/11/0X, 2/25/0X, 3/10/0X, 3/25/0X, and 5/27/0X Mr. NAME was paid \$XX.XX for overtime wages. Review of time sheets and payroll records indicated XX hours of overtime worked in 200X (XX hours in 200X-1). As a result, an overpayment of \$XX.XX occurred.

<b>Description</b>		<b>Rate</b>		<b>Total</b>
XX hours of overtime	x	\$X.XX per hour	=	\$ XX.XX
XX hours of overtime	x	\$X.XX per hour	=	XX.XX
				<hr/> \$XX.XX
XX total hours of overtime paid	x	\$X.XX per hour	=	\$XX.XX
				<hr/> \$ X.XXX
Overpayment				

<sup>14</sup> This example is both for proposed and approved findings for recovery. The **bold** red font language applies to **proposed** notices of findings. However, do not use red font in the letter you issue!

Notice of Proposed Findings

July 14, 2009

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In accordance with the foregoing facts and pursuant to Ohio Rev. Code Section 117.28, a Finding for Recovery for public monies illegally expended **may be / is** hereby issued against NAME in the amount of \$XXX.XX, and in favor of NAME OF GOVERNMENT NAME OF Fund, in the amount of \$XXX.XX.

Under Ohio law, any public official who either authorizes an illegal expenditure of public funds or supervises the accounts of a public office from which such illegal expenditure is strictly liable for the amount of the expenditure. *Seward v. National Surety Corp.* (1929), 120 Ohio St. 47; 1980 Op. Att'y Gen. No. 80-074; Ohio Rev. Code Section 9.39; *State, ex. Rel. Village of Linndale v. Masten* (1985), 18 Ohio St.3d 228. Public officials controlling public funds or property are liable for the loss incurred should such funds or property be fraudulently obtained by another, converted, misappropriated, lost or stolen to the extent that recovery or restitution is not obtained from the persons who unlawfully obtained such funds or property, 1980 Op. Att'y Gen. No. 80-074.

Township Officers signed the warrants resulting in improper payments. Township Trustees NAME, NAME, NAME, and Fiscal Officer NAME, and their bonding company, NAME, will be jointly and severally liable in the amount of \$XXX and in favor of the NAME OF FUND to the extent that recovery is not obtained from NAME.

**[If a Finding for Recovery were to be issued, the]** [The] Auditor of State **[would be]** [is] required, under Ohio Revised Code section 117.28, to forward a copy of the audit report containing this Finding For Recovery to the statutorily designated legal counsel for the public office, who then has the discretionary authority to institute legal proceedings to collect the amount alleged to be due the public office. Under certain circumstances such action might also be instituted by the Attorney General of the State of Ohio. **If legal counsel does not pursue legal proceedings, the Finding For Recovery will be considered to be a debt owed to a public office and will be certified to the Attorney General of the State of Ohio for collection.**

**In the event the Finding For Recovery is certified to the Ohio Attorney General for collection, collection costs, statutory interest and fees may be assessed and added to the total amount of the finding in accordance with Ohio Revised Code section 131.02. Once certified, the Ohio Attorney General will assign the matter for collection and may hire special counsel to collect the debt as authorized by Ohio Revised Code section 109.08. Prior to certification, you may pay the debt directly to the public office, and it is requested that you provide copies of such payment to the Auditor of State, Legal Department, 88 East Broad Street, Columbus, Ohio 43215, or to denise.carr@aos.state.oh.us. After certification, payments must be sent to the Ohio Attorney General.**

DELETE THIS PARAGRAPH FROM NOTICES SENT TO BONDING COMPANIES>> In addition, pursuant to Ohio Revised Code section 9.24, a person against whom an unresolved finding for recovery has been issued by the Auditor of State is precluded from receiving, from a state agency or political subdivision, a contract for goods, services, or construction, paid for in whole or in part with state funds. (This preclusion does not apply to employment contracts.)

**This “Notice of Proposed Finding for Recovery” has been prepared to permit you to submit any relevant information to this office for consideration. Please submit such information, as well as any questions concerning this Proposed Finding for Recovery, within five business days of receiving this Notice, to the Auditor of State at the following address:**

**GOOD GUY, CPA  
Senior Audit Manager**

## **AOS OFFICE ADDRESS**

If you wish to review the working papers on which the Proposed Finding is based, please contact me immediately to schedule an appointment. Reviewing the working papers, however, will not result in an extension of the time in which to respond.

