Updated by 131st GA, HB 2, effective 2/1/16:
- Requires a management company/operator that *receives* more than 20% of the gross annual revenues of a community school to provide a detailed accounting, include the nature and costs of the good and services it provides to the school, and subjects that information to verification through the auditing process.
- Prescribes the level of detail that must be presented in the detailed accounting based on current USAS expenditure coding requirements.

This Bulletin applies post-2016 amendment. See current guidance in AOS OCS 2-5.

Bulletin 2004-009

Auditor of State Bulletin

Date Issued: October 27, 2004

TO: All Community Schools

FROM: Betty Montgomery
Ohio Auditor of State

SUBJECT: Mandatory New Community School Footnote Disclosures for Management Companies

Background

Community schools frequently outsource significant administrative and instructional services to management companies. These schools' financial statements often present amounts paid to a management company in one income statement caption. Although this caption often represents well over half of a school's total expenses, it does not provide sufficient detail as to how the school's money was spent.

Pursuant to an amendment to the Ohio Revised Code, certain community schools using management companies are now required to more fully disclose accounting information regarding the nature and costs of services provided by these companies. This Bulletin describes the amended law, how schools should follow the law, and how the Auditor of State's Office (AOS) will audit these disclosures.

The Legal Requirement

House Bill 364 took effect on April 8, 2003, and added Ohio Rev. Code § 3314.02.4. This new Section states:

> A management company that provides services to a community school that amounts to more than twenty per cent of the annual gross revenues of the school **shall provide a detailed accounting including the nature and costs of the services it provides to the community school**. This information shall be included in the footnotes of the financial statements of the school and be subject to audit during the course of the regular financial audit of the community school. (*emphasis added*)

Footnote Disclosure

Community schools paying more than 20 percent of their gross revenues to a management company must add a new footnote to their audited financial statements beginning with the year ending June 30, 2005.

This footnote should list management company expenses during the year by object codes (e.g., salaries, supplies, etc.). Pursuant to Ohio Rev. Code § 3314.03(A)(8), community schools are required to use the Uniform Schools' Accounting System[1] (USAS), which requires classifying costs by function and object codes. Therefore, community schools should be familiar with this accounting method.

Furthermore, this footnote should differentiate between the direct costs and the overhead costs that a management company allocates to a community school. To demonstrate the manner in which management expenses should be presented, this Bulletin includes an example footnote disclosure as Appendix A.

Auditing the Footnote

Because the Legislature mandates the disclosure of this information (i.e., management company expenses for community schools) and because it equals at least 20 percent of a community school's revenue, AOS deems the information material and therefore, it requires audit assurance.

The management company may elect to have AOS audit this information at the management company. AOS will examine the books, records, and other supporting documentation prepared and maintained by the management company.

Alternatively, AOS will accept a management company's independently audited financial statements as meeting the requirements of Ohio Rev. Code § 3314.024, provided the audit meets the audit and disclosure requirements set forth in this Bulletin, as applicable to the specific community school.

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

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[1] A listing of object codes from USAS appears beginning on page 27 of the May, 2003 USAS Users Manual. You can access this manual at www.auditor.state.oh.us , under *Publications, Local Government Manuals and Handbooks*.

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

The management company's audit opinion must extend to the combining or consolidating columns. Auditors of management companies must set their materiality threshold to include assurance the supplemental information for each school is not materially misstated.[2] Opinions that report only on the individual school statement's fair presentation in relation to the management company's basic financial statements[3] do not provide sufficient audit assurance, unless accompanied with an agreed-upon procedures report related to the supplemental information. See Appendix B for procedures to which AOS would agree.

Failure to Comply

Since AOS deems this information material, failing to provide an adequate level of audit assurance (as described above) will require AOS to qualify a school's statements for omitting a required disclosure, or will require a scope qualification for an inability to audit the footnote. Finally, AOS will report this as material noncompliance with Ohio Rev. Code § 3314.02.4.

If you have any questions regarding this Bulletin, please contact AOS's Accounting and Auditing Support Group at (800) 282-0370.

