TOWNSEND COMMUNITY SCHOOL
ERIE COUNTY

REGULAR AUDIT

FOR THE FISCAL YEAR ENDED JUNE 30, 2016

Dave Yost • Auditor of State

TOWNSEND COMMUNITY SCHOOL
ERIE COUNTY

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INDEPENDENT AUDITOR'S REPORT

Townsend Community School
Erie County
207 Lowell Street
Castalia, Ohio 44824

To the Board of Directors:

Report on the Financial Statement

We have audited the accompanying financial statement of Townsend Community School, Erie County, Ohio (the School), as of and for the year ended June 30, 2016, and the related notes to the financial statement.

Management's Responsibility for the Financial Statement

Management is responsible for preparing and fairly presenting this financial statement in accordance with the accounting principles generally accepted in the United States of America. This responsibility includes the designing, implementing and maintaining internal control relevant to preparing and fairly presenting a financial statement that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to opine on this financial statement based on our audit. We audited in accordance with auditing standards generally accepted in the United States of America and the financial audit standards in the Comptroller General of the United States' *Government Auditing Standards*. Those standards require us to plan and perform the audit to reasonably assure the financial statement is free from material misstatement.

An audit requires obtaining evidence about financial statement amounts and disclosures. The procedures selected depend on our judgment, including assessing the risks of material financial statement misstatement, whether due to fraud or error. In assessing those risks, we consider internal control relevant to the School's preparation and fair presentation of the financial statement in order to design audit procedures that are appropriate in the circumstances, but not to the extent needed to opine on the effectiveness of the School's internal control. Accordingly, we express no opinion. An audit also includes evaluating the appropriateness of management's accounting policies and the reasonableness of their significant accounting estimates, as well as our evaluation of the overall financial statement presentation.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse audit opinion.

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Basis for Adverse Opinion

As described in Note 2 of the financial statement, the School prepared this financial statement using the accounting basis Ohio Revised Code Section 117.38 and Ohio Administrative Code Section 117-2-03(D) permit. However, Ohio Administrative Code Section 117-2-03(B) requires this statement to follow accounting principles generally accepted in the United States of America. The effects on the financial statement of the variances between the regulatory basis of accounting described in Note 2 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumably material.

Adverse Opinion

In our opinion, because of the matter described in the *Basis for Adverse Opinion* paragraph, the financial statement does not present fairly the financial position, results of operations, and cash flows, where applicable, of Townsend Community School as of and for the year ended June 30, 2016 in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated January 26, 2018, on our consideration of the School's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. That report describes the scope of our internal control testing over financial reporting and compliance, and the results of that testing, and does not opine on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the School's internal control over financial reporting and compliance.

Dave Yost

Dave Yost
Auditor of State

Columbus, Ohio

January 26, 2018

TOWNSEND COMMUNITY SCHOOL
ERIE COUNTY

STATEMENT OF RECEIPTS, DISBURSEMENTS
AND CHANGE IN FUND BALANCE (REGULATORY CASH BASIS)
FOR THE FISCAL YEAR ENDED JUNE 30, 2016

Operating Cash Receipts	
Foundation Payments	$5,966,499
Operating Cash Disbursements	
Salaries	1,806,944
Employee Fringe Benefits	783,835
Purchased Services	1,103,477
Supplies and Materials	983,622
Other	162,853
Capital Outlay	2,018,435
Total Operating Cash Disbursements	6,859,166
Operating Loss	(892,667)
Non-Operating Receipts (Disbursements)	
Intergovernmental	355,308
Earnings on Investments	1,743
Other Non-Operating Receipts	26,081
Lease Payment	(154,470)
Total Non-Operating Receipts (Disbursements)	228,662
Net Change in Fund Cash Balance	(664,005)
Fund Cash Balance, July 1	1,172,150
Fund Cash Balance, June 30	$ 508,145

The notes to the financial statement are an integral part of this statement.

NOTE 1 – DESCRIPTION OF THE SCHOOL

Townsend Community School, Erie County, Ohio (the "School") is a state nonprofit corporation established pursuant to Ohio Rev. Code Chapters 3314 and 1702 to maintain and provide a school exclusively for any educational, literary, scientific and related teaching service. The School, which is part of the State's education program, is independent of any school district. The School may sue and be sued, acquire facilities as needed, and contract for any services necessary for the operation of the School.

The School was approved for operation under contract with Margaretta Local School District (the Sponsor) in previous audits. The current contract is effective for the period of December 31, 2015 through December 31, 2021. The School operates under a self-appointing five-member Board of Directors (the Board). The School's Code of Regulations specifies that vacancies that arise on the Board be filled by the appointment of a successor director by a majority vote of the then existing directors. The Board is responsible for carrying out the provisions of the contract with the Sponsor, which includes, but is not limited to, state mandated provisions regarding student population, curriculum, academic goals, performance standards, admission standards, and qualifications of teachers. The School has one instructional/support facility staffed by one director/superintendent, one principal, one vice-principal, twenty certified teaching personnel, six support staff, two enrollment attendants, two psychologist, two treasurer's office staff, and one technology support staff who provide services to an enrollment of 872 students.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Although required by Ohio Admin. Code § 117-2-03(B) to prepare its annual financial report in accordance with accounting principles generally accepted in the United States of America, the School chooses to prepare its financial statement and notes in accordance with standards established by the Auditor of State for governmental entities that are not required to prepare annual financial reports in accordance with generally accepted accounting principles. This basis of accounting is similar to the cash receipts and disbursements basis of accounting. Receipts are recognized when received in cash rather than when earned, and disbursements are recognized when paid rather than when a liability is incurred.

