



**ACADEMY OF CLEVELAND
CUYAHOGA COUNTY**

REGULAR AUDIT

FOR THE YEAR ENDED JUNE 30, 2002



**Auditor of State
Betty Montgomery**

**ACADEMY OF CLEVELAND
CUYAHOGA COUNTY**

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**Auditor of State
Betty Montgomery**

INDEPENDENT ACCOUNTANTS' REPORT

Academy of Cleveland
Cuyahoga County
9114 Miles Park Avenue
Cleveland, Ohio 44105

To the Governing Board:

We have audited the financial statements of the Academy of Cleveland, Cuyahoga County, Ohio (the Academy) as of and for the year ended June 30, 2002, as listed in the table of contents. These financial statements are the responsibility of the Academy'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 our opinion the financial statements referred to above present fairly, in all material respects, the financial position of the Academy of Cleveland, Cuyahoga County, Ohio as of June 30, 2002 and the results of its operation and cash flows for the year ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 3 to the financial statements, the Academy has suffered a loss from operations and has borrowed funds from the Charter School Administration Services to continue its operation.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 30, 2003 on our consideration of the Academy'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.

A handwritten signature in black ink that reads "Betty Montgomery".

Betty Montgomery
Auditor of State

June 30, 2003

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ACADEMY OF CLEVELAND
CUYAHOGA COUNTY

BALANCE SHEET
AS OF JUNE 30, 2002

Assets:

Current Assets:

Cash and Cash Equivalents	\$49,968
Receivables:	
Intergovernmental	19,752
Other	<u>1,166</u>
Total Current Assets	70,886

Non-Current Assets:

Fixed Assets (Net of Accumulated Depreciation and Amortization)	<u>50,971</u>
Total Assets	<u><u>121,857</u></u>

Liabilities and Equity:

Current Liabilities:

Accounts Payable	171,846
Due to Other Governments	1,056
Accrued Payroll	<u>14,014</u>
Total Current Liabilities	186,916

Equity:

Accumulated Deficit	<u>(65,059)</u>
Total Liabilities and Equity	<u><u>\$121,857</u></u>

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

**ACADEMY OF CLEVELAND
CUYAHOGA COUNTY**

**STATEMENT OF REVENUES, EXPENSES, AND
CHANGES IN ACCUMULATED DEFICIT
FOR THE YEAR ENDED JUNE 30, 2002**

Operating Revenue:

Foundation Payments	<u>\$435,958</u>
Total Operating Revenues	435,958

Operating Expenses:

Salaries	175,193
Fringe Benefits	31,267
Payroll Taxes	5,758
Purchased Services	255,786
Materials and Supplies	74,027
Depreciation and Amortization	<u>24,908</u>
Total Operating Expenses	<u>566,939</u>
Operating Loss	<u>(130,981)</u>

Non-Operating Revenue:

Grants-State	3,000
Grants-Federal	<u>62,922</u>
Total Non-Operating Revenue	<u>65,922</u>
Accumulated Deficit	(65,059)
Retained Earnings Beginning of Year	<u>0</u>
Accumulated Deficit End of Year	<u><u>(\$65,059)</u></u>

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

ACADEMY OF CLEVELAND
CUYAHOGA COUNTY

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2002

Increase/Decrease in Cash and Cash Equivalents:

Cash Flows from Operating Activities:

Cash Received from State of Ohio	\$428,128
Cash Payments to Suppliers for Goods and Services	(160,338)
Cash Payments to Employees for Services	(81,471)
Cash Payments to Advance Funds from Management Company	(81,641)
Cash Payment Employee Benefit	(27,315)
Cash Payment Payroll Taxes	<u>(5,516)</u>
Net Cash Provided By Operating Activities	<u>71,847</u>

Cash Flows from Noncapital Financing Activities:

Grants and Contributions Received	<u>54,000</u>
Net Cash Provided By Noncapital Financing Activities	<u>54,000</u>

Cash Flows from Capital and Related Financing Activities:

