ACADEMY OF CLEVELAND
CUYAHOGA COUNTY

REGULAR AUDIT

FOR THE YEAR ENDED JUNE 30, 2003

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 Board of Trustees:

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, 2003, 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, 2003 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.

The accompanying financial statements have been prepared assuming that the Academy of Cleveland will continue as a going concern. As shown in the financial statements the Academy has incurred an operating loss in the amount of $185,937 for the year ended June 30, 2003, has a working capital deficiency of $165,385, and an accumulated deficit of $139,775. Accordingly, there is substantial doubt about the Academy's ability to continue as a going concern. These matters are described in Note 4. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 17, 2004 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.

Betty Montgomery

Betty Montgomery
Auditor of State

May 17, 2004

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ACADEMY OF CLEVELAND
CUYAHOGA COUNTY

BALANCE SHEET
AS OF JUNE 30, 2003

Assets:	
Current Assets:	
Cash and Cash Equivalents	$62,840
Receivables:	
Intergovernmental	94,229
Other	25
Total Current Assets	157,094
Non-Current Assets:	
Fixed Assets (Net of Accumulated Depreciation and Amortization)	25,610
Total Assets	182,704
Liabilities and Equity:	
Current Liabilities:	
Accounts Payable	137,203
Due to Other Governments	156,972
Accrued Payroll	28,304
Total Current Liabilities	322,479
Equity:	
Accumulated Deficit	(139,775)
Total Liabilities and Equity	$182,704

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, 2003

Operating Revenue:	
Foundation Payments	$622,800
Other Revenue	400
Total Operating Revenues	623,200
Operating Expenses:	
Salaries	282,589
Fringe Benefits	62,330
Payroll Taxes	13,288
Purchased Services	350,380
Materials and Supplies	75,860
Depreciation and Amortization	24,690
Total Operating Expenses	809,137
Operating Loss	(185,937)
Non-Operating Revenue:	
Grants-State	6,077
Grants-Federal	105,221
Total Non-Operating Revenue	111,298
Non-Operating Expenses:	
Loss on disposition of fixed assets	(77)
Net Revenue over Expenditures	(74,716)
Accumulated Deficit at Beginning of Year	(65,059)
Accumulated Deficit at End of Year	($139,775)

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, 2003

Increase/Decrease in Cash and Cash Equivalents:	
Cash Flows from Operating Activities:	
Cash Received from State of Ohio	$775,292
Cash Payments to Suppliers for Goods and Services	(457,044)
Cash Payments to Employees for Services	(270,151)
Cash Payment Employee Benefit	(56,573)
Cash Payment Payroll Taxes	(13,177)
Net Cash Used By Operating Activities	(21,653)
Cash Flows from Noncapital Financing Activities:	
Grants and Contributions Received	33,931
Net Cash Provided By Noncapital Financing Activities	33,931
Cash Flows from Capital and Related Financing Activities:	
Proceeds from disposition of fixed assets	1,615
Payments for Capital Acquisitions	(1,021)
Net Cash Provided by Capital and Related Financing Activities	594
Net Increase in Cash and Cash Equivalents	12,872
Cash and Cash Equivalents Beginning of the Year	49,968
Cash and Cash Equivalents End of the Year	$62,840

(Continued)

ACADEMY OF CLEVELAND
CUYAHOGA COUNTY

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2003

Reconciliation of Operating Loss to Net Cash Used for Operating Activities:	
Operating Loss	($185,937)
Adjustments to Reconcile Operating Loss to Net Cash Used for Operating Activities:	
Depreciation and Amoritiation	24,690
Changes in Assets and Liabilities:	
Decrease in Intergovernmental Receivable	7,830
Decrease in Accounts Payable	(37,980)
Increase in Due to Other Governments	155,454
Increase in Accrued Payroll	14,290
Total Adjustments	164,284
Net Cash Used for Operating Activities	($21,653)

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

NOTES TO THE FINANCIAL STATEMENTS
AS OF JUNE 30, 2003

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, and acquire facilities as needed.

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 7 certificated full time teaching personnel who provide services to 123 students.

The Governing Authority 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 16).

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.

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, 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 are 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 date 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.

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 2003, the Academy received $35,403 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. DEPOSITS

On June 30, 2003, the carrying amount of the Academy's deposits was $62,840 and the bank balance was $89,298. All of which was covered by federal depository insurance.