A. Reporting Entity

The School's reporting entity has been defined in accordance with GASB Statement No. 14, "*The Financial Reporting Entity*" as amended by GASB Statement No. 39, "Determining whether Certain Organizations Are Component Units", and GASB Statement No. 61, "The Financial Reporting Entity Omnibus and Amendment of GASB Statements No. 14 and No. 34". The reporting entity is comprised of the primary government, component units, and other organizations that are included to ensure that the financial statements of the School are not misleading. The primary government consists of all funds, departments, boards, and agencies that are not legally separate from the School. For the School, this includes general operations of the School. Component units are legally separate organizations for which the School is financially accountable. The School is financially accountable for an organization if the School appoints a voting majority of the organization's governing board and (1) the School is able to significantly influence the programs or services performed or provided by the organization; or (2) the School is legally entitled to or can otherwise access the organization's resources; the School is legally obligated or has otherwise assumed the responsibility to finance the deficits of, or provide financial support to, the organization or the School is obligated for the debt of the organization. Component units may also include organizations that are fiscally dependent on the School in that the School approves the budget, the issuance of debt, or the levying of taxes for the organization. The financial statement of the reporting entity includes only those of the School (the primary government). The School has no component units.

The following organization is described due to its relationship to the School:

Public Entity Risk Pool

Schools of Ohio Risk Sharing Authority

The School participates in the Schools of Ohio Risk Sharing Authority Board (SORSA), an insurance purchasing pool. SORSA's business affairs are conducted by a nine member Board of directors consisting of a President, Vice President, Secretary, Treasurer and five delegates. SORSA was created to provide joint self-insurance coverage and to assist members to prevent and reduce losses and injuries to the School's property and persons. It is intended to provide liability and property insurance at reduced premiums for the participants. SORSA is organized as a nonprofit corporation under provisions of Ohio Rev. Code 2744.

B. Fund Accounting

The School uses fund accounting to segregate cash which is restricted to use. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain School functions or activities.

For financial statement presentation purposes, the various funds of the School are grouped into a single proprietary operating fund.

A proprietary fund is used to account for the School's ongoing activities which are similar to those found in the private sector.

C. Basis of Accounting

Although required by Ohio Admin. Code § 117-2-03(B) to prepare its annual financial report in accordance with accounting principles generally accepted in the United States of America, the School chooses to prepare its financial statement and notes in accordance with standards established by the Auditor of State for governmental entities that are not required to prepare annual financial reports in accordance with generally accepted accounting principles. This basis of accounting is similar to the cash receipts and disbursements basis of accounting. Receipts are recognized when received in cash rather than when earned, and disbursements are recognized when paid rather than when a liability is incurred.

As a result of the use of this cash basis of accounting, certain assets and their related revenues (such as accounts receivable and revenue for billed or provided services not yet collected) and certain liabilities and their related expenses (such as accounts payable and expenses for goods or services received but not yet paid, and accrued expenses and liabilities) are not recorded in this financial statement.

D. Budgetary Process

Unlike other public schools located in the State of Ohio, community schools are not required to follow budgetary provisions set forth in Ohio Rev. Code Chapter 5705, unless specifically provided in the School's contract with its Sponsor. The contract between the School and its Sponsor requires a detailed school budget for each year of the contract; however, the budget does not have to follow the provisions of Ohio Rev. Code Chapter 5705. The School is required to file a five year forecast each fiscal year under Ohio Rev. Code Section 5705.391.

E. Restricted Assets

Assets are reported as restricted when limitations on their use change the nature or normal understanding of the availability of the asset. Such constraints are either imposed by creditors, contributors, grantors, or laws of other governments, or imposed by law through constitutional provisions or enabling legislation. The School reported no restricted assets.

F. Inventory and Prepaid Items

The School reports disbursements for inventory and prepaid items when paid. These items are not reflected as assets.

G. Capital Assets

Acquisitions of property, plant, and equipment are recorded as disbursements when paid. These items are not reflected as assets.

H. Accumulated Leave

In certain circumstances, such as upon leaving employment or retirement, employees are entitled to cash payments for unused leave. Unpaid leave is not reflected as a liability under the School's cash basis of accounting.

I. Employer Contributions to Cost-Sharing Pension Plans

The School recognizes the disbursement for employer contributions to cost-sharing pension plans when they are paid. As described in Notes 6 and 7, the employer contributions include portions for pension benefits and for postretirement health care benefits.

J. Operating and Non-Operating Receipts and Disbursements

Operating receipts are those receipts that are generated directly by the School's primary mission as well as other charges for services and other operating revenues. For the School, operating receipts consist of foundation payments received from the State of Ohio. Operating disbursements are necessary costs incurred to support the School's primary mission.

Non-operating receipts and disbursements are those that are not generated directly by or used directly toward, respectively, the School's primary mission. Grants comprise the majority of the non-operating receipts of the School, while lease payments are the only reported non-operating disbursement.

K. State Foundation Program Receipts

The School currently participates in the State Foundation Program through the Ohio Department of Education. Revenue from this program is recognized when received. Foundation revenue received by the School during fiscal year 2016 was $5,966,499.

L. Pensions

For purposes of measuring the net pension liability, information about the fiduciary net position of the pension plans and additions to/deductions from their fiduciary net positon have been determined on the same basis as they are reported by the pension systems. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. The pension systems report investments at fair value.