Sincerely,

Dave Yost  
Auditor of State

## **Draft Letter on Findings for Recovery**

[Date]

[Name of legal counsel to public office]

[Title]

[Agency/Company Name]

[Street Address, PO Box]

[City, State Zip]

Re:      Audit of [Name of Entity]  
Released on [Date]

Dear [Name]:

Enclosed please find a certified copy of the audit report in the above captioned matter.  
During our audit, we found expenditures of public money that are subject to recovery  
under Ohio Rev. Code Section 117.28, which states, in part:

Where an audit report sets forth that any public money has been illegally expended, or that any public money collected has not been accounted for, or that any public money due has not been collected, or that any public property has been converted or misappropriated, the officer receiving the certified copy of the report...may, within one hundred twenty days after receiving the report, institute civil action in the proper court in the name of the public office to which the public money is due or the public property belongs for the recovery of the money or property and prosecute the action to final determination.

Although this statute references a 120 day period for your office to notify the Ohio Attorney General in writing of any legal action taken, if you intend to pursue such action, you must notify the Auditor of State within 30 days after the date of this letter. Within that period, please contact Denise Carr, Office Manager, Legal Division, at (614) 728-7116 or by e-mail at [DLCarr@ohioauditor.gov](mailto:DLCarr@ohioauditor.gov). If we do not receive notice from your office within 30 days, the Finding For Recovery will be certified to the Attorney General for collection. Upon

certification, collection costs, statutory interest and fees may be assessed and added to the total amount of the finding in accordance with Ohio Revised Code section 131.02. Once certified, the Ohio Attorney General will assign the matter for collection and may hire special counsel to collect the debt as authorized by Ohio Revised Code section 109.08.

In the event that you are pursuing a payment plan with the debtor, please contact the Auditor of State. Upon receipt of an acceptable payment plan that includes appropriate terms and conditions, the Auditor of State will not certify the Finding For Recovery to the Ohio Attorney General. This will avoid the collection process and associated costs.

The enclosed audit includes the following findings for recovery:

[Details of who, what, amount, any other relevant information and total amount to be recovered]

Pursuant to Ohio Revised Code Section 9.39, public officials are liable for all public money received or collected by them or by their subordinates under color of office. (See, e.g., AOS Bulletin 2008-006). Even if a referral does not include a finding for recovery against the office holder or other persons employed by the public office acting in a supervisory capacity, please be advised the Ohio Attorney General or appointed legal counsel is not precluded from naming those persons in an action for recovery. The policy reasons behind making public officials accountable for the funds that they receive include the need to prevent frauds against the public, to protect public funds, and to place final responsibility for public funds on the shoulders of the officials charged with the collection and care of such funds. *Village of Linndale v. Maston* (1985) 18 Ohio St.3d 228.

Thank you for your attention to this matter.

Sincerely,

Dave Yost  
Auditor of State

[name]  
Chief Auditor  
[region] Region

cc: Legal Division, Attention: Denise Carr  
County Prosecutor

### Additional Considerations

- Where a proposed finding for recovery has been paid in whole ~~or in part~~ prior to the completion of the audit, the audit report finding should disclose the repayment as a “Finding for Recovery Repaid Under Audit.”
- The Auditor of State does not generally issue Findings for Recovery where the amount in question aggregates<sup>15</sup> \$100 500 or less. However, auditors should consult on all potential findings for recovery, regardless of the amount, the matter in the management letter with the legal department and the Center for Audit Excellence (prior to pursuing) because in some cases, findings for recovery will be issued for amounts less than \$500. (Example: disbursing public money for alcohol will always result in a finding for recovery per Bulletin 2003-05). Amounts aggregating more than \$100 All findings for recovery are to be reported in the GAGAS report due to their qualitative significance. (Exception: disbursing public money for alcohol will always result in a finding for recovery and be reported in the GAGAS report per Bulletin 2003-05.) Additionally, all findings for recovery are subject to the documentation requirements listed in AOS Audit Division Advisory Memo 2012-01 .Potential findings for recovery that are not deemed findings for recovery during the consultation process due to falling below the amount threshold, will be reported in the Management Letter as non-compliance citations (not findings for recovery).
- If a government identifies a finding for recovery *before* the auditors do and the entity or individual repays the money before the audit report is issued, the auditor should not report the matter as a Finding for Recovery. However, the auditor should evaluate the issue for other possible matters of audit interest, such as the possibility of fraud or reportable internal control weaknesses. Also, the matter might be a citation for an illegal expenditure of money or other violation of law. Conversely, the entity’s identification and resolution of the matter may indicate the internal control structure is properly detecting and correcting errors, in which case the auditor might determine not to report the matter.
- The auditor should determine the amount of a finding for recovery during audit field work. The method used to calculate the amount must be clearly set forth in the working papers. Any partial payment or reimbursement made prior to completing the audit should be noted in the audit report with appropriate credit given when calculating the amount.
- If a finding for recovery is issued because public property has been converted or misappropriated, the amount of the finding should reflect the fair market value of the property at the time that it was discovered to be missing. The basis for determining this amount must be disclosed in the working papers.
- Where the amount of the finding for recovery may change prior to or after the release of the audit report, the auditor should date the amount. Example: "As of December 31, 20XX, this amount is \$X,XXX." In these instances, the method of calculating the amount should be stated in the audit report so that the amount can be calculated on the day of repayment.