Payments for Capital Acquisitions	<u>(75,879)</u>
Net Cash Used for Capital and Related financing Activities	<u>(75,879)</u>
Net Increase in Cash and Cash Equivalents	49,968
Cash and Cash Equivalents Beginning of the Year	<u>0</u>
Cash and Cash Equivalents End of the Year	<u><u>\$49,968</u></u>

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

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**ACADEMY OF CLEVELAND
CUYAHOGA COUNTY**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF JUNE 30, 2002**

1. DESCRIPTION OF THE SCHOOL AND REPORTING ENTITY

The Academy of Cleveland (the Academy) is a nonprofit corporation established pursuant to Ohio Revised Code Chapters 3314 and 1702. The Academy's objective is to prepare all students to be successful citizens, cooperative workers and profitable entrepreneurs by developing their unique potential. This program is offered for students in kindergarten through sixth grade. The Academy, which is part of the State's education program, is independent of any school district and is nonsectarian in its programs, admission policies, employment practices, and all other operations. The Academy may acquire facilities as needed and contract for any services necessary for the operation of the school. The Academy may sue and be sued, acquire facilities as needed, and contract for any services necessary for the operation of the school.

The Academy was approved for operation under contract between the Governing Authority of the Academy of Cleveland (Governing Authority) and the Ohio State Board of Education (the Sponsor) for a period of five years commencing July 1, 1999 which terminates on June 30, 2004. The Sponsor is responsible for evaluating the performance of the Academy and has the authority to deny renewal of the contract at its expiration or terminate the contract prior to its expiration.

The Academy operates under the direction of a five-member Governing Board. The Governing Board is responsible for carrying out the provisions of the contract which include, but are not limited to, state-mandated provisions regarding student population, curriculum, academic goals, teacher performance standards, admission standards, and qualifications of teachers. The Governing Board controls the Academy's one instructional/support facility with a staffing level of 4 non-certified and 1 certificated full time teaching personnel who provide services to 77 students.

The Governing Board has entered into a management contract with Charter School Administration Services, Inc. (CSAS), to provide consulting services including teacher training, curriculum development, financial management, and State relations. (See Note 17).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Academy have been prepared in conformity with generally accepted accounting principles 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 Academy also applies Financial Accounting Standards Board 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 Academy'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.

**ACADEMY OF CLEVELAND
CUYAHOGA COUNTY**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF JUNE 30, 2002
(Continued)**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. Measurement Focus and Basis of Accounting

The accounting and financial reporting treatment is determined by its measurement focus. 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.

The accrual basis of accounting is used for reporting purposes. Revenues are recognized when they are earned, and expenses are recognized when they are incurred.

C. 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 Revised Code Chapter 5705, unless specifically provided in the Academy's contract with its Sponsor. The contract between the Academy and its Sponsor does prescribe an annual budget requirement in addition to preparing a 5-year forecast which is to be updated on an annual basis.

D. Cash

All monies received by the Academy are accounted for by the Academy's management company, the Charter School Administration Services, Inc. (CSAS), which serves as the Academy's fiscal agent. All cash received by the fiscal agent is maintained in a separate bank account in the Academy's name. Monies of the Academy is maintained in this account or temporarily used to purchase short-term investments. For purposes of the statement of cash flows and for presentation on the balance sheet, investments with a maturity of three months or less at the time they are purchased by the Academy are considered to be cash equivalents.

E. Fixed Assets and Depreciation

Fixed assets are capitalized at cost and updated for additions and retirements during the year. Donated fixed assets are recorded at their fair market values as of the dates received. The Academy does not possess any infrastructure. The Academy maintains a capitalization threshold of \$500.

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 and leasehold improvements is computed using the straight-line method over an estimated useful life of five years.

**ACADEMY OF CLEVELAND
CUYAHOGA COUNTY**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF JUNE 30, 2002
(Continued)**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

F. Intergovernmental Revenues

The Academy currently participates in the State Foundation Program and the State Disadvantaged Pupil Impact Aid (DPIA) Program. Revenues 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 Academy must provide local resources to be used for a specified purpose, and expenditure requirements, in which the resources are provided to the Academy on a reimbursement basis.

The Academy also participates in the Federal Charter School Grant Program through the Ohio Department of Education. During 2002 the Academy received \$50,000 to offset start-up costs of the Academy. Revenue received from this program is recognized as non-operating revenue in the accompanying financial statements.