NOTE 3 – COMPLIANCE

Ohio Admin. Code Section 117-2-03 (B) requires the School to prepare its annual financial report in accordance with generally accepted accounting principles. However, the School prepared its financial statement on the regulatory basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The accompanying financial statement omits assets, liabilities, net position/fund balances, and disclosures that, while material, cannot be determined at this time. The School can be fined and various other administrative remedies may be taken against the School.

Contrary to Ohio law, the School lacked attendance policies and procedures to track true student attendance and learning opportunities.

NOTE 4 – DEPOSITS

Custodial credit risk is the risk that in the event of bank failure, the School's deposits may not be returned to it. According to state law, public depositories must give security for all public funds on deposit in excess of those funds that are insured by the Federal Deposit Insurance Corporation (FDIC) or by any other agency or instrumentality of the federal government. These institutions may either specifically collateralize individual accounts in lieu of amounts insured by the FDIC, or may pledge a pool of government securities valued at least 105 percent of the total value of public monies on deposit at the institution.

As of June 30, 2016, $139,926 of the School's bank balance of $702,031 was exposed to custodial risk because it was uninsured and collateralized with securities held by the pledging financial institution's trust department or agent, but not in the School's name.

NOTE 5 – RISK MANAGEMENT

The School is a member of the Schools of Ohio Risk Sharing Authority (SORSA). SORSA is a member owned organization having approximately 110 members. SORSA is a joint self-insurance pool. SORSA assumes the risk of loss up to the limits of the School's policy. SORSA covers the following risks, as applicable:

- Property
- Electronic Data Processing
- Boiler and Machinery
- Crime
- General Liability
- Automobile Liability and Physical Damage
- School Board Errors and Omissions.

The School contributes to the funding, operating and maintaining of the SORSA joint self-insurance pool. The School's contributions cover deductible losses, loss fund contribution, insurance costs, and administration cost.

The School paid $8,995 in premiums to the pool for fiscal year 2016 coverage. Settled claims have not exceeded commercial coverage in any of the past three years. There has been no significant reduction in coverage from the prior year.

SORSA financial statements are available by contacting SORSA at
Schools of Ohio Risk Sharing Authority, Inc.
8050 North High Street, Suite 160
Columbus, Ohio 43235

NOTE 6 – PENSION PLANS

A. School Employees Retirement System

Net Pension Liability

Pensions are a component of exchange transactions, between an employer and its employees, of salaries and benefits for employee services. Pensions are provided to an employee on a deferred payment basis as part of the total compensation package offered by an employer for employee services each financial period.

The net pension liability represents the School's proportionate share of each pension plan's collective actuarial present value of projected benefit payments attributable to past periods of service, net of each pension plan's fiduciary net position. The net pension liability calculation is dependent on critical long-term variables including estimated average life expectancies, earnings on investments, cost of living adjustments, and others. While these estimates use the best information available, unknowable future events require adjusting this estimate annually.

The Ohio Rev. Code limits the School's obligation for this liability to annually required payments. The School cannot control benefit terms or the manner in which pensions are financed; however, the School does receive the benefit of employees' services in exchange for compensation, including pension.

GASB Statement No. 68 assumes the liability is solely the obligation of the employer because (1) they benefit from employee services, and (2) State statute requires all funding to come from the employers. All contributions to date have come solely from the employer (which also includes costs paid in the form of withholdings from employees). State statute requires the pension plans to amortize unfunded liabilities within thirty years. If the amortization period exceeds thirty years, each pension plan's board must propose corrective action to the State legislature. Any resulting legislative change to benefits or funding could significantly affect the net pension liability. Resulting adjustments to the net pension liability would be effective when the changes are legally enforceable.

Plan Description - School Employees Retirement System (SERS)

Plan Description - School classified employees participate in SERS, a cost-sharing multiple-employer defined benefit pension plan administered by SERS. SERS provides retirement, disability and survivor benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Authority to establish and amend benefits is provided by Ohio Revised Code Chapter 3309. SERS issues a publicly available stand-alone financial report that includes financial statements, required supplementary information, and detailed information about SERS' fiduciary net position. The report can be obtained by visiting the SERS website at www.ohsers.org under employers/audit resources.

Age and service requirements for retirement are as follows:

	Eligible to retire on or before August 1, 2017 *	Eligible to retire on or after August 1, 2017
Full Benefits	Any age with 30 years of service credit	Age 67 with 10 years of service credit; or Age 57 with 30 years of service credit
Actuarially Reduced Benefits	Age 60 with 5 years of service credit; or Age 55 with 25 years of service credit	Age 62 with 10 years of service credit; or Age 60 with 25 years of service credit

* Members with 25 years of service credit as of August 1, 2017, will be included in this plan.

Annual retirement benefits are calculated based on the final average salary multiplied by a percentage that varies based on years of service; 2.2 percent for the first thirty years of service and 2.5 percent for years of service credit over thirty years. Final average salary is the average of the highest three years of salary.

One year after an effective benefit date, a benefit recipient is entitled to a 3 percent cost-of-living adjustment (COLA). This same COLA is added each year to the base benefit amount on the anniversary date of the benefit.

Funding Policy - Plan members are required to contribute 10 percent of their annual covered salary and the School is required to contribute 14 percent of annual covered payroll. The contribution requirements of plan members and employers are established and may be amended by the SERS Retirement Board up to statutory maximum amounts of 10 percent for plan members and 14 percent for employers. The Retirement Board, acting with the advice of the actuary, allocates the employer contribution rate among four of the System's funds (Pension Trust Fund, Death Benefit Fund, Medicare B Fund, and Health Care Fund). For the fiscal year ended June 30, 2016, the allocation to pension, death benefits, and Medicare B was 14 percent. No allocation was made to the Health Care Fund.

