

## Chapter 6

# OTHER POTENTIALLY DIRECT AND MATERIAL LAWS AND REGULATIONS

The Auditor of State has identified the following laws and regulations not elsewhere classified that could directly and materially affect an entity’s financial statements in certain circumstances.

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**Section A: Various Entity Types**

**Revision per SB 55,  
effective January 8, 2004.**

**6-1 Compliance Requirement:** Ohio Rev. Code Section 9.833 - Health Care Self Insurance <sup>1</sup>

**Summary of Requirement:** This section requires individual, self-insured governments or joint self-insured health-care programs to calculate (i.e., reserve<sup>2</sup>) amounts required to cover health care benefit liabilities. (Health care insurance includes, but is not limited to health care, prescription drugs, dental care and vision care.) It also requires programs to prepare a report, within 90 days after the fiscal year-end, reflecting those reserves (i.e., liabilities) and the disbursements made to pay self-insured claims, legal and consultant costs during the preceding fiscal year. This report is not filed with any office, including the Auditor of State; the government should make it available upon request.

An actuary must certify that the amounts reserved are fairly stated in accordance with sound loss reserving principles. The actuary must be a member of the American Academy of Actuaries.

Individual governments subject to this requirement must establish an internal service fund to account for this activity.

Per ORC 9.833(E), some of the aforementioned requirements do not apply to counties, townships, and municipalities. See the matrix appended to Auditor of State Bulletin 2001-05 regarding which provisions apply to various government types.

**Note: Auditors should refer to Auditor of State Bulletin 2001-05 for additional guidance.**

In determining how the government ensures compliance, consider the following:	What control procedures address the compliance requirement?	W/P Ref.
<ul style="list-style-type: none"> <li>• Policies and Procedures Manuals</li> <li>• Knowledge and Training of personnel</li> <li>• Tickler Files/Checklists</li> <li>• Legislative and Management Monitoring</li> <li>• Management’s identification of changes in laws and regulations</li> <li>• Management’s communication of changes in laws and regulations to employees</li> </ul>		

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

<sup>1</sup> FYI: SB 55, effective Jan. 8, 2004, also permits subdivisions to procure group life insurance for its employees in conjunction with an individual or joint self insurance program. However, neither a government nor a pool can self insure for life insurance. (That is, a government must purchase life policies from commercial insurers.)

<sup>2</sup> “Reserved” means liabilities measured in accordance with accepted actuarial principles.

<ul style="list-style-type: none"> <li>• Subdivisions<sup>3</sup> (except municipalities, townships and counties) must establish an internal service fund to account for health self-insurance activity. Determine if the subdivision established the required fund.</li> <li>• Determine whether the subdivision obtained a report presenting the actuarially-measured liabilities and disbursements.</li> <li>• Inspect the actuary’s certificate (i.e. opinion) that the amounts reserved conform to accepted loss reserving standards.</li> <li>• Test information the client submitted <b>to the actuary</b> to determine this information is supported by the client’s accounting or other applicable records. Testing information the client provides to the actuary is necessary to comply per No. 73, <i>Using the Work of a Specialist</i>. SAS 73 (AU 336.12(b)) when the actuary’s liability calculation is accrued as a GAAP liability<sup>4</sup> or presented in a cash-basis entity’s notes.</li> <li>• Determine whether the actuary’s opinion language (including the scope of the work) generally complied with the example described in the “Actuarial Opinions” section of Auditor of State Bulletin 2001-05.</li> <li>• Consider whether any qualification in the actuary’s report affects the financial statement opinion or indicates noncompliance with 2744.081.</li> <li>• Determine if a cash-basis (or AOS basis) government’s audited statements disclose self insurance activity based on the example disclosure in Bulletin 2001-05. (For cash-basis entities, an inability to adequately calculate and present the liability may constitute a qualification related to the adequacy of disclosure.)</li> </ul>	
<p><b>Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b></p>	

<sup>3</sup> ORC 9.833 and 2744.08 define a subdivision as any municipal corporation, township, county, school district or other body corporate and politic responsible for governmental activities in a geographic area smaller than the State.

<sup>4</sup> As Bulletin 2001-005 describes, actuarial principles for measuring these liabilities are similar but not identical to GAAP requirements per GASB 10. A government can use the actuarially-computed liability in its financial statements if it does not materially differ from GAAP measurement requirements.

**6-2 Compliance Requirement:** Ohio Rev. Code Section 2744.081 - Liability Self Insurance

**Summary of Requirement:** This section requires joint self-insurance programs (such as governmental self-insurance pools) insuring against judgments, settlement of claims, expense, loss and damages that arise, or are claimed to have arisen, from an act or omission of the subdivision or any of its employees and to indemnify or hold harmless the subdivision’s employees, to reserve<sup>5</sup> amounts to cover potential costs. It also requires the program to prepare a report, within 90 days after the program’s fiscal year-end, reflecting those reserves (i.e., liabilities) and the disbursements made to pay self-insured claims, legal and consultant costs during the preceding fiscal year. This report is not filed with any office, including the Auditor of State; it should be retained by the government and be made available upon request.

An actuary must certify that the amounts reserved are fairly stated in accordance with sound loss reserving principles. The actuary must be a member of the American Academy of Actuaries.

The aforementioned requirements apply only to governmental risk pools or other joint governmental liability insurance programs.