Grants and entitlements are recognized as non-operating revenues in the accounting period in which they are earned and become measurable.

G. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from these estimates.

3. COMPLIANCE ACCOUNTABILITY AND FINANCIAL OUTLOOK

For fiscal year 2002, the Academy had an operating loss of \$130,981 a working capital deficiency of \$116,030 and an accumulated deficit of \$65,069. This operating loss and accumulated deficit was the result of operating expenses incurred by the Academy. From June 30, 2002 to June 30, 2003 the Academy continued to experience losses and deficits. The Academy has no formal plan in place to alleviate the losses and deficits.

4. DEPOSITS

On June 30, 2002, the carrying amount of the Academy's deposits was \$49,968 and the bank balance was \$67,363. All of which was covered by federal depository insurance.

5. ACCOUNTS PAYABLE

On June 30, 2002 the accounts payable totaled \$171,846 and consisted of \$81,641 due CSAS for monies advanced for payroll purposes, \$60,195 for overhead and management fees due CSAS based on the provisions of the management agreement, \$3,337 for miscellaneous items paid for by CSAS, and \$26,673 due to vendors for various purposes.

**ACADEMY OF CLEVELAND
CUYAHOGA COUNTY**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF JUNE 30, 2002
(Continued)**

6. FIXED ASSETS

A summary of the Academy's fixed assets at June 30, 2002, follows:

Furniture and Equipment	\$ 2,885
Leasehold Improvements	<u>72,994</u>
	75,879
Less: Accumulated Depreciation	<u>(24,908)</u>
Net Fixed Assets	<u>\$ 50,971</u>

7. RISK MANAGEMENT

A. Property and Liability

The Academy 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 the period August 1, 2001 through August 1, 2002, the Academy contracted with Employers Mutual Casualty Company for property and general liability insurance.

Professional liability is protected by Employers Mutual Casualty Company with a \$1,000,000 single occurrence limit and \$2,000,000 aggregate and no deductible.

B. Workers' Compensation

The Academy pays the State Worker's 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.

C. Employee Medical, Dental, Vision, Prescription, and Life Benefits

The Academy has contracted with private carriers to provide employee medical, dental, vision, prescription, life insurance, and long term disability insurance to its full time employees who work 40 or more hours per week.

8. DEFINED BENEFIT PENSION PLANS

A. School Employees Retirement System

The Academy 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 retirement and disability benefits, annual cost-of-living adjustments, and death benefits to members and beneficiaries. Authority to establish and amend benefits is established by Chapter 3309 of the Ohio Revised Code.

SERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to the School Employees Retirement System, 45 North Fourth Street, Columbus, Ohio 43215-3634.

**ACADEMY OF CLEVELAND
CUYAHOGA COUNTY**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF JUNE 30, 2002
(Continued)**

8. DEFINED BENEFIT PENSION PLANS (Continued)

A. School Employees Retirement System (Continued)

Plan members are required to contribute 9 percent of their annual covered salary and the Academy is required to contribute an actuarially determined rate. The current rate is 14 percent of annual covered payroll; for the year June 30, 2002, 5.46 percent was the portion to fund pension obligations. The contribution requirements of plan members and employers are established and may be amended, up to statutory maximum amounts, by the SERS Retirement Board. The Academy's required contribution for pension obligations to SERS for the year ended June 30, 2002 was \$2,774. 97 percent has been contributed for fiscal year 2002. The unpaid contribution for fiscal year 2002, in the amount of \$83 is recorded as a liability.

B. State Teachers Retirement System

The Academy 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 retirement and disability benefits, annual cost-of-living adjustments, and death benefits 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. The report may be obtained by writing to the State Teachers Retirement System, 275 East Broad Street, Columbus, Ohio 43215-3771.

Plan members are required to contribute 9.3 percent of their annual covered salary and the Academy is required to contribute 14 percent; 9.5 percent was the portion used to fund pension obligations for the year 2002. 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 Academy's required contribution for pension obligations to STRS for fiscal year 2002 was \$11,815. 91.75 percent has been contributed for fiscal year 2002. The unpaid contribution for fiscal year 2002, in the amount of \$973, is recorded as a liability.