The School's contractually required contribution to SERS was $68,892 for fiscal year 2016.

Plan Description - State Teachers Retirement System (STRS)

Plan Description - School licensed teachers and other certified faculty members participate in STRS Ohio, a cost-sharing multiple-employer public employee retirement system administered by STRS. STRS provides retirement and disability benefits to members and death and survivor benefits to beneficiaries. STRS issues a publicly available stand-alone financial report that includes financial statements, required supplementary information, and detailed information about STRS' fiduciary net position. The report can be obtained by writing to STRS, 275 East Broad Street, Columbus, Ohio 43215-3771, by calling (888) 227-7877, or by visiting the STRS website at www.strsoh.org.

New members have a choice of three retirement plans; a Defined Benefit Plan (DBP), a Defined Contribution Plan (DCP) and a Combined Plan (CP). Benefits are established by Ohio Revised Code Chapter 3307. The DBP plan offers an annual retirement allowance based on final average salary multiplied by a percentage that varies based on years of service. Effective August 1, 2015, the calculation is 2.2 percent of final average salary for the five highest years of earnings multiplied by all years of service. With certain exceptions, the basic benefit is increased each year by 2 percent of the original base benefit. For members retiring August 1, 2013, or later, the first 2 percent is paid on the fifth anniversary of the retirement benefit. Members are eligible to retire at age sixty with five years of qualifying service credit, at age fifty-five with twenty-five years of service credit, or thirty years of service credit regardless of age. Age and service requirements for retirement increased effective August 1, 2015, and will continue to increase periodically until they reach age sixty with thirty-five years of service or age sixty-five with five years of service on August 1, 2026.

The DCP allows members to place all of their member contributions and 9.5 percent of the 14 percent employer contribution into an investment account. Investment allocation decisions are determined by the member. The remaining 4.5 percent of the 14 percent employer contribution rate is allocated to the defined benefit unfunded liability. A member is eligible to receive a retirement benefit at age fifty and termination of employment. The member may elect to receive a lifetime monthly annuity or a lump sum withdrawal.

The CP offers features of both the DBP and the DCP. In the CP, 11 percent of the 12 percent member rate goes to the DCP and 1 percent goes to the DBP. Member contributions to the DCP are allocated among investment choices by the member and contributions to the DBP from the employer and the member are used to fund the defined benefit payment at a reduced level from the regular DBP. The defined benefit portion of the CP payment is payable to a member on or after age sixty with five years of service. The defined contribution portion of the account may be taken as a lump sum payment or converted to a lifetime monthly annuity at age fifty.

New members who choose the DCP or CP will have another opportunity to reselect a permanent plan during their fifth year of membership. Members may remain in the same plan or transfer to another STRS plan. The optional annuitization of a member's defined contribution account or the defined contribution portion of a member's CP account to a lifetime benefit results in STRS bearing the risk of investment gain or loss on the account. STRS has therefore included all three plan options as one defined benefit plan for GASB Statement No. 68 reporting purposes.

A DBP or CP member with five or more years of credited service who is determined to be disabled may qualify for a disability benefit. Eligible survivors of members who die before service retirement may qualify for monthly benefits. New members on or after July 1, 2013, must have at least ten years of qualifying service credit that apply for disability benefits. Members in the DCP who become disabled are entitled only to their account balance. If a member of the DCP dies before retirement benefits begin, the member's designated beneficiary is entitled to receive the member's account balance.

Funding Policy - Employer and member contribution rates are established by the State Teachers Retirement Board and limited by Chapter 3307 of the Ohio Revised Code. For the fiscal year ended June 30, 2016, plan members were required to contribute 13 percent of their annual covered salary. Effective July 1, 2016, the statutory maximum employee contribution rate was increased 1 percent to 14 percent. The School was required to contribute 14 percent; the entire 14 percent was the portion used to fund pension obligations. The fiscal year 2016 contribution rates were equal to the statutory maximum rates.

The School's contractually required contribution to STRS was $176,652 for fiscal year 2016.

Net Pension Liability

The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The School's proportion of the net pension liability was based on the School's share of contributions to the pension plan relative to the projected contributions of all participating entities. Following is information related to the proportionate share:

	SERS	STRS	Total
Proportion of the Net Pension Liability Prior Measurement Date	0.003821%	0.00721228%	
Proportion of the Net Pension Liability Current Measurement Date	0.001093%	0.00979656%	
Change in Proportionate Share	(0.002728%)	0.00258428%	
Proportionate Share of the Net Pension Liability	$623,812	$2,707,482	$3,331,294

Actuarial Assumptions - SERS

SERS' total pension liability was determined by their actuaries in accordance with GASB Statement No. 67 as part of the annual actuarial valuation for each defined benefit retirement plan. Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts (e.g., salaries, credited service) and assumptions about the probability of occurrence of events far into the future (e.g., mortality, disabilities, retirements, employment termination). Actuarially determined amounts are subject to continual review and potential modification as actual results are compared with past expectations and new estimates are made about the future.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employers and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing benefit costs between the employers and plan members to that point. The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations.

Actuarial calculations reflect a long-term perspective. For a newly hired employee, actuarial calculations will take into account the employee's entire career with the employer and also take into consideration the benefits, if any, paid to the employee after termination of employment until the death of the employee and any applicable contingent annuitant. In many cases actuarial calculations reflect several decades of service with the employer and the payment of benefits after termination.