Betty Montgomery
Ohio Auditor of State

[2] This is permitted by Codified Auditing Standards AU 551.19[2] (also see footnote 8 to AU 551.16). This lower materiality threshold is similar in concept to an auditor opining on individual funds rather than the opinion units of a government's financial statements. See paragraphs 4.29, 4.30, 14.47 and Appendix 14 A, Example 12 of the AICPA's *Audits of State and Local Governmental Units.*

[3] See Codified Auditing Standards AU 551.12 or 551.18 for examples.

Appendix A (page 1 of 2): Example Footnote Disclosure

Note XX Management Company Expenses
For the years ended June 30, 2006 [4] and 2005, [5] ABC Management Company incurred the following expenses on behalf of the School.

Expense	**2006**	**2005**
Direct expenses:		
Salaries & wages		(100 object codes)
Employees' benefits		(200 object codes)
Professional & technical services		(410 object codes)
Property services		(420 object codes)
Travel		(430 object codes)
Communications		(440 object codes)
Utilities		(450 object codes)
Contracted craft or trade services		(460 object codes)
Tuition paid to other districts		(470 object codes)
Transportation		(480 object codes)
Other purchased services		(490 object codes)
Books, periodicals & films		(520, 530, 540 objects)
Food & related supplies		(560 object codes)
Other supplies		(510, 550, 570, 580, 590 object codes)
Depreciation		(Depreciation on assets capitalized under object codes 600, 700)
Interest		(Object code 820)
Judgments		(Code 860)
Other direct costs		(All other object codes)[6]
Indirect expenses: Overhead		
Total expenses		

Note: AOS will accept minor departures from USAS object codes. The USAS manual provides additional definitions and examples of expenses these object codes describe.

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[4] AOS requires only 2005 information with June 30, 2005 audits. For the next fiscal year, present this information comparatively if the statements are comparative, as Chapter 2A of Accounting Research Bulletin No. 43 suggests.

[5] If a management company's fiscal year does not end on June 30, the footnote should include information for its fiscal year ending during the school's fiscal year. For example, a school would report a management company's expenses for a fiscal year ended December 31, 2004 in the school's audited statements for fiscal year ending June 30, 2005. Modify the footnote dates accordingly.

[6] A management company can omit object codes comprising less than 3% of its total expenses, and classify those costs with "other direct costs." For example, if a school's transportation costs were less than 3% of total expenses, it is permissible to classify those costs as "transportation" or "other direct costs."

Appendix A (page 2 of 2): Example Footnote Disclosure

Note XX Management Company Expenses (concluded)
ABC Management Company charges expenses benefiting more than one school (i.e., overhead) pro rata based on revenues the Company receives from each school it manages. (Briefly describe the method used to assign overhead expenses. Modify this example as needed.)

Appendix B (page 1 of 2): Agreed Upon Procedures Guidelines

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

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

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

3. As a specified party, AOS requires the following procedures:
    a. Haphazardly or randomly select 100 direct nonpayroll expense transactions (checks, EFTs, etc.) the management company charged to its community schools.
    b. Compare the amount charged to the school to supporting documentation, including a canceled check (or EFT documentation, etc.) and vendor invoice, supporting that the cost:
        i. Is a direct expense benefiting the school.
        ii. Is recorded for the proper amount for the proper period in the accounting system.
        iii. Is charged to a proper object code.
    c. Haphazardly or randomly select 100 direct payroll expense transactions, including salaries and benefits the management company charged to its community schools.
    d. Compare the amount charged to the school to supporting documentation, including a canceled check and to personnel files supporting that the cost:
        i. Is a direct expense paid to an employee for services provided solely to the school
        ii. Is the cost recorded for the proper amount for the proper period in the accounting system
        iii. Is the cost charged to a proper object code
    e. Haphazardly or randomly select 100 expense transactions assigned to any indirect cost pool.
        i. Compare the transaction to source documentation, such as vendor invoice, personnel file, etc. supporting the cost indirectly benefits the schools or other activities to which it is allocated.
        ii. Determine the transaction is recorded for the proper amount for the proper period in the accounting system.

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

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

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

5. AOS will judge whether any noncompliance reported in the agreed-upon procedures report requires the opinion to be qualified regarding the footnote.