9. POSTEMPLOYMENT BENEFITS

The Academy 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 Systems based on authority granted by State statute. Both systems are funded on a pay-as-you-go basis.

For STRS, all benefit recipients are required to pay a portion of health care costs 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. For fiscal year 2002, the Board allocated employer contributions equal to 4.5 percent of covered payroll to the Health Care Reserve Fund. For the Academy, this amount equaled \$5,599 during the year.

STRS pays health care benefits from the Health Care Reserve Fund. At June 30, 2001 (the latest information available). The balance in the Fund was \$3.256 million for the fiscal year ended June 30, 2001, net health care costs paid by STRS were \$300,772,000, and STRS had 102,132 eligible benefit recipients.

**ACADEMY OF CLEVELAND
CUYAHOGA COUNTY**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF JUNE 30, 2002
(Continued)**

9. POSTEMPLOYMENT BENEFITS (Continued)

For SERS, coverage is made available to service retirees with ten or more 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 the fiscal year ended June 30, 2002, employer contributions to fund health care benefits were 8.54 percent of covered payroll, a decrease of 1.3 percent from fiscal year 2001. 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, pro-rated for partial service credit. For fiscal year 2002, the minimum pay has been established at \$12,400. For the Academy, the amount to fund health care benefits, including surcharge, equaled \$4,339 for fiscal year 2002.

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 150 percent of annual health care expenses. Expenses for health care at June 30, 2000(the latest information available), were \$161,439,934, and the target level was \$242.2 million. At June 30, 2001, SERS had net assets available for payment of health care benefits of \$315.7 million. SERS has approximately 50,000 participants currently receiving health care benefits.

10. STATE SCHOOL FUNDING DECISION

On December 11, 2002, the Ohio Supreme Court issued its latest opinion regarding the State's school funding plan. The decision reaffirmed earlier decisions that Ohio's current school-funding plan is unconstitutional.

The Supreme Court relinquished jurisdiction over the case and directed "...the Ohio General Assembly to enact a school-funding scheme that is thorough and efficient...". The School District is currently unable to determine what effect, if any, this decision will have on its future State funding and its financial operations.

11. CONTINGENCIES

A. Grants

The Academy 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 funds. However, in the opinion of management, any such disallowed claims will not have a material adverse effect on the overall financial position of the Academy at June 30, 2002.

B. Ohio Community School Program

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 Academy is not presently determinable.

**ACADEMY OF CLEVELAND
CUYAHOGA COUNTY**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF JUNE 30, 2002
(Continued)**

12. SCHOOL 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.

As a result of this review, the Academy has recognized on its balance sheet an "Intergovernmental Receivable" for the amount that is to be refunded to the by the Ohio Department of Education based on the actual student full time equivalent (FTE) enrollment as determined at the end of the year, compared to the October 2001 enrollment that the School's monthly funding had been based upon. The receivable reflects that the Academy had been funded at a lower estimated enrollment figure through out the year than what the actual FTE figure was calculated to be at year end. The amount recognized at June 30, 2002 was \$7,830.

13. OPERATING LEASES

The Academy has entered into a sublease for the period August 1, 2001 through July 31, 2004 with "Academy of America, a Michigan non-profit corporation", which leases from the "Presbytery of the Western Reserve", lease space to house the Academy. Payments made totaled \$30,800 for the fiscal year. The Academy has the option to renew the lease for an additional three-year term, with the rent increase(s) not to exceed four percent.

The Academy has also entered into a lease commencing August 1, 2001 for a term of 36 months for a copier. Payments made during the year 2002 totaled \$3,597.

The following is a schedule of the future minimum payments required under the operating leases as of June 30, 2002.