Key methods and assumptions used in calculating the total pension liability in the latest actuarial valuation prepared as of June 30, 2015, are presented below:

Wage Inflation	3.25 percent
Future Salary Increases, including inflation	4 percent to 22 percent
COLA or Ad Hoc COLA	3 percent
Investment Rate of Return	7.75 percent net of investment expenses, including inflation
Actuarial Cost Method	entry age normal

For postretirement mortality, the table used in evaluating allowances to be paid is the 1994 Group Annuity Mortality Table set back one year for both men and women. Special mortality tables are used for the period after disability retirement.

The most recent experience study was completed on June 30, 2010.

The long-term return expectation for the pension plan investments has been determined using a building-block approach and assumes a time horizon, as defined in SERS' Statement of Investment Policy. A forecasted rate of inflation serves as the baseline for the return expectation. Various real return premiums over the baseline inflation rate have been established for each asset class. The long-term expected nominal rate of return has been determined by calculating an arithmetic weighted average of the expected real return premiums for each asset class, adding the projected inflation rate, and adding the expected return from rebalanced uncorrelated asset classes. The target allocation and best estimates of long-term expected real rate of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Cash	1.00%	0.00%
U.S. Stocks	22.50	5.00
Non-U.S. Stocks	22.50	5.50
Fixed Income	19.00	1.50
Private Equity	10.00	10.00
Real Assets	10.00	5.00
Multi-Asset Strategies	15.00	7.50
Total	100.00%	

Discount Rate - The total pension liability was calculated using the discount rate of 7.75 percent. The projection of cash flows used to determine the discount rate assumed the contributions from employers and from the members would be computed based on contribution requirements as stipulated by State statute. Projected inflows from investment earnings were calculated using the long-term assumed investment rate of return (7.75 percent). Based on those assumptions, the plan's fiduciary net position was projected to be available to make all future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefits to determine the total pension liability.

Sensitivity of the School's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate - Net pension liability is sensitive to changes in the discount rate and to illustrate the potential impact, the following table presents the net pension liability calculated using the discount rate of 7.75 percent as well as what each plan's net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.75 percent) or one percentage point higher (8.75 percent) than the current rate:

	1% Decrease (6.75%)	Current Discount Rate (7.75%)	1% Increase (8.75%)
School's Proportionate Share of the Net Pension Liability	$865,003	$623,812	$420,709

Changes Between Measurement Date and Report Date

In April 2016, the SERS Board adopted certain assumption changes which impacted their annual actuarial valuation prepared as of June 30, 2016. The most significant change is a reduction in the discount rate from 7.75 percent to 7.5 percent. Although the exact amount of these changes is not known, the impact to the School's net pension liability is expected to be significant.

Actuarial Assumptions - STRS

The total pension liability in the June 30, 2015, actuarial valuation was determined using the following actuarial assumptions applied to all periods included in the measurement:

Inflation	2.75 percent
Projected Salary Increases	12.25 percent at age 20 to 2.75 percent at age 70
Investment Rate of Return	7.75 percent, net of investment expenses
Cost of Living Adjustments (COLA)	2 percent simple applied as follows: for members retiring before August 1, 2013, 2 percent per year; for members retiring August 1, 2013, or later, 2 percent COLA paid on fifth anniversary of retirement date

Mortality rates were based on the RP-2000 Combined Mortality Table (Projection 2022-Scale AA) for males and females. Males ages are set back two years through age eighty-nine and no set back for age ninety and above. Females younger than age eighty are set back four years, one year set back from age eighty through eighty-nine, and no set back from age ninety and above.

Actuarial assumptions used in the June 30, 2015, valuation are based on the results of an actuarial experience study effective July 1, 2012.

STRS' investment consultant develops best estimates for the investment return assumption based on the target allocation adopted by the Retirement Board. The target allocation and long-term expected rate of return for each major asset class are summarized as follows:

Asset Class	Target Allocation	10 Year Expected Nominal Rate of Return *
Domestic Equity	31.00%	8.00%
International Equity	26.00	7.85
Alternatives	14.00	8.00
Fixed Income	18.00	3.75
Real Estate	10.00	6.75
Liquidity Reserves	1.00	3.00
	100.00%	

*10 year annualized geometric nominal returns include the real rate of return and inflation of 2.5 percent.

Discount Rate - The discount rate used to measure the total pension liability was 7.75 percent as of June 30, 2015. The projection of cash flows used to determine the discount rate assumes member and employer contributions will be made at the statutory contribution rates in accordance with rate increases described above. For this purpose, only employer contributions that are intended to fund benefits of current plan members and their beneficiaries are included. Projected employer contributions that are intended to fund the service costs of future plan members and their beneficiaries, as well as projected contributions from future plan members, are not included. Based on those assumptions, STRS' fiduciary net position was projected to be available to make all projected future benefit payments to current plan members as of June 30, 2015. Therefore, the long-term expected rate of return on pension plan investments of 7.75 percent was applied to all periods of projected benefit payment to determine the total pension liability as of June 30, 2015.

Sensitivity of the School's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate - The following table presents the School's proportionate share of the net pension liability calculated using the current period discount rate assumption of 7.75 percent as well as what the School's proportionate share of the net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.75 percent) or one percentage point higher (8.75 percent) than the current rate:

	1% Decrease (6.75%)	Current Discount Rate (7.75%)	1% Increase (8.75%)
School's Proportionate Share of the Net Pension Liability	$3,760,896	$2,707,482	$1,816,662

<u>Social Security System</u>

Effective July 1, 1991, all employees not otherwise covered by SERS or the STRS have an option to choose Social Security or the School Retirement System. As of June 30, 2016, certain members of the Board of Education have elected Social Security. The School's liability is 6.2 percent of wages paid.