4. COMPLIANCE ACCOUNTABILITY AND FINANCIAL OUTLOOK

For fiscal year 2003, the Academy had an operating loss of $185,937 and accumulated deficit of $139,775. This operating loss and accumulated deficit were the result of monies due CSAS for payroll purposes, management and overhead fees, and an over calculation of FTE funding based on the final verification of student counts. The School has no formal plan in place to alleviate the losses and deficits.

5. FIXED ASSETS

A summary of the Academy's fixed assets at June 30, 2003 is as follows:

Furniture and Equipment	$ 1,791
Leasehold Improvements	72,994
	74,785
Less: Accumulated Depreciation	(49,175)
Net Fixed Assets	$ 25,610

6. 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, 2002 through August 1, 2003, 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.

7. 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. 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, 300 East Broad Street, Columbus, Ohio 43215-3476.

7. 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 at an actuarially determined rate. The current School District rate is 14 percent of annual covered payroll. A portion of the Academy's contribution is used to fund pension obligations with the remainder being used to fund health care benefits; for fiscal year 2003, 8.17 percent of annual covered salary was the portion to fund pension obligations. For fiscal year 2002, 5.46 percent of annual covered salary was the portion used to fund pension obligations. The contribution requirements of plan members and employers are established and may be amended, up to a statutory maximum amount, by the SERS' Retirement Board. The Academy's required contributions for pension obligations to SERS for the fiscal years ended June 30, 2003 and 2002 were $4,965 and $2,774 respectively; 94 percent has been contributed for fiscal year 2003 and 100 percent for fiscal year 2002. $279 representing the unpaid contribution for fiscal year 2003 is recorded as a liability under "Due to Other Governments."

B. State Teachers Retirement System

The Academy participates in the State Teachers Retirement System of Ohio (STRS Ohio), a cost-sharing multiple employer public employee retirement system. STRS Ohio provides retirement and disability benefits to members, annual cost-of-living adjustments, and death benefits to members and beneficiaries. STRS Ohio issues a stand alone financial report that may be obtained by writing to STRS Ohio, 275 East Broad Street, Columbus, Ohio 43215-3771 or calling (614) 227-4090.

New members have a choice of three retirement plans, a Defined Benefits (DB) Plan, a Defined Contribution (DC) Plan, and a Combined Plan. The DP Plan offers an annual retirement allowance based on the final average salary times a percentage that varies based on the years of service or an allowance based on the members contributions and earned interest matched by STRS Ohio funds times an actuarially determined annuity factor. The DC Plan allows members to place all their member contributions and employer contributions equal to 10.5 percent of earned compensation into an investment account. Investment decisions are made by the member. A member is eligible to receive a retirement benefit at age 50 and termination of employment. The Combined Plan offers features of both the DC Plan and the DB Plan. In the Combined plan, the member contributions are invested by the member, and employer contributions are used to fund the defined benefit payment at a reduced level from the regular BD Plan. DC and Combined Plan members will transfer to the Defined Benefit Plan during their fifth year of membership unless they permanently select the DC or Combined Plan. Existing members with less than five years of service credit as of June 30, 2001, were given the option of making a one time irrevocable decision to transfer their account balances from the existing DB Plan into the DC Plan or the Combined Plan. This option expired December 31, 2001. Benefits are established by Chapter 3307 of the Ohio Revised Code.

A DB or Combined Plan member with five or more years of credited service who becomes disabled may qualify for disability benefits. Eligible spouses and dependents of these active members who die before retirement may qualify for survivor benefits. Members of the DC Plan who become disabled are entitled only to their account balance. If a member dies before retirement benefits begin, the members designated beneficiary is entitled to receive the members account balance.

7. DEFINED BENEFIT PENSION PLANS (Continued)

B. State Teachers Retirement System (Continued)

For the Fiscal year ended June 30, 2003, plan members were required to contribute 9.3 percent of their annual covered salary. The Academy was required to contribute 14 percent; 13 percent was the portion used to fund pension obligations. For fiscal year 2002, the portion used for pension obligations was 9.5 percent. 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. Chapter 3307 of the Ohio Revised Code provides the statutory authority for members and employers contributions.