<u>Fiscal Year Ending June 30,</u>	<u>Facility Rental</u>	<u>Copiers</u>
2003	\$33,600	\$3,924
2004	33,600	3,924
2005	<u>2,800</u>	<u>327</u>
Total minimum payments	<u>\$70,000</u>	<u>\$8,175</u>

14. PURCHASED SERVICE EXPENSES

For the period ended June 30, 2001, purchased service expenses were payments for services rendered, as follows:

<i>PURCHASED SERVICES</i>	
Advertising	\$38,379
Consulting Fees	26,081
Insurance	10,824
Leased Equipment	3,597
Maintenance and Repairs	5,203
Management Company Fees (See Note 17)	57,735
Overhead Fees to Management Company (See Note 18)	51,992
Professional Fees	4,981
Rent	30,800
Telephone	14,033
Meeting Expenses	2,779
Utilities	<u>9,382</u>
Total Purchased Services	<u>\$255,786</u>

**ACADEMY OF CLEVELAND
CUYAHOGA COUNTY**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF JUNE 30, 2002
(Continued)**

15. TAX EXEMPT STATUS

As of June 30, 2003, the Academy had not filed for tax exempt status under § 501(c)(3) of the Internal Revenue Code. The Academy has made no provision for any potential future tax liability which could result from not obtaining the § 501(c)(3) tax exempt status.

16. RELATED PARTY

Two of the board members of the Academy of Cleveland are also directors of the Academy of America in Michigan. They are also members of the boards of the Academy of Dayton Community School, and the Academy of Business and Technology, as well as shareholders in the Charter School Administrative Services, Inc. the management company of the Academy of Cleveland.

Total rent payments to Academy of America (Michigan) were \$30,800. Total payments to Charter School Administration Services, Inc. were \$109,727, which includes management fees and overhead fees.

17. MANAGEMENT AGREEMENT

The Academy entered into a ten-year contract, effective July 1, 2001 through June 30, 2011, with Charter School Administration Services, Inc. (CSAS) for educational management services, total payments to CSAS were \$57,735 of which \$33,730 is still due for the fiscal year ended June 30, 2002. In exchange for its services, CSAS receives a management fee equal to 12% of all revenue sources and is reimbursed for all cost incurred on behalf of the Academy. In addition, the Academy pays CSAS an annual incentive fee in an amount equal to fifty (50%) percent of the excess of revenue over expenditures, which was not collected by CSAS for the year ended June 30, 2002. Terms of the contract require CSAS to provide the following:

- A. All labor, materials, and supervision necessary for the provision of educational services to students, and the management, operation, and maintenance of the Academy;
- B. Implementation and administration of the Educational Program, including the selection and acquisition of instructional materials, equipment and supplies, and the administration of any and all extracurricular and co-curricular activities and programs;
- C. All personnel functions including the professional development of the School administrator and all instructional personnel and support staff;
- D. Control, maintenance, and operation of the school building, and the installation of technology integral to the school design;
- E. All aspects of the business administration of the Academy;
- F. Transportation and food service for the Academy.
- G. A projected annual budget prior to each school year.
- H. Detailed statements of all revenues received, from whatever source, and detailed statements of all direct expenditures for services rendered to or on behalf of the Academy, whether incurred on-site or off-site, upon request.
- I. Annual audits in compliance with state law and regulations, showing the manner in which funds are spent at the Academy.
- J. Reports on Academy operations, finances, and students' performance, upon request, but not less frequently than four (4) times per year.
- K. Any other function necessary or expedient for the administration of the Academy.

**ACADEMY OF CLEVELAND
CUYAHOGA COUNTY**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF JUNE 30, 2002
(Continued)**

18. CONSORTIUM AGREEMENT

On July 1, 2001 the Governing Board approved joining a consortium with eighteen other charter schools and public school academies, each of which is managed by Charter School Administration Services, Inc. under management agreements comparable to the Management Agreement between the Academy and CSAS. The members of the consortium including the Academy are:

<u>Academy</u>	<u>State of Operation</u>
Academy of Austin	Texas
Academy of Beaumont	Texas
Academy of Dallas	Texas
Academy of Dayton	Ohio
Academy of Cleveland	Ohio
Academy of Detroit West	Michigan
Academy of Flint	Michigan
Academy of Houston	Texas
Academy of Inkster	Michigan
Academy of Kansas City	Missouri
Academy of Lathrup Village	Michigan
Academy of Michigan	Michigan
Academy of Oak Park	Michigan
Academy of San Antonio	Texas
Academy of Southfield	Michigan
Academy of Business & Technology	Ohio
Academy of Westland	Michigan
Cherry Hill School of Performing Arts	Michigan
TUMC Academy	Florida