NOTE 7 – POST-EMPLOYMENT BENEFITS

A. School Employees Retirement System

Health Care Plan Description - The School contributes to the SERS Health Care Fund, administered by SERS for non-certificated retirees and their beneficiaries. For GASB 45 purposes, this plan is considered a cost-sharing, multiple-employer, defined benefit other postemployment benefit (OPEB) plan. The Health Care Plan includes hospitalization and physicians' fees through several types of plans including HMO's, PPO's, Medicare Advantage, and traditional indemnity plans as well as a prescription drug program. The financial report of the Plan is included in the SERS Comprehensive Annual Financial Report which can be obtained on SERS' website at www.ohsers.org under Employers/Audit Resources.

Access to health care for retirees and beneficiaries is permitted in accordance with Section 3309 of the Ohio Revised Code. The Health Care Fund was established and is administered in accordance with Internal Revenue Code Section 105(e). SERS' Retirement Board reserves the right to change or discontinue any health plan or program. Health care is financed through a combination of employer contributions and retiree premiums, copays and deductibles on covered health care expenses, investment returns, and any funds received as a result of SERS' participation in Medicare programs. Active employee members do not contribute to the Health Care Plan. Retirees and their beneficiaries are required to pay a health care premium that varies depending on the plan selected, the number of qualified years of service, Medicare eligibility and retirement status.

Funding Policy - State statute permits SERS to fund the health care benefits through employer contributions. Each year, after the allocation for statutorily required basic benefits, the Retirement Board allocates the remainder of the employer contribution of 14 percent of covered payroll to the Health Care Fund. For fiscal year 2016, no allocation of covered payroll was allocated to health care. In addition, employers pay a surcharge for employees earning less than an actuarially determined minimum compensation amount, pro-rated according to service credit earned. For fiscal year 2016, this amount was $23,000. Statutes provide that no employer shall pay a health care surcharge greater than 2 percent of that employer's SERS-covered payroll; nor may SERS collect in aggregate more than 1.5 percent of the total statewide SERS-covered payroll for the health care surcharge. For fiscal year 2016, the School surcharge obligation was $52.

The School's contribution for health care for the fiscal years ended June 30, 2016, 2015, and 2014 was $52, $2,803, and $158, respectively. The full amount has been contributed for all three fiscal years.

B. State Teachers Retirement System

Plan Description – The School participates in the cost-sharing multiple-employer defined benefit Health Plan administered by the State Teachers Retirement System of Ohio (STRS) for eligible retirees who participated in the defined benefit or combined pension plans offered by STRS. Ohio law authorizes STRS to offer this plan. Benefits include hospitalization, physicians' fees, prescription drugs and reimbursement of monthly Medicare Part B premiums. The Plan is included in the report of STRS which can be obtained by visiting www.strsoh.org or by calling (888) 227-7877.

Funding Policy – Ohio Revised Code Chapter 3307 authorizes STRS to offer the Plan and gives the Retirement Board authority over how much, if any, of the health care costs will be absorbed by STRS. Active employee members do not contribute to the Health Care Plan. All benefit recipients, for the most recent year, pay a monthly premium. Under Ohio law, funding for post-employment health care may be deducted from employer contributions. For fiscal year 2016, STRS did not allocate any employer contributions to post-employment health care.

The School's contribution for health care for the fiscal years ended June 30, 2016, 2015, and 2014 was $0, $0, and $7,414, respectively. The full amount has been contributed for all three fiscal years.

NOTE 8 – OTHER PURCHASED SERVICES

During the fiscal year ended June 30, 2016, other purchased service expenses for services rendered by various vendors were as follows:

Professional and Technical Services	$650,545
Payment to Sponsor	120,006
Property Services	51,061
Travel Mileage/Meeting Expense	170,459
Communications	38,454
Tuition	72,952
Total Purchased Services	$1,103,477

NOTE 9 – SPONSOR AGREEMENT

Margaretta Local School District, Erie County, Ohio (the Sponsor) sponsored the School in fiscal year 2016. The Sponsor receives 3% of the State Aid received by the School as set forth in the Shared Services Agreement. The School also entered into a lease agreement with the Sponsor for areas that housed the staff of the School, as well as various shared professional and technical services with the Sponsor. The agreement generated approximately $395,814 in revenue to the Sponsor.

NOTE 10 – OPERATING LEASE – LESSEE DISCLOSURE

The School is the lessee of property located in Castalia, Ohio. The lease is between Margaretta Local School District and the Board of Directors. The lease is $11,100 per month, payable in monthly installments on or before the last business day of the month, and includes a clause for maintenance services to be provided by the lessor to the lessee. This lease agreement commenced on August 1, 2015 and expires on July 31, 2016.

NOTE 11 – CONTINGENCIES

A. Grants

The School received financial assistance from Federal and State agencies in the form of grants. The expenditure of funds received under these programs generally requires compliance with terms and conditions specified in the grant agreements and are subject to audit by the grantor agencies.

Any disallowed claims resulting from such audits could become a liability of the general fund or other applicable funds. The effect of any such disallowed claims on the overall financial position of the School at June 30, 2016, if applicable, cannot be determined at this time.

B. Litigation

The School is not party to legal proceedings that would have a material effect on the financial condition of the School.