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<sup>15</sup> For example, if five employees were all overpaid (for the same cycle-payroll for example) and they were each overpaid by \$100, then we would issue a finding for recovery because the payroll cycle had an aggregate of \$500 in findings for recovery (5 X \$100).

## Finding for Recovery Procedures for Independent Public Accountants (IPA)

Ohio Rev. Code 117.12 prohibits IPAs from issuing Findings for Recovery. IPAs should report these matters exceeding \$100500 (and any alcohol purchase and other findings for recovery determined by the Auditor of State, even if less than \$100 regardless of amount) as noncompliance findings, but they should not label them as *finding for recovery* and the finding should not state: “In accordance with the forgoing facts, and pursuant to Ohio Rev. Code Section 117.28, a Finding for Recovery for public money collected but not accounted for (or illegally expended, etc.) is hereby issued against . . .”<sup>16</sup>

The following procedures apply to IPAs in instances where they determine a finding for recovery may be necessary.

- An IPA should NOT inform anyone other than the Auditor of State of possible Findings for Recovery either orally or in writing.
- As soon as the IPA has an indication there could be any Findings for Recovery, regardless of the amount, the IPA should contact the regional chief auditor.
- The IPA should provide the regional chief auditor with all relevant supporting audit documentation for the Finding.
- ~~After notifying the Chief Auditor of the Center for Audit Excellence that a finding for recovery may be issued, the regional chief auditor or his designee will prepare a preliminary Finding, and submit it to the Auditor of State Legal Division for review. Once the regional chief becomes aware of the potential Finding for Recovery, the regional chief should follow Advisory Memo 2012-01 which requires all potential Findings for Recovery, regardless of amount, to be reviewed by Legal and the Center for Audit Excellence. When submitting potential Findings for Recovery related to an IPA Report to the Center, please submit the information to your assigned regional Center consultant. When the Center consultant responds to the Region on a potential Finding that is related to an IPA audit, the assigned Center consultant will carbon copy the IPAResport mailbox (ipareport@ohioauditor.gov) with the resulting action. This will allow the matter to be identified for follow up during the review of the IPA audit report.~~
- ~~The Legal Division and the Center will review the potential Finding and if it is determined that a Finding will be issued, the regional chief will submit all needed supporting documentation and the Notice of Proposed Findings letters to the Legal Division.~~
- The Legal Division will review the proposed Finding and may ask the regional chief auditor or the IPA for additional information.

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<sup>16</sup> This is to comply with RC Section 117.12 which states, “IPAs have no authority to make formal findings of illegality, malfeasance, or gross neglect under this division or section 117.23 of the Revised Code.”

- After the Legal Division has approved the Finding, the regional chief auditor or his/her designee will obtain the limited waiver from the IPA<sup>17</sup> and send the *Notice of Proposed Finding* to all applicable parties. The applicable parties are normally given five days to respond. If they respond, the chief auditor evaluates the response along with the Legal Division and decides whether to withdraw or modify the Finding.
- The regional chief auditor will send a copy of the approved finding to the Chief Auditor, Center for Audit Excellence or his designee for inclusion with the Acceptance Letter and send the *Notice of Finding* to the applicable parties upon releasing the report.

IPAs should refer any matters involving possible criminal activities to the regional chief auditor and to the Chief of the Auditor of State's Special Investigations Unit, who is a law enforcement officer.