The Management Agreement between the Academy and CSAS provides for the allocation of indirect costs incurred by CSAS on behalf of the Academy and the other members of the consortium. Based upon the count of students at the Academy and the other members of the consortium as of September 2001, and the experiences of CSAS in both incurring costs for consortium members and allocation of such costs to consortium members, the Academy and CSAS have agreed upon an equitable method of such allocation. Based upon the above count, the Academy shall pay CSAS, for all indirect reimbursable expenses incurred by CSAS on behalf of the Academy and other members of the consortium, for the 2001-2002 school year in an amount equal to \$67 per month per student enrolled at the Academy, totaling \$51,992 for the school year of which \$26,465 is still due as of June 30, 2002.

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Auditor of State Betty Montgomery

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

Academy of Cleveland
Cuyahoga County
9114 Miles Park Avenue
Cleveland, Ohio 44105

We have audited the financial statements of the Academy of Cleveland, Cuyahoga County, Ohio, (the Academy) as of and for the year ended June 30, 2002, and have issued our report thereon dated June 30, 2003, in which we noted the Academy has sustained an operating loss and accumulated deficit. 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 Academy'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 no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial instances of noncompliance that we have reported to management of the Academy in a separate letter dated June 30, 2003.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Academy'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 Academy's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings as items 2002-001 through 2002-005.

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, of the reportable conditions described above, we consider items 2002-003 and 2002-04 to be material weaknesses.

This report is intended for the information and use of the audit committee, management, Board of Trustees, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Betty Montgomery". The signature is written in a cursive, flowing style.

Betty Montgomery
Auditor of State

June 30, 2003

ACADEMY OF CLEVELAND
CUYAHOGA COUNTY

SCHEDULE OF FINDINGS
JUNE 30, 2002

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

FINDING NUMBER	2002-001
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Tax Exempt Status

The Academy has not applied to the Internal Revenue Service to obtain tax exempt status pursuant to Section 26 USC 501 (c) (3) of the Internal Revenue Service code. The Academy has made no provision for any potential current or future tax liability which could result from not obtaining the § 501(c)(3) tax exempt status. Further the Academy has not filed any tax returns. The accompanying financial statements do not include amounts associated with an income tax liability or associated files or penalties.

We recommend that the Academy establish provisions for federal local and accrued taxes. We also recommend the Academy consult with qualified tax counsel to determine necessary tax filings with the internal revenue service, pay any outstanding taxes due, and negotiate a settlement concerning any fees and/or penalties which may be assessed.

FINDING NUMBER	2002-002
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Developing and Implementing an Effective Monitoring Control System

Monitoring controls are comprised of regular management and supervisory activities established to oversee whether management's objectives are being achieved. Effective monitoring controls should assist management in assessing the quality of internal control performance over time. This process involves assessing the design and operation of controls on a timely basis and taking necessary corrective actions. Monitoring controls should assist management in identifying unexpected results and/or possible misstatements.

Some effective monitoring controls include:

- Regular review of monthly financial statements;
- Review of revenues and expenses with independently accumulated information (budgets, past performances, peer group representatives, etc.);
- Review of large or unusual transactions;
- Identification of unusual fluctuations;
- Review of items which have been outstanding for extended periods of time (outstanding check listing for payroll and non payroll transactions);
- Monitoring compliance with grant agreements;
- Ensuring that an adequate segregation of duties exists; and,
- Review of monthly bank reconciliations by someone independent of their preparation.

Financial reports are not presented to the Board on a monthly basis. There was no evidence that monthly bank reconciliations were reviewed by someone independent of their preparation.

The lack of effective monitoring controls could lead to the misallocation or misstatement of school funds, expenditure of funds contrary to the directives of the governing board, non-compliance with federal or state laws or regulations, which could result in a loss of funding from these sources, and errors or irregularities occurring in financial transactions affecting the bank reconciliations which go undetected.

