HARMONY COMMUNITY - CINCINNATI, INC.
HAMILTON COUNTY

REGULAR AUDIT

FOR THE YEAR ENDED JUNE 30, 2001

JIM PETRO
AUDITOR OF STATE
STATE OF OHIO

HARMONY COMMUNITY - CINCINNATI, INC.
HAMILTON COUNTY

TABLE OF CONTENTS

TITLE	PAGE

This page intentionally left blank.

STATE OF OHIO
OFFICE OF THE AUDITOR
JIM PETRO, AUDITOR OF STATE

250 West Court Street
Suite 150 E
Cincinnati, Ohio 45202
Telephone 513-361-8550
800-368-7419
Facsimile 513-361-8577
www.auditor.state.oh.us

REPORT OF INDEPENDENT ACCOUNTANTS

Harmony Community - Cincinnati, Inc.
Hamilton County
3653 Michigan Avenue
Cincinnati, OH 45209

To the Management Cabinet:

We have audited the accompanying Balance Sheet of Harmony Community - Cincinnati, Inc., Hamilton County, Ohio (the School), as of June 30, 2001, and the related Statement of Revenues, Expenses, and Changes in Retained Earnings, and the Statement of Cash Flows for the year then ended. These financial statements are the responsibility of the School's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In May 2000, the Ohio Department of Education (ODE) completed a comprehensive full-time equivalency enrollment review and determined the School was overpaid $174,660 in fiscal year 1999. As a result, the amount was withheld in the subsequent fiscal year. As discussed in Note 16, the School filed suit against ODE asserting ODE improperly conducted this review because there is no statutory basis for such a review. The School has recorded $174,660 as Intergovernmental Receivable and Intergovernmental Revenue on the financial statements. In our opinion, the recognition of revenue for this disputed receivable does not conform with accounting principles generally accepted in the United States of America. Intergovernmental revenue, intergovernmental receivable, and retained earnings are overstated by $174,660.

In our opinion, because of the effect of the matter discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of Harmony Community - Cincinnati, Inc., Hamilton County, Ohio, as of June 30, 2001, or the results of its operations or its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, the School failed to file its annual information return for fiscal years 1999 and 2000 to the Internal Revenue Service. Despite having no tax liability, the School has been assessed a penalty by the Internal Revenue Service.

The accompanying financial statements have been prepared assuming that the School will continue as a going concern. The School has incurred a significant operating loss in the amount of $308,725 for the year ended June 30, 2001 and has a working capital deficiency of $140,592. Accordingly, there is a substantial doubt about the School's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 18.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 19, 2002 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 grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Jim Petro
Auditor of State

April 19, 2002

HARMONY COMMUNITY-CINCINNATI, INC.
HAMILTON COUNTY

BALANCE SHEET
AS OF JUNE 30, 2001

Assets	
Current Assets	
Cash	$24,840
Cash on Hand	313
Intergovernmental Receivable	348,573
Prepaid Items	1,100
Total Current Assets	374,826
Noncurrent Assets	
Furniture and Equipment (Net of accumulated depreciation)	283,690
Total Noncurrent Assets	283,690
Total Assets	$658,516
Liabilities and Fund Equity	
Current Liabilities	
Account Payable	$155,131
Capital Lease Payable	4,020
Accrued Wages and Benefits	167,276
Intergovernmental Payable	78,991
Line of Credit Payable	110,000
Total Current Liabilities	515,418
Noncurrent Liabilities	
Capital Lease Payable	12,093
Total Liabilities	527,511
Fund Equity	
Retained Earnings	
Unreserved	131,005
Total Fund Equity	131,005
Total Liabilities and Fund Equity	$658,516

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

HARMONY COMMUNITY-CINCINNATI, INC.
HAMILTON COUNTY

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN RETAINED EARNINGS FOR THE YEAR ENDED JUNE 30, 2001

Operating Revenues	
Foundation Payments	$2,789,807
Disadvantaged Pupil Impact Aid	17,110
State Special Education	87,605
Other Operating Revenue	24,611
Total Operating Revenues	2,919,133
Operating Expenses	
Salaries	1,707,080
Fringe Benefits	493,749
Purchased Services	433,194
Materials and Supplies	295,793
Depreciation	94,506
Other Operating Expenses	203,536
Total Operating Expenses	3,227,858
Operating Loss	(308,725)
Non-Operating Revenues/Expenses	
Interest Income	4,056
Federal Grants	15,652
State Grants	7,740
Loss on Fixed Assets (See Note 5)	(115,925)
Total Non-Operating Revenues/Expenses	(88,477)
Net Loss	(397,202)
Retained Earnings at Beginning of Year	528,207
Retained Earnings at End of Year	$131,005