In addition, independent public accountants are to make an immediate, written report of all illegal acts or indication of illegal acts which may result in findings for recovery of which they become aware to the regional chief auditor.

### **Example Findings for Recovery**

An example *finding for recovery* is included below:

Receipts issued for impounding fees by the County Dog Pound and Dog Warden totaled \$1,234 more than deposits made to the County Auditor. Ohio Rev Code Section 9.39 states all "public officials are liable for all public money received or collected by them or by their subordinates under color of office."

In accordance with the forgoing facts, and pursuant to Ohio Rev. Code Section 117.28, a Finding for Recovery for public money collected but not accounted for is hereby issued against John Doe, County Dog Warden, and the Ace Insurance Company, his bonding company, jointly and severally, for \$1,234 and in favor of the County Dog and Kennel Fund.

(Note: Per the preceding discussion, IPAs would modify this finding by deleting the second paragraph and instead stating, for example, "We have referred this matter to the Auditor of State for resolution.")

### **Responsibility for Paying Findings for Recovery: Strict Liability Laws**

Public officials are strictly liable to account for public funds entrusted to their care. "Strict liability" means a person may be found liable for the loss even though he or she may not have been personally at fault. Also, any public official who either authorizes an illegal expenditure of public funds or supervises the accounts of a public office from which such illegal expenditure is made is strictly liable for the amount of such expenditure. Mere unidentified shortages of public

<sup>17</sup> NOTE: ORC 4701.19 provides that an IPA's audit documentation remains the property of the IPA, even in the possession of the Auditor of State's office, and states that these materials are not public records available for public disclosure. However, we will request a limited waiver of this statutory provision after the AOS Legal Department has approved the proposed finding for recovery. This limited waiver will request the IPA to make audit documentation supporting the proposed finding for recovery available for inspection by the person named in the finding and legal counsel. This waiver will include only documentation directly related to the finding for recovery. Documents subject to the waiver will also become subject to public records disclosure.

moneys, or such an illegal expenditure, are sufficient reasons for a Finding for Recovery against such a public official.

Thus, public officials (including fiscal officers) must be aware of their role in approving expenditures and safeguarding amounts collected, and take steps to prevent mistakes, errors or omissions resulting in the loss of public funds. In the context of an AOS audit, both the supervising/approving officer or employee and the fiscal officer may be liable for such losses, and may therefore be included as a party liable for repaying a *finding for recovery*, even if they did not personally account for the transaction. The Auditor of State issued Bulletin 2010-01 clarifying this policy for county officials. However, general concepts included in the Bulletin apply to all public offices.

When a public official (including fiscal officers) is named in a finding for recovery based on the strict liability laws, auditors should modify the wording of the Finding accordingly. An example follows:

Joe's Service Business, Inc. improperly submitted invoices for, and had expenditures paid on its behalf, of \$125,000 in excess of the amounts City's Council authorized.

In accordance with the forgoing facts, and pursuant to Ohio Rev. Code Section 117.28, a Finding for Recovery for public money illegally expended is hereby issued against Joe's Service Business, Inc. and in favor of the City of Anyplace, in the amount of \$125,000.

Fifteen thousand dollars of the net expenditures of \$125,000 illegally paid to, or on behalf of, Joe's Service Business occurred when Jim Smith was the City Finance Director, and \$110,000 of these net illegal expenditures occurred when Bill Wilson was the City Finance Director.

Under Ohio law, any public official who either authorizes an illegal expenditure of public funds or supervises the accounts of a public office from which such illegal expenditure is made is strictly liable for the amount of the expenditure. Seward v. National Surety Corp., 120 Ohio St. 47 (1929); 1980 Op. Atty Gen. No. 80-074: Ohio Rev. Code Section 9.39; State, ex. rel. Village of Linndale v. Masten, 18 Ohio St. 3d 228 (1985). Public officials controlling public funds or property are liable for the loss incurred should such funds or property be fraudulently obtained by another, converted, misappropriated, lost or stolen to the extent that recovery or restitution is not obtained from the persons who unlawfully obtained such funds or property, 1980 Op. Atty Gen. No. 80-074.

Jim Smith and Bill Wilson and their bonding company Ace Insurance Corp. will be jointly and severally liable in the amount of \$15,000 and \$110,000, respectively, and in favor of the City of Anyplace ~~to the extent that recovery is not obtained from Joe's Service Business, Inc.~~

*Note: The Strikeout above results from AOS Bulletin 2010-01.*

## Referring Audit Reports

When an audit report includes a noncompliance citation which falls under the jurisdiction of a particular state agency, it often is desirable to refer a copy of the released audit report to the agency. Reports may also be referred to the Attorney General under the authority of Ohio Rev. Code Section 117.42, which empowers the Attorney General, at the request of the Auditor of State, to undertake appropriate action to secure compliance with the laws by a public office.