**ACADEMY OF CLEVELAND
CUYAHOGA COUNTY**

**SCHEDULE OF FINDINGS
JUNE 30, 2002
(Continued)**

FINDINGS RELATED TO THE FINANCIAL STATEMENTS REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS
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FINDING NUMBER	2002-002
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Developing and Implementing an Effective Monitoring Control System (Continued)

Although the Board has contracted with CSAS to maintain the financial records and perform the financial functions of the Academy, we recommend the Board request and review financial statements on a monthly basis. The Board should review these financial statements and approve them through the minute records. In addition, management should ensure that any reports required by the grantor agencies, per the terms of grant agreements, are completed and filed with the respective grantor agencies in a timely manner. Management should also ensure that proper segregation of duties exists, including an independent review of the monthly bank reconciliations.

FINDING NUMBER	2002-003
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Development and Implementation of Payroll Processing and Documenting Procedures

Procedures for payroll disbursements should include, but are not limited to:

- Approval by the Board of Trustees of all pay rates;
- Comparison of all employees' gross wages paid with the approved pay rates as documented in employee contracts;
- Verification of the completeness of the personnel files

During the review of the minute record of the Board of Trustees we noted that:

- The Board did not approve the hiring of personnel or establish pay rates;
- All payroll related items were managed by CSAS without the approval of the school
- Personnel files did not contain hiring authorization
- Personnel files were incomplete, properly executed deduction authorization forms for withholding deductions were missing

We recommend the Board formally approve employment contracts and/or pay scales for all employees. In addition we recommend that the Academy establish procedures to help ensure that personnel files are complete. The management agreement between the Academy and CSAS provides that CSAS is responsible for all personnel related items. The Board should review and determine the appropriateness of the personnel decisions made and should approve or confirm the actions of CSAS. Without this review it is possible that the Board objectives in relation to personnel and payroll could be misinterpreted.

**ACADEMY OF CLEVELAND
CUYAHOGA COUNTY**

**SCHEDULE OF FINDINGS
JUNE 30, 2002
(Continued)**

FINDINGS RELATED TO THE FINANCIAL STATEMENTS REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS
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FINDING NUMBER	2002-004
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Fixed Assets

We noted the following control weaknesses over fixed assets:

- A fixed asset accounting system which maintains a complete fixed asset listing, by location, with tag or other identification numbers and other pertinent information has not been developed; and,
- The School has not developed and implemented procedures to assist in recording assets as additions when purchased and deletions when disposed of throughout the year.

Failure to prepare timely reports or employ adequate controls over the acquisition and disposal of fixed assets could result in misappropriation of assets and/or misstatement of recorded amounts on the financial statements.

To maintain adequate safeguards over fixed assets and to reduce the risk that the School's assets may be misstated, we recommend management develop and implement procedures to be performed throughout the year for the recording and updating of fixed assets. These procedures should include tagging all fixed assets meeting the capitalization threshold. Further, addition and disposal forms should be completed and approved by management when assets are acquired or retired. This information should then be entered into the fixed asset accounting system and include such information as the tag number, location of the asset, description of the item, cost, acquisition date, and any other pertinent information. Periodic physical inventories should be performed, and the fixed assets listed on the accounting system should be compared to the items on hand and any discrepancies should be investigated.

FINDING NUMBER	2002-005
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Fiscal Monitoring

The Academy had an accumulated deficit as of June 30, 2002. Additionally, twenty-six percent of the operating expenditures reported in the Statement of Revenues, Expenses, and Changes in Accumulated Deficit were funded by the management company of the Academy. The Management Agreement entered into makes no provisions for the continued funding of operations due to the insufficiency of funds by the Academy.

The Contract entered into between the Sponsor and the Academy provides in part that "School budgets will be reviewed quarterly by the internal accounting staff. Yearly comparisons will be made with actual data to maximize proper disbursement of funds and for future financial planning".

We recommend that the Academy develop a financial plan, which includes realistic goals, to assist in the reduction of expenses, expansion of revenues and operation within the limits of this plan.



**Auditor of State
Betty Montgomery**

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ACADEMY OF CLEVELAND

CUYAHOGA 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
AUGUST 19, 2003**