**Note: Auditors should refer to Auditor of State Bulletin 2001-05 for additional guidance.**

In determining how the government ensures compliance, consider the following:	What control procedures address the compliance requirement?	W/P Ref.
<ul style="list-style-type: none"> <li>• Policies and Procedures Manuals</li> <li>• Knowledge and Training of personnel</li> <li>• Tickler Files/Checklists</li> <li>• Legislative and Management Monitoring</li> <li>• Management’s identification of changes in laws and regulations</li> <li>• Management’s communication of changes in laws and regulations to employees</li> </ul>		
<b>Suggested Audit Procedures - Compliance (Substantive) Tests</b>		
<ul style="list-style-type: none"> <li>• Determine whether a report presenting the actuarially-measured liabilities and disbursements during the year was obtained.</li> <li>• Inspect the actuary’s certificate that the amounts reserved conform to accepted loss reserving standards.</li> <li>• Test information the client submitted to the actuary to determine this information is supported by the client’s accounting or other applicable records. Testing information the client provides to the actuary is necessary to comply per No. 73, <i>Using the Work of a Specialist</i>. SAS 73 (AU 336.12(b) when the actuary’s liability calculation is accrued as a GAAP liability<sup>6</sup> or presented in a cash-basis entity’s notes.</li> </ul>		

<sup>5</sup> “Reserve” means liabilities measured in accordance with accepted actuarial principles.

<sup>6</sup> As Bulletin 2001-005 describes, actuarial principles for measuring these liabilities are similar but not identical to GAAP requirements per GASB 10. A government can use the actuarially-computed liability in its financial statements if it does not materially differ from GAAP measurement

<ul style="list-style-type: none"><li>• Determine whether the actuary’s opinion language (including the scope of the work) generally complied with the example described in the “Actuarial Opinions” section of Auditor of State Bulletin 2001-05.</li><li>• Consider whether any qualification in the actuary’s report affects the financial statement opinion or indicates noncompliance with 2744.081.</li><li>• Determine if a cash-basis (or AOS basis) government’s audited statements disclose self insurance activity based on the example disclosure in Bulletin 2001-05. (For cash-basis entities, an inability to adequately calculate and present the liability may constitute a qualification related to the adequacy of disclosure.)</li></ul>	
<p><b>Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b></p>	

**6-3 Compliance Requirement:** Ohio Admin Code Sections 3745-27-15 through 18 Landfill Financial Responsibility and Certifications

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

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

An index to the relevant OAC requirement follows:

- 3745-27-15: Solid waste facility or scrap tire transporter final closure requirements (Section (L) describes the local government test)
- 3745-27-16: Solid waste facility or scrap tire transporter final postclosure requirements (Section (L) describes the local government test)
- 3745-27-17: Wording of financial assurance instruments (Section (H) describes the wording for the letter governments assured under the local government test must submit to OEPA).
- 3745-27-18: Corrective measures financial assurance required, such as to remediate landfill groundwater contamination. (Section (M) describes the local government requirements.)

**I.** The Federal EPA adopted a regulation (40 CFR 258.74(f)) allowing governmental solid waste landfills (GSWLFs) to avoid acquiring third-party financial instruments (such as letters of credit, insurance or establishing trust funds) to assure current final closure, postclosure and/or corrective measure cost estimates and any other environmental obligations to the extent they meet certain financial tests. The Federal EPA placed the responsibility for monitoring compliance with this rule on the states. In response, the Ohio EPA adopted a regulation that parallels the Federal regulation in most aspects.

**II.** A GSWLF need not obtain third-party instruments for amounts up to 43% of the local government's **total revenue**,<sup>7</sup> *provided* that it meets the tests described in **III** below. A GSWLF must obtain a third-party instrument (e.g., insurance, trust fund, bond) for all current final closure, postclosure and/or corrective measure cost estimates and any other environmental obligations, exceeding 43% of total revenue.

**III.** There are two alternatives to the third-party financial instruments nongovernments must have for (closure + postclosure + mandated corrective care costs). Governments do not need these instruments (for up to 43% of total annual revenue), if:

**Alternative I**

a. The GSWLF issues GAAP financial statements.

b. The GSWLF has not:

1. Defaulted on GO bonds, or has not issued GO bonds of less than investment grade per Moody's or S&P.

Local governments issuing bonds secured by collateral or a guarantee (e.g. AMBAC insurance) must meet the minimum rating without that security. (This means consider the *government's* debt rating, not the rating of a particular insured or collateralized *issue*.)

<sup>7</sup> Terms defined in the *State Support Document for the Local Government Financial Test* are printed in **boldface type** the first time they appear. A copy of this document was sent to each region

2. Has not operated at a deficit of greater than or equal to (5% x annual revenue) in either of the past two fiscal years. (The federal rule defines a deficit as total revenue minus **total expenditures**);
3. Received a qualified opinion.