Ohio Rev. Code Section 117.27 also requires the Auditor of State to provide a certified copy of the audit report to any officer required by state law, municipal or county charter, or municipal ordinance to act as legal counsel to the officers of the public office. If no officer is required by state law, municipal or county charter, or municipal ordinance to act as legal counsel, a copy shall be filed with the prosecuting attorney of the county within which the fiscal office of the public office is located. Field auditors who prepare reports containing Findings for Recovery and forward it together with a copy of the certified audit report to the appropriate statutory legal counsel or the local prosecutor's office.

### Referring Findings for Recovery to the Attorney General

Ohio Rev. Code Section 117.28 requires the Auditor of State to notify the Attorney General of Findings for Recovery, whether or not repaid before the audit report's release. ~~Letters are automatically sent by the Auditor of State's office when Findings for Recovery are reported during report submission. Findings for Recovery identified by IPAs are included in the AOS certification instead of the IPA's report since IPAs do not have the authority to issue Findings for Recovery. Field auditors who prepare reports containing Findings for Recovery and Quality Assurance staff who certify IPA reports containing Findings for Recovery, should prepare a letter, substantially in the following form, for the Auditor of State to sign upon release of the reports:~~

[Date]  
The Honorable [Name of Attorney General]  
Attorney General of the State of Ohio  
30 E. Broad St.  
Columbus, OH 43266-0410

Re: Findings for Recovery in an Audit Report

Dear Attorney General [last name]:

Attached is a copy of the audit report of [entity] for the year ended [date]. The Auditor of State filed certified copies of this audit report with the public officials listed in Ohio Revised Code Section 117.26. Pursuant to Ohio Revised Code Section 117.28, ~~we electronically distributed certified copies of this audit report to you [use if audit report is sent electronically] or~~ we are providing you a copy of this audit report ~~[use if hard copy of the audit report is sent]~~ because it includes a Finding for Recovery. In addition, we sent a certified copy of the report to [entity]'s legal counsel as required by Ohio Revised Code sections 117.27 and 117.28.

If you have any questions, or if you need further information, please contact the Auditor of State's Legal Division at 614 752-8683.

Very truly yours,

**Mary Taylor, CPA**  
Auditor of State

~~Referrals to the Attorney General, involving matters other than Findings for Recovery, will be limited to situations involving gross malfeasance, repeated serious material budgetary violations, or any unusual noncompliance items that warrant legal action, and may only be done by the Legal Division.~~

## **Referrals to the Ethics Commission, Other State Agencies, and the IRS**

### 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.

### IRS, Ohio Department of Taxation, and OPERS Comments

The Internal Revenue Service, the Ohio Department of Taxation, and the Ohio Public Employees Retirement System have requested that we notify them when AOS issues reports (in the case of the IRS and Taxation, also management letters) containing comments or findings pertaining to their respective agencies. The Auditor of State has agreed to these requests. Auditors and the Center for Audit Excellence should send a copy of the released report or management letter, including the number of the finding related to the referral to [Referrals@auditor.state.oh.us](mailto:Referrals@auditor.state.oh.us). The Center for Audit Excellence division will notify these agencies via email based upon being informed by either Auditor of State regional auditors or the Center for Audit Excellence division that such reports (or management letters) exist.

### Referrals to Other Agencies

When referring an audit report to any other State or Federal agency, the regional audit office will prepare and send the referral. The Regional office will also notify the Auditor of State’s Legal Division of the referral prior to sending the referral. The regional office should retain a copy of the cover letter. Currently, there is no requirement to send referral to School Employees Retirement System, School Teachers Retirement System and Ohio Police & Fire. We should also not send a referral letter when (1) the audit report already describes the problem and (2) we are certain the person we are sending the letter to is on the audit report distribution list. For example, OMB Circular A-133 already requires sending a copy of the audit report to cognizant or oversight agencies.

## **Questions and Comments**

The Auditor of State welcomes comments and suggestions on the *Ohio Compliance Supplement*. Please submit them through:

<http://www.ohioauditor.gov/Contact/Default.htm>