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

HARMONY COMMUNITY-CINCINNATI, INC.
HAMILTON COUNTY

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2001

Increase (Decrease) in Cash	
Cash Flows from Operating Activities	
Cash Received from State of Ohio	$3,032,891
Cash Payments to Employees for Services and their benefits	(2,212,243)
Cash Payments to Suppliers for Goods and Services	(931,921)
Other Operating Revenue	30,953
Net Cash Used for Operating Activities	(80,320)
Cash Flows from Noncapital Financing Activities	
State and Federal Grants Received	23,391
Net Cash Provided by Noncapital Financing Activities	23,391
Cash Flows from Capital and Related Financing Activities	
Acquisition of Capital Assets	(140,920)
Equipment Lease Payments	(91,012)
Capital Lease Payable Payments	(237)
Line of Credit Proceeds	110,000
Net Cash Used for Capital and Related Financing Activities	(122,169)
Cash Flows from Investing Activities	
Cash Received from Interest Revenue	4,056
Net Cash Provided from Investing Activities	4,056
Net Decrease in Cash	(175,042)
Cash at Beginning of Year	200,195
Cash at End of Year	$25,153

Reconciliation of Operating Loss to Net Cash Provided for Operating Activities	
Operating Loss	($308,725)
Adjustments To Reconcile Operating Loss to Net Cash Used for Operating Activities	
Depreciation	94,506
Changes in Assets and Liabilities	
Decrease in Intergovernmental Receivable	138,369
Decrease in Accounts Receivable	3,470
(Increase) in Prepaid Items	(1,000)
Increase in Accounts Payable	21,299
Increase in Intergovernmental Payable	66,314
(Decrease) in Accrued Wages	(94,553)
Total Adjustments	228,405
Net Cash Used for Operating Activities	($80,320)

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

This page intentionally left blank.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2001

1. DESCRIPTION OF THE SCHOOL AND REPORTING ENTITY

Harmony Community – Cincinnati, Inc. (the School) is a nonprofit corporation established pursuant to Ohio Rev. Code Chapters 3314 and 1702 to provide an appropriate educational facility and program for all age groups and to provide instruction in courses which meet general educational requirements compatible with and approved by the State of Ohio. The School qualifies as an exempt organization under Section 501(c)(3) of the Internal Revenue Code. The School has not filed with the Internal Revenue Services, form 990 for the fiscal years ending June 30, 1999 and 2000. The School was assessed a penalty by the Internal Revenue Service in the amount of $50,821. The School has taken proper steps to request a waiver of the penalty. The School 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 creation of the School was initially proposed to the State Board of Education, the sponsor, on June 9,1998 for a three year contract. The State Board of Education approved the proposal and entered into a contract with the Management Cabinet of the School. By-Laws of the School were amended to allow for the creation of the Management Cabinet of Harmony Community School. Members of the Cabinet were appointed by the Corporate Board of Directors. The contract provided for the commencement of School operations on September 16, 1998.

The fiscal operations of the School are under a seven-member Management Cabinet which is directed by the Chief Financial Officer. This Cabinet is responsible for formulating policies regarding fiscal operations and monitoring the expenditure of funds. The Chief Financial Officer of the School directs the financial affairs of the School including accounting, purchasing, insurance, housekeeping, and maintenance and is responsible for reporting the progress of the School against those responsibilities. Additionally, an Accountability Cabinet monitors and reports academic progress.

Two members of the Management Cabinet are members of the Board of another community school, A.B. Miree Community School.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the School have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to governmental nonprofit organizations. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The School also applies Financial Accounting Standards Board (FASB) statements and interpretations issued on or before November 30, 1989, provided they do not conflict with or contradict GASB pronouncements. The more significant of the School's accounting policies are described below.

A. Basis Of Presentation

Enterprise accounting is used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or where it has been decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. Measurement Focus and Basics of Accounting

Enterprise accounting uses a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities are included on the balance sheet. Operating statements present increases (e.g., revenues) and decreases (e.g., expenses) in net total assets.

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made.

Revenues are recognized when they are earned. Expenses are recognized when they are incurred.

C. Budgetary

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 does prescribe a budgetary process for the School.

D. Cash

All monies received by the School are accounted for by the School's Chief Financial Officer. For cash management, all cash received by the Chief Financial Officer is pooled in an interest bearing central bank account. Total cash for the School is presented as "cash" and "cash on hand" on the accompanying balance sheet.

The School had no investments during the fiscal year.

E. Fixed Assets and Depreciation

Fixed assets are capitalized at cost (or estimated historical cost) and updated for additions and retirements during the year. Donated fixed assets are recorded at their fair market value as of the dates received. The School maintains a capitalization threshold of two hundred dollars. The School does not possess any infrastructure.

Improvements are capitalized. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend an asset's life are not capitalized.