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

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

**OR:**

**Alternative II:**

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

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

**IV. Reporting requirements:**

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

**V. Definitions:**

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

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

**VI. Other**

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

<b>In determining how the government ensures compliance, consider the following:</b>	<b>What control procedures address the compliance requirement?</b>	<b>W/P Ref.</b>
<ul style="list-style-type: none"> <li>• Policies and Procedures Manuals, including copies of updated Ohio Admin. Code Sections 3745-27-15 through 18.</li> <li>• Knowledge and Training of personnel</li> <li>• Tickler Files/Checklists</li> <li>• Legislative and Management Monitoring</li> <li>• Management’s identification of changes in laws and regulations</li> <li>• Management’s communication of changes in laws and regulations to employees</li> </ul>		

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

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

**For AOS staff: If the reporting differs from the example AUP available to AOS staff on the Briefcase, you must submit your draft report to Accounting & Auditing Support for review.**

Determine whether the estimate of closure, postclosure and other corrective care liabilities has been updated through the most recent balance sheet date. Such estimates may require corroboration by an environmental specialist. (The auditor may need to consider SAS 73, *Using the Work of a Specialist*.)

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

Prepare the agreed-upon procedures report required by the Federal EPA. An example report is available to AOS staff in the Audit Briefcase under “Shells”.

If the government cannot meet the government test, or has liabilities exceeding 43% of

<p>annual revenue, inquire which method the government has selected to assure these amounts. If the government has (1) established a final closure trust fund; (2) secured a surety bond guaranteeing payment; (3) obtained an irrevocable letter of credit or; (4) obtained commercial insurance to finance these liabilities, then inspect documentation that the required funds, bonds, letter of credit, or insurance have been obtained, and are in force.</p> <p>GASB 18, paragraph 7(e) requires disclosing the methods /instruments used to finance closure and postclosure care. This requirement applies to OCBOA /cash statements, too.</p>	
<p><b>Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b></p>	

**New step per HB 87,**  
**Effective 3/31/03**

**6-4 Compliance Requirement:** Ohio Rev. Code Section 5735.29 – Municipalities, counties and townships: Supplementing rather than supplanting motor fuel excise taxes (the Fuel Excise Tax).

**Summary of Requirement:** The State increased the Fuel Excise Tax rates from 2 cents per gallon to:

- 4 cents per gallon July 1, 2003;
- to 6 cents per gallon July 1, 2004 and to
- 8 cents per gallon July 1, 2005.

Municipalities, counties and townships should receive a corresponding increase in Fuel Excise Taxes each of these periods. Municipal corporations, counties, and townships must disburse Fuel Excise Taxes for the highway-related purposes stated in RC 5735.29. These purposes include costs related to constructing or maintaining (etc.): state highways, public bridges, public street signs and public traffic lights and certain public harbors and waterways.

Also, each municipal corporation, county, or township shall use at least ninety per cent of all Fuel Excise Taxes to supplement, rather than supplant, other *local*<sup>8</sup> funds used for highway-related purposes.

**The following text from RC 5735.29 describes the allowable uses:**

To provide revenue for supplying the state's share of the cost of constructing, widening, maintaining, and reconstructing the state highways; to maintain and repair bridges and viaducts; to purchase, erect, and maintain street and traffic signs and markers; to purchase, erect, and maintain traffic lights and signals; to pay the expense of administering and enforcing the state law relative to the registration and operation of motor vehicles; to make road improvements associated with retaining or attracting business for this state, to pay that portion of the construction cost of a highway project which a county, township, or municipal corporation normally would be required to pay, but which the director of transportation, pursuant to division (B) of section 5531.08 of the Revised Code, determines instead will be paid from moneys in the highway operating fund; to provide revenue for the purposes of sections 1547.71 to 1547.78 of the Revised Code; and to supplement revenue already available for such purposes, to pay the expenses of the department of taxation incident to the administration of the motor fuel laws, to supplement revenue already available for such purposes; and to pay the interest, principal, and charges on highway obligations issued pursuant to Section 2i of Article VIII, Ohio Constitution, and sections 5528.30 and 5528.31 of the Revised Code; to enable the counties and townships of the state to properly plan, construct, widen, reconstruct, and maintain their public highways, roads, and streets; to enable counties to pay principal, interest, and charges on bonds and other obligations issued pursuant to Chapter 133. of the Revised Code or incurred pursuant to section 5531.09 of the Revised Code for highway improvements; to enable municipal corporations to plan, construct, reconstruct, repave, widen, maintain, repair, clear, and clean public highways, roads, and streets; to enable municipal corporations to pay the principal, interest, and charges on bonds and other obligations issued pursuant to Chapter 133. of the Revised Code or incurred pursuant to section 5531.09 of the Revised Code for highway improvements; and to pay the costs apportioned to the public under section 4907.47 of the Revised Code, a motor fuel excise tax is hereby imposed on all motor fuel dealers upon their receipt of motor fuel within the state at the rate of two cents on each gallon so received; provided, that effective July 1, 2003, the motor fuel excise tax imposed by this

<sup>8</sup> The statute does not define *Local funds*. We believe it would be any amounts other than (1) direct or pass-through Federal money, or (2) State Funds paid from the State Treasury or appropriated by the State legislature.

section shall be at the rate of four cents on each gallon so received; effective July 1, 2004, the motor fuel excise tax imposed by this section shall be at the rate of six cents on each gallon so received; and, subject to section 5735.292 [5735.29.2] of the Revised Code, effective July 1, 2005, the motor fuel excise tax imposed by this section shall be at the rate of eight cents on each gallon so received. This tax is subject to the specific exemptions set forth in this chapter of the Revised Code. It shall be reported, computed, paid, collected, administered, enforced, and refunded, and the failure properly and correctly to report and pay the tax shall be penalized, in exactly the same manner as is provided in this chapter. Such sections relating to motor fuel excise taxes are reenacted and incorporated as if specifically set forth in this section. The tax levied by this section is in addition to any other taxes imposed under this chapter.