The Academy's required contribution for pension obligations to STRS for fiscal year 2003 and 2002 were $29,062 and $11,815. 82 percent has been contributed for fiscal year 2003 and 100 percent for fiscal year 2002. $5,210 representing the unpaid contribution for fiscal year 2003 is recorded as a liability under "Due to Other Governments."

8. POSTEMPLOYMENT BENEFITS

The Academy provides comprehensive health care benefits to retired teachers and their dependents through the State Teachers Retirement System (STRS Ohio), 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.

All STRS benefit recipients and sponsored dependents are eligible for health care coverage. The STRS Ohio Board has statutory over how much, if any, of the health care costs will be absorbed by STRS Ohio. Most benefit recipients pay a portion of health care costs in the form of a monthly premium. By law, the cost of coverage paid from STRS Ohio funds in included in the employer contribution rate, currently 14 percent of covered payroll. For the fiscal year ended June 30, 2003, the STRS Ohio Board allocated employer contributions equal to 1 percent of covered payroll to the Health Care Reserve fund. For the Academy, this amount equaled $2,238 during fiscal year 2003, of which $432 was payable at June 30, 2003.

STRS pays health care benefits from the Health Care Reserve Fund. At June 30, 2002 (the latest information available) the balance in the Fund was $3.011 billion. For the fiscal year ended June 30, 2002, net health care costs paid by STRS were $354,697,000, and STRS Ohio had 105,300 eligible benefit recipients.

8. 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.

After allocation of benefits, the remainder of the employer's 14 percent contribution is allocated to providing health care benefits. For the fiscal year ended June 30, 2003, the employer contributions to fund health care benefits was 5.83 percent of covered payroll a decrease of 2.71 percent from fiscal year 2002. 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 2003, the minimum pay was established at $14,500. For the Academy, the amount contributed to fund health care benefits, including the surcharge, during the 2003 fiscal year was $3,544. Of which $199 represents the unpaid contribution for fiscal year 2003 which is recorded as a liability under "Due to Other Governments."

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, 2002 (the latest information available), were $182,946,777, and the target level was $274.4 million. At June 30, 2002, SERS had net assets available for payment of health care benefits of $335.2 million. SERS has approximately 50,000 participants currently receiving health care benefits.

9. 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 Academy is currently unable to determine what effect, if any, this decision will have on its future State funding and its financial operations.

10. 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 Academy. 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, 2003.

10. CONTINGENCIES (Continued)

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. On April 21, 2003 the court dismissed the counts containing constitutional claims and stayed the other counts pending appeal of the constitutional issues. The plaintiffs appealed to the Court of Appeals, the issues have been briefed, and arguments were heard on November 18, 2003.

11. 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.

12. 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 $33,600 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 2003 totaled $5,143

The following is a schedule of the future minimum payments required under the operating leases as of June 30, 2003.

Fiscal Year Ending June 30,	Facility Rental	Copiers
2004	$ 33,600	$ 3,924
2005	2,800	327
Total minimum payments	$ 36,400	$ 4,251

13. PURCHASED SERVICE EXPENSES

For the period ended June 30, 2003, purchased service expenses were payments for services rendered, as follows:

PURCHASED SERVICES	
Advertising	$15,333
Consulting Fees	20,392
Insurance	8,276
Leased Equipment	7,083
Maintenance and Repairs	12,380
Management Company Fees **(See Note 16)**	97,059
Overhead Fees to Management Company **(See Note17)**	110,818
Professional Fees	27,328
Rent	33,600
Telephone	9,524
Meeting Expenses	1,603
Utilities	6,984
Total Purchased Services	$350,380

14. 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.

15. 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 Administration Services, Inc. the management company of the Academy of Cleveland.

Total rent payments to Academy of America (Michigan) were $33,600. Total payments to Charter School Administration Services, Inc. were $207,877, which includes management fees and overhead fees.

16. 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 $97,059 of which $21,017 is still due for the fiscal year ended June 30, 2003. 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, 2003. Terms of the contract require CSAS to provide the following:

16. MANAGEMENT AGREEMENT (Continued)

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; and,
K. Any other function necessary or expedient for the administration of the Academy.

17. 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:

Academy		State of Operation
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

17. CONSORTIUM AGREEMENT (Continued)

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 2002-2003 school year in an amount equal to $67 per month per student enrolled at the Academy, totaling $110,818 for the school year of which $24,723 is still due as of June 30, 2003.