Depreciation of furniture and equipment, computer software, and textbooks is computed using the straight-line method over an estimated useful life of five years. Improvements to fixed assets are depreciated over the remaining useful lives of the related fixed assets.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

F. Intergovernmental Revenues

The School currently participates in the State Foundation Program and the State Disadvantaged Pupil Impact Aid (DPIA) Program. Revenues received from these programs are recognized as operating revenues in the accounting period in which all eligibility requirements have been met.

Grants and entitlements are recognized as non-operating revenues in the accounting period in which all eligibility requirements have been met.

Eligibility requirements include timing requirements, which specify the year when the resources are required to be used or the fiscal year when use is first permitted, matching requirements, in which the School must provide local resources to be used for a specified purpose, and expenditure requirements, in which the resources are provided to the School on a reimbursement basis.

Amounts awarded under the above named programs for the 2001 school year totaled $2,743,253.

3. CASH AND DEPOSITS

At June 30, 2001, the school had a cash balance of $24,840 and cash on hand of $313 which is presented as cash and cash on hand in the accompanying financial statements. The bank balance of the School's deposits was $61,488 of which all was insured by the Federal Depository Insurance Corporation (FDIC).

4. RECEIVABLES

Receivables at June 30, 2001 consisted of intergovernmental receivables ($348,573). None has been collected as of February 28, 2002. $174,660 not collected is in dispute with the Ohio Department of Education. See Note 16 for details of the dispute.

5. FIXED ASSETS

A summary of the School's fixed assets at June 30, 2001:

Computer Hardware	$197,135
Computer Software	89,467
Furniture & Equipment	81,943
Textbooks	152,270
Total Fixed Assets	520,815
Less: Accumulated Depreciation	(237,125)
Net Fixed Assets	$283,690

5. FIXED ASSETS (Continued)

The School had $115,925 (net of accumulated depreciation) in leasehold improvements which were abandoned in June 2001.

6. RISK MANAGEMENT

A. Property and Liability

The School is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. For fiscal year 2001, the School contracted with EMC Insurance Companies for property and general liability insurance. There is a $1,000 deductible with a one hundred percent blanket, all risk policy.

There were no significant reductions in insurance coverage from the prior year. Also, there were no settlements that exceeded insurance coverage for the past three years.

B. Workers Compensation

The School pays the State Workers Compensation System a premium for employee injury coverage. The premium is calculated by multiplying the monthly total gross payroll by a factor that is calculated by the State.

7. CAPITAL LEASE

The School leases a copier for $1,089 a month with an imputed interest rate of 6.25% for five years. The lease qualifies as a capital lease and is recorded as a fixed asset at the present value of the future minimum lease payments. The copier is depreciated by the School over the term of the lease and the capitalized value of the copier is $16,350.

The future minimum lease payments are as follows:

Year Ended June 30	
2002	$13,068
2003	13,068
2004	5,462
Total minimum lease payments	31,598
Less: imputed interest	(15,485)
Present value of net minimum lease payments	$16,113

Insurance of the copier is the responsibility of the School.

8. OPERATING LEASE

The School has a twelve-month lease for 66,869 square feet of building space to be used for educational purposes. This lease is renewed on an annual basis. The School paid $10,243 per month plus $297 per month for each child above a census of 300 students. Beginning in October 2001, the School's monthly lease payment was $20,000 per month. The School also has a month-to-month lease for 399 square feet of building space to be used for sale of ice cream and juices. In fiscal year 2001, the School paid $400 per month. At June 30, 2001, the School paid $193,230 in rent, and had a payable of $40,000 for both leases.

9. DEFINED BENEFIT PENSION PLANS

A. School Employees Retirement System

The School contributes to the School Employees Retirement System of Ohio (SERS), a cost sharing multiple employer defined benefit pension plan administered by the School Employees Retirement Board. SERS provides basic retirement benefits, disability, survivor, and health care benefits based on eligible service credit to members and beneficiaries. Benefits are established by Chapter 3309 of the Ohio Revised Code. SERS issues a publicly available financial report that includes financial statements and required statements and required supplementary information for SERS. That report may be obtained by writing to the School Employees Retirement System, 45 North Fourth Street, Columbus, OH 43215-3634.

Plan members are required to contribute 9 percent of their annual covered salary and the School is required to contribute 14 percent; for fiscal year 2001, 5.5 percent was the portion to fund pension obligations. The contribution rates are established by SERS's Retirement Board within the rates allowed by State statute. The School's required contributions for pension obligations to SERS for the fiscal years ended June 30, 2001, 2000, and 1999 were $73,957, $28,841, and $11,324 respectively; 64 percent has been contributed for fiscal year 2001 and 100 percent for fiscal year 2000 and 1999. $26,952 represents the unpaid contributions for fiscal year 2001 and is recorded as a liability.