In determining how the government ensures compliance, consider the following:	What control procedures address the compliance requirement?	W/P Ref.
<ul style="list-style-type: none"> <li>• Accounting system designed to separately identify fuel excise taxes and other State, local or Federal sources restricted or appropriated for road construction / repair, etc.</li> <li>• Policies and Procedures Manuals</li> <li>• Knowledge and Training of personnel</li> <li>• Tickler Files/Checklists</li> <li>• Legislative and Management Monitoring</li> <li>• Management’s identification of changes in laws and regulations</li> <li>• Management’s communication of changes in laws and regulations to employees</li> </ul>		
<b>Suggested Audit Procedures - Compliance (Substantive) Tests</b>		
<ol style="list-style-type: none"> <li>1. Scan or otherwise test disbursements from the highway fund(s) into which the government deposits motor Fuel Excise Taxes. Determine whether the disbursements were for highway and related purposes RC 5735.29 permits.</li> <li>2. Obtain the government’s calculation of disbursements from <i>local funds</i> for highway purposes in the current and preceding year. If local fund disbursements were higher in the current year than the prior year, do not complete the remaining steps. The government has met the requirement.</li> <li>3. If local fund disbursements decreased in the most recent year, calculate if the total amount of highway disbursements adequately supplemented Fuel Excise Tax contributions as follows:               <ol style="list-style-type: none"> <li>(a) Multiply current year Fuel Excise Tax receipts x 10%.</li> <li>(b) Subtract current-year highway local fund disbursements from the prior-year local disbursements from step 2.</li> <li>(c) Determine whether the decrease from step (b) was <math>\geq</math> the amount computed from 3(a) above. We should report material declines of <math>\geq 10\%</math> as noncompliance with the supplement not supplant requirement.<sup>9</sup></li> </ol> </li> </ol>		
<b>Audit Implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable</b>		

<sup>9</sup> Example: Assume a government receives \$10,000 of Fuel Excise Tax in 2005. The government could reduce its disbursement of *local funds* for road purposes by  $\leq 10\%$  of this amount in 2005 (i.e., could reduce *local* road disbursements no more than \$1,000 vs. 2004 disbursements).

conditions/material weaknesses, and management letter comments):

**Section B: School Districts**

**6-5 Compliance Requirement:** Ohio Rev. Code Sections 3317.03 (E), 3313.981 (F), and Ohio Admin. Code Section 3301-51-13. - School district Average Daily Membership.

**Summary of Requirements:** Average Daily Membership (ADM) is one variable used to compute school districts’ funding, pursuant to Ohio Rev. Code Section 3317.022(A). Ohio Rev. Code Section 3317.03 defines ADM.

Ohio Rev. Code Section 3317.03 (E) requires a school district to accurately show, for each day the school is in session, the actual membership enrolled in regular day classes. This code provision further delineates which students should and should not be included in a school district’s ADM count on the basis of residency, school attendance, and proficiency testing attendance.

Each school district is responsible for accurately reporting statistics to the Ohio Department of Education’s Educational Management Information System (EMIS), which uses the statistics to compute the school district’s ADM. Of the many statistics required to be reported, one of the most important is the determination of school attendance. Pursuant to Ohio Rev. Code Section 3317.03 (E), a school district’s attendance for ADM purposes is arrived at by determining the number of students *enrolled* during the first full school week in October. This code provision also defines *enrolled* to include students who are handicapped and receiving home instruction, in attendance, or not attending but having an excused absence for a valid legal reason.

When counting the number of students enrolled for ADM purposes, Ohio Rev. Code Section 3313.981 sets the requirements for the inclusion and exclusion of students who live in one district but who are paying tuition and enrolled in another district. A student should be included in the ADM count of the district in which he/she resides and not the district in which he/she pays tuition to attend.

Valid legal reasons for non-attendance from Ohio public schools are set forth in Ohio Admin. Code Section 3301-51-13. Any reason not delineated in this code provision shall be deemed unexcused and the pupil should not be reported as enrolled for that day for ADM purposes. Valid legal reasons for school non-attendance include personal illness, illness in the family, quarantine of the home, death of a relative, work being done at the home due to the absence of parents or guardians, observance of a religious holiday, or emergency circumstances which the school superintendent judges are good and sufficient cause. See Ohio Admin. Code Section 3301-51-13(B)(2)(a-g).

In determining how the government ensures compliance, consider the following:	What control procedures address the compliance requirement?	W/P Ref.
<ul style="list-style-type: none"> <li>• Policies and Procedures Manuals</li> <li>• Knowledge and Training of personnel</li> <li>• Tickler Files/Checklists</li> <li>• Legislative and Management Monitoring and reconciliation</li> <li>• Management’s identification of changes in laws and regulations</li> <li>• Management’s communication of changes in laws and regulations to employees</li> </ul>		
<b>Suggested Audit Procedures - Compliance (Substantive) Tests</b>		
Document and evaluate procedures for enrolling and withdrawing pupils, and for processing excused student absences.		