18. ACCOUNTS PAYABLE

On June 30, 2003 the accounts payable totaled $137,203 and consisted of $84,286 due CSAS for monies advanced for payroll purposes, $45,740 for overhead and management fees due CSAS based on the provisions of the management agreement, and $7,177 due to vendors for various purposes.

19. DUE TO OTHER GOVERNMENTS

The Academy reported an intergovernmental payable in the amount of $156,972 on its balance sheet. Of this amount, $12,310 represented monies due to state and local governments, medicare withholdings, and employer and employee portions of STRS and SERS.

The remaining amount of $144,662 represents a payable by the Academy to the Ohio Department of Education for differences in active full time equivalent (FTE) enrollment and the level of foundation funding for fiscal year 2003 as determined by the Ohio Department of Education.

The Academy of Cleveland has met with the Ohio Department of Education about this overpayment.

20. SUBSEQUENT EVENTS

The Sponsor is responsible for evaluating the performance of the Academy and has the authority to deny renewal of the contract at its expiration. Based on an evaluation performed, the Sponsor has made the determination not to renew the contract between the Governing Authority and the Sponsor. Consequently, the relationship between the Ohio Department of Education and the Governing Authority of the Academy of Cleveland will terminate on June 30, 2004.

The Ohio Council of Community Schools has approved a contract to be the sponsor for the Academy of Cleveland.

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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, 2003, and have issued our report thereon dated May 14, 2004. In our report, we express substantial doubt about the Academy's ability to continue 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 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 a certain immaterial instance of noncompliance that we have reported to management of the Academy in a separate letter dated May 14, 2004.

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 2003-001 through 2003-005.

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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 item 2003-003 to be a material weakness.

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

Betty Montgomery

Betty Montgomery
Auditor of State

May 14, 2004

SCHEDULE OF FINDINGS
JUNE 30, 2003

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

FINDING NUMBER	**2003-001**

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	**2003-002**

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.

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

FINDING NUMBER	**2003-002**

Developing and Implementing an Effective Monitoring Control System (Continued)

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. The Board established an audit committee which consists of two employees of CSAS and one member of the Board. The Board has delegated to CSAS and the audit committee the authority to review the financial statements and other financial information and only report to the Board if financial problems or concerns were noted.

Although the Board has delegated the responsibility to CSAS of maintaining the financial records and to CSAC and the audit committee the responsibility of reviewing all financial information of the Academy we recommend the Board request and review financial statements on a monthly basis. The Board entered into the contract with the Ohio Department of Education and has the ultimate responsibility to meet its requirements and the operation of the Academy. 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. Also, the Board should request and review the minute records of the meetings of the audit committee.

FINDING NUMBER	**2003-003**

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.

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

FINDING NUMBER	**2003-003**

Development and Implementation of Payroll Processing and Documenting Procedures (Continued)

We recommend the Board formally approve employment contracts and/or pay scales for all employees. In addition we recommend 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.

FINDING NUMBER	**2003-004**

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.

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

FINDING NUMBER	**2003-005**

Fiscal Monitoring

As of June 30, 2003 the Academy had cash and cash equivalents of $62,840, accumulated deficit of $139,775, and accounts payable of $137,203. Of the total accounts payable, $130,028 was due to the management company for the advance of funds for payroll purposes, overhead and management fees, and miscellaneous items paid for by the management company. 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.

ACADEMY OF CLEVELAND
CUYAHOGA COUNTY

SCHEDULE OF PRIOR AUDIT FINDINGS
JUNE 30, 2003

Finding Number	Finding Summary	Fully Corrected?	Not Corrected, Partially Corrected; Significantly Different Corrective Action Plan Taken; or Finding No Longer Valid; **Explain:**
2002-001	Tax Exempt Status	No	Not Corrected - Reissued as 2003-001
2002-002	Development and Implementation of Monitoring Controls	No	Not Corrected - Reissued as 2003-002
2002-003	Development and Implementation of Payroll Cycle Controls	No	Not Corrected - Reissued as 2003-003
2002-004	Development and Implementation of Fixed Asset Accounting System	No	Not Corrected – Reissued as 2003-004
2002-005	Fiscal Monitoring	No	Not Corrected – Reissued as 2003-005

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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
MAY 27, 2004