B. State Teachers Retirement System

The School contributes to the State Teachers Retirement System of Ohio (STRS), a cost-sharing multiple employer public employee retirement system administered by the State Teachers Retirement Board. STRS provides basic retirement benefits, disability, survivors, and health care benefits based on eligible service credit to members and beneficiaries. Benefits are established by Chapter 3307 of the Ohio Revised Code. STRS issues a publicly available financial report that includes financial statements and required supplementary information for STRS. That report may be obtained by writing to the State Teachers Retirement System, 275 East Broad Street, Columbus, OH 43215-3771.

Plan members are required to contribute 9.3 percent of their annual covered salary and the School is required to contribute 14 percent; 6 percent was the portion used to fund pension obligations. Contribution rates are established by STRS, upon recommendation of its consulting actuary, not to exceed statutory maximum rates of 10 percent for members and 14 percent for employers. The School's required contributions for pension obligation to STRS for the fiscal years ended June 30, 2001, 2000, and 1999 were $62,446, $40,073 and $22,535 respectively; 94 percent has been contributed for fiscal year 2001 and 100 percent for fiscal year 2000 and 1999. $3,562 represents the unpaid contribution for fiscal year 2001and is recorded as a liability.

10. POST EMPLOYMENT BENEFITS

The School provides comprehensive health care benefits to retired teachers and their dependents through the State Teachers Retirement System (STRS), and to retired non-certified employees and their dependents through the School Employees Retirement System (SERS). Benefits include hospitalization, physicians' fees, prescription drugs, and reimbursement of monthly Medicare premiums. Benefit provisions and the obligations to contribute are established by the System based on authority granted by State statute. Both systems are on a pay-as-you-go basis.

For STRS, all benefit recipients are required to pay a portion of health care cost in the form of a monthly premium. By Ohio Law, the cost of coverage paid from STRS funds shall be included in the employer contribution rate, currently 14 percent of covered payroll. The board currently allocates employer contributions equal to 8 percent of covered payroll to the Health Care Reserve Fund from which payments for health care benefits are paid. For the School, this amount equaled $78,512 during the 2001 fiscal year.

STRS pays health care benefits from the Health Care Reserve Fund. At June 30, 2000 (the latest information available) net health care costs paid by STRS were $283,137,000 and STRS had 99,011 eligible benefit recipients.

For SERS, coverage is made available to service retirees with ten or more fiscal years of qualifying service credit, disability and survivor benefit recipients. Members retiring on or after August 1, 1989, with less than twenty-five years of service credit must pay a portion of their premium for health care. The portion is based on years of service up to a maximum of 75 percent of the premium.

For this fiscal year, employer contributions to fund health care benefits were 8.5 percent of covered payroll. In addition, SERS levies a surcharge to fund health care benefits equal to 14 percent of the difference between a minimum pay and the member's pay, prorated for partial service credit.

For fiscal year 2001, the minimum pay has been established at $12,400. For the School, the amount to fund health care benefits, including surcharge, equaled $114,297 during the 2001 fiscal year.

The surcharge, added to the unallocated portion of the 14 percent employer contribution rate, provides for maintenance of the asset target level for the health care fund. The target level for the health care reserve is 125 percent of annual health care expenses. Expenses for health care at June 30, 2000 (the latest information available), were $140,696,340 and SERS has approximately 50,000 participants currently receiving health care benefits.

11. OTHER EMPLOYEE BENEFITS

A. Compensated Absences

The criteria for determining leave components are derived from school policies and State Laws. Full-time employees are eligible for fifteen days of paid vacation each year. Employees may not carry more than twenty-five days of accrued vacation at any one time. Unused vacation leave is not compensable upon termination.

B. Insurance Benefits

The School District provides life, short-term, and long term disability insurance to all employees through a private carrier. Coverage is provided for all certified and noncertified employees.

C. Employee Medical, Dental, and Vision Benefits

The School has contracted with a private carrier to provide employee medical/surgical benefits. The School pays 100% of the monthly premium.

12. DEBT

During fiscal year 1999, the Treasurer entered into a loan with Firstar Bank with a limit of $275,000 at an interest rate of 7 percent. As of June 30, 1999, $237,916 was borrowed against the limit. The Agreement allows the school to purchase or lease equipment and make payments to the bank in monthly installments. The balance of the loan at July 1, 2000 was $91,012.

As of June 30, 2001, the loan was paid in full.

During fiscal year 2001, the Treasurer entered into a line of credit with Provident Bank with a limit of $155,000 at an interest rate of the prime rate plus .75 percent. As of June 30, 2001, $110,000 was borrowed against the limit. Principal and interest are immediately due and payable on demand. Monthly payments shall be equal to accrued and unpaid financial charges and are to be paid each month until the principal is paid. The line of credit is collaterlized by the School's inventory, chattel paper, accounts, equipment and general intangibles, assignment of warrant payment from the State of Ohio.