<p>Compare final counts per the EMIS system with the count sheets during ADM week. Seek explanations for any significant differences or adjustments.</p> <p>Perform Analytical Procedures such as:</p> <ul style="list-style-type: none"><li>• Comparing the number of students enrolled as of October of the year under audit and the prior two years. Investigate any unusual or significant changes. All material changes should relate to events such as increased housing in an area, large businesses moving in or out of a school district, and any other major event that may impact enrollment.</li><li>• Compare counts the week before, the week of, and the week after, the ADM count week. Note any apparent significant differences and seek explanations from management.</li><li>• Compare this year's counts by building with previous periods. Ask for management's explanation for any significant differences.</li></ul> <p>Where the number of students paying tuition is expected to be significant, inspect documentation that indicates students who are paying tuition to attend are excluded from the school district's ADM (consider using analytical procedures).</p>	
<p><b>Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b></p>	

Revised effective July 1, 2005, per  
ODE's revision to OAC 3301-61-16

**6-6 Compliance Requirement:** Ohio Administrative Code Rule 3301-61-16 (the Rule) regarding *vocational* educational weighted funding, and RC 3317.022(C)(5), *special* education weighted funding

**Summary of vocational education requirement:** To help assure schools spend the weighted funding on Vocational Education, the State Department of Education adopted this Rule, which:

- (1) Describes allowable costs;
- (2) Provides ~~2 alternative formulas~~ a formula by which school districts can measure whether they have spent sufficient vocational weighted funding. ~~These two formulas appear in subsections A(2)(b) and A(3) of the Rule, respectively.~~ Effective July 1, 2005, the formula appears in subsection (B)(2) of the Rule.

Annually, the Department of Education will ~~certify~~ report the amount school districts must spend to avoid refunding unspent amounts to the Department. A web link to a site with these reports appears in the attached program. Auditors need not have a detailed understanding of the ~~two~~ formulas, since the Department of Education is responsible for those computations.

The ~~A(2)(b)~~ formula requires spending 75% of the weighted revenue ~~certified under A(2)(B)~~ ODE reports on the SF-3 (See web link later in this program) for eligible costs (examples listed below). The remaining weighted funds can be spent for other vocational-related purposes. ~~The A(3) formula requires spending (1) 15% of the certified A(3) formula revenue on the eligible costs listed below and (2) spending no more than 5% for indirect and administrative costs. Schools can annually elect which spending rule they wish to follow [A(2)(B) or A(3)]. However, since the formulas and circumstances differ, some schools will actually require spending less amounts for eligible costs under the A(2)(b) Rule than under the A(3) Rule.~~

Auditors must understand the allowable and unallowable costs, and consider whether a District must record a GAAP liability for under spending or for ineligible costs charged to the weighted funding.

(This OAC requirement also applies to community school vocational education students through RC 3317.014 via RC 3314.08(A)(5).)

Acceptable Career-Technical Vocational Education Expenditures under A(2)(b) & A(3) B(2)	Typical Function Code
1. Curriculum development, including teacher stipends necessary to develop curricula.	2212
2. Student assessment costs, including expenditures for Work Keys, student industry certifications, and Occupational Competency Analysis Profile assessments.	2123
3. Instructional resources and supplies including textbooks	1300
4. Career-technical student organization operational costs including teacher stipends for activities beyond the regular school day and year.	4300
5. Work-site learning experience costs.	1300
6. Extended programming costs including teacher personnel costs for extended programming. Please note the definition of extended programming in the rule is more restrictive than extended service.	1300
7. Marketing costs that are solely attributable to marketing career-technical education programs.	2930
8. Technology costs directly associated with career-technical instruction	2960
9. Costs associated with receiving industry certification of career technical education programs	1300
10. Costs associated with student credentialing, such as the cosmetology certification exam.	1300
11. Instructional equipment.	1300
12. Computers used for instruction.	2960
13. Professional development costs for career-technical educators including administrative staff. These costs do NOT include expenditures required to meet basic teacher licensing requirements.	1300
14. Curriculum consultant costs such as High Schools That Work implementation or career pathways development.	1300 or 2200
15. Teacher and student travel expenses related to instruction.	1300
16. Conference expenses for teachers and administrators such as the All-Ohio Career Technical Conference.	Varies
17. Equipment repairs and service contracts.	1300
18. Specifically metered utility costs that are directly attributable to career technical instructional programming.	1300
19. Instructional materials production costs including copier costs that are directly attributable to vocational instructional activities.	1300

**Summary of Requirements (continued):**

Under 3301-61-16(A)(2)(b) allowable salaries are only those for teachers ODE has approved for career-technical instruction. This may include the portion of academic teacher time allocated to classes the state has approved for career-technical weighted funding. EMIS reports list classes approved for this funding. (The district can charge only extended programming salaries to meet its 75% requirement; but can pay other teacher salaries from the remaining 25% of weighted funds. ODE must approve any teacher for career technical instruction to charge to any career tech weighted funds.)

Eligible costs encumbered at June 30 are also allowable, to the extent they are subsequently paid in cash.