C. Foundation Funding

The Ohio Department of Education conducts reviews of enrollment data and full-time equivalency (FTE) calculations made by the schools. These reviews are conducted to ensure the schools are reporting accurate student enrollment data to the State, upon which State foundation funding is calculated. The School is due $78,201 for the fiscal year ended June 30, 2016, as a result of the enrollment review.

NOTE 12 – LEASE-PURCHASE

The School began construction of a $1.7 million addition to the new facility in October, 2015. This construction project will be funded through a lease-purchase agreement with Margaretta Local School District. The principal amount of the lease-purchase agreement is $1,700,000. The term of the lease is five years through December 1, 2020. There is a call period whereby the balance of the lease can be paid in full no sooner than December 1, 2018. The Ground Lease between Margaretta Local School District and Townsend Community School is being used to collateralize the lease between Margaretta Local School District and First Merit Bank. The Ground Lease has been amended to include the requirement that Townsend Community School will pay back the principal and interest plus a three percent service charge on a monthly basis beginning February 1, 2016.

NOTE 13 – SUBSEQUENT EVENT

The Ohio Department of Education conducts review of enrollment data and full-time equivalency (FTE) calculations made by schools. The School owes $2,995,803 for fiscal year ended June 30, 2017, as a result of the enrollment review. The amount will be repaid through monthly State Foundation Program deductions over sixty months. Management believes the repayment plan will not negatively impact the School's operations.

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS REQUIRED BY *GOVERNMENT AUDITING STANDARDS*

Townsend Community School
Erie County
207 Lowell Street
Castalia, Ohio 44824

To the Board of Directors:

We have audited, in accordance with auditing standards generally accepted in the United States and the Comptroller General of the United States' *Government Auditing Standards*, the financial statement of Townsend Community School, Erie County, Ohio, (the School) as of and for the year ended June 30, 2016, and the related notes to the financial statement, and have issued our report thereon dated January 26, 2018, wherein we issued an adverse opinion on the School's financial statement because the School followed financial reporting provisions Ohio Revised Code Section 117.38 and Ohio Administrative Code Section 117-2-03 permit for governments not required to report using accounting principles generally accepted in the United States of America. The School is required by Ohio Administrative Code Section 117-2-03 to follow accounting principles generally accepted in the United States of America.

Internal Control Over Financial Reporting

As part of our financial statement audit, we considered the School's internal control over financial reporting (internal control) to determine the audit procedures appropriate in the circumstances to the extent necessary to support our opinion on the financial statement, but not to the extent necessary to opine on the effectiveness of the School's internal control. Accordingly, we have not opined on it.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, when performing their assigned functions, to prevent, or detect and timely correct misstatements. A *material weakness* is a deficiency, or combination of internal control deficiencies resulting in a reasonable possibility that internal control will not prevent or detect and timely correct a material misstatement of the School's financial statement. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all internal control deficiencies that might be material weaknesses or significant deficiencies. Therefore, unidentified material weaknesses or significant deficiencies may exist. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings that we consider material weaknesses. We consider findings 2016-001 through 2016-003 to be material weaknesses.

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Compliance and Other Matters

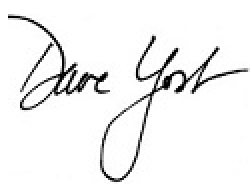
As part of reasonably assuring whether the School's financial statement is free of material misstatement, we tested its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could directly and materially affect the determination of financial statement amounts. However, opining on compliance with those provisions was not an objective of our audit and accordingly, we do not express an opinion. The results of our tests disclosed instances of noncompliance or other matters we must report under *Government Auditing Standards*, which are described in the accompanying schedule of findings as items 2016-001 through 2016-002.

School's Response to Findings

The School's responses to the findings identified in our audit are described in the accompanying schedule of findings. We did not audit the School's responses and, accordingly, we express no opinion on them.

Purpose of this Report

This report only describes the scope of our internal control and compliance testing and our testing results, and does not opine on the effectiveness of the School's internal control or on compliance. This report is an integral part of an audit performed under *Government Auditing Standards* in considering the School's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Dave Yost
Auditor of State

Columbus, Ohio

January 26, 2018

FINDINGS RELATED TO THE FINANCIAL STATEMENT REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS

FINDING NUMBER 2016-001

Noncompliance Citation / Material Weakness

Ohio Rev. Code § 117.38 provides that each public office shall file a financial report for each fiscal year. The Auditor of State may prescribe forms by rule or may issue guidelines, or both, for such reports. If the Auditor of State has not prescribed a rule regarding the form for the report, the public office shall submit its report on the form utilized by the public office.

Ohio Admin. Code § 117-2-03 (B), which further clarifies the requirements of **Ohio Rev. Code § 117.38**, requires the School to file annual financial reports which are prepared using generally accepted accounting principles (GAAP). For fiscal year 2016, the School prepared its financial statement in accordance with the regulatory basis of accounting prescribed or permitted by the Auditor of State for governments not required to report in accordance with GAAP as a cost savings measure. This presentation differs from generally accepted accounting principles. The accompanying financial statement and notes omit assets, liabilities, fund equities, and disclosures that, while material, cannot be determined at this time. The School can be fined, and various other administrative remedies may be taken against the School.

We recommend the School take the necessary steps to ensure the financial report is prepared in accordance with generally accepted accounting principles.

Officials' Response:

The School has contracted with a third party to report its financials in accordance with GAAP going forward to address this issue.