Debt	Balance as of 7/1/00	Increases	Decreases	Balance as of 6/30/01
Equipment Lease (loan with Firstar Bank)	$ 91,012	$ 0	$ 91,012	$ 0
Capital Lease	0	16,350	237	16,113
Line of Credit	0	110,000	0	110,000
Total	$ 91,012	$126,350	$ 91,249	$126,113

12. DEBT (Continued)

The line of credit is not evidenced by notes. Notes are statutorily limited to maturing at the end of the year unless the debt issued obligates or is collateralized by the State monies received by the School under Ohio Law. The line of credit above issued during the year does not specifically exclude State foundation monies and extended beyond year end, contrary to State statutes.

13. STATE SCHOOL FUNDING DECISION

On September 6, 2001, the Ohio Supreme Court issued its latest opinion regarding the State's school funding plan. The decision identified aspects of the current plan that require modification if the plan is to be considered constitutional, including:

-- A change in the school districts that are used as the basis for determining the base cost support amount. Any change in the amount of funds distributed to school districts as a result of this change must be retroactive to July 1, 2001, although a time line for distribution is not specified.

-- Fully funding parity aid no later than the beginning of fiscal year 2004 rather than fiscal year 2006.

The Supreme Court relinquished jurisdiction over the case based on anticipated compliance with its order.

In general, it is expected that the decision would result in an increase in State funding for most Ohio school districts. However, as of April 19, 2002, the Ohio General Assembly is still analyzing the impact this Supreme Court decision will have on funding for individual school districts.

Further, the State of Ohio, in a motion filed September 17, 2001, asked the Court to reconsider and clarify the parts of the decision changing the school districts that are used as the basis for determining the base cost support amount and the requirement that changes be made retroactive to July 1, 2001.

On November 2, 2001, the Court granted this motion for reconsideration. The Court may reexamine and redetermine any issue upon such reconsideration.

As of April 19, 2002, the School is unable to determine what effect, if any, this decision and the reconsideration will have on its future State funding and on its financial operations.

14. RELATED PARTIES

During fiscal year 2001, the husband of a cabinet member of the School was the Director of Harmony Community – Cincinnati, Inc. This Cabinet member was also employed by the School as a guidance counselor. Salaries for the Director and his wife were $79,500 and $39,273, respectively. Another Cabinet member is employed by the School as a part-time teacher. The salary of the employee is $10,400. These relationships are allowed under Ohio law, however; accounting standards require disclosure on these relationships.

15. PURCHASED SERVICES

Purchased Services during fiscal year 2001 were comprised of the following:

Utilities	$105,322
Copier Lease	19,119
Student Testing	12,882
Professional Fees	58,257
Building Lease	218,038
Security	4,588
Maintenance	14,988
Total	$433,194

16. CONTINGENCIES

A. Grants

The School received financial assistance from federal and state agencies in the form of grants. The disbursement of funds received under these programs generally requires compliance with terms and conditions specified in the grant agreements and is subject to audit by the grantor agencies. Any disallowed claims resulting from such audits could become a liability of the School. However, in the opinion of management, any such disallowed claims will not have a material adverse effect on the overall financial position of the School at June 30, 2001.

B. Litigation

A suit was filed in Franklin County Common Pleas Court on May 14, 2001, alleging that Ohio's Community (i.e. Charter) Schools program violates the state constitution and state laws. The effect of this suit, if any, on the School is not presently determinable.

The Ohio Department of Education (Department) conducted an "enrollment review" of the student full-time equivalency attendance for the fiscal year ended June 30, 1999. The Department determined that the School had been over-paid $174,660 for foundation revenue, and deducted the overpayment from the School's fiscal year 2000 foundation revenue.

The School filed suit against the Department on December 11, 2000. The suit asserts that the Ohio Department of Education improperly conducted this review because there is no statutory basis for such an review to be performed and the review failed to count fully the full-time equivalency attending the School. The School is requesting that the withheld amount be paid to the School.

16. CONTINGENCIES (Continued)

C. State 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 will receive $173,913 from the Ohio Department of Education as a result of its review for the year ended June 30, 2001. It is recorded as an intergovernmental receivable.

D. Payroll Withholdings

The School received a discrepancy notice from the Ohio Department of Taxation stating the state withholding reported is less than the state withholding calculated. The effect of this notice, if any, on the School is not presently determinable.

The School received a notice from the Internal Revenue Service stating they did not receive a 941 tax form for the period December 31, 1998. The School also received a notice for the tax year ending December 31, 1999 stating the amount reported on the 941 tax forms does not agree with the W-2 tax forms. The effect of these notices, if any, on the School is not presently determinable.

17. SUBSEQUENT EVENTS

In August 2001, Provident Bank agreed to increase the line of credit from $110,000 to $205,000. As of June 30, 2001 $110,000 had been borrowed. The entire amount has been borrowed against the line of credit as of August 2001.