**Examples of ineligible costs under 3301-61-16(A)(2)(b)&(e) (B)(2) and for purposes of meeting the 15% requirement under A(3):**

1. Indirect costs based on estimates or percentage allocations. These costs include utilities, administration, general school marketing, etc.
2. Base teacher salary and fringe benefits.<sup>10</sup>
3. Facilities construction and remodeling.
4. Costs associated with initial teacher licensing.
5. Expenditures made from any fund other than the general fund, a permanent improvement fund, or the DPIA fund.
6. Any costs associated with instructional programming not receiving career-technical weightings.
7. Student stipends or salaries paid to students.

**Summary of Special education weighted funding requirement:**

RC 3317.022(C)(5) states in part: "In any fiscal year, a school district shall spend for purposes that the department designates as approved for special education and related services expenses at least the amount" ODE calculates using the weighted funding formula.

ODE monitors disbursements (including special education staff costs) districts report through the EMIS system under function codes related to special education.

ODE compares amounts districts report as special education function disbursements with special education funding reported on Form SF-3. ODE determines remedies for schools that have spent less than they received for special education weighted funds. The Auditor of State's State Region tests ODE's monitoring system in the State's audit. The State Region annually transmits ODE's list of noncompliant schools to the Auditor of State's local regional offices. Auditors of noncompliant schools should use this list to determine if whether a district complied with RC 3317.022(C)(5).

**For additional information, see Auditor of State Bulletin 2000-16.**

<sup>10</sup> As an example, a district using the 75% test could not include base teacher salaries or benefits as eligible costs comprising its use of 75% of the funding (except for extended programming). However, a district could pay base teacher salaries and benefits from the remaining 25% of weighted funds, per ~~(A)(2)(e)~~ (B)(1).

In determining how the government ensures compliance, consider the following:	What control procedures address the compliance requirement?	W/P Ref.
<ul style="list-style-type: none"> <li>• Adequate knowledge of eligible and ineligible costs by persons assigned to code/post disbursements</li> <li>• Periodic summarization of eligible costs compared to certified revenue</li> <li>• Periodic supervisory review of transactions recorded as eligible costs, and analysis of progress towards spending certified funds</li> <li>• Rechecking or comparing amounts entered on a spreadsheet to amounts posted to the USAS system (if a spreadsheet is used)</li> <li>• Annual computation of any refund due to ODE</li> </ul>		
<b>Suggested Audit Procedures - Compliance (Substantive) Tests</b>		
<p><b>Regarding vocational education weighted funds:</b></p> <ol style="list-style-type: none"> <li>1. Obtain the amount of weighted funds ODE paid to the school district from the SF-3 report, available at <a href="http://www.ode.state.oh.us/school_finance/foundation/default.asp">www.ode.state.oh.us/school_finance/foundation/default.asp</a></li> <li>2. Obtain an understanding of the method the District uses to measure eligible costs vs. weighted vocational education revenue. (Such methods may include using USAS special cost centers or job codes, or using spreadsheet software to record eligible costs).</li> <li>3. Inspect and foot or test foot the client’s computation of amounts spent/refundable.</li> <li>4. Scan summary records of eligible expenditures claimed, and evaluate for reasonableness.</li> <li>5. Commensurate with assessed control risk and the level of assurance provided from scanning procedures, select a representative number of eligible costs charged. Trace to supporting documentation and determine whether the expenditures were allowable.</li> </ol> <p><b>Regarding special education weighted funds:</b></p> <ol style="list-style-type: none"> <li>6. <u>Read the Excel spreadsheet, <i>List of schools in non-compliance with Special Education weighted funds requirements</i> (or the comparable list for JVS districts). The AOS State Region normally provides this approximately the beginning of each December.</u></li> <li>7. <u>Scan the listing to determine if the school district you are auditing is listed.</u></li> <li>8. <u>Discuss with management any corrective actions ODE has required to address this noncompliance. Considering the materiality of the underspending, report the noncompliance in the management letter or GAGAS report (or verbally if minor in amount).</u></li> </ol>		
<p><b>Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b></p>		

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**Section C: Community Schools**

<p><b>6-7 Compliance Requirement:</b> Ohio Rev. Code Section 3314.03(11)(b) - Liability insurance.</p> <p><b>Summary of Requirement:</b> The governing authority of each community school must purchase liability insurance, or otherwise provide for the potential liability of the school.</p>		
<p><b>In determining how the government ensures compliance, consider the following:</b></p> <ul style="list-style-type: none"> <li>• Policies and Procedures Manuals</li> <li>• Knowledge and Training of personnel</li> <li>• Tickler Files/Checklists</li> <li>• Legislative and Management Monitoring</li> <li>• Management’s identification of changes in laws and regulations</li> <li>• Management’s communication of changes in laws and regulations to employees</li> </ul>	<p><b>What control procedures address the compliance requirement?</b></p>	<p><b>W/P Ref.</b></p>
<p><b>Suggested Audit Procedures - Compliance (Substantive) Tests</b></p>		
<p>Secure a copy of the school’s insurance policy and evaluate the reasonableness of the coverage.</p>		
<p><b>Audit Implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b></p>		