FINDING NUMBER 2016-002

Noncompliance Citation / Material Weakness

Ohio Rev. Code § 3314.08 (H) in part requires the department of education shall adjust the amounts subtracted and paid under division (C) of this section to reflect any enrollment of students in community schools for less than the equivalent of a full school year. The state board of education within ninety days after April 8, 2003, shall adopt in accordance with Chapter 119 of the Ohio Rev. Code rules governing the payments to community schools under this section including initial payments in a school year and adjustments and reductions made in subsequent periodic payments to community schools and corresponding deductions from school district accounts as provided under division (C) of this section. For purposes of this section:

(2) A student shall be considered to be enrolled in a community school for the period of time beginning on the later of the date on which the school both has received documentation of the student's enrollment from a parent and the student has commenced participation in learning opportunities as defined in the contract with the sponsor, or thirty days prior to the date on which the student is entered into the education management information system established under section 3301.0714 of the Ohio Rev. Code. For purposes of applying this division and divisions (H)(3) and (4) of this section to a community school student, "learning opportunities" shall be defined in the contract, which shall describe both classroom-based and non-classroom-based learning opportunities and shall be in compliance with criteria and documentation requirements for student participation which shall be established by the

FINDING NUMBER 2016-002
(Continued)

department. Any student's instruction time in non-classroom-based learning opportunities shall be certified by an employee of the community school.

(3) The department shall determine each community school student's percentage of full-time equivalency (FTE) based on the percentage of learning opportunities offered by the community school to that student, reported either as number of hours or number of days, is of the total learning opportunities offered by the community school to a student who attends for the school's entire school year. However, no internet- or computer-based community school shall be credited for any time a student spends participating in learning opportunities beyond ten hours within any period of twenty-four consecutive hours. Whether it reports hours or days of learning opportunities, each community school shall offer not less than nine hundred twenty hours of learning opportunities during the school year.

The School's procedures to track FTE during fiscal year 2016 was to assess FTE based on the period between a student's enrollment date, if applicable, or last day of school. If a student was enrolled the entire school year, the Academy reported an FTE of 1 for the student in EMIS; similarly, for example, if a student was enrolled for a period of half the school year, the School reported an FTE of 0.50 out of 1 for the student in EMIS. The School also granted students attendance based on their submission of weekly exams. If a student submitted an exam for a given week and obtained a passing grade, that student was credited for full attendance of that week.

The School did attempt to collect durational data for students' participation in learning opportunities including the submission of weekly exams, library sign-in sheets, on-site sign-in sheets from the school facility, and manual student logs. However, during our testing of 6 randomly selected students, we noted that the amount of durational support provided by the School did not substantiate the FTEs reported to ODE by the School for those students. We were unable to accept weekly exam submissions as appropriate supporting documentation of a student's participation of learning opportunities as these did not display detail on how much time a student actually spent participating in those activities. As a result, we determined the School was reporting more FTEs than they would be allowed funding under Ohio law and ODE's FTE Handbook.

We recommend the School review current statutory requirements and guidance issued by ODE to determine the documentation needed to support the FTE data to be reported for each student. Once the School has a clear understanding of what is required to support FTE, the School should review and, if applicable, update current policies and procedures to capture all critical elements of time spent by students participating in learning opportunities.

This issue will be referred to ODE for further consideration.

A response to the Noncompliance Citation/Material Weakness comment was received from Townsend Community School. A portion of that response is included below. The response in its entirety is available from the School upon request.

Officials' Response:

The School has implemented an attendance policy that fully aligns with all ODE FTE Handbook requirements, including all guidelines for documenting student participation in non-computer, non-classroom based learning opportunities.

FINDING NUMBER 2016-003

Material Weakness – Financial Reporting

Transactions should be properly classified in the annual financial statement. Additionally, all intra-fund activity should be eliminated for financial reporting purposes. We identified the following errors requiring adjustment to the financial statement for the fiscal year ended June 30, 2016:

Interfund transfers in the amount of $791,449 were improperly included in the Total amount of Non-Operating Receipts and Non-Operating Disbursements. Furthermore, these interfund transfers should have been eliminated for financial reporting purposes.

These errors were not identified and corrected prior to the School preparing its financial statement due to deficiencies in the School's internal controls over financial statement monitoring. The accompanying financial statement and notes to the financial statement, and where applicable, the School's accounting records, have been adjusted to reflect these changes. Sound financial reporting is the responsibility of the Treasurer and the Board of Directors and is essential to ensure the information provided to the readers of the financial statement and accompanying notes is complete and accurate.

To help ensure the School's financial statement and notes to the statement are complete and accurate, the School should adopt policies and procedures, including a final review of the statement and notes by the Treasurer and Board of Directors, to identify and correct errors and omissions.

Officials' Response:

The School's contract with a third party to report its financials in accordance with GAAP going forward will address this issue.

TOWNSEND COMMUNITY SCHOOL
ERIE COUNTY

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
JUNE 30, 2016

Finding Number	Finding Summary	Status	Additional Information
2015-001	Ohio Rev. Code § 117.38 and Ohio Admin. Code § 117-2-03(B) for reporting on basis other than generally accepted accounting principles	Not corrected and reissued as Finding 2016-001 in this report.	See Officials' Response in Finding 2016-001.

TOWNSEND COMMUNITY SCHOOL

ERIE COUNTY

CLERK'S CERTIFICATION

This is a true and correct copy of the report which is required to be filed in the Office of the Auditor of State pursuant to Section 117.26, Revised Code, and which is filed in Columbus, Ohio.

Susan Babbitt

CLERK OF THE BUREAU

CERTIFIED
MARCH 13, 2018

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