In September 2001, the School entered into a $40,000 loan with Provident Bank which Dr. Nordyke, the Director, guaranteed. As of November 30, 2001, this loan has been paid in full to the bank.

Dr. Nordyke entered into a personal loan with the School for $50,000 in August 2001. Payment is to be made in 10 monthly installments of $5,000 plus the prime interest rate at the time of the loan. As of March 31, 2002, $35,000 of the loan has been paid and $15,000 is outstanding.

The School moved to a new location on August 23, 2001. The School received a zoning permit to hold School in the building, however, later the City of Cincinnati Zoning Board repealed the decision. The School is currently appealing the zoning board decision in the Hamilton County Court of Common Pleas. The School, the City of Cincinnati, and the Dog Gone, Inc. entered into an agreement allowing the School to stay in its present location until the end of the 2001-2002 school year.

18. MANAGEMENT'S PLAN REGARDING OPERATING LOSS

The School's operating loss of $308,725 resulted in part because the School incurred expenses in anticipation of a higher level of special education funding than was eventually provided by the State. Interpretation by the State of the special education funding formula resulted in the State providing less funding that the School anticipated. Managements' plan to eliminate future operating losses include reduction of payroll expenses and purchased services. Management also plans to apply for additional Federal grants.

As of March 31, 2002:

- Cash receipts for School Foundation have increased by $84,265 over the same period last year (July through March), from $2,248,915 to $2,333,180.

- Cash payments for employee payroll have decreased by $67,335 over the same period last year (July through March), from $1,216,953 to $1,149,618.

19. MATERIAL NONCOMPLIANCE

The School was delinquent in its School Employment Retirement System (SERS) payments for employer's and employee's portions. As of June 30, 2001, the School owed SERS $75,012. As of April 19, 2002, the School is current on its employer's and employee's portions of SERS.

This page intentionally left blank.

STATE OF OHIO
OFFICE OF THE AUDITOR

JIM PETRO, AUDITOR OF STATE

250 West Court Street
Suite 150 E
Cincinnati, Ohio 45202
Telephone 513-361-8550
800-368-7419
Facsimile 513-361-8577
www.auditor.state.oh.us

REPORT OF INDEPENDENT ACCOUNTANTS ON COMPLIANCE AND ON INTERNAL CONTROL REQUIRED BY *GOVERNMENT AUDITING STANDARDS*

Harmony Community - Cincinnati, Inc.
Hamilton County
3653 Michigan Avenue
Cincinnati, OH 45209

To the Management Cabinet:

We have audited the financial statements of Harmony Community - Cincinnati, Inc., Hamilton County, Ohio, (the School), as of and for the fiscal year ended June 30, 2001, and have issued our an adverse report thereon dated April 19, 2002 in which we have noted that the School's financial statements referred to above include an intergovernmental receivable that does not meet the revenue recognition criteria described by accounting principles generally accepted in the United States of America, describes the School's failure to file annual information returns, and describes the School's viability as a going concern. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the School's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards* which are described in the accompanying schedule of findings as items 2001-10431-001 through 2001-10431-004.

We also noted certain immaterial instances of noncompliance that we have reported to the management of the School in a separate letter dated April 19, 2002.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the School's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the School's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are described in the accompanying schedule of findings as items 2001-10431-005 through 2001-10431-006.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable conditions described above are not material weaknesses.

We also noted other matters involving the internal control over financial reporting that do not require inclusion in this report, that we have reported to the management of the School in a separate letter dated April 19, 2002.

This report is intended for the information and use of management and the Management Cabinet and is not intended to be and should not be used by anyone other than these specified parties.

Jim Petro
Auditor of State

April 19, 2002

SCHEDULE OF FINDINGS
JUNE 30, 2001

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

FINDING NUMBER 2001-10431-001

Finding for Recovery

State ex rel. McClure v. Hagerman, 155 Ohio St. 320 (1951) provides that expenditures made by a public entity should serve a proper public purpose. McClure indicates that as a general rule, the question whether the performance of an act or the accomplishment of a specific purpose constitutes a "public purpose" for which funds may be lawfully disbursed rests in the judgement of the authorities.

In fiscal year 2001, the School was in the process of opening a clothing store as part of an entrepreneurial class. The Supervisors Debbie Redder (from the period 9/1/00 to 2/15/01) and David Licata (from the period 2/15/01 to 6/30/01) were responsible for helping the students run the store. The students were responsible for making purchases. These purchases included such items as purchasing trips, clothes for resale, advertising, computers, and phone system and lines. These items were purchased, however the store never opened. A few items were sold, however, there is no supporting documentation to show money was collected on the clothing sold, and no evidence could be provided that the School still had the inventory. Finally, no explanation was given for the failure to collect money or the status of the unsold merchandise. The School moved to a new location at the end of the year, and the inventory were misplaced in the move.