<p><b>6-8 Compliance Requirement:</b> Ohio Rev. Code Section 3314.08(I) - Tuition.</p>		
<p><b>Summary of Requirement:</b> No community school is permitted to charge tuition to any student.</p>		
<p><b>In determining how the government ensures compliance, consider the following:</b></p> <ul style="list-style-type: none"> <li>• Policies and Procedures Manuals</li> <li>• Knowledge and Training of personnel</li> <li>• Tickler Files/Checklists</li> <li>• Legislative and Management Monitoring</li> <li>• Management’s identification of changes in laws and regulations</li> <li>• Management’s communication of changes in laws and regulations to employees</li> </ul>	<p><b>What control procedures address the compliance requirement?</b></p>	<p><b>W/P Ref.</b></p>
<p><b>Suggested Audit Procedures - Compliance (Substantive) Tests</b></p>		
<ol style="list-style-type: none"> <li>1. Obtain a copy of the school’s enrollment application and scan the receipts journal or ledger for evidence of tuition charges.</li> <li>2. Inquire of the treasurer regarding any tuition charges.</li> </ol>		
<p><b>Audit Implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b></p>		

**6-9 Compliance Requirement:** Ohio Rev. Code Section 3314.02(E) – Governing authority.

**Summary of Requirement:** Each new start-up\* community school established under this chapter shall be under the direction of a governing authority which shall consist of a board of not less than five individuals who are not owners or employees, or immediate relatives of owners or employees, of any for-profit firm that operates or manages a school for the governing authority. For purposes of this section, immediate relatives are limited to spouses, children, parents, grandparents, and in-laws.

In addition, no person shall serve on the governing authority or operate the community school under contract with the governing authority so long as the person owes the state any money or is in a dispute over whether the person owes the state any money concerning the operation of a community school that has closed.

\* A start-up community school is any community school except those converted from public schools.

In determining how the government ensures compliance, consider the following:	What control procedures address the compliance requirement?	W/P Ref.
<ul style="list-style-type: none"> <li>• Policies and Procedures Manuals</li> <li>• Knowledge and Training of personnel</li> <li>• Tickler Files/Checklists</li> <li>• Legislative and Management Monitoring</li> <li>• Management’s identification of changes in laws and regulations</li> <li>• Management’s communication of changes in laws and regulations to employees</li> </ul>		
<b>Suggested Audit Procedures - Compliance (Substantive) Tests</b>		
<ol style="list-style-type: none"> <li>1. Inquire of management and read the minutes to determine whether the Board includes five members.</li> <li>2. Review the board membership for inappropriate relationships.</li> <li>3. Inquire of management whether any board members are owners or employees, or immediate relatives of owners or employees, of any for-profit firm that operates or manages a school for the governing authority.</li> <li>4. Inquire of management and other appropriate personnel whether any board members or individuals responsible for operating the community school owe the state any money or is in a dispute over whether that person owes the state any money concerning the operation of a community school that has closed.</li> <li>5. Determine whether board members abstained from voting on matters affecting them personally. A board member voting to approve his or her own compensation or other transactions between himself / herself and the school would violate Ohio’s Ethics Law, per Ohio Ethics Commission Advisory Opinion No. 2003-001</li> <li>6. Obtain representations from management regarding the requirements indicated above.</li> </ol> <p>Noncompliance noted per steps 2 -- 5 may result in referral to the Ohio Ethics Commission. Summarize potential ethics issues in a Matter for Attention, and review ethics referral procedures in the Introduction to the Ohio Compliance Supplement.</p>		
<b>Audit Implications (adequacy of the system and controls, and the direct and material effects of</b>		

**non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):**

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

**6-10 Compliance Requirement: Sponsor monitoring of community schools:**

- The sponsor may contract with the school to receive 3% or less of the amount the State pays to a school annually, solely for the costs of its oversight and monitoring activities.<sup>11</sup> [3314.03(C)]
- The contract between the sponsor and the school must require the sponsor to monitor the following [3314.03(D)]:
  - Compliance with laws the contract specifies
  - At least annually, monitor and evaluate the academic and fiscal performance and the organization and operation of the community school
  - Report the results of the preceding evaluation to ODE and to the students' parents.
  - Provide technical assistance to the school in complying with applicable laws and terms of the contract;
  - Intervene in the school's operation to correct problems in the school's overall performance,
  - Declare the school to be on probationary status pursuant to section 3314.073 of the Revised Code,
  - Suspend the operation of the school pursuant to section 3314.072 of the Revised Code,
  - Terminate the contract of the school pursuant to section 3314.07
  - Have in place a plan of action to be undertaken in the event the community school experiences financial difficulties or closes prior to the end of a school year

**In determining how the government ensures compliance, consider the following:**

**What control procedures address the compliance requirement?**

- Policies and Procedures Manuals
- Knowledge and Training of personnel
- Tickler Files/Checklists
- Legislative and Management Monitoring
- Management's identification of changes in laws and regulations
- Management's communication of changes in laws and regulations to employees

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

1. Examine the contract between the school and the sponsor. Determine if it provides payment to the sponsor for monitoring activities.
  - a. Trace actual payments to the sponsor to the accounting records to determine whether they were ≤ 3% of the school's State assistance (or met the terms of the contract of the sponsor provides additional services).
2. Inquire regarding the nature and extent of the sponsor's monitoring activities.
  - a. Examine minutes, correspondence, reports or other evidence supporting that the sponsor fulfilled its monitoring duties described above.

<sup>11</sup> A sponsor can earn more than 3% if it provides additional services beyond sponsorship. A contract should specify these additional services, and should differentiate them from the services required of a sponsor.