Students and advisors were advanced money for the trips taken to purchase clothes, however, when they returned, proper receipts were not always provided to the Treasurer. No documentation could be provided for these disbursements and some of these disbursements were not for proper public purpose as seen in the table below.

The above reasons led to the following finding for recoveries:

Debbie Redder, Supervisor and David Nordyke, Director, jointly and severally		
A rental car from Cincinnati to Tennessee and a rental car in Florida, rented by people not related to the School.	$543.00	
The School gave the clothing store $1,000 start-up money; however, only $750 was deposited.	250.00	
Disbursement approved for a student to have 2 cell phones and many calls were made late in the evening without support that they were legitimate.	380.38	
Gas purchases not supported for purposes of the School or the clothing store	52.50	
Advanced to a student, no receipts were returned.	100.00	
		$1,325.88
Debbie Redder, Supervisor and Robert Witt, Treasurer, jointly and severally		
Advertising, the invoice did not have a company address, and the company could not be located.	500.00	
Advanced to student $500, only had receipts to support $292.68, no evidence the money was returned or an explanation for where the balance went.	207.32	
		$707.32

FINDING NUMBER 2001-10431-001
(Continued)

<u>Debbie Redder, Supervisor</u>		
A receipt was written for items purchased, but no documentation to support the money was deposited.		$50.00
<u>David Licata, Supervisor</u>		
Check written to student for change for the cash register. School never opened and no documentation money was given back to the School.	$150.00	
A receipt was written for items sold, but no documentation to support the money was deposited	200.00	
A note was written by student to borrow the money, but no evidence money was returned.	250.00	
Missing Inventory	8,367.78	
		$8,967.78
<u>Jerome Johnson, Teacher</u>		
Did not pay for merchandise purchased.		$250.00
<u>Eric Davis, Teacher</u>		
Did not pay for merchandise purchased.		$250.00
<u>Taz Holley, Teacher</u>		
Did not pay for merchandise purchased.		$350.00
Total Finding for Recovery		**$11,900.98**

All employees are bonded with Hamilton Mutual.

In accordance with the foregoing facts, and pursuant to Ohio Rev. Code Section 117.28, a Finding for Recovery in favor of Harmony Community-Cincinnati, Inc. in the amount of $1,325.88, for the illegal expenditure of public monies, is hereby issued against Debbie Redder, David Nordyke, and Hamilton Mutual, jointly and severally.

In accordance with the foregoing facts, and pursuant to Ohio Rev. Code Section 117.28, a Finding for Recovery in favor of Harmony Community-Cincinnati, Inc. in the amount of $707.32, for the illegal expenditure of public monies, is hereby issued against Debbie Redder, Robert Witt, and Hamilton Mutual, jointly and severally.

In accordance with the foregoing facts, and pursuant to Ohio Rev. Code Section 117.28, a Finding for Recovery in favor of Harmony Community-Cincinnati, Inc. in the amount of $50, for money collected but unaccounted for, is hereby issued against Debbie Redder and Hamilton Mutual, jointly and severally.

FINDING NUMBER 2001-10431-001
(Continued)

In accordance with the foregoing facts, and pursuant to Ohio Rev. Code Section 117.28, a Finding for Recovery in favor of Harmony Community-Cincinnati, Inc. in the amount of $8,967.78, for the illegal expenditure of public monies, and in the amount of $200, for money collected but unaccounted for is hereby issued against David Licata and Hamilton Mutual, jointly and severally.

In accordance with the foregoing facts, and pursuant to Ohio Rev. Code Section 117.28, a Finding for Recovery in favor of Harmony Community-Cincinnati, Inc. in the amount of $250, for money due but not collected, is hereby issued against Jerome Johnson and Hamilton Mutual, jointly and severally.

In accordance with the foregoing facts, and pursuant to Ohio Rev. Code Section 117.28, a Finding for Recovery in favor of Harmony Community-Cincinnati, Inc. in the amount of $250, for money due but not collected, is hereby issued against Eric Davis and Hamilton Mutual, jointly and severally.

In accordance with the foregoing facts, and pursuant to Ohio Rev. Code Section 117.28, a Finding for Recovery in favor of Harmony Community-Cincinnati, Inc. in the amount of $350, for money due but not collected, is hereby issued against Taz Holley and Hamilton Mutual, jointly and severally.

FINDING NUMBER 2001-10431-002

Noncompliance Citation

Ohio Rev. Code §3314.08(J), states a community school may borrow money to pay any necessary and actual expenses of the school in anticipation of the receipt of any portion of the payments to be received by the school pursuant to division (D) of this section. The school may issue notes to evidence such borrowing to mature no later than the end of the fiscal year in which such money was borrowed. The proceeds of the notes shall be used only for the purposes for which the anticipated receipts may be lawfully expended by the school. The School has a Line of Credit with Provident Bank, but it is not evidenced by notes and it did not mature by fiscal year end.

We recommend the School restructure repayment to comply with the Ohio Rev. Code.

FINDING NUMBER 2001-10431-003

Noncompliance Citation

Ohio Rev. Code § 3309.47 states that each school employees retirement system contributor shall contribute eight per cent of the contributor's compensation to the employees' savings fund. Ohio Rev. Code § 3309.49 requires each employer to pay to the school employees retirement system an amount certified by the secretary that shall be a certain per cent of the earnable compensation of all employees. The School was delinquent in paying its employer and employee portions of SERS payments throughout the year. When timely payments are not made the School could incur unnecessary penalty fees, and employees may not receive appropriate retirement benefits. At June 30, 2001, the School owed $75,012 in employer and employee portions to SERS for fiscal year 2001 payroll. We recommend the Treasurer monitor payment deadlines and ascertain payments to SERS are paid by the due date.

As of April 19, 2002, the School is current on its payments to SERS.

FINDING NUMBER 2001-10431-004

Noncompliance Citation

26 C.F.R. §1.6033, states organizations described in section 501(c)(3) in the Internal Revenue Code shall file an annual return stating the items of gross income, receipts, and disbursements, a balance sheet showing its assets, liabilities, and net worth at the beginning of such year, and any other information the Internal Revenue Service may require. The School has not filed such returns for the fiscal years ending June 30, 2001, June 30, 2000, and June 30, 1999. The School has been assessed penalties of $50,821 by the Internal Revenue Service. The School has taken proper steps to request a waiver of the penalties. As of the date of the report, they have not received a response from the Internal Revenue Service.

FINDING NUMBER 2001-10431-005

Reportable Condition

Monitoring Controls

An effective monitoring control system has not been implemented to assist management in detecting material misstatements in financial or other information. The School should develop and implement a monitoring control system to reduce the risk of not detecting material misstatements.

Monitoring controls are comprised of regular management and supervisory activities established to oversee whether management's objectives are being achieved. These controls should address operational, legal compliance, and financial control objectives. Effective monitoring controls should identify unexpected results or exceptions (including significant compliance exceptions), investigate underlying causes, and take corrective action. There was no documentation in the minutes that the Board reviews financial information on a regular basis.

Monitoring controls may be in the nature of ongoing activities or separate periodic evaluation by either management or an internal audit function. They can relate to a specific transaction cycle or can be more overview in nature.

Monitoring controls should assist management in detecting material misstatements in financial or other information and can include:

- regular review of budget and actual expenditures;
- regular review of financial report summaries of sufficient detail (monthly detailed revenue and expenditure reports);
- review of key performance indicators;
- review of revenues/expenditures with independently accumulated information (budgets, past performance, etc.);
- review of unusual or significant items, long outstanding items, etc.;
- identification of unusual fluctuations;
- ensuring an adequate segregation of duties exist;
- review of monthly reconciliations, and
- approval of grants.

FINDING NUMBER 2001-10431-006

Reportable Condition

<u>Reimbursement Policy</u>

The School does not have an employee reimbursement policy. The Treasurer advances money to employees (with the Director's approval) who are attending a seminar to cover their travel costs or to purchase items. Receipts supporting employee expenditure of the funds are not always returned to the Treasurer after the advance. Without proper documentation, the School's money could be spent for items that are not a proper public purpose, and funds not expended and due back to the School could go undetected.

The School should establish a policy and procedures regarding employee reimbursements. This policy should include requiring receipts for all purchases made, completion of reimbursement forms with the employee's signature indicating the items for which the employee is being reimbursed, and an approval from an appropriate authority authorizing the reimbursement.

This page intentionally left blank.

HARMONY COMMUNITY-CINCINNATI, INC.
HAMILTON COUNTY

SCHEDULE OF PRIOR AUDIT FINDINGS
OMB CIRCULAR A -133 § .315 (b)
JUNE 30, 2001

Finding Number	Finding Summary	Fully Corrected?	Not Corrected, Partially Corrected; Significantly Different Corrective Action Taken; or Finding No Longer Valid; ***Explain***:
001	Finding for Recovey - Computers paid for not received.	No	Not Corrected - No action taken
002	Finding for Recovery - Overpayment to an employee	No	Not Corrected - No action taken
003	Weak controls over payroll processing	No	Partially Corrected - Reissued in Management Letter
004	Weak controls over disbursement procedures for assuring that goods or services are received prior to payment.	No	Partially Corrected - Reissued in Management Letter

STATE OF OHIO
OFFICE OF THE AUDITOR
JIM PETRO, AUDITOR OF STATE

88 East Broad Street
P.O. Box 1140
Columbus, Ohio 43216-1140
Telephone 614-466-4514
800-282-0370
Facsimile 614-466-4490

HARMONY COMMUNITY-CINCINNATI, INC.

HAMILTON 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
MAY 9, 2002