- b. Read the sponsor's annual report to ODE. Based on other audit procedures, judge whether that report suggests the sponsor is diligent in its monitoring and is frank in its reporting to ODE.<sup>12</sup>
3. If based on other audit procedures, the school is experiencing financial or performance problems, judge whether the sponsor is taking the actions the ORC prescribes above (e.g., declaring the school in probationary status, preparing an action plan to address financial difficulties).
4. Assess whether the sponsor's overall monitoring generally fulfills the requirements above. Report significant noncompliance as necessary.

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

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<sup>12</sup> Staff should not spend significant time reviewing this report. We are not opining or providing any assurance on it. Consider tracing a "handful" of key financial amounts to current or prior audited statements or to accounting records we used in the audits. Read key passages to determine whether they are generally consistent with our understanding. If we find material misrepresentations in the report to ODE, we can report this as noncompliance by the sponsor. Our noncompliance finding should avoid imprecise statements such as "The sponsor's report was inaccurate." Instead, quote statements or amounts from the sponsor's report compared to quotes or amounts we obtained from other sources. List our source in the finding.

## Section D: Townships

New step per OAG opinion 2004-036, effective October 19, 2004

**6-11 Compliance Requirement:** Ohio Rev. Code Section 505.24(C) Allocating township trustee per diem costs or salaries to funds. (Amplified by Ohio Attorney General Opinion 2004-036)

**Summary of Requirement, per Ohio Rev. Code Section 505.24(C):**

- (1) **Trustees receiving per diem compensation:** The trustees must resolve a method by which each trustee shall periodically notify the township clerk of the number of days spent on township services *and the kinds of services rendered* on those days. The per diem compensation shall be paid from the township general fund or from other township funds in proportion to the kinds of services rendered, as documented. (For example, the township could charge trustee time spent on road repairs to the road & bridge fund.)
- (2) **Trustees receiving compensation by annual salary:** By resolution, RC 505.24(C) permits trustees to receive annual salaries instead of per diem payments. When paid by salary, RC 505.24(C) does not prescribe a “documentation of time spent” requirement.

However, for salaries **not** paid from the general fund, effective October 19, 2004 OAG Opinion 2004-036 requires trustees to establish administrative procedures to document the proportionate amount chargeable to other township funds based on the kinds of services rendered. The “administrative procedures” can be timesheets or a similar method of record keeping, as long as the trustees document all time spent on township business and the type of service performed, in a manner similar to trustees paid per diem compensation. If trustees do not document their time, then no part of salaries may be paid from these other funds.

Per the above, trustees must keep records of the time spent on various tasks and the fund to which the township will charge their costs. (The sole exception to this is for trustees charging all salaries to the general fund, as described above.) There is no one method for documenting time and the kinds of services rendered. A diary, time sheets or other methods will suffice if they include the information described above.

**Important note:** Prior to this OAG Opinion, regarding (2) above, the AOS accepted resolutions that specified percentages of salaries to allocate to various funds, as complying with RC 505.24(C). This OAG Opinion alters that conclusion. Resolutions to pay trustees by salary should now specify that a township will allocate salaries based on **documentation** the trustees submit, not based on percentages a **resolution specifies**.

For example, subsequent to the OAG Opinion, it is **not** acceptable for a township to resolve that they will “charge 50% of trustee salaries and benefits to the general fund and 50% of this compensation to the road & bridge fund.”

For townships that have allocated salaries based on specified percentages, the AOS will issue a

<p>management letter comment for fiscal years ending through December 31, 2005. The AOS will not issue findings for adjustment for 2005 audits.<sup>13</sup> However, commencing January 1, 2006, townships must comply with the OAG opinion. Noncompliance with the OAG opinion for subsequent audits may result in:</p> <p>(1) GAGAS level findings and findings for adjustment</p> <p>(2) Scope qualifications in the AOS' opinion on the financial statements because we would have no acceptable evidence supporting how the township allocated salaries to funds.</p> <p>(3)</p>		
<b>In determining how the government ensures compliance, consider the following:</b>	<b>What control procedures address the compliance requirement?</b>	<b>W/P Ref.</b>
<ul style="list-style-type: none"> <li>• Policies and Procedures Manuals</li> <li>• Knowledge and Training of personnel</li> <li>• Time summaries / timecards</li> <li>• Legislative and Management Monitoring</li> <li>• Management's identification of changes in laws and regulations</li> <li>• Management's communication of changes in laws and regulations to employees</li> </ul>		
<b>Suggested Audit Procedures - Compliance (Substantive) Tests</b>		
<ol style="list-style-type: none"> <li>1. Document how the township records the time spent on each township service.</li> <li>2. Recompute selected clerk allocations of trustee salaries or per diem amounts to each fund.</li> <li>3. Trace hours to time sheets, if used.</li> <li>4. Agree selected postings of the salaries from step 2 to the township's check register.</li> </ol> <p>Note: A failure to document the time spent on township tasks would constitute a scope restriction on the allocation of trustee salaries. This could affect our financial statement opinion, if the undocumented allocation is material to the financial statements.</p>		
<b>Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b>		

<sup>13</sup> Except: If a township subject to a Federal Single Audit charges undocumented salaries (or other costs) to a Federal program, Federal audit requirements might require reporting this noncompliance as a Federal finding / questioned cost, etc. in the *current* audit.